

How to Challenge Illegitimate Debt



Theory and Legal Case Studies

Max Mader and André Rothenbühler, Editors



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Introduction



Despite multilateral initiatives such as the Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI), in 2007 the world's developing countries still spent a combined total of approximately USD 1.5 billion every day on external debt servicing. Amongst their number are the poorest countries in the world; these low income countries spent around USD 34 million every day on external debt servicing.¹ In the current global financial crisis, many of the countries which have benefited from debt relief in recent years now face substantial risk of new debt distress.²

To date, only a very few measures have been taken to address the origins of this problem and to promote both more responsible lending and borrowing in order to further reduce the debt burden and to prevent new debt crises. A major weakness of the current debt relief initiatives is their failure to assess and address the legitimacy of debts. In the past, many loans have been given to undemocratic and corrupt regimes, to irresponsible projects, on fraudulent terms and without appropriate due diligence, but there has been no attempt to cancel these illegitimate or odious debts within the current debt relief mechanisms.

Political campaigns and initiatives

'Aktion Finanzplatz Schweiz', together with many other civil society organisations in the South-North International Campaign on Illegitimate Debt, is committed to securing the implementation of new mechanisms for both the assessment and cancellation of illegitimate or odious debts within the broader context of a transparent and fair debt workout procedure.

It is clear that the affected countries in the South have not only the moral, but also the legal right to repudiate illegitimate or odious debts. We support their demands for both compensation and reparation for the social, ecological and historical damage done to them by Northern countries. Moreover, we support initiatives for more equitable international relationships and for a new global financial system which respects the sovereignty of the countries in the South and gives them greater independence from the North, the Northern creditors and the existing International Financial Institutions.

In recent years, the international campaign on illegitimate or odious debt has contributed to a new political dynamic resulting in a more intensive academic debate, new political initiatives in some countries and greater interest from international organisations. In 2006, Norway acknowledged its responsibility for a development policy failure and cancelled debts of USD 80 million owed to the country by five developing countries. In 2007,

Ecuador launched the world's first debt audit commission to have the full support and involvement of its government. In its final report, published in November 2008, the audit commission concluded that much of Ecuador's foreign debt was both illegitimate and illegal.³ In December 2008, President Rafael Correa followed the recommendations of his government's commission and announced that Ecuador would default on the debt service for its bonds. Civil society groups all over the world hope that this first official debt audit will encourage other countries to follow Ecuador's example. Even so, the results of the Ecuadorian audit have not found unanimous approval, notably among the legal profession, as we will see in this publication.

The Norwegian Government supports the concept of illegitimate or odious debt but criticises the lack of distinct criteria. It therefore decided to finance a three year long UNCTAD project for Promoting Responsible Sovereign Lending and Borrowing which began in November 2008. One of the goals of this project is to develop a set of guidelines and criteria for assessing the legitimacy of sovereign debt.

Intensified academic debate

The doctrine of odious debt was formulated in 1927 by Alexander Sack, former minister of Tsarist Russia and professor of law in Paris and it has become the starting point for modern discussion on the issue.⁴ His three criteria for the definition of a debt as odious are: first, that the debt must have been contracted by a despotic regime; second, that the money must not have been used in the interest of the state and third, that the lender must have known this. Since then, the theory on odious debt has developed and widened much further, especially in recent years, as many new contributions by different scholars have been published and given a new dynamic to the debate.

Sack's original definition is now viewed by many scholars as being both very limited and difficult to implement. They have suggested other definitions and other legal avenues as alternatives. An overview of those authors who have shaped the recent debate is laid out below:

Joseph Hanlon⁵ defines illegitimate debts as being against the law, not sanctioned by law, unfair, improper, objectionable or in contradiction to public policy. This definition has found considerable recognition within civil society but it has also been criticised as being too broad, inasmuch as it makes almost all debts illegitimate.

Michael Kremer and Seema Jayachandran⁶ introduce a new form of economic sanction by suggesting the creation of a new institution which would decide which regimes are to be seen as illegitimate



International Conference on Illegitimate Debt in Berne, Switzerland on 3rd-4th October 2007. Picture: Aktion Finanzplatz

or odious. They argue that an institution which simply announces regime types would deter lending to odious governments as banks would have little incentive to lend to these governments if successor regimes could refuse to repay debts without hurting their reputation. In this way, the debate shifts from the illegitimacy of the debt to the illegitimacy of the regime.

Jeff King, Ashfaq Khalfan and Bryan Thomas⁷, like Sack, define odious debts as “those contracted against the interests of the population of a state, without its consent and with the full awareness of the creditor”. Like Kremer and Jayachandran, they focus on the odiousness of the regime arguing that dictatorial regimes by definition act without the consent of the population and not to its benefit. In the case of democratic or quasi-democratic regimes, debtor states must prove that there was an absence of benefit to the population.

Lee C. Buchheit, Mitu Gulati and Robert B. Thompson⁸ refer to the shift in the debate from “odious debt” to “odious regime” and argue that if this new version of the odious debt doctrine is to be workable, someone must assume to decide which regimes are odious. The authors are skeptical as to whether this definitional challenge can be met. Instead, they investigate how far the principles of private (domestic) law could be used to shield a successor government from the legal enforcement of a debt incurred by a prior regime under irregular circumstances. The authors believe that such defenses exist under U.S. law (and presumably elsewhere) and could be used to address many cases of allegedly odious debt.

Sabine Michalowski⁹ gives the odious debt doctrine a new focus by moving away from the traditional emphasis given to the consent of and benefit to the people of a country, to one of the violation of imperative norms of international law. She argues that a doctrine based on *ius cogens* violations provides clearer criteria than the traditional odious debt doctrine and overcomes its weaknesses. If the application of *ius cogens* is rather limited at the moment, its content might gradually expand to see its scope of application increase (for details, see the chapter on international law.)

The following authors address the problem of odious debt by focusing on new insolvency and arbitration procedures:

Since the 1980s, the Austrian economist Kunibert Raffer¹⁰ has advocated a “Fair Transparent Arbitration Process” (FTAP) in case of sovereign insolvency, based on an international version of Chapter 9 of the US Bankruptcy Code (Municipal Bankruptcy)¹¹. FTAP respects impartial decision making, which is the foundation of the Rule of Law, and protects bona fide creditors. Affected populations, international organisations and NGOs would have the right to be heard. Juan Pablo Bohoslavsky¹² develops a general theory of responsibility for the granting of abusive loans based on the private law systems of different countries. In a second step he argues that this theory can be extended from private law to a general principle of international law and thus can be applied to sovereign insolvency.

In particular, he argues that loans granted without following the most elementary prudential guidelines regarding risk analysis should be subordinated to those not classified as abusive in the case of bankruptcy. He recommends that the final decision on the subordination criteria and reduction of the debt should be made by a specially convened neutral arbitration tribunal.

In 2007 and 2008, two long-awaited research papers on the issue of odious debt were published by UNCTAD and the World Bank.¹³ Robert Howse, the author of the UNCTAD paper, argues that although a political transition does not break the continuity of state-to-state debt obligations, state practice, the rulings of international tribunals and the writings of most academic authorities put some equitable limits to the sanctity of state-to-state debt agreements. The obligation to repay debt in international law has frequently been limited or qualified by equitable considerations, some of which may be regrouped under the concept of “odiousness”. On the other hand, Vikram Nehru and Mark Thomas, authors of the World Bank discussion paper, dismiss the idea that there could be anything like an applicable odious debt doctrine because of the wide range of proposals for defining odious debt and the lack of grounds in international law. The World Bank paper was both criticised and refuted by civil society and legal experts.¹⁴

Objective and origin of this book

The struggle for the repudiation and cancellation of illegitimate or odious debt is first and foremost a political one but a better knowledge of the existing legal instruments serves to strengthen the political argumentation and campaigns of civil society. In 2006, Aktion Finanzplatz Schweiz decided to bridge the gap between political and legal initiatives and to encourage a better communication and understanding between civil society and legal experts.

In 2007 we launched a three year programme to examine odious debt, mainly sponsored by the Ford Foundation and the Sigrid Rausing Trust. The launch was marked by our International Conference on Illegitimate Debt in October 2007 in Berne, Switzerland. For the first time, representatives of NGOs and legal experts from the North and South came together and debated the concept of illegitimate or odious debt.¹⁵ The conference highlighted the fact that there was a lack of specific cases which could contribute to a better understanding of the legal frameworks.

As a consequence, Aktion Finanzplatz Schweiz decided to create an informal work group of legal experts who would give their legal opinion on a number of cases of presumably illegitimate or odious debt and to publish these studies as a book. In this publication, we construct fictional law cases out of existing cases¹⁶ of sovereign debt in order to explore the legal avenues and the constraints of debt contestation and arbitration. It is partly an academic exercise, as in some cases the old debts have meanwhile either been repaid by the debtor countries or abated in the context of the multilateral debt relief initiatives. Even though all the legal

cases in this book have been written by lawyers and legal scholars, it does not pretend to conform to the strict quality standards of an academic work. It is dedicated to a broader audience and is intended above all to deliver information, in the form of examples based in practice, which is useful to non-jurists and non-academics working in this field.

The different chapters of this book reflect the plurality of opinions which exists in the ongoing debate regarding illegitimate or odious debt. When the authors of the legal case studies met in Zürich in June 2009, it became evident that at times, they fundamentally disagreed with one another with regard to both the assessment of the cases and the definitions of illegitimate or odious debt. Therefore, every chapter stands alone and must be seen as the individual opinion and assessment of its author, without necessarily having common ground with the arguments and opinions expressed elsewhere.

The work of the authors was influenced by the fact that in the majority of the cases it was not possible to obtain the original contracts. As a consequence, the authors sometimes had to make presumptions in order to be able to give their legal opinion. The result of the analyses could have been different in some cases, had they had access to original contracts.

Contents

The book is divided in two parts: the first is the theory section which provides all the necessary background (Chapters 1 to 8); part two consists of the legal case studies (Chapters 9.1 to 9.9). In our conclusions, we summarize the lessons learned from the legal cases, recall the main points of dissent and consent, and specify the areas where further work is needed.

Part One

Chapter 1: Charles Abrahams introduces the concept of illegitimate debt by explaining its evolution and expansion and its current impact. According to him, the concept of illegitimate debt encompasses both odious and illegal debts as well as different other forms of debt such as those resulting from loans made for ideological or political reasons or those which cannot be serviced without violating basic human rights. It also includes those debts incurred under predatory repayment terms. Illegitimate debts are to be seen in their historical, social, political and economic context.

Chapter 2: Sabine Michalowski introduces the *ius cogens* approach, affirming that loan transactions leading to violation of *ius cogens* norms are odious and the underlying contracts therefore void. *Ius cogens* norms are universally applicable; not only to treaties between states but also to other state acts and even private parties. Accordingly, states cannot contract out of the obligation to comply with *ius cogens* by entering into private contracts, as these are also subject to the norms of *ius cogens*.

Chapter 3: Michalowski introduces different private law principles which may be an alternative for the repudiation of odious debt, rather than having to rely on public international law principles. One of

the most important private law principles is that of agency, where it is argued that the government of a debtor country acts as an agent for the people of the state (principal) and that the resulting agreement will bind the state. Although debtor compliance is interpreted as acceptance of the contract as binding, in US agency law there is a reversal of the burden of proof that the debtor's agent is authorized.

Chapter 4: Ramiro Chimuris Sosa introduces the concept of "illicitness" as a theoretical link between non-binding and binding legal instruments. Specifically, he links the general definition of illicitness as "being against the public order" to violations of general principles of law. Interestingly, Chimuris remarks that both in private law (tort) and international law (*ius cogens*), illicitness is the common denominator that nullifies certain debt contracts.

Chapter 5: Cephias Lumina discusses the concept of illegitimate debt from the perspective of human rights. He argues that human rights principles should be part of the framework to be used when determining whether or not a sovereign debt should be declared illegitimate. He also shows that different opinions exist among developed and developing countries as to whether foreign debt should be considered as a human rights issue.

Chapter 6: Charles Mutasa explains the need for a new Fair and Transparent Arbitration Process (FTAP). This mechanism, developed by Kunibert Raffer, puts developing countries on a more equal footing with their creditors. According to Mutasa, it also enshrines the principle that basic human rights take precedence over creditor rights.

Chapter 7: Jürgen Kaiser explains why Jubilee Germany (erlassjahr.de) mandated a legal expertise on the case of former GDR warships sold to Indonesia during the Suharto regime. The author of the expertise, August Reinisch, focused strongly on the applicability of the classical odious debt doctrine. However, based on the experiences of the campaign, erlassjahr.de shifted its focus from the classical doctrine of Sack to the concept of *ius cogens* violation and tried to find a solution to the question as to whether the unconditional cancellation of Indonesia's illegitimate debt would really benefit the victims of the atrocities which were committed.

Chapter 8: Mimi Lytje and Neil Watkins illuminate the campaign for the Jubilee Act for Responsible Lending and Expanded Debt Cancellation in the United States Congress. If passed, the Jubilee Act would expand debt relief to up to 24 additional poor countries not currently eligible for the Heavily Indebted Poor Countries (HIPC) Initiative. Moreover, it would require the US Comptroller General to conduct an audit of past, possibly odious, lending by the US government and advocate a framework for responsible lending in the future.

Part Two

Chapter 9.1: Luke Espiritu examines the case of the Austrian Medical Waste Project in the Philippines and gives his legal opinion on the fact that the incinerators bought by the Philippines did not comply with existing environmental standards.

The Austrian Government however, refuses to renounce the right to repayment of the loan made for the installations.

Chapter 9.2: Maurizio De Martino gives his legal expertise on the case of the Yacyretá dam and hydro-electric power station on the border of Argentina and Paraguay. According to him, this project did not provide the population with the advantages contemplated but rather has caused damage to the communities involved. Moreover, De Martino points to the fact that the dictatorial and authoritarian regimes were the main beneficiaries of the project.

Chapter 9.3: Eve Tessera and Renaud Vivien analyse the legal aspects of the Inga dam debt in the Democratic Republic of the Congo during the Mobutu regime. According to them, the Inga dam project is an exemplary case of a failed development project. From the outset, this project involved big operational risks, mortgaging the chances of the debt being paid back and seriously compromising the Congolese economy.

Chapter 9.4: Maurizio de Martino examines two cases from Ecuador; that of the drinking water facility in Guayaquil, and the hydroelectric power plant 'Marcel Laniado de Wind'. In the first case, he explains that the State of Ecuador was in an urgent state of need because Guayaquil was suffering from a water crisis and the lenders exploited this situation. In the second case, he argues that the impact of the whole dam project was not fully considered and the machines which were delivered were not those which had been ordered.

Chapter 9.5: Recalling the case of the Norwegian ships exported to developing countries in the 1970s, Charles Abrahams gives his legal opinion on the case of three Swedish coast guard ships sold to Liberia. He questions whether the Swedish export guarantee was illegitimate on the grounds that the Swedish Government intended to boost the fortunes of a declining industry by way of exports to Liberia, knowing that Liberia was faced with very serious political and economic challenges at the time. He also questions whether the interest of more than triple the capital sum is legal.

Chapter 9.6: Another interesting case, analyzed by Maud Perdril-Vaissière, concerns the practice of oil-backed loans in Congo-Brazzaville. Because this type of loan creates an environment which favours corruption and bad governance, the Republic of the Congo claimed to no longer have recourse to it in order to benefit from the HIPC programme. However, reality is quite different. Perdril-Vaissière explores concrete remedies available in French law which could be used to challenge this debt.

Chapter 9.7: Charles Abrahams looks at the debts which contributed to the financing of the apartheid regime in South Africa. Even though apartheid was declared a crime against humanity by the UN General Assembly, the debts incurred during the apartheid regime were paid back in full by South Africa. However, Abrahams shows that it may have been possible to build up a defence under international law.

Chapter 9.8: Sandrine Giroud examines the case

of Jean-Claude Duvalier, better known as “Baby Doc”. The former Haitian dictator is known for having embezzled enormous sums of Haitian public funds to maintain his regime and for his personal interest. He is also the alleged author of numerous human rights violations and crimes against humanity. Looking at these acts from the perspective of the odious debt scholarship, Giroud reviews the possible defences Haiti could have in order to repudiate Baby Doc’s debts.

Chapter 9.9: The last case discussed involves the State of Paraguay and this case was brought to Swiss tribunals. Sabine Michalowski analyzes the question as to whether the former consul of Paraguay in Geneva, Gustavo Gramont Berres, had the necessary authority to sign guarantees to obtain money from different banks for two failed projects in Paraguay. Gramont Berres was later sentenced to imprisonment in Paraguay.

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Max Mader and André Rothenbühler, Editors



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1. Understanding the Concept of 'Illegitimate Debt'

Charles Abrahams

Introduction

In recent years, civil society debt campaigns around the world have begun to give consideration to the concept of 'illegitimate debt': an expansive concept that refers to a broad range of debts encompassing both odious and illegal debts, as well as debts resulting from losing a war, debts to creditors who lent irresponsibly, and debts resulting from loans made for ideological or political reasons.² The concept also includes: debts incurred by undemocratic means, without transparency or participation by civil society or representative branches of government; debts that cannot be serviced without violating basic human rights; and debts incurred under predatory repayment terms, including situations where original interest rates skyrocketed and compound interest made repayment impossible.³ The rationale for understanding 'illegitimate debt' is for the debt problem to be seen in its historical, social, political and economic context, as this raises the fundamental and essential question of the legitimacy of the 'debt' and the so-called indebtedness of the people of the South.⁴

In May 2008, Mr. Cephias Lumina, the United Nations Human Rights Council's Independent Expert on the effects of foreign debt and other related international financial obligations of states on the full enjoyment of all human rights, particularly economic, social and cultural rights, issued the following press statement on the subject of 'illegitimate debt':

"The issue of illegitimate debt is one that requires further elaboration in a collaborative manner by both creditor and debtor countries, in order to promote responsible financing and fair and transparent treatment of foreign debt, to ensure that all countries are able to fulfill their human rights obligations.

It is clear that the absence of an internationally accepted definition of illegitimate debt is an obstacle in the efforts to systematically address the debt issue at the global level."⁵

However, a recent World Bank Policy Research Paper⁶ criticised the concept for its lack of precision, notably the manner in which it is articulated in advocacy materials, which, it believes, resulted in a failure to allow for a meaningful debate on the topic.

This paper intends to provide an overview of the current discussion of the concept of 'illegitimate debt'. It does not purport to develop the concept or to give it a theoretical base. Instead, the approach adopted herein is to look at the evolution of the concept and focus on the attention it has gained at both a political and a legal level. At a political level, this paper explores the evolution of the concept by first looking at its early reference in the Tegucigalpa and Gauteng Declarations, then at the more expansive declarations and statements by civil so-

ciety as to what it entails. Similarly, at a legal level, this paper looks at Joseph Hanlon's early attempt at providing a legal basis for the concept, and at how it has been overtaken by other legal approaches which link the concept to general principles of law and to the violation of socio-economic rights. This paper argues that although a clear understanding of what the concept of 'illegitimate debt' entails has not yet developed, nevertheless debate and discussions around it, by both civil society and multilateral organisations, as well as by certain states, are beginning to shape our understanding of what it means.

Evolution of the concept of 'illegitimate debt'

In 1998, debt campaigners from the South put forward the concept of 'illegitimate debt' at the time of the 'Jubilee Call for Debt Cancellation' issued at the first international meeting of the Jubilee movement in November 1998 in Rome. The diverse contexts and experiences, particularly from Southern campaigns, led to an evolving understanding of the debt cancellation call. At the conference in Rome, participants struggled with the word 'unpayable', and sought interpretations that reflected their diversity. Whilst the 'Jubilee Call for Debt Cancellation' categorised four kinds of debt as being 'unpayable',⁷ voices from Southern campaigns insisted on the need to go beyond setting a 'sustainable' level of debt, to seeking debt cancellation in the name of justice, reparation and redistribution. Rev. Molefe Tsele, the then Chair of the South African Jubilee Campaign, explained that debts have been: "a political tool that is used to subjugate and inflict suffering, at times with more severity than outright war on the people... Loans are extended under conditions that make recipients losers from the start."

Given that context, to cancel debt outright is a moral imperative. 'Illegitimate debt' is premised on the view that the debt problem should be seen in its historical, social, political and economic context, as such an understanding raises the fundamental and essential question of the legitimacy of the 'debt' and the so-called indebtedness of the peoples of the South.

Shortly after the 'Jubilee Call for Debt Cancellation' the concept found an early expression in a number of declarations that would begin to lay the foundation for a gradual evolution and understanding of its meaning. In January 1999, the Jubilee 2000 movement of Latin America and the Caribbean adopted the Tegucigalpa Declaration, marking one of the early instances of the use of the term 'illegitimate debt'. Contextually, it was used to refer to the regions' debt contracted from 1982 to 1996, of which the debt servicing was put



at USD 739 billion. There are two rationales for arguing that the debt is illegitimate. The first is that the debt is odious, as it is alleged to have been contracted by dictatorships throughout the region. The second is that the debts bore exorbitant interest and the imposition of conditionalities by creditors.

The Gauteng Declaration followed the Tegucigalpa Declaration in March 1999. The Gauteng Declaration's description of illegitimacy maintains a close relation to the concept of odious debt. Since it focuses mainly on the debts incurred by the southern African states in their defence against apartheid South Africa, it makes out the case that southern Africa's apartheid-caused debts are not only odious but also illegitimate. Apartheid-sponsored wars and economic destabilisation caused countries to borrow billions of dollars because of the failure of the international community to enforce the international law violated by apartheid. According to the Gauteng Declaration, the total estimated cost of apartheid-caused destabilisation in southern Africa exceeds USD 115 billion, while apartheid-caused debt is some USD 27 billion.

What is evident from the two declarations is that the concept of 'illegitimate debt' is intended to be more expansive than notions of 'odious debt' or 'dictators' debt', which had, hitherto, been associated with calls for debt cancellation or repudiation. Also evident is the fact that the concept of 'illegitimate debt' marks a shift away from lender countries having to take responsibility or co-responsibility for certain debts incurred by borrowing countries, as such lender countries should or ought to have been aware of the unlawfulness or illegality associated with the debt. An argument based on 'illegitimate debt' in its broadest sense, as per Tsele's statement above, implies that there is no need for creditor awareness and by implication creditor responsibility, as the whole system of indebtedness is brought into question.

Expanding the concept of 'illegitimate debt'

Since the Tegucigalpa and the Gauteng Declarations, the concept of 'illegitimate debt' has taken on different forms and expressions. Over time, it has expanded to include debts contracted where one or a combination of the following are present:

- Fraud and deception
- Lack of compliance with democratic processes or legal requirements
- Grossly disadvantageous terms and/or onerous and harmful conditions
- Financing of failed projects, or projects with damaging effects on people, on the environment, or on the economy
- Purchasing overpriced, unnecessary goods or services
- Support of policies that result in the violation of human rights
- Debt accumulation due to unjust economic relations
- Aggressive and unscrupulous pushing by lenders to promote their vested interests at the expense of the borrowers and of the people who will pay the debts

In view of the above, 'illegitimate debts' can broadly be seen to fall into the following categories: odious debts,⁸ apartheid-caused debts,⁹ stolen wealth,¹⁰ debts from failed and harmful projects,¹¹ debts resulting from creditors' destructive economic conditions¹² and immoral debts.¹³ Africa Action's statement on 'illegitimate debt' provides the broadest spectrum on what 'illegitimate debt' entails.

This does not mean that there is consensus among civil society organisations on all the expanded notions and categories mentioned above. As can be seen, the concept is so broad in its inclusion of every conceivable category of debt that it has been seriously criticised for its lack of precision.¹⁴ However, in very broad terms, there appears to be some form of consensus within the global debt movement that 'illegitimate debt' refers to unacceptable, irregular, inappropriate, irresponsible, dubious and fraudulent features of debts: features that go against widely accepted legal, political, financial, economic, environmental and, most especially, ethical standards and principles.¹⁵ There is, however, no firm consensus as to its precise definition, coverage, application and translation into policy.¹⁶

A further difficulty in providing certainty around the concept is the fact that a distinction is made between the 'illegitimacy of debt' and 'illegitimate debt'. 'Illegitimacy of debt' refers to the system of sovereign indebtedness between lender and borrower countries as a whole, by having regard to the systematic, historical, structural, political and economic analysis. 'Illegitimate debt', on the other hand, refers to specific debts based on the more specific categories referred to above.¹⁷ Based on the aforesaid distinction, the concept is utilised differently according to the locations, the organisations, the strategies, etc. Whilst for some organisations, such as the Committee for the Abolition of Third World Debt (CADTM), specific cases of 'illegitimate debt' emphasise the entire illegitimacy of the system of indebtedness as a means of domination of the countries of the South by the governments of the North, other organisations differ on this issue.¹⁸

Legal definition of 'illegitimate debt'

Various attempts have been made to give a legal definition to the term 'illegitimate debt.' Joseph Hanlon, starting from the premise that 'illegitimate debt' has no existing definition in law, proposes a definition that satisfies any one of the following conditions: the debt is against the law or not sanctioned by law; it is unfair, improper or objectionable; or it infringes on some public policy.¹⁹ Hanlon refers to very specific instances in law where such debts would be regarded as illegitimate. Britain's Consumer Credit Act of 1974, in particular Section 137, states, for instance, that if the court finds a credit bargain extortionate it may reopen the credit agreement so as to do justice between the parties. Section 138 defines a credit bargain as extortionate if it requires the debtor or a relative of his to make payments (whether unconditionally, or on certain contingencies) which are grossly exor-

bitant, or otherwise grossly contravenes ordinary principles of fair dealing.²⁰

Kunibert Raffer adopts a somewhat similar approach to Hanlon, except that he divides ‘illegitimate debts’ into two categories: illegal debts; and, debts that might be legal by strictly formal standards, yet the existence or servicing of them violates socially established norms.²¹ Illegal debts are debts that are incurred in violation of national laws, international law – such as in breach of legal obligations or statutes of International Financial Institutions (IFIs) – or universally accepted legal principles, especially those whose servicing violates human rights. Debts that originate from loans IFIs disbursed to corrupt governments, such as Suharto’s in Indonesia, knowing that large parts of these loans would be embezzled, are criminal debts and are also regarded as illegal debts.²²

Debts that might be legal by strictly formal standards, yet whose existence or servicing violates socially established norms are, for instance, gambling debts, which may be unenforceable due to moral considerations reflecting societal disapproval.²³ According to Raffer, in some European legal systems gambling debts are permitted under law (if paid they extinguish an obligation and repayment cannot be demanded later) but nevertheless not enforceable (payment cannot be enforced by the winner-creditor) due to moral considerations reflecting societal disapproval of the underlying reason for such debts.²⁴

The use of terms such as ‘unfair’, ‘improper’ or ‘objectionable’, ‘infringement of public policy’, ‘violation of socially established norms’ and ‘moral considerations’ are common to most legal systems. They mostly derive from the principle of equity which has long been developed and recognised in most legal systems. In terms of Article 38 of the Statute of the International Court of Justice, equity is held as a general principle of law recognised by civilised nations. The term ‘general principles’ refers to both principles of international law and principles common to international law and various municipal systems of law.

Even though Hanlon and Raffer do not expressly make the argument, their writings do suggest that the legal foundation for ‘illegitimate debt’ is based on these equitable principles that have long been recognised in both domestic and international law. Equity represents the spirit of the law. In the Norwegian Ship Owners’ Claims²⁵ (between the U.S. and Norway) it was held that:

“the words ‘law and equity’ ... can not be understood ... in the traditional sense The majority of international lawyers seem to agree that these words are to be understood to mean general principles of justice as distinguished from any particular system of jurisprudence or the municipal law of any state.”

In addition to tying the concept of ‘illegitimate debt’ to equitable principles, some²⁶ have gone one step further to make a connection between ‘illegitimate debt’ and its impact on socio-economic rights. The New Economics Foundation argues that it is a violation of human rights if govern-



Victims of apartheid united in the “Khulumani Support Group for Survivors of Violence and Torture” march to Parliament in Kapstadt on 28th November 2005. Picture: Marina Peterhans



A recent World Bank policy paper criticized the concept of illegitimate debt.
Picture: Erlassjahr

ments are forced to cut expenditure required to meet basic human needs (the rights enshrined in the UN Charter and elsewhere, for basic education, health, water, shelter and food) in order to pay debt service.²⁷ Under international law states have a duty to protect, a duty to respect and a duty to fulfill. In the context of socio-economic rights, the duty to respect prevents a state from interfering with a social right that is already being enjoyed by the right's holder, the duty to protect requires that a state prevents third parties from interfering with social rights held by others, and the most far-reaching duty is the duty to fulfill, as it imposes on a state an obligation 'to take appropriate legislative, administrative, budgetary, judicial and other measures towards the full realization of such rights.'²⁸

Would a country violate its social rights obligations if it were to repay debts, instead of dedicating all funds to social policies until the minimum standard of protection is met? According to Michalowski, it could be argued that debt repayment made by a country which lacks sufficient funds to guarantee both the servicing of its sovereign debt and a minimum protection of the core of the social rights of its people always amounts to a social rights violation.²⁹ If this is the case, then the argument is even more persuasive that repayment of 'illegitimate debts' would constitute a violation of a state's international law duty to fulfill its socio-economic rights obligations towards its people. In this regard, it is likely that citizens of a country affected by a state intending to repay 'illegitimate debts' to its creditors may very well be able to approach its domestic courts to have such a decision reviewed, depending on the relevant domestic laws.

Current impact of the concept of 'illegitimate debt'

Despite the fact that the concept of 'illegitimate debt' has gained consideration at a legal level, it cannot be said that it has risen to the level of a discernable legal concept. The same cannot be said for the development of the concept at a political level. This is the area where it has made most impact. Since the Tegucigalpa and Gauteng Declarations the concept has grown immensely in the richness of an expanded definition. Whether in its narrow or broad political context, it has moved beyond the realm of debate within civil society organisations by finding resonance among certain states and multilateral institutions.

The Norwegian government was the first to actively engage in considering the concept of 'illegitimate debt' in its 'Plan of Action' aimed at helping to solve the debt problems of developing countries.³⁰ However, the Norwegian government is critical of the concept as it is concerned that it could refer to all types of debt and that the net effect of this may lead to a recommendation to cancel all developing countries' debt.³¹ However, Norway is not dismissive of the concept, as it believes that the debate on 'illegitimate debt' may result in:

1. Loans not being granted for countries and regimes, on moral grounds, as lenders would be more cautious.

2. The debate having a stronger focus on countries emerging from war and conflict.
3. The possibility that, at some time in the future, it will be 'lawfully' determined that dictators like Iraq's Saddam Hussein or the Philippines' Ferdinand Marcos will be shown to have taken up loans that would be regarded as illegitimate
4. The perspective on 'illegitimate debts' changing, which might be helpful when democratic regimes try to reclaim personal assets which dictators have built up illegitimately.³²

Whilst Norway was the first country to engage in it, the government of Ecuador was the first to utilise the concept of 'illegitimate debt' as a basis for repudiation, and, by doing so, it declared its country's foreign debt of USD 10 billion as 'illegitimate'.³³ In July 2007, it appointed the Commission for the Full Audit of Public Credit (CAIC) which, after a year, found that the foreign commercial debt of Ecuador had functioned as an illegitimate and illegal looting mechanism between 1976 and 2006, rising from USD 16 million in 1976 to USD 4.2 billion in 2006, despite the fact that there was a net transfer to lenders of USD 7.1 billion in interest and principal payments over that 30 year period.³⁴

On April 14 2008 the World Bank hosted a round table discussion in Washington DC, following the publication of its draft discussion paper entitled 'Odious Debt: Some Considerations' in September 2007.³⁵ Participants included representatives from civil society organisations, universities, the World Bank itself, the IMF, Paris Club banks and donor governments, who discussed the finding of the Bank paper and broader issues of

odious/illegitimate debt and responsible lending. Even though the Bank's paper is highly critical of the concept, it has nonetheless prompted the Bank to begin looking at effective lending mechanisms.³⁶ The United Nations Conference on Trade and Development (UNCTAD), for its part, has also commissioned a paper on the issue of odious and 'illegitimate debt'.³⁷

Conclusion

Whilst it is almost impossible to establish what the concept of 'illegitimate debt' entails with an exactitude, it is evident from the above that the extent of engagement and discussion around it has already done much to shape, what it means, albeit in very broad terms. Clearly, there is a need for ongoing engagement. Ongoing efforts on the part of UNCTAD can only deepen the debate and lead to a greater understanding of what the concept entails.

At a legal level it is evident that the concept of 'illegitimate debt' can be associated with certain norms and rules that exist in domestic and international law, which may be invoked as a legal basis for non-payment or debt repudiation. However, such non-payment or repudiation would be based on a specific legal norm or rule and not on the broad concept as a whole. As stated, the concept is too broad to be regarded as a legal norm or rule. However, it may very well be that, in future, and with greater clarity, the concept of 'illegitimate debt' may align itself within the narrow construct of legal norms and rules and that states may begin to give consideration to it as a legal concept.

1 Even though the term was used in earlier writings, it resurfaced in 1998, at the time of the 'Jubilee Call for Debt Cancellation'.

2 See Jubilee USA Network, What are Odious & Illegitimate Debts, in Recent Developments on Odious & Illegitimate Debt, Briefing Note 5, April 2008, available at http://www.jubileeusa.org/fileadmin/user_upload/Resources/Policy_Archive/408briefnoteodiousilldebt.pdf.

3 See Africa Action, Africa Action Statement on Illegitimate Debt, 13 April 2007, available at <http://www.africaaction.org/newsroom/docs/IllegitimateDebt0407.pdf>.

4 See Nacpil, L., The Illegitimacy of Debt, Discussion Paper Based on the Unities of Jubilee South, 17 November 2005, available at www.oid-ido.org/article.php?id=123.

5 Lumina, C., press conference statement, Quito, Ecuador, 8 May 2009, available at <http://www2.ohchr.org/english/issues/development/debt/docs/statementLUMINA.doc>.

6 Nehru, V. & Thomas, M., The Concept of Odious Debts: Some Considerations, Policy Research Working Paper 4676, World Bank Economic Policy and Debt Department, July 2008, available at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2008/07/23/000158349_20080723095102/Rendered/PDF/WPS4676.pdf.

7 The four kinds of debt categorised as 'unpayable' are: debt which could not be serviced without placing a burden on impoverished people; debt that in real terms, has already been paid; debt for improperly designed projects and programmes;

odious debt and debt incurred by repressive regimes.

8 Africa Action Statement on Illegitimate Debt, supra note 3, This sets out different categories of 'illegitimate debt': In the context of the political dynamics of the Cold War, the international financial community eagerly extended substantial loans to African leaders, who were considered strategically important at that time. These creditors were not concerned that many of those same leaders were widely recognised to be authoritarian and repressive. The loans were extended to secure the allegiance of those leaders during the Cold War and to help cement their hold on power; however, these loans did not serve the interests of those countries' populations. The loans were not intended for economic development and were frequently used to oppress people and sustain autocracies. This Cold War dynamic led to the accumulation of 'odious debts' throughout the African continent. The principle of 'odious debt', enshrined in international law, describes cases of debt incurred for purposes contrary to the interest of the nation's people, and in which these purposes are known by the creditors. This principle maintains that there is no obligation for the people to repay debt for which they saw no benefit. The argument concerning the odious nature of certain debts has been applied in other cases. Most recently, it was used by the Bush administration to push for the cancellation of Iraq's Saddam Hussein-era debts after he was deposed. This rationale must now be applied to the many similar cases in Africa,

where debts are clearly illegitimate and also merit immediate cancellation.

For example, in Liberia, a country that recently celebrated the election of Africa's first female president, more than two decades of dictatorship under Samuel Doe and Charles Taylor led to the expansion of debt to over USD 3.5 billion, a sum that now undermines progress in that newly democratic state. The international community's claims to support Liberia in its new beginning ring hollow in the face of its continued demands for repayment of this odious and illegitimate debt.

9 The apartheid regime in South Africa and the debts incurred during its years in power provide a well-known example of illegitimate debt, resulting from external loans that funded the repressive practices of the apartheid government. Apartheid in South Africa also contributed to the accumulation of illegitimate debt among its neighbouring countries, which were destabilised by war with the apartheid regime. The apartheid government's efforts to aggressively assert its control throughout southern Africa, in order to preserve its own hold on power, fuelled colonial wars in Angola, Mozambique, Zimbabwe and Namibia.

For example, apartheid South Africa's sponsorship of rebel forces in Mozambique sustained a conflict that cost over USD 15 billion in damage and lost production and that forced the government of Mozambique to borrow millions of dollars to rebuild. The countries of southern Africa continue to feel the effect of this illegitimate apartheid-era debt.

10 In the context of the Cold War, there were also examples where corrupt leaders and government officials misappropriated loans for their own personal enrichment. This phenomenon is often referred to as 'stolen wealth'. It is well established that the international creditors knew of the nature of such regimes and the purposes for which the money would be used, and therefore those lenders were complicit and corrupt in making such loans.

In the case of Mobutu Sese Seko's rule in the former Zaire, now called the Democratic Republic of the Congo, the World Bank, the IMF and Western governments continued to disburse loans in excess of USD 4 billion throughout the early 1980s, even in the immediate aftermath of a 1982 IMF report confirming that the funds were being looted by the nation's leadership. Mobutu used these loans to build mansions and for other personal luxuries, and the people of the country saw no benefit. Nevertheless, today they are being held liable for those illegitimate debts.

11 Many of the loans made by the World Bank and IMF since the 1970s were designated for poorly conceived and badly implemented projects that did not help the people to whom they were supposedly directed. Often these programmes envisioned by international creditors, were not designed for the development of the countries of the global South but rather to facilitate the business dealings and increase the profits of foreign companies. Many of these loans were contracted without the support or knowledge of local populations. In fact, in numerous cases, these projects were destructive to local communities and environments. Such irresponsible lending practices have undermined Africa's long-term economic development and put livelihoods at risk in many countries.

For example, plans for the Chad-Cameroon pipeline, a project financed by the World Bank, were launched in 2000 and involved over USD 300 million in loans. Completed in 2003, the pipeline was elevated as a demonstration of how revenues from extracted resources might contribute both to development and to poverty reduction. Chadian and international civil society organisations immediately raised concerns about the Chadian government's human rights abuses and corruption, as well as the environmental costs of the pipeline on local communities. Four years after the completion of the project, there is little indication that the oil revenues have benefited the people of Chad. Today, in Chad and elsewhere, local communities continue to pay the price of these old debts, as government budgets are largely devoted to servicing these debts, and thus this injustice continues to be compounded.

12 Economic conditions, such as high interest rates imposed by creditor governments, the IMF, and other financial bodies, have also caused debt levels to skyrocket throughout Africa. In many countries, the original debt (or principal) has already been paid off, and yet countries struggle to continue to ser-

vice these old, illegitimate debts. Between 1970 and 2003, it is estimated that Africa received USD 540 billion in loans. African countries repaid USD 580 billion in principal and interest over those years, but, as a result of accrued interest, at the end of that time period, the continent still owed over USD 300 billion on the original loans.

13 Debt payments by African countries to rich creditors are paralyzing national efforts to direct resources towards social spending. In the absence of such investment, and as a direct result of the drain of debt servicing, the impoverishment of Africa's people continues. African countries are stripped of their capacity to respond to urgent challenges such as halting the HIV/AIDS pandemic, which claimed over 2 million lives in Africa in 2006. In a demonstration of this pattern, the 2005-2006 budget for the Kenyan government allocated some 22 percent of spending to debt service, almost four times the amount of available funding for the health sector. Even after the incremental progress of international debt relief schemes in recent years, African countries still expend more repaying old illegitimate debts than on vital social services. As former Tanzanian president Julius Nyerere said: "Must we starve our children to pay our debts?" The history of African nations' interactions with global powers has been marked by exploitation and external domination. The current debt crisis stands as an extension of a centuries-long pattern in which African resources are siphoned towards the development of northern economies. In this context, Africa Action poses the question: "Who really owes whom?"

14 Nehru & Thomas, *supra* note 6.

15 See Nacpil, L., *The Illegitimacy of Debt and Illegitimate Debt*, 15 January 2009, available at http://www.oid-ido.org/article.php3?id_article=669.

16 *Id.*

17 *Id.*

18 Statement of the South-North International Campaign on Illegitimate Debt, issued on 26 September 2008 by North/South Study and Strategy Meeting on Illegitimate Debt, Quito, 9-15 September 2008.

19 Hanlon, J., *Defining Illegitimate Debt and Linking its Cancellation to Economic Justice*, at 7, Open University, commissioned by Norwegian Church Aid, June 2002, available at <http://www.odiousdebts.org/odiousdebts/publications/DefiningIllegitimateDebt.pdf>.

20 *Id.*

21 Raffer, K., *Odious, Illegitimate, Illegal, or Legal Debts - What difference does it make for International Chapter 9 Debt Arbitration?*, *LAW AND CONTEMPORARY PROBLEMS*, Volume 70:221, at 226 (September 2007).

22 *Id.* at 227.

23 *Id.*

24 *Id.*

25 Reports of International Arbitral Awards 307 (1922).

26 The New Economics Foundation (nef), *Debt Relief as if Justice Mattered*, 2008, available at <http://www.jubileeresearch.org/news/debt%20relief%20as%20if%20justice%20mattered.pdf>.

27 *Id.* at 12.

28 Michalowski, S., *Sovereign Debt & Social Rights - Legal Reflections on a Difficult Relationship*, *HUMAN RIGHTS LAW REVIEW*, Volume 8:35-68, at 39 (21 January 2008).

29 *Id.* at 48.

30 Royal Norwegian Ministry of Foreign Affairs, *Debt Relief for Development: A Plan of Action*, May 2004, available at <http://www.regjeringen.no/upload/kilde/ud/pla/2004/0004/ddd/pdfv/217377-debt-summary.pdf>.

31 *Id.* at 10.

32 *Id.* at 20-21.

33 Ecuador defaults on foreign debt, BBC, 13 December 2008, available at <http://news.bbc.co.uk/2/hi/business/7780984.stm>.

34 Small, D., *Ecuador Declares Partial Debt Moratorium*, *EXECUTIVE INTELLIGENCE REVIEW*, at 44 (26 December 2008).

35 The Bank's final paper was released in July 2008, see Nehru & Thomas, *supra* note 6.

36 *Id.* at 31-32.

37 Howse, R., *The Concept of Odious Debt in Public International Law*, No. 185, July 2007, UNCTAD/OSG/DP/2007/4, available at http://www.unctad.org/en/docs/osgdp20074_en.pdf.



2. The Doctrine of Odious Debts in International Law

Sabine Michalowski

1. The Odious Debts Doctrine in Its Traditional Form

Among the theories that provide some support for the existence of potential legal arguments against debt repayment, the doctrine of odious debts is probably the most popular. The 'traditional' doctrine of odious debts can be traced back to the writings of Alexander Sack in 1927.¹ Over the past few years, it has received a lot of attention both from campaigners and academics. It was, for example, discussed in great detail in a Centre for International Sustainable Development Law (CISDL) working paper,² and also found its way into the academic legal debate, mainly in the United States.³ In its traditional form, the doctrine of odious debts states that a sovereign debt is odious and can be repudiated if (1) it was contracted without the consent of the people of the country that is said to owe the debt; (2) it was not contracted for the benefit of the people of that country; and (3) the creditors were aware of the odious nature of the debt.

1.1. Does International Law Recognise the Doctrine of Odious Debts in Its Traditional Form?

The idea that certain debts are odious and therefore might not have to be repaid was first formulated by Alexander Sack, a professor of international law whose writings on the issue are still one of the main points of reference for the contemporary discussion of odious debts. According to him, a debt that was properly contracted by a regular government can nevertheless be odious if the new government can prove to an international tribunal:

"a) that the purposes in the light of which the old government had contracted the debt in question were 'odious' and openly contrary to the interests of the people ...

b) that the creditors, at the moment when the loan was issued, were aware of its 'odious' destination."⁴

He argued that:

"The reason why these 'odious' debts cannot attach to the territory of the state is that they do not fulfil one of the conditions determining the lawfulness of state debts: that state debts must be incurred, and the proceeds used, for the needs and in the interests of the state."⁵

While the doctrine of odious debts has received a lot of academic attention in recent years, it needs to be noted that there is no unanimity as to whether the doctrine of odious debts does or does not, and should, or should not, form part of international law, and what its exact content is or should be.⁶

The doctrine of odious debts has been evidenced in some instances of state practice,⁷ case law and the work of the International Law Commission (ILC). In the context of the drafting of the Vienna Convention on the Succession of States

in respect of State Property, Archives and Debts (1983),⁸ the ILC "recognised the importance of the issues raised in connection with the question of 'odious' debts, but was of the opinion ... that the rules formulated for each type of succession of states might well settle the issues raised by the question and might dispose of the need to draft general provisions on it."⁹ While the draft provision on odious debts was therefore not included in the final document, this was not an expression of opposition against the recognition of the doctrine of odious debts.¹⁰

The United States' repudiation of Cuba's debts with Spain in 1898 is often quoted as one of the most significant examples of the repudiation of a country's debts based on their odious nature.¹¹ In the course of peace negotiations between the United States and Spain, the American Commissioner rejected the view that Cuba was obliged to repay loans that the Spanish state had taken out to finance its operations in Cuba and which Spain had secured with Cuban revenues. His argument was that Cuba had not had a voice in the taking up of these debts, and that they had been "contracted by Spain for national purposes, which in some cases were alien and in others actually adverse to the interest of Cuba."¹² However, the Commissioner did not provide a detailed legal analysis of the doctrine of odious debts, and seems to have relied mainly on moral, rather than on legal considerations.¹³ His statement is in line with the then predominant view in the Anglo-Saxon world that successor states were not bound by law to assume the debts of their predecessor, but instead had no more than a moral obligation to do so, and that the winning power was free to define this moral position according to its own free will.¹⁴ While it is nevertheless regarded by many as a clear expression of the doctrine of odious debts,¹⁵ another possible interpretation of this statement would be to view the repudiation of these debts as mainly reflecting the balance of power at the relevant time.¹⁶

Among other examples frequently cited as applications of the odious debts doctrine are: Mexico's refusal in 1867 to assume the debts contracted by Austria in order to strengthen its power over Mexico; the refusal of Britain in 1902 to assume the debts that the Boer Republics had contracted to finance their war against Britain; and the repudiation of Polish debts to Germany in the Treaty of Versailles of 1919.¹⁷

The debates surrounding debt cancellation for Iraq revived the discussion of the doctrine of odious debts. However, the interim Iraqi government did not invoke that Iraq's debt should be repudiated as odious, and the decision to grant Iraq substantial debt reduction was reached as part of



a Paris Club deal¹⁸ and through bilateral agreements with creditor countries which do not form part of the Paris Club.¹⁹ The case of the cancellation of parts of Iraq's debt can therefore not be regarded as evidence of a state practice that recognises the doctrine of odious debts as a principle of international law.

On 2 October 2006 Norway unilaterally cancelled USD 80 million of debt owed by five developing countries,²⁰ recognizing that the loans had benefited Norwegian interests, but not the developmental needs of the borrowing countries. However, the Norwegian approach is clearly focused on arguments around development policies and not based on legal considerations.²¹

Even if some of the above instances could be interpreted as state practices that are based on the considerations underlying the odious debts doctrine, the doctrine would nevertheless only obtain the necessary status of a recognised rule under customary international law if the state practice was based on *opinio juris*, which means that the state would have had to repudiate the debt out of a sense of legal, not just moral obligation.²² It is very questionable that this can be sustained with regard to any of the above examples. Therefore, it is difficult to say with much conviction that state practice exists from which it could be inferred that the doctrine of odious debts is recognised as a rule of customary international law.

With regard to case law, the one and only decision that lends some support to the doctrine of odious debts is the arbitral decision in the so-called Tinoco case, which arose between Costa Rica and Great Britain.²³ In that case, Great Britain claimed that the Costa Rican government and the Banco Internacional de Costa Rica had to honour their obligations to the Royal Bank following from transactions between that bank and the government of Costa Rica under President Tinoco. The government of Costa Rica denied the validity of the claim on the basis that at the end of the *de facto* regime of Tinoco, the restored Costa Rican government had passed the Law of Nullities which invalidated all contracts between the executive power and private persons made during the time of the Tinoco government, and also annulled all transactions on which the bank transfer was based.²⁴

While Taft, U.S. Chief Justice and sole arbitrator in this case, did not expressly refer to the doctrine of odious debts, he rejected the claim on the basis of arguments that are closely related to the doctrine of odious debts.²⁵ Indeed, his decision seems to be based on a combination of factors, these being that the debt in question had been incurred for personal and not for legitimate government purposes; that the transactions were full of irregularities; that they were made when the popularity of the regime had already faded away and its fall was imminent; and that the bank must have been aware of these facts.²⁶ Thus, the purpose of the loan and the fact that it was not taken up for the benefit of the people of Costa Rica; the fact that the regime no longer had the support of the people; and the awareness of the Royal Bank of these facts,

were important factors for the outcome of the case, and these considerations closely resemble the three elements of the odious debts doctrine. However, the decision does not provide a detailed and principled legal analysis of the issue of odious debts. Instead, it seems to be based on a very narrow factual setting and on what Taft regarded as a fair outcome under the given circumstances and Taft did not justify his conclusion with reference to well-defined principles of international law. It is then questionable to what extent this isolated decision provides evidence of the recognition of the doctrine of odious debts as a rule of international law.²⁷

Whether or not the aforementioned instances of state practice, the Tinoco decision and the writings of Sack and some other academics are sufficient to support the claim that the doctrine of odious debts has found recognition in international law is controversial. Given the lack of recent state practice, and indeed the more or less consistent approach by successor states to assume the debts of their predecessors in recent times, the traditional doctrine of odious debts stands on rather weak ground in international law.²⁸ This is even more so with regard to the extension of the odious debts doctrine beyond cases of state succession to those of mere regime change but with state continuity.²⁹ More and more academics reject as unjustifiable a distinction which means that where a dictator contracted odious debts and at the end of his regime a new state emerges, this debt could be repudiated, while repudiation would be denied were the very same dictator to be succeeded by a democratic regime.³⁰ However, it needs to be noted that in case of a mere regime change, there is even less academic support for the assumption that a recognised principle of international law exists that allows for the repudiation of debts.

1.2. How Can It Be Determined Whether a Debt Is Odious?

Most promoters of the odious debts doctrine assert that three requirements need to be met in order for a debt to be regarded as odious, which are that (1) it was contracted without the consent of the people of the country that is said to owe the debt; (2) it was not contracted for the benefit of the people of that country; and (3) the creditors were aware of the odious nature of the debt. The main problems here are those of how to determine lack of consent and lack of benefit.

With regard to the issue of consent, to require an examination of whether there was actual consent or lack thereof in any given case would be completely impracticable.³¹ More importantly, the consent of the people to a loan is irrelevant under international law and debts contracted by a dictator stand, in principle, on the same footing as debts contracted by a democratic government. Thus, even if it were easy to determine the consent of the people in any given case, Sack's requirement that a debt be contracted by a dictator or a dictatorial regime is not helpful, as under international law, a debt contracted by such a despot or dictatorial regime is usually regarded as a valid act of state.³²

To determine the presence or absence of benefits of a loan to the people of a country is even more difficult and contentious.³³ Moreover, international law is not usually concerned with the internal use of a loan even if it is not used in the interest of or to the benefit of the people of a state. Whilst most of the debt contracted by dictators or dictatorial regimes would generally not be in the interest of or to the benefit of the people, it cannot be said that all such debts are therefore odious under international law.³⁴

2. Odiousness of Debts Because of Violations of International Law

Given the many uncertainties of the status and content of the odious debt doctrine in its traditional form, a change of focus might provide a better starting point for determining the odiousness of certain debt under international law.

In his report to the ILC on a draft of the Vienna Convention on Succession of States in respect of State Property, Archives and Debts (1983), Special Rapporteur Mohammed Bedjaoui suggested a two-fold definition of odious debts. According to a draft article to the Convention suggested by him, odious debts would comprise “(a) all debts contracted by the predecessor state with a view to attaining objectives contrary to the major interests of the successor state or of the transferred territory,” a definition which is very close to the doctrine of odious debts discussed so far. However, Bedjaoui proposed that a second group of debts be regarded as odious, namely (b) “all debts contracted by the predecessor state with an aim and for a purpose not in conformity with international law and, in particular, the principles of international law embodied in the Charter of the United Nations.”³⁵

The ILC formulation put forward by Bedjaoui provides the opportunity for looking at the odious debts doctrine in a completely new way by inviting a focus on the conformity of loan agreements with international law. As a minimum, this approach applies where a loan violates *ius cogens* norms. According to Article 53 of the Vienna Convention on the Law of Treaties (1969):

“A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law [*ius cogens*] is a norm accepted and recognized by the international community of states as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character.”

The current consensus on norms which form part of *ius cogens* includes the outlawing of genocide,³⁶ slavery,³⁷ torture,³⁸ apartheid³⁹ and other crimes against humanity,⁴⁰ the use of force,⁴¹ and the protection of the right to self-determination.⁴² There exists, thus, agreement on a minimum catalogue of *ius cogens* norms.⁴³ More and more, it is suggested that protection of all fundamental human rights forms part of *ius cogens*.⁴⁴ This is, however, still controversial.⁴⁵ While Article 53 of the Vienna



Dr. Mohammed Bedjaoui developed the concept of odious debt further and, apart from holding many other institutional mandates, was United Nations Legal Expert at the Conference of Plenipotentiaries in Vienna on the Convention on Succession of States in Respect of State Property, Archives and Debts in 1983. Picture: Institut Diplomatique et des Relations Internationales



Inaugural session of the International Court of Justice at the Peace Palace in The Hague on 18th April 1946 in the presence of Her Royal Highness Princess Juliana of the Netherlands. Picture: International Court of Justice

Convention only applies to treaties between states, it is widely recognised that *ius cogens* norms are universally applicable⁴⁶ and that the obligation not to violate *ius cogens* norms is thus not limited to violations that occur in the context of such treaties and instead applies to all state acts.⁴⁷ States can accordingly not contract out of the obligation to comply with *ius cogens* by entering into private contracts that are in conflict with *ius cogens* norms,⁴⁸ and debt agreements that violate *ius cogens* norms could consequently be void.⁴⁹

This means that, where a loan contract expressly makes reference to the loan's use for a purpose amounting to a violation of *ius cogens*, such as a loan contracted for the purchase of torture equipment, the underlying contract is void and repayment claims would therefore not be enforceable. However, loan agreements themselves will in most cases be neutral with regard to *ius cogens* violations. Indeed, in many cases it will only be possible to demonstrate that governments used the loans obtained to commit violations of *ius cogens* norms, for example where they used the incoming money in order to purchase arms with which they committed crimes against humanity within their own country, or acts of aggression towards the people of other countries.

When focusing on the use of the borrowed money it becomes more difficult to establish a direct link between the loan and the *ius cogens* violation, or at least a sufficiently close link to justify regarding the loan contract itself as void. However, given that international law does not tolerate *ius cogens* violations regardless of the form in which they are committed, loan transactions that lead to such violations are odious and the underlying contracts void, whether or not the violation was the agreed purpose of the transaction.⁵⁰

In order to define the exact criteria according to which it can be assessed whether the relationship between a loan and a *ius cogens* violation is significant enough to cause the invalidity of a lending agreement where only the use of the loan, rather than the contract itself, causes the violation, an analogy can be drawn with the discussion of accomplice liability in international criminal⁵¹ and civil law⁵² of corporations for gross human rights violations committed by governments. In this respect, the International Commission of Jurists, for example, argues that the "criminal liability of a financier will depend on what he or she knows about how his or her services and loans will be utilised and the degree to which these services actually affect the commission of a crime."⁵³ Unlike in the context of Sack's odious debts doctrine, the argument is here related to the lender's complicity in criminal offences committed by the borrower, not to whether the people consented to the loans or to the beneficial or harmful effects of loans in general.

Given that loans to regimes that commit *ius cogens* violations will in all likelihood at least indirectly facilitate these,⁵⁴ where a lender knows of the likelihood that loans to a regime facilitate *ius cogens* violations, these loans should be regarded as odious and consequently void, unless it can ex-

ceptionally be shown that the loan did not have such an effect. This, again, can be determined in analogy to principles governing corporate complicity. Thus, the lender can avoid the invalidity of the loan if due diligence was exercised when assessing the risk that the loan might facilitate the violation of *ius cogens*.⁵⁵

The *ius cogens* approach to odious debts has a clear legal basis in international law and is in line with evolving trends in international law in the context of liability for corporate complicity. Indeed, since the Nuremberg Trials, international law has developed considerably in its “denunciation of financing human rights abuses.”^{56 57}

1 Sack, *LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÈRES* (Receuil Sirey: Paris 1927). But see also Nitti, *PRINCIPIOS DE LA CIENCIA DE LAS FINANZAS*, at 754-755 (Talleres Gráficos Argentinos: Buenos Aires 1931); Jèze, *COURS DE SCIENCE DES FINANCES ET DE LÉGISLATION FINANCIÈRE FRANÇAISE* (M. Giard: Paris 1922).

2 King, *The Doctrine of Odious Debt under International Law: Definition, Evidence and Issues Concerning Application*, in CISDL Working Paper: *Advancing the Odious Debt Doctrine* (Montreal 2003), available at <http://www.cisd.org/pdf/debt-entire.pdf>.

3 See, for example, the articles published in the two special issues of 70 *LAW AND CONTEMPORARY PROBLEMS* (Numbers 3 and 4) (2007) that were especially dedicated to Odious Debts and State Corruption.

4 Sack, *supra* note 1, at 163.

5 *Id.* at 157.

6 For a discussion see, for example, Michalowski, *UNCONSTITUTIONAL REGIMES AND THE VALIDITY OF SOVEREIGN DEBT: A LEGAL PERSPECTIVE*, at 41-43 (Ashgate, Aldershot 2007).

7 A good overview of incidents in which debt was repudiated in international, as well as national settings, can be found in King, *supra* note 2, at 21-34 and 40-42.

8 The Vienna Convention on the Succession of States in respect of State Property, Archives and Debts has not yet come into force.

9 Report of the International Law Commission on the work of its thirty-third session, 4 May – 24 July 1980, part 2, at 79, Document A/36/10, 2 YB ILC (1981).

10 See also Howse, *The Concept of Odious Debt in Public International Law*, UNCTAD Discussion Papers No.185, at 4-5 (2007); Michalowski, *supra* note 6, at 45.

11 See, e.g., King, note 2, at 25; Sack, note 1, at 159.

12 Moore (1906), at 358-59.

13 See, e.g., Foorman, Jehle, ‘Effects of state and government succession on commercial bank loans to foreign sovereign borrowers’, (1982) *University of Illinois Law Review* 9-38, at

23; Feilchenfeld, *Public Debts and State Succession*, (The MacMillan Company: New York 1931), at 340.

14 Hoeflich, *Through a Glass Darkly: Reflections upon the History of the International Law of Public Debt in Connection with State Succession*, U. ILL. L. REV. 39, 55-56 (1982).

15 See, e.g., Frankenberg, Knieper, *Legal Problems of the Overindebtedness of Developing Countries: The Current Relevance of the Doctrine of Odious Debts*, 12 *INTERNATIONAL JOURNAL OF THE SOCIOLOGY OF LAW* 415, at 431 (1984).

16 See, e.g., Pérez, Weissman, *Public Power and Private Purpose: Odious Debt and the Political Economy of Hegemony*, 32 *NORTH CAROLINA JOURNAL OF INTERNATIONAL LAW AND COMMERCIAL REGULATION* 699, at 719 (2007).

17 For a discussion, see also Howse, *supra* note 10, at 10-16.

18 Press Release, Paris Club, available at <http://www.clubdeparis.org/sections/communication/archives-2004/irak6017>.

19 Toussaint, *La dette odieuse de l’Irak*, 16 May 2006, available at <http://www.cadtm.org/spip.php?article1884>.

20 Jubilee Debt Campaign, *Norway sets standard for rich countries*, available at <http://www.jubileedebtcampaign.org.uk/?iid=2423>.

21 Norwegian Ministry of Foreign Affairs, *Debt Relief for Development: A Plan of Action (2004)*, available at <http://www.regjeringen.no/upload/kilde/ud/rap/2004/0225/ddd/pdfv/217380-debtplan.pdf%20>

22 Abrahams, *A Fresh Look at the Odious Debt Doctrine*, in *ILLEGITIME SCHULDEN – VERSCHULDUNG UND MENSCHENRECHTE*, at 29 (Aktion Finanzplatz Schweiz, Basel 2005).

23 *Great Britain v. Costa Rica* (1923), Reports of International Arbitral Awards, Vol. 1, at 371.

24 For the complex facts underlying the claim of the bank see *id.*, at 375.

25 See also Paulus, ‘Odious Debts’ vs. Debt Trap: A Realistic Help? 31 *BROOKLYN J. INT’L L.* 83, 85 (2005).

26 *Great Britain v. Costa Rica* (1923), Reports of International Arbitral Awards, Vol. 1, at 393-394.

- 27 For an interesting discussion of the decision see, for example, Lienau, Who is the "Sovereign" in sovereign debt?: Reinterpreting a rule-of-law framework from the early twentieth century, 33 *YALE JOURNAL OF INTERNATIONAL LAW* 63 (2008).
- 28 See also Paulus, *supra* note 25, at 86.
- 29 See, e.g., *US v. Iran*, Case No. B36, Award No. 574-B36-2, note 33, 1996.
- 30 For further discussion see Howse, *supra* note 10, at 16-17; Michalowski, *supra* note 6, at 47-49.
- 31 For a detailed discussion see Michalowski, *supra* note 6, at 49-51.
- 32 See Abrahams, *supra* note 22, at 31. For a discussion on how unconstitutionality of state acts under domestic law might influence their validity at the international level; see Michalowski, *supra* note 6, Chapter 7.
- 33 For a detailed discussion see, for example, Michalowski, *supra* note 6, at 51-58.
- 34 Abrahams, *supra* note 22, at 32.
- 35 Mohammed Bedjaoui, Ninth Report on Succession of States in Respect of Matters Other than Treaties, U.N. Doc. A/CN.4/301, (1977) 2 YB ILC, part 2, at 70.
- 36 Case Concerning Armed Activities on the Territory of the Congo (New Application: 2002), (*Democratic Republic of the Congo v Rwanda*), ICJ, Judgment of 3 February 2006, General List No.126, at para. 64.
- 37 See, e.g., *Doe v. UNOCAL*, 395 F.3d 932, 945 (9th Cir. 2002).
- 38 Prosecutor v. Furundzija (Case No: IT-95-17/1-T), paras. 155-157.
- 39 See, e.g., Security Council Resolution 556, U.N. Doc. S/RES/556 (23 October 1984).
- 40 See, e.g., In re "Agent Orange" Product Liability Litigation, 373 F. Supp. 2d 7, 136 (E.D.N.Y. 2005). For an extensive list of crimes against humanity see Article 7(l) of the Rome Statute of the International Criminal Court.
- 41 See, e.g., Military Activities in and against Nicaragua (*Nicaragua v. US*), (1986) ICJ Rep 14, Separate Opinion of President Nagendra Singh, at 153 and Separate Opinion of Judge Sette Cama, at 199.
- 42 See, e.g., Legal consequences for states of the continued presence of South Africa in Namibia (South West Africa) notwithstanding Security Council Resolution 276 (1970), 1971 ICJ. 16, at 98-90 per Judge Ammoun (Separate opinion); Gros Espiell, Report on the Right to Self-Determination, E/CN.4/Sub.2/405/rev.1 (1980), at para 12.
- 43 See, e.g., Koskenniemi, Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Report of the Study Group of the International Law Commission, General Assembly A/CN.4/L/682, 2006, at 189; ILC, Draft Articles on State Responsibility, Commentary on Article 40, at paras. 4-6, A/56/10.
- 44 See, e.g., *Yassin Abdullah Kadi v. Council of the European Union and Commission of the European Communities*, Case T-315/01 (21 September 2005, European Court of First Instance), at para. 228.
- 45 For an overview of the discussion see, for example, Orakhelashvili, Peremptory Norms in International Law, (OUP: Oxford 2006); Tams, Enforcing Obligations Erga Omnes in International Law, (CUP: Cambridge 2005), at 53-60, containing ample references.
- 46 See Brownlie, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW*, at 490 (OUP: Oxford, 6th ed. 2003).
- 47 See also Inter-American Court of Human Rights, Advisory Opinion OC-18/03 of 17 September 2003, Juridical Condition and Rights of the Undocumented Migrants, at para. 99.
- 48 See Harris, *CASES AND MATERIAL ON INTERNATIONAL LAW*, at 856 (Sweet & Maxwell: London 2004).
- 49 See also Reinisch, Analysis of the Export of Warships from the Former GDR Navy to Indonesia between 1992-2004 in Terms of the Legitimacy of the German Entitlement to Payment, at paras 100-113, available at http://www.erlassjahr.de/dev/cms/upload/presse/pk-berlin/gutachten_englisch.pdf; Hobér, The Legal Status of Odious Debt, paper presented at the International Symposium on Illegitimate Debt in Oslo, 20 to 23 October 2008 (copy on file with the authors).
- 50 Fischer-Lescano, Odious Debts und das Weltrecht, *KRITISCHE JUSTIZ*, 225, 235 (2003); See also Reinisch, *supra* note 49, at para.12 (making reference to the objectives behind the concept of *ius cogens* in international law as manifested in Art.53 of the VCLT and the Articles on State Responsibility).
- 51 For an overview of the discussion see, ICJ, Report of the International Commission of Jurists Expert Legal Panel on Corporate Complicity in International Crimes, Volume 2: Criminal Law and International Crimes (2008).
- 52 ICJ, Report of the International Commission of Jurists Expert Legal Panel on Corporate Complicity in International Crimes, Volume 3: Civil Remedies (2008).
- 53 ICJ, Volume 2, Criminal Law, at 39-40.
- 54 See also Tofalo, Overt and Hidden Accomplices: Transnational Corporations' Range of Complicity for Human Rights Violations, in *TRANSNATIONAL CORPORATIONS AND HUMAN RIGHTS*, at 345-346 (De Schutter ed., Hart: Oxford 2006).
- 55 ICJ, Volume 3, Civil Remedies, at 31.
- 56 Scott, Taking Riggs Seriously: the ACTA Case against a Corporate Abettor of Pinochet Atrocities, 89 *MINNESOTA LAW REVIEW* 1497 (2005) (referencing the U.S. decisions in *Doe v. UNOCAL*, 395 F.3d 932 (9th Cir. 2002) and *Burnett v. Al Baraka Inv. & Dev. Corp.*, 274 F. Supp. 2d 86 (D.D.C. 2003), as well as developments in the context of international codes of conducts for transnational corporations, money-laundering, and funding of terrorist activities). Scott in addition points to UN efforts to create a corporate code of conduct, at 1533-1534.
- 57 More detailed analyses of its criteria and its application in practice can be found elsewhere. See Michalowski, Bohoslavsky, *Ius cogens*, Transitional Justice and Other Trends of the Debate on Odious Debts: A Response to the World Bank Discussion Paper on Odious Debts, 48(1) *COLUMBIA JOURNAL OF TRANSNATIONAL LAW* 2009 (forthcoming); see also Michalowski, *supra* note 6, at chapter 4.



3. Using Private Law for the Repudiation of Odious Debts

Sabine Michalowski

Introduction

In recent years, more and more academics have focused on private law solutions to the problem of odious debts.¹ Trying to find solutions to the problems around odious or illegitimate debt in private law has some obvious attractions. First of all, the law applicable to loan agreements is usually the private law of whichever country the parties agreed should govern the contract. Therefore, a private law approach can draw on the legal principles governing the contract,² rather than having to rely on public international law principles so as to exceptionally invalidate an otherwise valid contract, a task that many courts might not feel comfortable with.³ It is therefore worth considering to what extent reliance on well-established principles of national private law can address the problems of odious debts.⁴

Agency

One of the most important private law principles on which some of the purposes of an odious debts doctrine might be based is that of agency. The law of agency regulates the situation where the principal (i.e. the party in whose name the contract is entered and who will be bound by it), is not involved in the negotiation of the contract, but is represented by an agent. To apply this terminology to the context of sovereign debt, it could be argued that the government of a debtor country acts as an agent of the people of the state, and that the resulting agreements will usually bind the state, not the acting government officials. The state is bound by the contract either because the agent acted with the principal's actual authorisation, with apparent authority, or because the principal later ratified the unauthorised acts of the agent.

Most sovereign debt agreements contain a choice-of-law clause that stipulates which law governs the contract (usually not the law of the debtor state). This means that questions with regard to the validity of the contract will have to be decided according to the chosen national law. However, the issue of determining the scope of authority of the state party is usually regarded as governed by the domestic law of the debtor country.⁵ From the internal perspective of the debtor state, provisions as to who has the authority to act on behalf of a state, and which acts a state organ is authorised to carry out can often be found in the constitution of the relevant country.

In many cases of odious debts, the state organs will have acted with authority according to national law. However, even to the extent that this is not the case and a government has in fact exceeded its competencies under national law,⁶ in its dealings with international creditors, government officials

will usually be deemed to act with authority.⁷ Moreover, many governments will, upon return to democracy, start to repay their debt, which could be regarded as a ratification, i.e. an acceptance of the fact that the debt binds the country.⁸

However, most national agency laws recognise some exceptions to these general principles. In U.S. agency law, for example, the presence of obviously suspicious elements that shed doubt on the fidelity of the agent to the principal shift to the other party, in the context of sovereign debt the creditor, the burden of verifying whether the government official, or indeed the government as a whole, was in fact authorised to carry out the transaction in the name of the state.⁹ As explained by Buchheit, Gulati and Thompson:

“In addition, the validity of the delegation of actual authority from the governing authority to the agent who acted for the regime is constrained by several principles of agency law. The existence of actual authority of the agent to perform certain functions does not automatically mean that the agent has the apparent authority to bind the principal in all matters, nor does it always remove from the third party the responsibility for ensuring that the agent has not strayed into the realm of self-dealing. For example, the Restatement of Agency specifies that the authority to act as an agent includes only the authority to act for the benefit of the principal and that agents owe a fiduciary duty to their principals. When a third party is aware that the agent is acting for a personal purpose, the principal is not liable to the third party. ... If the circumstances of the transaction raise reasonable doubts about whether the agent is faithfully representing the interests of the principal, these principles suggest that the third party is under a duty to investigate.”¹⁰

This was accepted by a U.S. court in the context of a case involving a corporate officer who signed a guaranty for a debt that in no way benefited the corporation. According to the court, the “duty of diligence in ascertaining whether an agent is exceeding his authority devolves on those who deal with him, not on his principal.”¹¹

It follows from these principles that corrupt loans, i.e. loans that are given as bribes or otherwise for the personal use of the governing regime, would be unenforceable against the state, as long as the lender has knowledge of this use of the loan, as agency law does not protect creditors who collude with corrupt agents.¹² Similar considerations apply where, in spite of suspicious circumstances, the lender does not investigate with due diligence whether the state officials negotiating the loan are in fact acting in the interest of the state.

It is here that the reputation of a corrupt government becomes relevant to the analysis. A loan





Enugu, Nigeria in December 2002. A typical result of large-scale corruption in public procurement: Only one lane of the road has been tared. Picture: Max Mader

will not be unenforceable merely because it was contracted by a corrupt regime. But that regime's reputation for corruption may place upon the lender, as a matter of agency law, a higher burden to satisfy itself that the proceeds of the loan are benefiting the principal (the country) and not just the agent (the government officers signing the loan agreement).¹³

On the other hand, where a loan does not serve a useful purpose and might even be "utterly fatuous," absent corruption.¹⁴

The issue of agency has also come up in some international arbitration cases. While in most cases where an agent acted without actual authority, the tribunals found either apparent authority, or apparent ratification of an invalid contract, such a finding largely rests on whether the other party was acting in good faith concerning the appearance of original authority or of ratification. It must further have applied reasonable care in order to ascertain the authority of the state official, and the amount of care required seems to depend on the expertise of the creditor and the importance and the subject matter of the contract.¹⁵

The agency approach has, however, also found its critics. Jeff King, for example, questions the appropriateness of an agency analogy for the relationship between the people of a state and the state government on the basis that the relationship between a principal and an agent usually comes about through consent, but "consent to be governed is not a mandatory requirement in international law."¹⁶

Other Private Law Principles

As with agency, most other private law doctrines mentioned in the odious debt debate focus on bad faith and, in particular, on corruption. The Anglo-American doctrine of 'clean hands', for example, stipulates that only a claimant who comes to the court with clean hands will receive the protection of the court. Thus, a lender who bribed a state official¹⁷ or otherwise encouraged corruption in the context of the loan will not be able to enforce repayment of the loan in any state in which this equitable doctrine applies.¹⁸

An example of a case in which this doctrine became relevant is that of *Adler v. Nigeria*.¹⁹ In that case, a U.S. businessman had been approached by various Nigerian individuals, including at least one government official, to participate in a fraudulent scheme of over-invoiced government contracts that would allow them to convert Nigerian government funds for their personal use. In return for taking part in some activities, including the provision of pro-forma invoices, Adler was promised a share in the profits of the scheme of about 60 million dollars. Adler made payments of about 5 million dollars, more than 2 million of which was used to bribe government officials, upon being told that in return the 60 million dollars would be deposited in his bank account.²⁰ However, he never received the promised money and the scheme instead turned out to be a scam. When Adler realised this, he sued the Nigerian state and a government official who had participated in the scheme,

in order to recover the money he had paid, in a U.S. district court. The court decided that his recovery was barred by the unclean hands doctrine and Adler appealed, arguing that the doctrine should not apply in his case because the Nigerian officials were more at fault than he was; the Nigerian officials would be unjustly enriched if they did not return the funds to him; and that by granting Adler a remedy the Nigerian officials would be discouraged from perpetrating such schemes in the future.²¹ The Court of Appeals did not accept the arguments and rather stated that:

“First, it is not clear that Adler is any less blameworthy than the Nigerian officials. The Nigerian officials proposed the criminal scheme, but Adler voluntarily participated in it. And while the Nigerian officials successfully defrauded Adler of over five million dollars, Adler attempted to steal sixty million dollars from the Nigerian government. Second, the fact that the defendants will receive a windfall is not an absolute bar to the unclean hands defense ... Finally, it is not clear that justice would be served by compelling the Nigerian government to return the money to Adler. Making a judicial remedy available when the bribe fails to accomplish the intended result would reduce the risk inherent in paying bribes, and encourage individuals such as Adler. In short, public policy favors discouraging frauds such as the one perpetrated on Adler, but it also favors discouraging individuals such as Adler from voluntarily participating in such schemes and paying bribes to bring them to fruition.”²²

Thus, in cases of corruption, lenders’ claims for debt repayment might be barred by the doctrine of unclean hands if they knowingly colluded in the corruption. It could even be argued that the unclean hands doctrine applies where the lender, without having actual knowledge of corruption, should have been suspicious in this respect, “depending on how deliberately obtuse the lender may have been in its investigation of the use of proceeds of the loan.”²³

Reference is also sometimes made to principles of consumer protection. Hanlon²⁴ and Raffer,²⁵ for example, refer to the provisions of the British Consumer Credit Act 1974, which confers upon the courts the power to change the terms of or refuse to enforce a loan that is grossly unfair, taking account of the borrowers experience, business capacity, and whether the borrower acted under financial pressure. More generally, Paulus argues that, though problematic, an analogy with consumer protection law might be appropriate in the context of odious debts, as “calls for the recognition of the doctrine of ‘odious debts’ practically all appear to be based on a de facto power gap between the

lender and the borrower (or at least the population of the borrowing state).”²⁶ He also refers to a comparable principle in Article 3.10 of the UNIDROIT Principles of International Commercial Contracts,²⁷ which allows a party to avoid a contract in case of gross disparity, for example, where “the other party has taken unfair advantage of the first party’s dependence, economic distress or urgent needs, or of its improvidence, ignorance.”²⁸ However, it is questionable whether it can be said that sovereign governments are so inexperienced and in such a weak bargaining position that loan agreements entered into by their representatives should therefore be regarded as void. This discourse, which particularly arises in the context of debt refinancing, is difficult to reconcile with the claim for recognising the sovereignty of the debtor governments.

General Principles of International Law

The aforementioned principles of private law do not only come into play to the extent that they are part of the national law applicable to a specific loan contract. Private law principles that are shared by many countries might in addition have the status of general principles of international law. This means that under Article 38 of the Statute of the International Court of Justice, they form part of the recognised sources of international law. According to Howse, this might be true for principles of “illegality, fraud, fundamentally changed circumstances, knowledge that an agent is not properly acting on behalf of the contracting principal and duress.”²⁹

Conclusion

To the extent that reliance on private law principles achieves the aims behind the doctrine of odious and/or illegitimate debt, such an approach has some obvious advantages over a public law approach, as the principles themselves are fairly well-developed and courts might be more comfortable in applying them. However, as could be seen, the applicability of private law principles that are in themselves well-established to the particular scenarios arising in the context of odious debts has yet to be defined. Moreover, private law principles mainly seem to assist in cases of corruption, but less so in other situations that are of importance in the context of odious debts, such as loans that are used to commit human rights violations or to oppress the population. To some extent, it might be possible to refer in such scenarios to the invalidity of contracts that violate public policy or the *ordre public*.³⁰ However, these arguments have so far received insufficient attention to provide a workable tool to question odious debts.

- 1 See Buchheit, Gulati & Thompson, *The Dilemma of Odious Debts*, 56 *DUKE LAW JOURNAL* 1201 (2007).
- 2 See also Howse, *The Concept of Odious Debt in Public International Law*, UNCTAD Discussion Papers No.185, at 21 (2007).
- 3 Feibelman, *Contract, Priority and Odious Debt*, 85 *NORTH CAROLINA LAW REVIEW* 727, 742-743 (2007).
- 4 Buchheit, Gulati & Thompson, at 1230.
- 5 DICEY, MORRIS & COLLINS ON THE CONFLICT OF LAWS, Volume 2, Rule 162 (Sir Lawrence Collins ed., Sweet & Maxwell: London, 14th ed. 2006); Stone, *EU PRIVATE INTERNATIONAL LAW*, at 299-300 (Edward Elgar: Cheltenham, Northampton 2006). The English Court of Appeal also seems to have assumed that the domestic law of the debtor country governs the authority of the state party. See *Marubeni v. Mongolian Government* [2005] EWCA Civ 395, [2005] 1 WLR 2497, at 2508-2509 per Carnwath LJ with regard to state representatives.
- 6 This could, for example, be argued in the case of Argentinian debt going back to the last military dictatorship. See Michalowski, *UNCONSTITUTIONAL REGIMES AND THE VALIDITY OF SOVEREIGN DEBT: A LEGAL PERSPECTIVE*, Chapter 7 (Ashgate, Aldershot 2007).
- 7 For a discussion on U.S. agency law, see Buchheit, Gulati & Thompson, at 1240.
- 8 See also De Mott, *Agency by analogy: A comment on odious debt*, 70 *LAW AND CONTEMPORARY PROBLEMS* 157, 165 (2007).
- 9 Buchheit, Gulati & Thompson, at 1240.
- 10 *Id.* at 1242-1243, footnotes omitted.
- 11 *Strip Clean Floor Refinishing v. New York District Council No. 9*, 333 F. Supp. 385, 396 (E.D.N.Y. 1971).
- 12 See also De Mott, at 165.
- 13 Buchheit, Gulati & Thompson, at 1245.
- 14 *Id.*
- 15 Meron, *Repudiation of Ultra Vires State Contracts and the International Responsibility of States*, 6 *ICLQ* 273, 288-289 (1957). For a discussion, see also Michalowski, at 177-185.
- 16 King, *Odious Debt: The Terms of the Debate*, 32 *NORTH CAROLINA JOURNAL OF COMMERCIAL AND INTERNATIONAL REGULATION* 605, 644 (2007).
- 17 See also Buchheit, Gulati & Thompson, at 1232-1233.
- 18 For a discussion in the context of odious debt, see Buchheit, Gulati & Thompson, at 1235-1236; see also Reinisch, *Analysis of the Export of Warships from the Former GDR Navy to Indonesia between 1992-2004 in Terms of the Legitimacy of the German Entitlement to Payment*, at paras. 79-80, available at http://www.erlassjahr.de/dev/cms/upload/presse/pk-berlin/gutachten_englisch.pdf
- 19 *Adler v. Nigeria*, 219 F.3d 869 (9th Cir. 2000).
- 20 *Id.* at 872-873.
- 21 *Id.* at 877.
- 22 *Id.*
- 23 Buchheit, Gulati & Thompson, at 1237.
- 24 Hanlon, *Defining Illegitimate Debt and linking it to economic justice*, (2002), www.odiousdebts.org/odiousdebts/publications/DefiningIllegitimateDebt.pdf, at 7-8.
- 25 Raffer, *Odious, Illegitimate, Illegal, or Legal Debts - What Difference Does it Make for International Chapter 9 Debt Arbitration*, 70 *LAW AND CONTEMPORARY PROBLEMS* 221, 228 (2007).
- 26 Paulus, *"Odious Debts" vs. Debt Trap: A Realistic Help?*, 31 *BROOKLYN JOURNAL OF INTERNATIONAL LAW* 83, 90 (2005).
- 27 UNIDROIT Principles of International Commercial Contracts, available at <http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf>. For a discussion, see Paulus at 95-96.
- 28 UNIDROIT Principles of International Commercial Contracts, Article 3.10(1)(a).
- 29 Howse, at 6; Reinisch, paras. 53-99.
- 30 See, e.g., Howse, at 19-20; Reinisch, at paras. 59-62 and 81-85.



4. Illicitness in Various Legal Instruments Relating to External Debt

Ramiro Chimuris Sosa

Introduction

In this article, I present the concept of illicitness as a legal term that could mitigate the tension that exists between the importance of binding legal instruments and non-binding resolutions within the subject of public debt. I suggest that general principles of law can have a similar importance to that of binding legal instruments with respect to the eventual success of arguments used in debates over public debt.

The first section of the article defines what a legal transaction is. The second describes the legal notion of illicitness, in contrast to illegitimacy, in international law and criminal law. Then, the third section talks about the nullity of treaties according to international law and the doctrine of Carlos Calvo. Following, I discuss when individuals can be subjects of international law and how investors have become new subjects of international law in the fourth part of the article. Finally, I put these theoretical discussions in context by presenting a concrete example from the Ecuadorian debt audit.

I. General Definition of a Legal Transaction

A legal transaction is a declaration of will directed toward an end. Legal transactions involve at least three basic prerequisites: the form (declaration), the content (object), and the purpose (cause). If any of these are missing, the transaction is not properly configured. Legal capacity and transactional normative power constitute the preliminary framework for the effective performance of subjects of law. For the subjects of a transaction to enjoy legal protection (domestic, international, regional, etc.), it is necessary for them to conform to the normative framework imposed by the legal order.

Contracts are legal norms that cause or give rise to subjective rights and duties; they are the manifestation of normative power with which the parties to the contract are vested by law. In analyzing the various legal instruments relating to external debt, we must begin by studying the what and the how of such contracts.

There are situations where the law prohibits certain subjects of law from transacting with respect to a type of transaction that is in itself licit. By way of example, in external debt contracts when: (1) representatives do not qualify to act on behalf of the state; (2) an official has acted in excess or abuse of power; (3) a representative of the state belongs to a *de facto* government, not recognized by the international legal order; or (4) statutory prohibitions on the non-interference of international agencies in the internal affairs of member countries have been violated.

When observing contractual-transactional normative power, one sees that legal relationships

are only created between subjects of law (states, international organizations, individuals) that are vested with such power; but, not all legal relationships have this power as their source. The law itself grants the authority and is the cause of legal relationships that are imposed on the subjects of law regardless of their will.

II. The Legal Notion of Illicitness

An illicit act is an act contrary to the legal order, be it national or international, for instance, acts contrary to general principles of law—such as the rule that anyone who commits a wrongful act that causes harm to another must repair the damage; the notion that no one can be the judge in his or her own cause; and the principle of unjust enrichment. The general principles of law recognized by the major legal systems are regarded as a source of international law, as are treaties and custom.^{1 2}

There exist various legal positions regarding the application and reach of these principles. Within the civil-Roman doctrine, general principles of private law apply to external debt because a state's debt is a contract.³ In contrast, the internationalists adhere to a different analysis: in external debt relations, where at least one of the subjects is a subject of international law (a state or an international organization), the legal relationship is governed by international public law, not by private law.

In this article, I suggest that there is a distinction between illegitimacy and illicitness. Illegitimacy is a broader category than illicitness, it subsumes any hypothesis that violates legal standards in a broad sense and refers to acts that lack or are defective in their essential elements, in their process, or externalization.⁴

Emilio Betti, who influenced Italian and foreign doctrine, developed a doctrine dealing with illicitness. According to Betti:

“The vices concerning the cause are those that can affect the transaction when, despite proper and regular execution, and despite belonging to an admissible type, the transaction is made to serve a purpose or interest with an illicit character, that is to say, rejected by prohibitive legal norms or contrary to public policy or good customs, or if there are defects of the appropriate typical cause to justify the protection of the law.”⁵

According to Betti, a contract is void: (1) “when there is an absence of an essential element (agreement of the parties, the cause, the purpose, and the form required for the validity of the act)” or (2) “when it is illicit, that is, contrary to peremptory norms, the public order, and good custom.”⁶

For example, illicit would be the obligation to commit theft, which is illicit in itself. But some licit obligations may generate illicitness due to the



relationship in which they appear in relation to each other. Thus, it is licit to promise not to steal or to promise a sum of money to another person, but if anyone were made to promise to take a sum of money in return for not stealing, illicitness would result, because the obligation/condition in which these unique promises find themselves constitute a departure from the legal order.

Emilio Biasco teaches: “Illegitimacy differs from illicitness insofar as the latter consists of the violation of legal norms that do not regulate actions, but instead regulate any behaviors of the administration that violate the individual rights of others. Consequently, illicit is an act contrary to law, for which the legal order assigns responsibility and subjects the perpetrator to a penalty.”⁷

A. Illicitness from the Perspective of International Law

Illicitness is a fundamental concept in international law. There is an illicit act under international law when conduct consisting of an action or omission: (1) is attributable, according to international law, to the various subjects of law (states, international organizations, public and private legal persons, etc.); and (2) constitutes a violation of an international obligation of the state, which would extend to international financial organizations belonging to the United Nations system.

Since the late 1970s, the work of the International Law Commission and international doctrine and jurisprudence (International Court of Justice, Inter-American Court of Human Rights) have incorporated elements concerning the issue of external debt and illicitness: “Unlawful action against non-material interests, such as acts affecting the honor, dignity or prestige of a State, entitle the victim State to receive adequate reparation, even if those acts have not resulted in a pecuniary or material loss for the claimant State.”^{8 9}

Meanwhile the International Law Commission made a draft of fifty-nine articles on: “The responsibility of states for internationally illicit acts,” which was included in the agenda of the General Assembly’s 85th plenary meeting on 12 December 2001.¹⁰

B. Illicitness from the Perspective of Criminal Law

Criminal illicitness has the characteristic of typicality – the only crimes are those that the law expressly defines, describes, and qualifies as punishable.

The paradigmatic case in criminal law has been the case concerning the foreign debt of Argentina, filed in 1982 by Argentine journalist Alejandro Olmos, who brought, before the Juzgado de lo Criminal y Correccional No. 2 (Criminal and Correctional Federal Court No. 2), legal proceedings spanning 18 years, which culminated with a decision dated 13 July 2000. The judge, after hearing the experts and the testimonies, and after making relevant inquiries, concluded in a passage from the decision:

“The manifest arbitrariness with which the political and economic leaders with the highest responsibility in the nation conducted themselves

in the periods analyzed has been shown in the transcript of the proceedings. (...) there was no hesitation in violating the Organic Charter of the Central Bank of Argentina; the modification of legal instruments with the purpose of extending the jurisdiction of national courts to foreign judges was facilitated and enacted; the accounting records of external debt were non-existent (...) the lack of control over contracted debt with state guarantees has also been noted. All of this was noted in no less than four hundred seventy-seven cases, (...) this could not go unnoticed to the authorities of the International Monetary Fund, who oversaw the economic negotiations.”¹¹

The importance of this ruling is that there is a final decision on the illegality of the maneuvers around Argentina’s external debt during the years 1976 to 1982.

This was not the only court decision on Argentina’s external debt. Following the return to “democracy,” the former President of the Republic, Fernando de la Rúa, Finance Minister, Domingo Cavallo, and his economic team were prosecuted for fraud in the handling of Argentina’s external debt. In 2006, Fernando de la Rúa and Domingo Cavallo were found guilty of fraud against the state, committed during the swap of external debt bonds held in June 2001.

In reality, the operation realized by the government increased debt by USD 55 billion, according to the conclusions of experts in the case. Accounting experts also noted that the only clear beneficiaries of the program were the banks that participated in the operation, which charged a fee of USD 150 million for doing practically nothing, given that they exchanged papers that they already had in their investment portfolios.¹²

III. The Nullity of Treaties

A. United Nations Conventions

To analyze the nullity of treaties, one should look at the capacity and legitimacy to enter into contractual obligations involving the external debt of states. Apart from the representation invoked by public law contracts or public securities, one should analyze the legitimacy of the purposes of debt contracts. For example, on the side of the creditors and lenders, one observes the setting aside and violation of the statutes of the World Bank and IMF, and principles embodied in the UN Charter, General Assembly resolutions, and the Charter of the Organization of American States.

In 1989, the General Assembly adopted (with 118 votes in favor, none against, and with some abstentions), Resolution 44/215, condemning economic measures used to exert political and economic pressure on developing countries. And in 1991, the General Assembly, by consensus, adopted Resolution 46/43 on the protection and security of small states, in which it recognized the vulnerability of small states to external threats and interference in their internal affairs, and noted the vital importance, for all states, of unconditional respect for the principles of the UN Charter, especially those

principles concerning sovereign equality, territorial integrity, non-interference in internal affairs, and peaceful settlement of disputes.¹³

The illicitness and unlawfulness (acts contrary to law in a broad sense) of certain loan instruments or titles of external debt, is evidenced when one applies the norms of the Vienna Convention on the Law of Treaties, in particularly Section II (Articles 46 to 53) under the title Invalidity, Termination and Suspension of the Operation of Treaties. Under Article 46 of the Vienna Convention on the Law of Treaties, there can be grounds for invalidating a treaty when the treaty has been concluded in manifest violation of a rule of fundamental importance to the domestic law of a party to the treaty.

An example is the case of public debt loans that were not ratified by national law. The debt of Argentina during the military dictatorship (1976-1983), for example, was not ratified by the National Congress as required by the Constitution of Argentina.¹⁴ The status of debts under other Latin American dictatorships of the 1970s, which were not ratified by the legislative branch, pursuant to the constitutional order of each country, is similar. Hence, these debts violate the principle of legality and suffer from absolute nullity, and, thus, they cannot be validated by subsequent acts and ratifications.¹⁵

“According to Article 53 of the Convention:

A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted by the international community of States as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character.”

From the perspective of Articles 46 and 53, the conclusion of a treaty in violation of fundamental rights and guarantees enshrined in the constitution of a state and in the principal norms of the international law of human rights would be cause for revocation. Failing to exercise any other fundamental domestic precept, like the examination of the conformity of a treaty with the constitution by national courts, would also be a ground for annulment. This happens, for example, when arbitration tribunals are granted the authority to resolve controversies involving constitutional clauses, given that for reasons of state sovereignty, control over questions of constitutionality must exclusively remain a responsibility of national courts.¹⁶

B. The Calvo Doctrine

Apart from the United Nations conventions discussed above, there are Latin American and Caribbean doctrines that have international application with respect to illegal debts. These are the doctrines of Carlos Calvo (the Calvo Doctrine), Luis María Drago, and Espeche Gil. These doctrines were mainly developed in the early twentieth century, and are reflected in international documents and in legal and diplomatic practices. Below, I will discuss only the Calvo Doctrine for the sake of brevity.

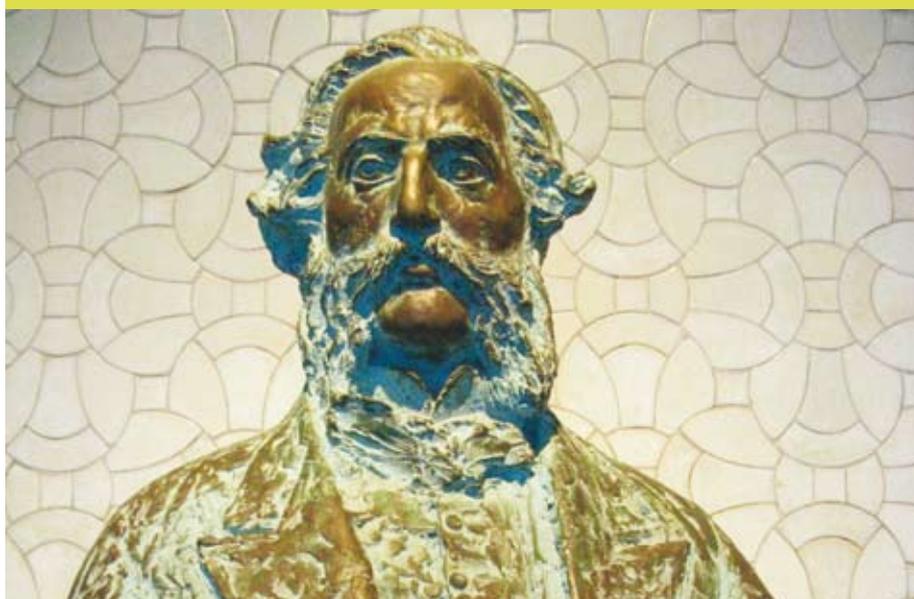
In the nineteenth century, Carlos Calvo, in his work *Derecho Internacional Teórico y Práctico* (Theoretical and Practical International Law) formulated the Calvo Doctrine. This doctrine is based on the principles of national sovereignty, equality between nationals and foreigners, and territorial jurisdiction. According to Calvo, sovereign states have the right to be free from any form of interference by other states, and foreigners have the same rights as nationals and, in the case of litigations or claims, shall have the obligation to exhaust all legal recourse available before local courts without seeking diplomatic protection and intervention from their country of origin.

The practical application of Calvo's ideas are, on the one hand, crystallized in the so-called Calvo Clause, which consists of a provision introduced into agreements with foreign citizens, stating that they accept the jurisdiction of national courts and waive the diplomatic protection of their own country. On the other hand, they are found in the Calvo Doctrine, which is the institutional recognition of this principle, and has had mixed fortunes given that the United States has always opposed it.¹⁷ The Calvo Doctrine is enshrined in various international documents and in the constitutions of several Latin American countries.¹⁸

The Ninth Conference of American States (Bogotá, 1948) enshrined the Calvo Doctrine at the regional level in the Charter of the Organization of American States, Article 16, which reads: “The jurisdiction of States within the limits of their national territory is exercised equally over all the inhabitants, whether nationals or aliens.” At the same conference the Pact of Bogotá was adopted. Article 7 of that pact reads: “The High Contracting Parties bind themselves not to make diplomatic representations in order to protect their nationals, or to refer a controversy to a court of international jurisdiction for that purpose, when the said nationals have had available the means to place their case before competent domestic courts of the respective state.”

On 12 December 1974 the UN General Assembly adopted the Charter of Economic Rights and Duties of States, whose Article 2.2(c) establishes the right of states to nationalize, expropriate, or transfer ownership of foreign property by paying adequate compensation, “taking into account its relevant laws and regulations and all circumstances that the state considers pertinent.” It goes on to state that if the compensation is controversial, the issue “shall be settled under the domestic law of the nationalizing state and by its tribunals, unless all interested states freely and mutually agree to seek recourse in other peaceful means based on the sovereign equality of states and in accordance with the free election of means.”

Furthermore, the Calvo Doctrine was extended by Pasquale Fiori when he specified that the acts of government of a state may not be subjected to prosecution by another state, based on the principle of legal equality of states. In support of this argument, he cited a ruling by a French court in a case where a French citizen was a party against the Republic



Bust of Carlos Calvo in the Peace Palace, The Hague. The Calvo Doctrine has had mixed fortunes given that the United States has always opposed it. In 2005, due to its renewed use in debt litigation, the International Dispute Resolution Committee of the District of Columbia Bar organized a luncheon with the title “Resurgence of the Calvo Doctrine?”. Picture: Lybil / Wikimedia

of Haiti. The French citizen was declared incompetent given that “to submit a nation’s commitments to the jurisdiction of another, is completely equivalent to removing the country’s independence, subjecting it to another, whose jurisdiction it would be obliged to obey.”¹⁹

IV. The Subjects of International Law in the Incurring of Foreign Debt

A. Individuals as Subjects of International Law

One question that continues to give rise to important debates in international doctrine and jurisprudence has been how to determine whether individuals can be considered subjects of international law. The classic conception of international law, also called subjectivist or voluntarist, sustains that international law is the legal system that governs relations between states, and there can be no subject in international law that is not a state.²⁰ The dualistic doctrine sustains the same position, also denying the possibility that the individual can be a subject of international law.

The committee of jurists that drafted the Statute of the Permanent Court of International Justice (predecessor of the International Court of Justice) denied the possibility that the individual could be a subject of international law, reflecting the dualist doctrine. When Loder and Lapradelle proposed granting *locus standi* to individuals before the Court, Ricci-Bussati objected because “individuals are not and cannot be subjects of law.”²¹ The Statute of the Court was approved according to the dualist conception, expressed in Article 34, part 1 (“Only states may be parties in cases before the Court”). In sum, the jurisprudence of the International Court of Justice does not recognize the rights and interests of individuals²² to file claims when their rights have not been acknowledged, in violation of international law.

Notwithstanding, the jurisprudence of the International Court of Justice (as that of its predecessor, the Permanent Court of International Justice) recognizes the individual as subject to international duties and obligations, often based on customary law.²³

A case where international law supports individual responsibility is that of war criminals.²⁴ The criminal liability of individuals emerging from international standards is located in the Convention on the Prevention and Punishment of the Crime of Genocide, the 1949 Geneva Conventions of 1949 and Protocol I of 1977, the Convention on the Suppression and Punishment of the Crime of Apartheid, the International Criminal Tribunal for the former Yugoslavia, and so on.

In short, in some cases it is now accepted that in addition to states there are other subjects of international law, and there are known examples in international practice where such a privilege has been granted. Nevertheless, the recognition of individuals as subjects of international law has required a long struggle at the level of doctrine, international practice, and jurisprudence. In the area of doctrine, a number of authors have argued

that individuals are subjects of international law (Heffter, Pillet, Rougier, Fiore, Spiropoulos, Scelle, Lauterpacht, among others). In international practice, legal personality was granted to individuals in the following cases: (1) Convention No. XII of the Hague Conference of 1907;²⁵ (2) the Central American Court of Justice, established by the Treaty of Washington of 20 December 1907, before which individuals from any of the five Central American countries can raise their claims directly against any of the other four signatories;²⁶ (3) the German-Polish Convention Relating to Upper Silesia of 1922, applied until 1937;²⁷ (4) the European Convention on Human Rights of 1950;²⁸ (5) Article 87 of the UN Charter, which provides that the General Assembly and the Trusteeship Council may “accept petitions and examine them in consultation with the administering authority”; (6) the treaty establishing the European Coal and Steel community on 18 April 1951;²⁹ and (7) arbitration tribunals established by Articles 299 to 304 of the Treaty of Versailles and the peace treaties that ended the First World War.

B. Investors as New Subjects of International Law

The International Convention on the Settlement of Investment Disputes between States and Nationals of Other States, signed in Washington on 18 March 1965, and in force since 14 October 1966, created a system of arbitration within the World Bank called the International Center for the Settlement of Investment Disputes (ICSID). Its aims are to safeguard and protect the interests of international corporations in the case of controversies, conflicts, and disputes “between individual investors and States.”

It is the only arbitration system exclusively designed to solve disputes between states and foreign persons (companies and individuals) in relation to investments made by the latter. The ICSID Convention prohibits contracting parties from granting diplomatic protection or bringing international claims in disputes between their nationals and other contracting parties, if the parties to a dispute have consented to submit it to arbitration according to the Convention.

In 1964, during discussions on the arbitration system proposed by the World Bank, the Latin American group’s spokesman said:

“[the system] would give the foreign investor, by virtue of being foreign, the right to sue a sovereign state outside its territory, avoiding the competent national courts. This is contrary to legal principles accepted by our countries and, indeed, constitutes a privilege conferred on the foreign investor, putting nationals of the state concerned in a position of inferiority.”³⁰

The arguments used in favor of the ICSID are: (1) the search for certainty and legal security for investors; (2) the high degree of specialization of the arbitrators; (3) the speed of proceedings; (4) the non-application of national and international public law, and the recognition of *ius standi* (right of recourse to international arbitration bodies), but only for private investors.

The arguments against the ICSID are several, for example: (1) legal standing for individuals in countries receiving investments is not recognized, this implies a double violation of the principle of equality, given that individual investors are subject to international law with the same status as states, but are not subject to the relevant obligations; (2) the lack of guarantees for states, given that legal defense mechanisms, such as appeal, are not foreseen; (3) the arbitration proceedings are not public; (4) the arbitration tribunals are not judicial bodies – it is the privatization of justice, where one party acts in dual capacity as a judge and party (ICSID is one of the bodies of the World Bank); (5) the renunciation of sovereignty and the rights of states in accordance with the statutes and mechanisms of the ICSID.³¹

One of the negative aspects of the ICSID Convention, leading to the renunciation of rights and guarantees, is the repudiation of a general rule in international commercial arbitration, under which the submission of a dispute to an arbitration body does not limit the competence of national courts to issue interim measures to adequately safeguard the rights of the parties. Moreover, Arbitration Rule 39 (amended in 1985) establishes that parties wishing to retain the option of seeking interim relief before national courts must do so expressly in the instrument that contains their consent to arbitration.

Although adoption of the ICSID Convention does not constitute any obligation to submit arising disputes to arbitration before the Center without the state’s consent, once consent is granted, it may not be unilaterally revoked.

So submission to ICSID jurisdiction is voluntary, states may decline to sign the Convention or refuse to consent to the jurisdiction of the arbitration, but once the parties have consented to submit a dispute, they cannot withdraw their consent unilaterally.

Various ICSID arbitration panels have considered that the signing of bilateral investment treaties implies giving express consent to such jurisdiction on the part of signatory countries. To my understanding, this is not true. This interpretation gives primacy to rules that are lower in the legal hierarchy, and would involve granting validity to a flawed type of adherence, which contradicts good faith and international commitments made by states.

Moreover, the nationality of a legal person is not a simple issue, and the relevant definitions are not made clear in the text of the Convention, for which reason this determination is left to the subjective criteria of the arbitrators, resulting in lack of legal certainty. What criteria define the nationality of a corporation? The text does not say that. The arbitrators at the ICSID refer to the domicile or place of incorporation of the company, criteria that do not determine nationality and have generated procedural abuses within the system.^{32 33}

The consent of the parties to arbitration precludes any other remedy; as a consequence, the abovementioned procedures prevent any other form of intervention or judicial review, which ef-

fectively constitutes a waiver of the right to appeal and defend the substantive rights of the parties as provided by existing national legislation. Nevertheless, the treaty could be renounced by invoking Article 68 of the statutes of the ICSID, if a state believes that its constitution was violated or that rights and guarantees protected in its *magna carta* were affected.³⁴

Latin American countries signed the Treaty of Washington and subscribed to this particular dispute system that favors investors, due to the economic and political pressures of the 1990s, and through the constraints imposed in the Letters of Intent and Structural Adjustment Plans (IMF and World Bank).

1. The New Bilateral Treaties

Within international commercial and financial practice, to the recognition of new actors (corporations) with the capacity to sue states, one must also add the new international treaties (bilateral, regional and multilateral), especially those emerging since 2004. These new treaties limit the sovereignty and independence of states, protect foreign debt securities as a covered investment, and open the possibility for investors to sue states before one of the agencies of the World Bank (ICSID).

These new legal frameworks enable private actors, companies, non-controlling and minority shareholders, to resort to the tribunals (*ius standi*) for the purpose of suing states for changes to rates of return, variations in interest rates, delayed payment of dividends, etc. These private actors, however, cannot be sued by states or their nationals; that is to say, rights, capabilities, powers and immunities were awarded only to investors. In addition, the jurisdiction established in these treaties is that established by the ICSID.

These new subjects of international law (investors), relying on the combination of arbitration mechanisms and treaties for the promotion and protection of investments, contribute to systems that generate more debt, and the legal notion of illicitness becomes one of the legal elements that can be used to request the respective nullity of the various instruments of debt.

V. Experience of the Public Credit Audit Commission in Ecuador

The instruments of credit, loans and structural adjustment plans related to Ecuador's multilateral external debt follow a system implemented by international lending institutions representing orthodox economic thought. The Comisión para la Auditoría Integral del Crédito Público (Public Credit Audit Commission or CAIC) audited these loans to find the structural elements of external debt and its legally significant characteristics, defined as illegal, odious, and illicit, civilly and criminally.

In another work, I conducted a legal analysis of the findings of the CAIC, where I wrote about audited loans and discussed which laws were violated with respect to each of these loans. That analysis comprised nine chapters. Here I will discuss

the analysis of one of those chapters, which deals with the use of the funds.

A. BIRF Loan 3819/EC from the World Bank

This is the main loan of the four that were jointly signed under the framework of the 1994 Financial Plan and the Development Policy Letter submitted by the government of Ecuador to the World Bank on 17 November 1994. It was for USD 200 million, with a term of 20 years, a grace period of 5 years, and a variable interest rate determined semi-annually by the lender.

The loan was for the implementation of the Structural Adjustment Program for the Ecuadorian economy, especially to finance imports required during such execution and for the implementation of the Plan for the Reduction of Debt.

Annex 1 contains the schedule of disbursements. The Annex foresaw USD 150 million for imported goods and USD 50 million for the debt reduction plan.

The lender demanded confirmation of the constitutionality of the conditions of the loan, which was confirmed by the Director de Asesoría Jurídica de Presidencia de la República (General Counsel of the Office of the President), by memorandum No. 95-9411-DAJ-T-C2. The *magna carta* in effect during the signing of the loan, however, refers to telecommunications services, in Article 46, as one of the "areas of economic activity reserved to the state" and adds that "exceptionally, the exercise of any of the above activities may be delegated to private initiative." Consequently, with the legal pronouncement of the General Counsel, the government sought to legitimize an act of questionable adherence to the supreme law. The exceptional character is again distorted, when Paragraph 17 of Annex 5 provides for the privatization "of power distribution entities over which the Borrower has direct or indirect control," as electric power services is of the three areas reserved for the state under Article 46 of the constitution.

The terms of the loan were amended in 1995 and 1996, modifying their installments and priorities. Thus, the USD 50 million earmarked for the Debt Reduction Plan became the first tranche, and the second tranche, amounting to USD 50 million, was allocated for the financing of the Program, subject to the initiation of actions referred to in Part II of Annex 3 (before 5) of the Convention (privatization of public companies). The third tranche consisted of the remaining USD 100 million allocated for the financing of the Program, to be disbursed according to progress achieved in the implementation of the Program, as outlined in the agreement. In this manner were eliminated all of the clauses, phrases, and annexes that made mention of imports of goods urgently needed for implementing the Structural Adjustment Program.

Figures relating to Loan 3819 reveal loan disbursements for 49.9 percent of the contracted value. The amount cancelled, therefore, was USD 100 160 091.05, equivalent to 50.1 percent of the loan. The amount spent on servicing the debt and debt reduction constituted 199.7 percent of the

amount originally earmarked for these purposes. Nothing was used for the primary purpose of the loan agreement: Structural Adjustment – Macroeconomic Program Support.³⁵

B. BIRF Loan 3821/EC from the World Bank

The purpose of this loan was to provide technical assistance to the reform of the public enterprise sector. It constituted part of the World Bank package in the context of the Financial Plan 1994, the Brady Plan (see Box) for Ecuador, and the Country Assistance Strategy. The loan was for USD 12 million, had a term of 20 years, a grace period of 5 years, and a variable interest rate determined semi-annually by the lender.

The Brady Plan

Ecuador's Brady Plan, designed by the IMF and made public in 1994, required the purchase of collateral to cover the principal and interest on Discount and Par Bonds. The guarantees were made up of 30-year, zero-coupon bonds from the U.S. Treasury, which after capitalization would amount to USD 3.35 billion, corresponding to the entire capital of the Par and Discount Bonds, and which should be deposited in the Federal Reserve Bank of New York. The Brady Plan also demanded the provision of collateral for to the interest of the same Discount and Par Bonds, to cover 12 months of interest. In February 1995, the amount paid for the purchase of said collateral, of principal and interest on the Discount and Par bonds, amounted to USD 604 million.

The external commercial debt eligible to be novated through the issuance of Brady Bonds was USD 4.52 billion of principal and USD 2.55 billion of due interest, amounting to USD 7.07 billion. That debt was worth around 25 percent in the secondary market, meanwhile the debt reduction achieved through conversion into Brady Bonds was only worth USD 1.17 billion in principal share, there was no reduction in the interest share, which became PDI and IE Brady bonds.

The value of USD 2.55 billion, corresponding to penalty interest and past due interest, was transformed into Brady bonds (PDI and IE), which generated new interest. The payment of interest for PDI and IE Brady bonds from when they were issued to February 2008 was USD 531 million.

Furthermore, in the novation of external commercial debt through the conversion of Brady Bonds into Global Bonds, interest rates were increased from 7.5 percent to 12 percent (Global Bonds 2012) and 9.3 percent (Global Bonds 2030, on average), and there were costs for the use of collateral interest and budget resources.

Additionally, while the Par and Discount Brady Bonds were already guaranteed in their principal (i.e. it would not be necessary to pay the principal at the end of 30 years), the Global bonds must be paid at the end.

The loan agreement explicitly required the debtor to keep units of the telecommunications and electricity sectors in CONAM, as well as the strategic planning unit dedicated to the separation and privatization of public enterprises. In all cases, the agreement explicitly named the characteristics and

specializations of consultants that should be involved in the respective units.

According to Annex 2 to the loan agreement, the objectives of the project were: (1) to reduce electricity subsidies in a sustainable manner; (2) to reform the legal and regulatory framework for the electricity and telecommunications sectors in order to ensure a complete separation of state policies and regulations from the economic activities of the state in these sectors; (3) to strengthen (or establish and strengthen) institutions responsible for such policies and regulatory functions; and (4) to privatize the delivery of telecommunications and electricity services in Ecuador.

The loan resulted in several irregularities. First, 78.3 percent of the loan and the counterparty financing were used to pay consultancy and training fees.

Second, among the consultancy services to be realized by legal persons is the contract signed on 25 August 1997 with the Gerasin Consortium, composed of auditors, financial specialists, technicians and telecommunications lawyers, to assist the government in restructuring EMETEL, with the aim of transferring the operation of telephony into private hands, for the maximum amount of USD 2793437. However, there was an initial extension of USD 465275 and a second one of USD 483070.78 to update valuations. Furthermore, the Gerasin Consortium was given a 30-day contract for USD 101688 to advise CONAM regarding the development and implementation of the Regulations to the Law of the Electricity Sector Regime. The costs added up to USD 3843470.78.

C. Loan 831/EC from the Inter-American Development Bank

This loan was for a program of agricultural development. It was for an amount of USD 80 million, with a term of 20 years, a period of grace of 5 years, and an annual interest rate set for each semester based on the cost of borrowing for the previous semester, plus an annual percentage set by the IDB.

Under the loan agreement, the purpose of financing was to cooperate in the implementation of, first, a program consisting of reforms and strengthening of the agricultural sector in Ecuador and, second, a project to import eligible goods. The first program was to include the Policy Sub-program and the Sub-program for Technical Cooperation, relating to Loan Agreement No. 832/OC-EC, signed on the same date.

The precondition for the disbursement of the first installment follows: "maintain a sound macroeconomic framework consistent with the agreement signed by Ecuador with the International Monetary Fund for the period 1994–1996." The preconditions for the disbursement of the other tranches correspond to the plan of reorganization of the public agricultural sector. Several conditions are subdivided into such specific proposals as legislative measures to "reaffirm the principle of free commercialization and pricing of agricultural products and inputs," to repeal the National

Storage System, and to privatize ENAC, ENPROVIT, EMSEMILLAS, EMADE, ENDES, and PRONAMEC.

The analysis of the motions and supporting documents, as well as documents that are mentioned in each case, shows that the entire 831-OC loan was used to fund Ecuador's debt obligations. No funds were used to finance imports, as recorded in the loan agreement, or for the reorganization of the public agricultural sector.

In short, the conditions were applied faithfully (except the issue of the Ley de Aguas (Water Act)) without using a single dollar of Credit 831, that is of the USD 80 million. It follows then that it took only USD 12.5 million of another loan, Loan 832, to develop the Agricultural Sector Program, with such a broad spectrum of intervention and met conditions.

In these loans, the IDB moves away from its statutes and gets involved with loans that suffer from illicitness in the cause and origin, through various simulations and cross-conditions. The real purpose of the loans was to comply with the Brady Plan.

Conclusion

The consequences of an illicit benefit determine that no subject of law shall enjoy legal protection affecting any transaction. The prohibition on the benefit and the illicit object are present in the contracts of adhesion of external debt, with standard contracts drafted and imposed by international financial institutions that violate the sovereignty and jurisdiction of states, and the principles and sources of public international law.

If in the legal process an external precondition is lacking (lack of the normative power of a subject), this prevents the creation of a valid, effective, and licit transaction. Looking at this from the perspective of the party receiving the loan (the debtor) and the corresponding responsibility of the state, an example is the external debt contracted by de facto governments, such as dictatorships. In these cases, the will expressed by representatives of the state without normative power is not sufficient to form a legal transaction (a loan, the issuance of government bonds, debt restructuring, etc.).

Analyzing this from the perspective of the lender (creditor, international financial institution, private banks, etc.), examples are the loans from the IMF and World Bank to dictatorships

or de facto governments, or the apartheid regime in South Africa. These loans are illicit from the standpoint of civil and criminal statutes; they violate the statutes of the Bretton Woods institutions, but also have contributed to the perpetuation of regimes opposed to human rights, where the torture and death of those who thought differently was a normal, routine practice. Therefore, these loans, from their inception, violate peremptory norms of international law (*ius cogens*), including human rights.

In these examples it may be that illicitness is present on both sides of the contractual relationship: the debtor and the creditor. It is known that external debt operations were conducted by de facto regimes, dictatorships, as well as by democratic governments and international financial organizations. Despite the absence of valid transactions, the parties acted, causing the transfer of wealth between different countries of the Global South and the other subjects involved (leading to unjust enrichment, exorbitant profits for international financial institutions, multinational banks, transnational corporations, private speculators, etc.). Such modifications lack any title or justifying cause to support them, and can be repaired through the return of what was unduly paid – that is to say that restitution can and should be obtained.

Anyone who pursues an end, or interest that is rejected by peremptory norms commits an illicit act. The control that law is called to exercise on the autonomy of will, of legal facts and acts, is greater given the socioeconomic relevance of the external debt of the countries of the Global South. Legal control must be consistent with the purposes of international, regional, and national law. Debt audits are a sovereign instrument of states, supporting the self-determination of peoples, and can be used to provide evidence for, and make visible, the illegality of the system of domination and colonization through external debt and unlawful transfer of resources. Through judicial review those responsible for the illegal debt (individuals, such as public officials and former government leaders, and legal persons, such as international lending institutions, transnational corporations, domestic and international private banks) must be identified, so that they can be tried, and the debtors can claim refunds and receive effective reimbursement of undue payments.

- 1 Article 38, section 1, subsection c, of the Statute of the International Court of Justice, drafted in 1920.
- 2 The British representative, Lord Phillimore, defines the general principles of law as those rules of law “being established in a uniform way in a domestic forum, such as certain procedural principles, the principle of good faith, and *res judicata*.” Procès Verbaux, at 335, cited by Eduardo Jiménez de Aréchaga, *Derecho internacional público*, Vol. I, at 174 et seq., Montevideo, 1996.
- Good faith, for example, has its basis in the Charter of the United Nations, Article 2, paragraph 2. This is one of the principles applicable to debt contracts, whether they are founded on a loan or credit title (bonds, etc.).
- 3 S. Schipani, Principios y reglas relativos a la deuda externa. Perspectiva romanista-civilista, available at <http://www.derechouba.ar/institucional/proyectos/schipani1.pdf>; G. Jèze, *TOURS ÉLÉMENTAIRE DE SCIENCE DES FINANCES ET DE LEGISLATION FINANCIÈRE FRANÇAISE*, at 525 and 30, Paris, 1912; A. Sack, *LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEER DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÈRES*, at 30, Paris, 1927, cited by Atilio Aníbal Alterini, La injusticia de la deuda externa, in *Liber Amicorum per Francesco D. Busnelli, IL DIRITTO CIVILE TRA PRICIPII E REGOLE*, Vol. II at 284, 285, Milan, 2008; Carta de Sant’Agata dei goti, available at http://www.derechouba.ar/institucional/proyectos/dext_Sant_Gata_Dei_Goti.pdf, cited by Atilio Aníbal Alterini, La injusticia de la deuda externa en *Liber Amicorum per Francesco D. Busnelli, IL DIRITTO CIVILE TRA PRICIPII E REGOLE*, Vol. II, at 281 et seq., Milano, 2008.
- 4 Massimo Severo Giannini, *DIRITTO AMMINISTRATIVO*, Vol. I, at 622 et seq., cited by Emilio Biasco Marino, *EL AMPARO GENERAL EN EL URUGUAY*, at 267, Montevideo, 1998. For example, in the Constitution of Uruguay, an act contrary to law or dictated through misuse of power is illegitimate. Constitution of Uruguay, Article 309, section 1.
- 5 Emilio Betti, *TEORIA GENERALE DEL NEGOZIO GIURIDICO*, at 372, Edizioni Scientifiche Italiane, Naples, 2002, cited by Rómulo Morales Hervias, *Contrato inválido*, 2007.
- 6 Paolo Gallo, *ISTITUZIONI DI DIRITTO PRIVATO*, at 300, 2nd ed., Giapichelli Editore, Turin, 2003; Emilio Betti, *Teoría generale delle obbligazioni*, Vol. I, Milan, 1953.
- 7 Emilio Biasco Marino, *supra*, at 267.
- 8 Opinion of the former president of the International Court of Justice, Eduardo Jiménez de Aréchaga, A/CN.4/SER.A/1973/ADD.1, cited in Moyano Bonilla, César Ortiz Ahlf, Loretta, *La deuda externa y la Responsabilidad Internacional del Estado*, UNAM, Mexico, 1994.
- 9 It should be noted that judicial decisions dealing with issues of international law jointly with doctrine are “subsidiary means for the determination of rules of law” (Article 38 of the Statute of the International Court of Justice), and are not in themselves sources from which legal standards emanate. They are auxiliary means for showing the state of the law, sources of knowledge, but not of validity.
- 10 Mauricio Herdocia Sacasa, *La Obra de la Comisión de Derecho Internacional de las Naciones Unidas en el Quinquenio 1997-2001*. El aporte global de la América Latina, at 141 et seq., Managua, 2003; General Assembly Resolution, A/RES/56/83 and Annex.
- 11 Alejandro Olmos filed a case in Juzgado en lo Criminal y Correccional Federal No. 2 (Criminal and Correctional Federal Court No. 2) against Jose Alfredo Martinez de Hoz (case no. 14 467, filed on 4 April 1982, decided in 2000), and in 1993 before Juzgado en lo Criminal y Correccional Federal No. 8 (Criminal and Correctional Federal Court No. 8) (case no. 17 718). This case investigates the period of indebtedness between 1983 and 2000. The complaint analyzes how loans from multilateral lending agencies were used to refinance debt that was incurred illicitly and describes the direct participation of a group of banks led by Citibank in debt restructuring under the Brady Plan. See Alejandro Olmos Gaona, *La deuda odiosa*, Buenos Aires, 2005.
- 12 “The debt swap was gestated to promote interests other than those of the state” (...) “knowing that there would be a detriment to the public purse,” said the ruling by Federal Judge Jorge Ballester.
- 13 In Article 20, the Charter of the Organization of American States reads: “No State may use or encourage the use of coercive measures of an economic or political character in order to force the sovereign will of another State and obtain from it advantages of any.” Article 18 prohibits armed or unarmed interference by a state or group of states in the internal or external affairs of any other. See Alejandro Teitelbaum, *Deuda externa y Derechos Humanos*, 2002.
- 14 Article 75 of the Constitution of Argentina. Invalidity and nullity are prescribed in Argentine Civil Code, Articles 18, 502, and 953.
- 15 In Argentina decisions on the payment or non-payment of the country’s external debt correspond to the Congress, under the provisions of Articles 4 and 75, sections 4 and 7, of the Constitution. The Supreme Court has reaffirmed this principle, noting: “In short, it is within the authority of Congress to decree and contract loans that constitute public debt, and to make decisions on the financing, refinancing, and rescue of such debt.” CS, 10/12/1996, Brunicardi, Adriano v. Estado Nacional, Decisions 319:2886 (unanimous decision).
- 16 Ramiro Chimurís, *Orientales, la Patria o el CIADI (ICSID)*, Montevideo, *Semanario Siete sobre Siete*, 2005, available at <http://www.rebelion.org/noticia.php?id=20154>; Alejandro Teitelbaum, *Los Tratados Bilaterales de Libre Comercio*, available at <http://alainet.org/active/8022&lang=es>.
- 17 Alejandro Teitelbaum, *Los Tratados Bilaterales de Libre Comercio*.
- 18 For example, Article 116 of the Constitution of Argentina reads: “It is up to the Supreme Court and the lower courts of the nation to hear and decide all cases relating to matters governed by the Constitution and laws of the Nation (...) and by treaties with foreign nations (...)” The Constitution of Bolivia in Article 24, provides: “Corporations and foreign nationals are subject to Bolivian laws and can in no case invoke special circumstances or appeal to diplomatic claims.” Article 29 of Guatemala’s constitution reads: “Foreigners may only resort to diplomatic means in cases of denial of justice.” The Salvadoran constitution provides in Articles 98 and 99, respectively: “Neither Salvadorans nor foreign nationals may claim compensation from the government for damages or injury to their person or property. They may only do so against guilty officials or private individuals” and “Foreigners may not resort to the diplomatic option, except in cases of denial of justice and after having exhausted available legal remedies.” The Constitution of Ecuador provides in Article 14: “Contracts celebrated by state institutions with foreign individuals or foreign legal persons implicitly carry the renunciation of all diplomatic claims. If such contracts were entered into within the territory of Ecuador, subjection to a foreign jurisdiction cannot be agreed upon, except in the case of international conventions.” Cited by Alejandro Teitelbaum, *Los Tratados Bilaterales de Libre Comercio*, available at <http://alainet.org/active/8022&lang=es>.
- 19 Roberto Javier Ortega, *DEUDA EXTERNA Y LA RESTAURACIÓN DEL ESTADO DE DERECHO*, in *Colegio Público de Abogados de la Capital Federal*, at 88, Buenos Aires, 2005; Alejandro Olmos Gaona, *LA DEUDA ODIOSA*, Editorial Continente, Buenos Aires, 2005; Salvador María Lozada, *LA DEUDA EXTERNA Y EL DERECHO*, no. 6231, 31 January 2001.
- 20 For Anzilotti, “[i]t is inconceivable that there are subjects of international rights and duties other than States.” *IL DIRITTO INTERNAZIONALE NEI GIURIZI INTERNI*, at 44, 1905.
- 21 Minutes of the Commission of Jurists, at 208, cited by Eduardo Jiménez de Aréchaga, *CURSO DE DERECHO INTERNACIONAL PÚBLICO*, at 250 et seq., Montevideo, 1959.
- 22 Permanent Court of International Justice, Advisory Opinion in the matter of Danzig Railway Officials, series B, no. 15, paragraphs 17 and 18, March 1928.
- 23 *Lotus Case*, *PERMANENT COURT OF INTERNATIONAL JUSTICE*, series A, no. 10, 1927, at 18, 70. See also the Convention on the Law of the Sea, Articles 100, 101 and 105.
- 24 The paradigmatic example is that of the Nuremberg trials where defenders of the accused argued that individuals could not be subjects of international law and therefore they could not be punished for acts in which the state was responsible. The Nuremberg Tribunal rejected the argument, among other things, asserting: “it has been long recognized that international law imposes duties and responsibilities upon individuals as well as states (...) Violations of international law are committed by men, not by abstract entities, and only by punishing those individuals who commit such violations can the provisions of international law be enforced.”

- 25 It foresaw the creation of an International Prize Court; Articles 4 and 5, authorized neutral subjects to enforce their rights against a foreign state. This convention never entered into force due to a lack of ratifications.
- 26 The Court heard five cases brought by individuals against states, and rejected four of them for lack of exhaustion of domestic remedies.
- 27 This convention created an arbitral tribunal before which access was granted to individuals to claim damages against states “for any abolition or reduction of their acquired rights.”
- 28 Provides an optional system of individual petitions aimed at ensuring the protection of the rights recognized by said Convention.
- 29 In its Article 33, confers to companies or associations (referred to by Article 48) involved in the production of coal and steel the right to institute, under the same conditions as member states or the board, an action for annulment against decisions and recommendations deemed tainted by misuse of power.
- 30 Felipe Paolillo, *Los sujetos del derecho internacional*, in Eduardo Jiménez de Aréchaga, *Derecho internacional público*, Vol. II, at 40, F.C.U., Montevideo, 1995.
- 31 This implies a dependency, a legal subordination of the rights of states in private arbitration panels. Just as an example: *Gas Natural v. Republic of Argentina*, Case No. ARB/03/10, available at <http://www.asil.org/pdfs/GasNatural-Spanish.pdf>; *Camuzzi International S. A. v. Republic of Argentina*, CIADI (ICSID) No. ARB/03/2, available at http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC510_Sp&caseId=C10.
- 32 See Chapter II, Article 26 of the ICSID Convention.
- 33 See *American Manufacturing & Trading v. Republic of Zaire*, 21 February 1997, No. 5.15 (Where it was not the local company who filed the lawsuit, but the U.S. investor, the tribunal held that a majority stake in a local company constituted an investment by the U.S. company and, therefore, the company fell within the category of companies falling under Article 25.2.b of the Convention.), available at <http://ita.law.uvic.ca/documents/AmericanManufacturing.pdf>; *Aguas del Tunari S.A. v. República de Bolivia*, CIADI (ICSID) no. ARB/02/3 (Aguas de Tunari S.A., represented by Bechtel Enterprise Holding Inc. (incorporated in the United States of America), had several addresses, one of them in the Cayman Islands, and established domicile in the Netherlands with the use of a mailbox to be able to rely on a bilateral treaty between the Netherlands and Bolivia); available at <http://siteresources.worldbank.org/INTBOLIVIA/SPANISH/Resources/aguasdelunari.pdf>.
- 34 To waive the sovereign prerogative of a legal system guaranteeing the constitutional rights of a nation, is to deny it; therefore, the ICSID system is considered unconstitutional. To recognize these private arbitrations, means to give up the rights enshrined in the Charter of the Organization of American States and the Pact of Bogotá. Moreover, the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 18 March 1965, which established the ICSID, asserts in its Article 68: “This Convention shall be ratified, accepted or approved by the signatory States in accordance with their respective constitutional requirements.”
- 35 Report of the Multilateral Debt Subcommittee, July 2008.



5. Illegitimate Debt and Human Rights

Cephas Lumina

1. Introduction

Under international law, successor governments assume the international rights, capacities and obligations of their predecessors, irrespective of the nature of the former regime (O'Connell 1967; Henkin et al. 1993:286; Howse 2007:16-17; Cheng 2007:20-21).¹ Nevertheless, there are historical precedents when this principle has been challenged and wholly or partially set aside, notably through invocation of the odious debt doctrine (Howse 2007:10-16; Frankenberg and Knieper 1984). In recent years, debt relief campaigners have increasingly invoked the broader concept of 'illegitimate debts' as a rationale for sovereign debt repudiation or cancellation. They contend that a substantial portion of poor-country debt – estimated at some USD 495 billion in 2007 – is illegitimate and should not be repaid.²

This chapter briefly discusses the concept of 'illegitimate debt' from the perspective of human rights. It begins with a brief overview of the concept of illegitimate debt, highlighting the lack of consensus in relation to a precise definition of the concept. It then explores the linkage between sovereign debt (including illegitimate debt) and human rights and argues that human rights principles should inform the framework to be used when determining whether or not a sovereign debt should be declared illegitimate.

2. Defining 'illegitimate debt' – an elusive quest?

The term 'illegitimate debt' has no formal definition in law and although various attempts have been made to define the term,³ there is no consensus on the precise meaning of the term (Hanlon 2002:3). Debt relief campaigners often use the concept of 'illegitimate debt' to refer to a variety of questionable debt. This includes: debt incurred by undemocratic means, without transparency or participation by representative branches of government or civil society; debt that cannot be serviced without threatening the realisation of basic human rights; debt incurred under predatory repayment terms, including usurious interest rates; debt which was converted from private (commercial) to public debt under pressure to bail out creditors; loans which have been used for morally reprehensible purposes (such as the financing of a suppressive regime); and debt resulting from irresponsible projects that failed to serve development objectives or caused harm to the people and/or the environment (Hanlon 2002/7-19; AFRODAD 2002; Norwegian Ministry of Foreign Affairs 2004; Eurodad 2008).

These definitions indicate that illegitimacy is not narrowly conceived of as a strictly legal issue, but rather as a broader concept encompassing the ethi-

cal, social, political and economic implications of debt. Nevertheless, a common thread running through most definitions of illegitimate debt that have been advanced by debt campaigners is the theme of injustice.

It should be noted that while the concept of illegitimate debt has sometimes been equated with that of 'odious debt', the two terms are different. As originally articulated by the legal scholar Alexander Sack, debt was presumed to be odious if it fulfilled three essential conditions simultaneously:

- if it was contracted by a despotic regime,
- if it was not used for the needs of the population,
- if the creditor was aware of the nefarious use of the funds (Howse 2007; Adams 1991).

For Sack, odious debts were those debts which were contracted and utilised against the interests of the population of the borrower state, without its consent, and with the awareness of the creditor. Thus, the definition was applicable only in limited circumstances following regime change. However, the concept of odious debt is currently more broadly defined as any debt incurred by an authoritarian ruler for personal or nefarious purposes or any debt incurred by an odious regime.

Thus, while the term 'odious debt' is fairly narrow in meaning, the term 'illegitimate debt' is a more expansive concept which includes odious debt as well as any debt that is not sanctioned by law; debt that is unfair or objectionable; or debt that infringes on public policy (New Economics Foundation 2005; Eurodad 2008; Jubilee USA Network 2008).⁴ It thus includes debts incurred in respect of non-viable projects, those incurred in respect of sub-standard goods or services, or debts incurred in circumstances where the terms were unfair (e.g. usurious interest rates).

It is not proposed here to add to the myriad of definitions offered by debt campaigners. Rather, it is suggested that the various formulations of the concept of illegitimate debt thus far advanced by debt relief campaigners provide a reasonable starting point for the elucidation of the concept in more precise terms. However, it must be underscored that much more work needs to be done in order to arrive at a clear and internationally accepted definition of illegitimate debt. In this regard, human rights principles may provide invaluable guidance.

3. Debt as a human rights issue

There is some controversy as to whether or not foreign debt is a human rights issue. An examination of the resolutions and decisions of the United Nations Commission on Human Rights and the Human Rights Council reveal differences between developed and developing countries as to whether foreign debt should be considered as a hu-





Child soldiers in Liberia. Picture: thepenitentman.com

man rights issue. The developed (mainly creditor) countries have consistently opposed consideration of the impact of foreign debt on the realisation of human rights by the UN human rights bodies, arguing that these bodies are not the appropriate ones to address the debt problem. However, in terms of article 22 of the International Covenant on Economic, Social and Cultural Rights, the Economic and Social Council (ECOSOC)

“[m]ay bring to the attention of other organs of the United Nations, their subsidiary organs and specialized agencies concerned with furnishing technical assistance any matters arising out of the reports (submitted by the states parties to the Covenant) which may assist such bodies in deciding, each within its field of competence, on the advisability of international measures likely to contribute to the effective progressive realization of the present Covenant.”⁵

In its General Comment No. 2 (1990), the Committee on Economic, Social and Cultural Rights has interpreted this provision so as to include “virtually all United Nations organs and agencies involved in any aspect of international development cooperation” and it has expressed the view that

“[i]t would be appropriate for recommendations in accordance with article 22 to be addressed, inter alia, to the Secretary-General, subsidiary organs of the Council such as the Commission on Human Rights,⁶ the Commission on Social Development and the Commission on the Status of Women.”⁷

It is therefore within the competence of the Human Rights Council, which has replaced the Commission on Human Rights, to consider the impact of foreign debt on the realisation of the rights under the Covenant.

The position of those countries that oppose consideration of foreign debt by the UN human rights bodies is also arguably inconsistent with the holistic approach to the promotion and protection of human rights that is envisaged in paragraph 13 of the Vienna Declaration and Programme of Action which calls upon states to “eliminate all violations of human rights and their causes, as well as obstacles to the enjoyment of these rights.” Although the Declaration does not create binding obligations for states, it provides an indication of global opinion on the issues that it covers.

Further, the available evidence clearly shows that excessive debt service burdens seriously limit the ability of many poor countries to fulfil the obligations that they have assumed under various international human rights treaties. According to a recent report by the New Economics Foundation (2008:3), twenty countries spend more than 20 percent of their budget on debt service. In 2005, Lebanon spent 52 percent of its budget on debt service as compared with 23.1 per cent on education and health; Jamaica spent 27.9 percent on debt service and 16.1 percent on education and health; and Bulgaria spent 23 percent on debt service and 11.6 percent on education and health (New Economics Foundation 2008:11).

Under international human rights law, states have the primary responsibility of ensuring that

all people under their jurisdiction enjoy basic human rights, such as the rights to healthcare, education, food, safe drinking water, and adequate housing. Thus, governments should not be placed in a situation where they are unable to ensure the realisation of basic human rights because of excessive debt repayments. Debt becomes a human rights issue when it impairs the capacity of states to fulfil their human rights obligations towards their populations and when their citizens are unable to enjoy their rights as a consequence.

The fact that many developing countries are diverting a disproportionate part of their budgets (including funds earned from exports) away from programmes aimed at reducing poverty and improving a variety of social conditions (which contribute to the realisation of human rights) to debt service makes foreign debt and debt service a human rights issue. It is notable that many of these social conditions find expression as rights in the Universal Declaration and core international human rights instruments such as the International Covenant on Economic, Social and Cultural Rights (ICESCR), the Convention on the Elimination of all forms of Discrimination against Women (CEDAW) and the Convention on the Rights of the Child (CRC).

Several human rights, including the rights to life, health, work and education, are placed under threat or violated when states divert scarce national resources away from social expenditures in order to service debts. For example, spending money on debt service rather than on the provision of social services that ensure that vulnerable populations have access to adequate food, housing, health and education directly imperils their lives. Debt repayments have also had a negative impact on the realisation of the right to food. For example, in 2002, the government of Malawi was forced to sell maize from its National Food Reserve to raise funds to repay loans. Following a poor harvest that year, 7 million of a population of 11 million were left facing a serious shortage of food (Pettifor 2002).

In a tacit confirmation of the link between debt burdens and human rights, the various UN human rights treaty bodies have noted the significant challenge that excessive debt burdens pose to the realisation of human rights.⁸ Thus, the treaty bodies have often urged international financial institutions to pay greater attention to the protection of human rights in their lending policies, credit agreements and debt relief initiatives.⁹

4. A Human rights framework for addressing legitimate debts?

A human rights approach to debt

United Nations agencies have endorsed a human rights-based approach to development in terms of which development policies are anchored in a system of rights and corresponding obligations. The essential attributes of this approach are:

All programmes of development cooperation, policies and technical assistance should further the

realisation of human rights as laid down in the Universal Declaration of Human Rights.

Human rights standards contained in, and principles derived from, the Universal Declaration and other international human rights instruments guide all development cooperation and programming in all sectors and at all phases of the programming process.

Development cooperation contributes to the development of the capacities of 'duty bearers' to meet their obligations and of 'rights holders' to claim their rights.¹⁰

These principles underscore that the main objective of development policies and programmes should be to deliver human rights. A human rights-based approach identifies rights holders and their entitlements and corresponding duty bearers and their obligations, and aims to enhance the capacity of rights holders to make their claims and of duty bearers to fulfil their obligations. Thus, for example, a human rights-based approach to external debt means that debt sustainability analyses should take into account the human rights implications of debt service, as well as human rights principles such as transparency, accountability, participation and non-discrimination.¹¹

The effective and meaningful participation of the most vulnerable communities in the heavily indebted countries in policy and resource utilisation decision-making is a crucial aspect of a human rights-based approach to the debt problem. It should be noted that the principle of participation is also a fundamental right to which all persons are entitled.¹² In regard to the impact of foreign debt on the enjoyment of economic, social and cultural rights, participation requires respect for, and protection and fulfilment of, a range of human rights, including freedom of expression, freedom of assembly, freedom of association, the right to vote and to be elected, as well as the establishment of conditions designed to guarantee the full and informed participation of people in affected countries in the making of decisions concerning external debt and the use of savings from debt relief measures.

The relevance of human rights principles

Since illegitimate debt is rooted in the concept of injustice, human rights principles can provide invaluable guidance on how to create a more responsible international financial environment in which the effects of past injustices can be sufficiently addressed and the recurrence of illegitimate debt avoided. In particular, the human rights principles of participation, inclusion, transparency, accountability, the rule of law and non-discrimination, which find expression in international human rights law, provide universally recognised standards against which the legitimacy of debt can be assessed. Human rights language, with the body of international human rights law behind it, is uniquely equipped and indeed, a necessary tool for the adequate development of specific criteria to explain the unjust nature of debt characterised as illegitimate.

All individuals and communities have the right to participate in, and access information relating to, the decision-making processes that affect their lives and well-being. This includes decision-making processes concerning the negotiation, contraction and use of loans. Participation can be ensured, for instance, through representative national legislative bodies that have been elected through an electoral process deemed free and fair by independent observers. With specific reference to the issue of illegitimacy, debt arising from loans that have been contracted or, after contraction, have been used without the informed participation of the people through their duly elected representatives, could be considered to be illegitimate.

As the primary duty bearers under international human rights law, states are answerable for the observance of human rights. Thus, they have to comply with the legal norms and standards enshrined in international human rights instruments. If they fail to do so, individuals or groups whose rights are infringed or threatened are entitled to seek redress before the competent bodies in accordance with the rules and procedures provided by law. In the context of debt, accountability entails that creditors should acknowledge debtor governments' accountability to their own citizens in the loan negotiation and contraction process, and that creditors should avoid linking intrusive policy conditions to loans or debt relief as these may impair the principles of accountability and participation. It also means that the governments of the debtor countries should be open and accountable to their people with regard to the contraction of loans and in relation to how borrowed funds are utilised.

The principle of non-discrimination means that all individuals are equal as human beings and by virtue of their inherent dignity. Thus, no one should suffer discrimination on the basis of attributes such as race, ethnicity, gender, language, social or geographical origin, etc. Further, the principle of non-discrimination requires that states ensure that all measures adopted to fulfil their human rights obligations avoid disproportionate effects, and that targeted measures are adopted to secure equality of access to basic services for all groups in society, especially the poorest. In the context of foreign debt, non-discrimination can be ensured, for example, by assessing the distributional con-

sequences of loans across society to make certain that the use to which the borrowed funds are put benefits all individuals equitably.

Many definitions of the concept of illegitimate debt advanced by debt campaigners include the criteria that the loan funds were not used for the benefit of the population but rather for the elite in the borrowing country. For example, the Canadian Initiative and AFRODAD definitions of illegitimate debt include projects that did not benefit the people as they were intended to do. Such a situation may violate the principle of equality and non-discrimination.

It is proposed that any assessment of the legitimacy of a debt should take into account the activities to be funded, the negotiation of the loan, the terms of the contract and the use of the loan as stipulated in the contract. At each stage, the human rights principles of accountability, participation, inclusion, transparency, accountability and non-discrimination must be upheld by both the lender and the borrower. Thus, any lack of participation, transparency and accountability in such processes, as well as any lack of accessible redress mechanisms, and the exclusion of certain groups in the decision-making process concerning the use of borrowed funds, should all be factors in assessing the legitimacy or otherwise of a debt.

It should be noted that the foregoing proposals are offered on a tentative basis. More research and consultation are needed in order to clarify what mechanisms could be used to ensure adherence to the human rights principles outlined above in the context of negotiations and discussions concerning foreign debt, as well as how these principles may inform the framework for assessment of illegitimate debt.

5 Conclusion

This chapter has presented a brief discussion of the concept of illegitimate debt from the perspective of human rights. It has been tentatively suggested that since the issue of illegitimacy of debt is closely linked to the concept of injustice, the human rights principles of participation, inclusion, transparency, accountability, the rule of law and non-discrimination – all of which find expression in international human rights law – may provide a useful framework within which the legitimacy of debt can be assessed.

- 1 See also *The Sapphire*, 78 U.S. (11 Wall.) 164, 20 L.Ed. 127 (1871).
- 2 See, e.g., Africa Action, *Africa Action Statement on Illegitimate Debt*, April 2007. For estimates of 'illegitimate debt,' see Millet & Toussaint (2009) and Hanlon at 211-226 (2006).
- 3 Among the notable definitional attempts are those by the Latin American and Caribbean Jubilee 2000 Platform in the Tegucigalpa Declaration of January 1999; Canadian Ecumenical Jubilee Initiative, *Illegitimate Debt: Definitions and Strategies for Repudiation and Cancellation*, 15-16 November 2000; Latin-American Parliament (see Frere 2002); Eurodad, *Illegitimate Debt*, available at African Forum and Network on Debt and Development (AFRODAD) (2002 and 2005); Jubilee USA Network, *The Concept of Odious Debt*; Hanlon (2002); New Economics Foundation (2006).
- 4 See also Africa Action, *Africa Action Statement on Illegitimate Debt*, April 2007.
- 5 International Covenant on Economic, Social and Cultural Rights, adopted by the UN General Assembly on 16 December 1966, in force from 3 January 1976, available at <http://www2.ohchr.org/english/law/pdf/cescr.pdf>.
- 6 The Commission on Human Rights has since been replaced by the Human Rights Council. See General Assembly resolution 60/251, A/Res/60/251, 23 April 2006.
- 7 Office of the High Commissioner for Human Rights, International technical assistance measures (Art. 22) : 2 February 1990, CESCR General comment 2. (General Comments), fourth session 1990, available at [http://www.unhcr.ch/tbs/doc.nsf/\(Symbol\)/3659aaf3d47b9f35c12563ed005263b9?Opendocument](http://www.unhcr.ch/tbs/doc.nsf/(Symbol)/3659aaf3d47b9f35c12563ed005263b9?Opendocument).
- 8 For example, in its concluding observations on the report submitted by Honduras in 2001, the Committee on Economic, Social and Cultural Rights took "note that the efforts of the state party to comply with its obligations under the Covenant [were] impeded by the fact that it [was] classified as a highly indebted poor country and that up to 40 per cent of its annual national budget [was] allocated to foreign debt servicing." (E/C.12/1/Add.57). See also E/C.12/Add.71 (Algeria); E/C.12/1/Add.55 (Morocco); E/C.12/1/Add.63 (Syria); E/C.12/1/Add.48 (Sudan); E/C.12/1/Add.78 (Benin); E/C.12/1/Add.62 (Senegal); E/C.12/1/Add.106 (Zambia); E/C.12/1/Add.60 (Bolivia); E/C.12/1/Add.100 (Ecuador); E/C.12/1/Add.66 (Nepal); and E/C.12/1/Add.49 (Nepal).
- 9 For example, in its General Comment No. 2, the Committee on Economic, Social and Cultural Rights has indicated that "[i]nternational measures to deal with the debt crisis should take full account of the need to protect economic, social and cultural rights through, inter alia, international cooperation." It is also notable that the Maastricht Guidelines on Violations of Economic, Social and Cultural Rights deems a human rights violation of omission, "[t]he failure of a state to take into account its international legal obligations in the field of economic, social and cultural rights when entering into bilateral or multilateral agreements with other states, international organizations or multinational corporations." (par. 15(j)), International Commission of Jurists ICJ (26 January 1997), available at <http://www.unhcr.org/refworld/publisher,ICJURISTS,THEMGUIDE,,48abd5730,0.html>.
- 10 United Nations, *The Human Rights Based Approach to Development Cooperation: Towards a Common Understanding Among UN Agencies* (2003).
- 11 The criteria for assessing debt sustainability under the multilateral debt relief initiatives focus almost exclusively on the ability of debtor countries to repay their debts. According to the IMF, "the primary aim of the debt sustainability framework for low-income countries is to guide borrowing decisions of low-income countries in a way that matches their need for funds with their current and prospective ability to service debt, tailored to their specific circumstances." See IMF, *The Debt Sustainability Framework for Low-Income Countries* (October 2007).
- 12 See, e.g., Universal Declaration of Human Rights, Article 21; International Covenant on Civil and Political Rights, Article 25; Convention on the Elimination of all Forms of Discrimination Against Women, Article 7.

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6. Juxtaposing Debt Relief and Arbitration

Charles Mutasa

Introduction

The last two decades have seen the economic prospects of many developing countries thwarted by debt crises. Creditors have responded with a series of piecemeal but ultimately unsatisfactory mechanisms, the last example of which is the Multilateral Debt Relief Initiative (MDRI) agreed at the 2005 G8 meeting in Gleneagles, Scotland, and implemented in June 2006. Notwithstanding some positive results in areas of social spending, it is clear that the MDRI alone cannot provide the definitive solution for all severely indebted poor countries. In order to bring about a permanent solution to the debt overhang which is largely responsible for abject poverty and economic doldrums in these countries, a Fair and Transparent Arbitration Mechanism is required that is broader in scope and both more inclusive and participatory.

It has already been clearly established that the poorest countries will not be able to meet Millennium Development Goals without further debt cancellation and debt campaigners have long been advocating a systemic resolution to the problems of unpayable sovereign debt. The establishment of a Fair and Transparent Arbitration Process (FTAP) will be a step towards the cancellation of unpayable, illegitimate and odious debts.

Defining Arbitration

Arbitration is an alternative method to resolving a dispute outside the traditional court system. In this process a third independent party provides the final decision on a dispute between two parties.¹

In the arbitration process, a dispute can be defined as the existence of divergent or opposite views which cannot be reconciled by two parties and which therefore require a third party to make a decision on which view should prevail, depending on the arguments presented by the two parties. Arbitration agreements allow for settlement or final decisions to be made on grounds other than purely legal principles, such as considerations of justice, equity and human rights.

Debt arbitration may mean two technically different forms of arbitration, both equally blocked at present by official creditors: A fair and transparent process of debt reduction, aligning a country's total debts to its capacity to pay (international arbitration based on the main principles of the US Chapter 9 or FTAP²), or arbitration restricted to specific types of debts, such as illegitimate or odious debts.

Another technical aspect currently being discussed is the question of whether the FTAP should be established as an ad hoc panel or as a permanent court. Kunibert Raffer believes that a permanent court could also handle cases whilst ad

hoc panels can be established much more quickly and have the advantage of being custom made for each case.³

Why Arbitration in the Era of MDRI?

There is a serious need to recognize and acknowledge that the growing frequency and persistence of debt in developing countries is symptomatic of the deeper problem of a political imbalance in which it is the creditors who have control over the timing, pace and depth of debt relief mechanisms, as well as economic and political conditionality. Although those countries and multilateral institutions whose claims should be reduced were chosen arbitrarily, the decision made at the G8 summit in Gleneagles in 2005 advanced the idea of equal treatment by International Financial Institutions (IFIs). The Enhanced Heavily Indebted Poor Countries Initiative (HIPC), started in 1996 and enhanced in 1999, contained an element of "equal treatment", albeit a somewhat haphazard one. MDRI is an additional unilateral debt relief which proves that debt reduction is possible in the case of multilateral funds, a fact that had been vigorously denied by IFIs until 1996. However, the random choice of countries and institutions that was made at Gleneagles once again highlighted creditor arbitrariness and thus the urgent need for reform.

Our call for a FTAP is based on the following points:

- Whilst the MDRI will result in the cancellation of some debts, it is defective by virtue of its foundational leanings on the HIPC initiative and thus very limited in what it can actually achieve.
- Many countries that need debt cancellation are still outside the MDRI. By virtue of their indebtedness, Kenya and Nigeria can be regarded as "HIPCs outside the HIPC framework". There is a need to encourage debtor governments to demand relief that is rightly theirs – 'rightly' in the sense of economic justice. The cancellation of their multilateral debt could have freed up resources – cash that currently goes into servicing debt and reducing debt overhang.
- The cancellation of unpayable, illegitimate and odious debts remains neither touched nor resolved. In the case of the Democratic Republic of the Congo, IFIs continued to lend to the Mobutu regime despite knowing that the dictator was diverting a large chunk of the funds into his personal accounts; the point is not whether or not debts will one day end, but the morally and legally correct way to deal with them.
- The necessity of a mechanism to shield debtor economies from tortuous creditor behavior and advice has not been addressed. Poor, indebted countries are being denied a basic legal protec-



tion that is otherwise universally accepted and this must be redressed.

What will Arbitration achieve?

The Gleneagles debt promise was criticized at the time and continues to be criticized for two main reasons: First, the MDRI relies on completion of the HIPC process, which means it is subject to the same strict qualifying criteria and conditionalities as the HIPC initiative. Therefore, delays with HIPC result in delays in obtaining further multilateral debt cancellation. The second problem is that donors have interpreted their commitment to mean that the debt cancellation would be fully 'additional' to existing resources in the sense that debt relief counts as aid, so the full benefits are not accruing to each individual recipient country as some thought.

The FTAP will achieve the following:

- Give the affected people of the global South a right to be heard.
- Deal thoroughly with how to handle past, present and future debt by fostering a culture of responsible lending by creditors and prudent borrowing by debtors.
- An independent panel will judge debt sustainability within the development context of each debtor country, whereby government revenues are balanced against the need to finance poverty reduction programs.
- Help extend debt cancellation to other poor countries that are short of resources to meet the Millennium Development Goals or where creditor rights are being implemented at the cost of human rights. Despite the MDRI, quite a number of severely indebted poor countries continue to spend resources on debt service that should rightfully be going to education, health and social services.
- Enshrine the principle that basic human rights take precedence over creditor rights. A framework determining the level of debt that a given country is liable to repay would be linked to human development indices and human rights rather than arbitrary debt service/export ratios.
- The arbitration process should also question the current creditor dominance in prescribing solutions to Third World Debt. Most of their solutions have exacerbated rather than solved the financial woes of poor countries. The recent global financial crisis has demonstrated that what creditors and the World Bank had been preaching to poor countries about liberalizing the financial sector is not true, as governments in the North have been bailing out their own struggling banks. Imagine this having happened in a poor country where one of the conditionalities given was that the state must not interfere in or bail out the private sector.
- Ascertain the legitimacy of claims made by both creditor and debtor countries.
- Fulfill the long overdue demand of many debt campaigners and development practitioners of achieving Full Multilateral Debt Cancellation for Africa and the whole global South.

Who sees sense in Arbitration?

It is not only NGOs that have carried the burden of campaigning for debt arbitration, but also people within the public sector who want reform of present "debt management". Parliamentarians have supported debt arbitration, especially in Germany and Latin America, but also Italy and the US.

The new Norwegian government's 2005 declaration explicitly expresses the intention to support arbitration on illegitimate debts: "The government will support the work to set up an international debt settlement court that will hear matters concerning illegitimate debt".

The Helsinki Process on Globalisation and Democracy, created in 2002 at the initiative of the Finnish government in co-operation with the Tanzanian government also promotes innovative and empowering solutions to the dilemmas of global governance. The questions of sovereign debts and the FTAP proposal based on Chapter 9 were also discussed.⁴

The Italian parliament passed a law on debt relief in the summer of 2000, Article 7 of which requests an examination of present debt management. The article, entitled International Regulations on Foreign Debt, reads:

"The government will propose, to the relevant international institutions, the starting (initialize) of the necessary procedures to obtain a ruling from the International Court of Justice on the consistency between the international regulations governing developing countries' foreign debt and the general framework of legal principles and human and people's rights."

During a conference in Uruguay's parliament, the Montevideo Declaration calling for FTAP was formulated and signed by Latin American parliamentarians.⁵

The ACP-EU Joint Parliamentary Assembly demanded FTAP in 2000, believing that "consideration should be given to the creation of an International Debt Arbitration Panel to restructure or cancel debts where debt service has reached such a level as to prevent the country providing necessary basic social services."

The High-Level Regional Consultative Meeting on Financing for Development, Asia and Pacific Region (Jakarta, 2-5 August 2000, session 1) states:

"There is a need for an international bankruptcy procedure. It should also be ensured that private debt does not become government debt".

At the African Union's Experts' Preparatory Meeting in Dakar 2005, the President of the Republic of Senegal argued that any lasting solution to Africa's debt crisis must first and foremost be based on an audit – a "radioscopy" – to "make known the amount to be repaid" (AU 2005, p.4), recognizing the principle that debt should be repaid. This is a clear call to tackle the problem of illegitimate debts and those debts that could not exist in the North, where basic legal principles of debtor-creditor relations are respected.

The creation of a global partnership for development with regard to dealing comprehensively with the debt problem, which is part of the MDGs Goal

8, demands a substantial reform of present debtor-creditor relations, which is along the lines indicated by the US Chapter 9 based on a debt arbitration mechanism or FTAP.

As many African countries are members of the Commonwealth, this is a potential platform to discuss debt arbitration. The Commonwealth Secretariat could be approached to further the discussion on this issue. The question could also be brought up in the Commonwealth by a debtor government.

What are AFRODAD and other Debt Movements doing?

It is incumbent upon the UN to establish a fair arbitration court to resolve the current debt impasse. With this understanding AFRODAD is in the process of collecting the necessary court evidence from the global South as well as mobilizing support for the establishment of the arbitration court. The court evidence collected comes in the form of documented case evidence experience of debtor-creditor relations in a number of countries. AFRODAD is deeply convinced that despite its own weaknesses as a global institution, the UN remains the most suitable place to establish an arbitration court because of its legitimacy across nations. It also has an historical memory of both the debt question and economic problems of the global south and the personnel and facilities to handle the arbitration court.

AFRODAD has been promoting its case by soliciting for at least 10 cases to be brought to arbitration to provide an indication of the extent to which the argument of illegitimacy and undue imposition by the international financial institutions is valid. These cases can be found on the AFRODAD website and the outcomes are expected to result in changed behavior on the part of both creditors and debtors. The cases are to be deposited with both the UN Secretary General and the Chairperson of the African Union Commission between June and December of 2010. A Commission on Debt from civil society is to lead the process of research, dissemination of information and engaging with institutions on the establishment of the tribunal. The aim is to involve participation of civil society, to ensure that both creditors and debtors will promote the process and encourage a positive stance toward the arbitration tribunal.

The cases to be presented can easily be divided into three categories:

1. Illegitimate and Odious Debt

The premise behind the concept of 'illegitimate' debt is the idea that lenders must not lend without considering the solvency and reputation of the indebted. In other words, they must not lend in the hope of extracting interest payments ad infinitum at the cost of the debtor's socio-economic welfare. The practice is already widely accepted by commercial banks when lending to individuals or companies. Letters of reference, proof of collateral, etc. are pro forma in these kinds of loan contraction processes. It has not, however, been applied to national loan contraction processes, nor

is there a court of arbitration between countries with regard to debt.

While there is no internationally accepted definition of illegitimate debt, researchers have offered a number of definitions. An illegitimate debt⁷ is one which satisfies any of the following conditions:

- It is against the law or not sanctioned by law.
- It is unfair, improper, or objectionable.
- It infringes on some public policy.

The Canadian Ecumenical Jubilee Initiative proposed a more expansive, multi-part definition of illegitimate debt as those debts which:

- Cannot be serviced without causing harm to people and communities.
- Are incurred by illegitimate debtors and creditors (e.g. funds stolen via corruption).
- Are incurred for illegitimate uses (e.g. funds that do not go to the projects for which they were intended).
- Are incurred through illegitimate terms.

This final definition includes debts that become unpayable as a result of external factors over which debtors have no control, e.g. a fall in commodity prices. Defined thus, illegitimate debt includes odious debts, loans secured through corruption, usurious loans, and certain debts incurred under inappropriate structural adjustment conditions. McGill University legal scholars compiled a legal, financial, and political analysis of the principles of the Doctrine of Odious Debts in the 21st century.⁷ For this, they took into account international customs or precedents; international conventions, such as the 1983 Vienna Convention on Succession of States in Respect of State Property; general principles of law such as unjust enrichment; the abuse of rights and the obligations of agents; and judicial decisions. Their conclusion is, based on the doctrine of odious debts defined by Alexander Sack in 1927, that there are three necessary conditions for a debt to be considered odious:

- 1) The debt did not receive the consent of the nation.
- 2) The funds borrowed are contracted and spent in a manner that is contrary to the interests of the nation.
- 3) The creditor is aware of the above two facts.

The doctrine of odious debt imposes morality on the part of international financial institutions and makes them more responsible for the purpose to which their loans might be put. Many civil society groups believe that by challenging illegitimate debt they will help eliminate the moral hazard that has dominated public borrowing for the past 50 years which has so damaged the economic, political and social fabric of the Third World. They also believe that the elimination of odious debt would shift the balance of power in debt negotiations in favor of citizens; lenders would take greater care to lend to governments with real authority, not just apparent authority; and would exercise due diligence to ensure that money is used for legitimate governmental purposes. It would go a long way in securing those measures required for accountable public finance that citizens throughout the South have so thoughtfully articulated. Lenders would

be forced to demand evidence that the borrowing public is aware of and consents to its government borrowing *before* extending credit.

2. Wrong Policy Advice by Creditor Institutions/Donor Nations

These cases are based on the premise that, contrary to contemporary knowledge and usual claims, the International Financial Institutions (IMF and World Bank) are not wholly accountable, transparent and democratic. Due to the adverse effects of their policy advice in most developing countries, citizens have been denied education opportunities, health services and genuine public sector development. Ordinary citizens have not been involved in loan transactions, parliaments have been stripped of their right to approve external loans and there has not been transparent disclosure of information associated with the debt burden. To this end, the arbitration case studies should demonstrate that disclosure must be made policy and law in order to avoid repetition of mistakes made in the past.

3. Stolen Wealth

The case of Nigeria serves to show that a Fair and Transparent Arbitration mechanism to deal with issues of stolen wealth are worth pursuing if Africa is to liberate itself from exploitation and deprivation of its rich resources. True partnership between the North and the South is not genuine and profitable without resolving such historical and current trends. A call has been made by the civic body that international conventions and standards be agreed upon at UN level to arrest such illicit behavior. Anti-corruption treaties are the key to recovering monies stolen from African countries, embezzled by the likes of the military junta of Sani Abacha in Nigeria.

The 2006 Nairobi Declaration on International Obligations and the Recovery and Repatriation of Africa's Stolen Wealth was crafted by representatives of Transparency International from seven African countries. They recommended that international instruments such as the United Nations Convention against Corruption and the African

Union Convention for the Combating of and Prevention of Corruption be applied to end cases of stolen wealth in Africa. The group noted that over the decades, billions have been illegally and corruptly appropriated from Africa, by politicians, soldiers, businesspersons and other leaders. The monies have been kept abroad in the form of cash, stocks and bonds, real estate and other assets. The group further argued that the effective implementation and monitoring of these conventions will make it harder for the corrupt to circumvent rules designed to ensure fairness and efficiency, and make it easier to punish them for illicitly enriching themselves at the expense of the people.

Nigeria has already been in the spotlight for issues of official corruption, especially prior to the Obasanjo civil administration. Military rulers have shown no remorse in siphoning state assets for individual benefit. On the other hand, the Western financial institutions have managed to claim confidentiality and remain aloof when African leaders have stolen funds and banked them with European banks. Many Africans question whether Western governments and bankers have a moral conscience or feel any obligation to expose behavior that is mar- ring Africa's chances for economic development.

Conclusion

Debt sustainability challenges facing low-income countries remain formidable, especially in Africa, and will most likely be insurmountable if the prescriptions for meeting them remain the monopoly of creditor agencies' self-interest. The failure of G8 economic orthodoxy is attracting increasingly virulent challenges from a wide variety of social movements across the world and the efficacy of their debt sustainability framework proposals is finding rising opposition. Both creditors and borrowing countries must find a radical new perspective, particularly with regard to policy, if the current vicious cycle of debt is to be resolved. Nothing short of unequivocal debt cancellation through a Fair and Transparent Arbitration mechanism geared towards supporting fragile post-debt-dependency economies will suffice.

1 Oxford English Dictionary.

2 The proposed FTAP is based on Chapter 9 of the US insolvency code, which aims at restoring the municipality's financial viability. See Kunibert Raffer, Internationalizing U.S. Municipal Insolvency: A Fair, Equitable and Efficient Way to Overcome a Debt Overhang, *Chicago Journal of International Law* 6 (2005), at 361-379, available at <http://www.allbusiness.com/north-america/united-states-illinois-metro-areas-chicago/883635-1.html>, see also Kunibert Raffer, Implementing Fair Debt Arbitration: What Needs To Be Done, at 10 (AFRODAD 2006), available at: <http://www.afrodad.org/downloads/publications/Implementing%20Fair%20Arbitration.pdf>.

3 Id., see also, Kunibert Raffer, Let Countries Go Bankrupt, The Case for Fair and Transparent Debt Arbitration, in *Internationale Politik und Gesellschaft Online, International Politics and Society* 4/2001, available at http://www.fes.de/ipg/ipg4_2001/ARTRAFFER.htm.

4 See <http://www.helsinki.fi>.

5 See <http://www.erlassjahr.de/content/montevideo/submit.php>.

6 Joseph Hanlon, Defining Illegitimate Debt (Open University 2002), a study mandated by Norwegian Church Aid, available at <http://www.kirkensnodhjelp.no/Documents/Kirkens%20N%C3%B8dhjelp/Publikasjoner/Temahefter/Defining%20illegitimate%20debt.pdf>.

7 Ashfaq Khalfan, Jeff King, Bryan Thomas, Advancing The Odious Debt Doctrine, CISDL working paper (2003), available at <http://www.cisdsl.org/pdf/debtentire.pdf>.



Experiences from a Civil Society Campaign against Odious Debt

7. The Example of German Claims on Indonesia from the Sale of Former GDR Warships

Jürgen Kaiser

erlassjahr.de (Jubilee Germany) has worked on the issue of illegitimate debt since it was founded in 1997. The first publication ever produced by *Erlaßjahr 2000*¹ prominently featured an article on the World Bank's claims on Rwanda in the light of the Bank's role in Rwanda's pre-genocide years.² Due to the vagueness of the terms "odious debt" and "illegitimate debt," however, members of *erlassjahr.de* have felt in the past that it is far less "campaignable" to challenge the validity of individual claims on the basis of their illegitimacy or odiousness than to pursue other topics at the heart of campaigns taking place around the year 2000, in particular the "unpayability" of the immense debt overhang of the late 1990s, combined with creditors' resistance to recognizing that the poorest countries will not repay their entire debt.

erlassjahr.de's sceptical approach to the concept of odious debt changed when debt campaigners in Germany learned of Pat Adam's rediscovery of the odious debt doctrine through the writings of Alexander N. Sack. This development created the perception that it was possible to establish a coherent and defensible concept of odious debt and, therefore, provided fresh incentive within the Jubilee network.³ Receiving impulses from all over the world, network members felt encouraged to make illegitimate debt the central topic during *erlassjahr*'s mobilisation toward the 2007 G8 summit in Heiligendamm.

Between 2002 and 2007, campaigning by the public around the issue of illegitimate debt led only to limited political progress. Some support materialized through the collection of scattered signatures by parliamentarians under the "Parliamentary Declaration on Responsible Lending," but the political class in Germany remained largely indifferent and did not feel very pressured to take the issue up seriously.

Then, two external events shook the stalemate between a movement with limited capacities and a political class that, while not outright and unambiguously opposed, remained largely uninterested regarding the issue of illegitimate debt:

One driving event was Norway's decision to unilaterally cancel its claims on five countries due to its acceptance of creditor co-responsibility for failed financing.

The other impulse came from a decision taken among debt campaigners at a meeting of Eurodad (European Network on Debt and Development) at the end of 2006 to work in-depth on one concrete case of illegitimate debt in each G7 country.⁴

In Germany campaigners selected a case that was ideal in several respects and resulted in a lucky strike for the movement (if that wording is appropriate in the context of odious financing); it

was a case involving the sale of thirty nine warships formerly owned by the GDR to the Suharto regime in Indonesia.⁵ The Kohl government decided to push the deal through the untransparent parliamentary procedures in place to regulate arms exports, despite protests from the German parliamentary opposition, from the World Bank, which expressed fears regarding the misuse of development resources, and from the Portuguese government, which, rightly, expected that the vessels would be used to oppress opposition to the Indonesian occupation of East Timor. Certainly, the close personal relationship between the German chancellor and the Indonesian dictator also helped to facilitate the deal.

Notably, before the ships were transferred to Indonesia, they were occupied by members of the East German peace and solidarity movement. The peaceful and highly-visible action organized by a movement which only a few years earlier had been instrumental in bringing down a dictatorship in its own borders was essential to cementing the case in the memory of the solidarity movement.

In the time leading up to the Heiligendamm G8 summit, *erlassjahr.de* produced an extended version of the document *Skeletons in the Cupboard*, arguing that the Indonesia deal fulfilled all three requirements under the classical odious debt doctrine:

Lack of consent: The Indonesian people, who were left holding the bill after the fall of the Suharto regime and the rescheduling of Indonesia's foreign debt in 2000 and 2002, had not consented to the loan; the "guided democracy" of the "orde baru" regime did not provide any opportunity for the Indonesian people to influence the decisions of the dictator and his cabinet.

Lack of benefit: A substantial number of news reports demonstrated that, in violation of the German-Indonesian contract, the vessels were used in counter-insurgency operations in practically all conflict areas of the archipelago; thus, the purchase of the ships not only failed to benefit the Indonesian people, but caused real damage to the interests of the population.

Knowledge of the creditors: Finally, the German government was not misled by the Indonesian government into accepting the deal, but, instead, must have known before entering the contract that Suharto was one of the most bloodthirsty dictators in Asia, someone who never hesitated to use force against anyone who threatened his power. Moreover, current interviews with high-ranking navy officers have shown that the Indonesian government intended to use the vessels in ways that went beyond "coastal protection and combating piracy," in contradiction to the agreement.



In March 2007 *erlassjahr.de* closed ranks with one of the biggest Protestant churches in Germany, the Protestant Church of Westphalia (EKvW, for its acronym in German). The church has longstanding relationships with Protestant churches in Indonesia and sought to redefine its role in the globalized world. With the support of EKvW it was possible to set up a high-level dialogue on the subject of illegitimate debt with the German Ministry of Finance, the ultimate decision-maker in German politics when it comes to the claims of Southern sovereigns.

That dialogue, led by the Bishop of EKvW, Alfred Buss, and the Vice-Minister of Finance, Thomas Mirow, was the first time that the German government seriously considered the concept of illegitimate debt. In the end, however, the German Ministry of Finance clearly rejected the concept of illegitimate debt as “unworkable,” and asserted that the concrete case presented by *erlassjahr.de* was unconvincing. Its major arguments were:

- There is no coherent definition of “illegitimate debt,” and neither state practice nor international treaties validate the concept in any coherent way.
- Even if a coherent definition of illegitimate debt existed, it would not apply in the Indonesian case because the ships were used to combat piracy, a legitimate interest, even if they were at times misused, an occurrence that was only documented in a few scattered cases.
- The Kohl government had duly adhered to all formal requirements for the sale. Moreover, the “restrictive” German arms export policy would have ruled out the misuse of the ships. (Any evidence to the contrary “would still have to be checked.”) *erlassjahr.de* and the EKvW were not convinced by the Ministry’s references to the effectiveness of parliamentary procedures in Germany, as they have been notoriously instrumental in circumventing a formally restrictive arms export policy. *erlassjahr.de*, however, had to take seriously the ministry’s references to both the legitimate benefit provided by the ships in combating piracy and the lack of coherency in the concept of illegitimate debt.

The Ministry of Finance considered the case closed after the dialogue, but the church and the debt campaign decided that a strong push could indeed keep it open. Up until that point, in the high-level dialogue and in discussions with other ministries, the legal dimension of the case had not been explored thoroughly. While debt campaigners treated Sack’s doctrine and the scattered examples of its application as sufficiently solid grounds with which to support a case, Treasury officials argued that a legal doctrine of which they were unaware could not bind the Federal Republic.

Thus, it seemed advisable to seek a serious legal opinion before either accepting defeat and closing the case or moving forward with a fresh tailwind.⁶ *erlassjahr.de* and EKvW commissioned a legal opinion from August Reinisch, a professor of international law at the University of Vienna.⁷ Reinisch’s opinion focussed strongly on the applicability of the classical odious debt doctrine. He concluded that the doctrine has legal validity and

that the Indonesian case fulfilled the doctrine’s requirements for putting a claim into question. While *erlassjahr.de* had not considered taking the case to court, the document forced the German government to reconsider the case and present its arguments in a more serious way.

The Treasury dismissed the paper on the same day we presented it at a press conference in Berlin, alleging that it contained basic errors and omissions. Later, a letter from the Ministry of Finance only repeated what had already been said during the high-level dialogue the previous year.

The Ministry of Development conducted a serious analysis of the paper carried out by an in-house attorney. Her paper dismissed Reinisch’s approach.⁸ More specifically, she wrote that:

- Reinisch had failed to review the original contract, and could therefore not make diligent conclusions regarding its content.
- It would have been impossible to assume that Suharto’s cabinet was not the lawful representative of the Indonesian state.
- The validity of the odious debts doctrine had not been proven.
- Indonesia never questioned the claim.
- The German government could not have known that Indonesia would misuse the vessels.
- The German government and debt campaigners discussed existing objections to expert opinions on the issue on two occasions.

An expert round table was organized on the fringes of the World Bank and International Monetary Fund annual meetings in 2008 at the World Bank in Washington. The round table included legal experts from the World Bank, the Fund, and the Executive Director of the World Bank for Germany. From the NGO side, the Protestant Development Service (Evangelischer Entwicklungsdienst or EED) the Westphalian church, Professor Reinisch, Jubilee USA and American partner churches participated. Concrete reactions to the Indonesia case and the Reinisch paper were scarce at the meeting. The World Bank’s legal counsel attempted to dismiss the odious debt concept; given more recent progress in legal debates over the concept this seemed to be rearguard action, as Professor Reinisch labelled it.

In November 2008 *erlassjahr.de* and the German Ministry of Development met for an informal discussion on the Reinisch paper and the abovementioned legal opinion issued by the ministry. Some of the points that had been put forth by the ministry were countered by *erlassjahr.de*:

It was pointless for the German government to demand that Professor Reinisch review the original contract, as the Ministry was not prepared to reveal it. (Germany is extremely untransparent regarding its export credits.) Furthermore, the German government’s contention that it was surprised by the Indonesian government’s violation of the clause limiting the uses of the ships was patently inappropriate, given Germany’s awareness of its partner’s record.

Two points seemed valid, however, and propelled our own reconsideration of the case:

Details of the Ship Sale and the Current Debt Situation

In 1992 Germany sold most of the war fleet formerly owned by the German Democratic Republic (GDR) to Indonesia: a total of thirty nine vessels (corvettes, mine-sweepers, supply vessels and landing craft) for 20 million German Marks (DM),¹ a price only slightly above the scrap value of the vessels. Given the ships' poor condition, the sale only made economic sense because Germany sold the ships together with a package including their modernization and construction of the appropriate marine infrastructure in Indonesia by German companies.

The alteration of the ships in Germany cost almost DM 475 million.² KfW Bankengruppe³ financed the entire deal at a value of DM 561 million⁴ (DM 425 million for the repair and modernization of the ships and DM 136 million for the new Siemens telecommunication equipment with digital technology). The deal was secured with a Hermes guarantee,⁵ which, all measures included, had a value of DM 700 million.⁶ To make the controversial deal possible the German and the Indonesian ministries of de-

fence agreed in a unpublished agreement: "The buyer commits himself to apply the subject of the contract only for the purpose of the safeguarding of the coasts and the seaways and for combating smuggling." This agreement has since been broken by the Indonesians. Under the presidency of Habibie, Wahid and Megawati Sukarnoputri the ships were deployed in all interior conflicts (massacre in East Timor in the summer of 1999,⁷ naval blockade of the Moluccas in January 2000,⁸ transportation of troops to the embattled province of Papua on 14 March, 2000,⁹ transportation of troops and tanks to the war-torn province of Aceh on 21 May 2003¹⁰). It is estimated that between 1993 and 1998 less than two thirds of the outstanding debt claims from the sale of the GDR ships were paid by Indonesia to Germany. Since then Indonesia's entire debt has been restructured several times. At the end of 2008 it was estimated that Indonesia had to pay at least EUR 100 million to Germany from the original debt claims in the sale of the GDR ships¹¹



The occupation of the GDR warships in the port of Peenemünde shows that the risks of the deal were known when the contract was made. Source: Robert Havemann Gesellschaft, Rolf Walter.

1 EUR 10.2 million (1 euro=1.95583 DM)

2 EUR 242.9 million (1 euro=1.95583 DM)

3 KfW Bankengruppe is a bank under the ownership of the Federal Republic and the Länder (federal states). It offers support for sustainable improvement initiatives, such as projects involving small and medium-sized enterprises, entrepreneurship, environmental protection, housing, infrastructure, educational finance, project and export finance, and development cooperation. See <http://www.kfw.de>.

4 EUR 286.3 million (1 euro=1.95583 DM)

5 Export credits guarantee by the German state.

6 EUR 357.9 million (1 euro=1.95583 DM)

7 Ulrich Delius, Ehemalige NVA-Schiffe werden in Indonesien vertragswidrig zur Aufstandsbekämpfung eingesetzt, Gesells-

chaft für bedrohte Völker, 2003, available at <http://www.gfbv.de/inhaltsDok.php?id=97>.

8 Jakarta Post, 7 January 2000.

9 Ulrich Delius (referring to the Papuan human rights organisation Elsham), Ehemalige NVA-Schiffe werden in Indonesien vertragswidrig zur Aufstandsbekämpfung eingesetzt, Gesellschaft für bedrohte Völker, 2003, available at <http://www.gfbv.de/inhaltsDok.php?id=97>.

10 "Indonesian forces execute 10 civilians in Aceh," reported by witnesses, dpa (Deutsche Presse-Agentur GmbH), 23 May 2003.

11 [erlassjahr.de](http://www.erlassjahr.de), Leichen im Keller, Illegitime Forderungen der Bundesrepublik Deutschland, DDR-Kriegsschiffe für Indonesien 1992-2004, 3. aktualisierte Auflage, November 2008, available at http://www.erlassjahr.de/dev/cms/upload/presse/pk-berlin/Leichen_im_Keller.pdf.

It must be assumed that there was a benefit to the people of Indonesia stemming from the sale of the ships. There is no evidence, nor can one logically assume, that the ships were not put to some use that benefitted the Indonesian people, in addition to the uses that contributed to the carrying out of atrocities.

Piracy is a very real problem that affects the Indonesian state and people. Within a strict interpretation of the doctrine this would be sufficient to rule out its applicability.

The lack of consent was also a complex question, because, while the Suharto government clearly lacked legitimacy, it was de facto considered and treated as the legal representative of Indonesia by the whole international community.

We subsequently shifted the focus from Sack's doctrine to another important strand in the international legal debate on illegitimate debt – the concept of *ius cogens* violations as a basis for declaring a claim invalid. In the instant case this more focussed concept seems to be more fruitful, as one of the “binding norms of international law” is the prohibition of the use of force in international relations. Indonesia had been occupying East Timor since 1976 and continued to brutally repress the Timorese people. Diplomatically, Germany has always supported Portugal's position that it would not abandon sovereignty over its former colony in the absence of a true democratic process towards self-determination. Thus, Germany's supply of arms to the Suharto government equalled aiding and abetting a war of aggression, even by German standards.

Lastly, our approach to the Indonesian case was challenged by some human rights organisations in Germany that work on Indonesia, particularly WatchIndonesia (Berlin). These human rights advocates questioned whether the unconditional cancellation of Indonesia's illegitimate debt would ultimately benefit the victims of the atrocities committed with its help. Given the continuity,

particularly in the military apparatus of the Indonesian state, would an unconditional cancellation benefit the perpetrators who would ultimately receive their weaponry for free?

The assumption (at times dogmatic) in the anti-debt movement that the cancellation of claims would benefit the whole population may be sufficiently defensible in many countries. The present case, however, provided strong reasons to doubt this assumption. In what way would villagers in Aceh and Sulawesi (not to speak of East Timor) benefit from the net resource flow that an unconditional cancellation of these illegitimate claims would create? Rather, the foreseeable budgetary effect would enhance the manoeuvring space of those who continue to be in command of the extensive and largely untransparent military budget of Indonesia.

More recently, with the aim of opening further debate on the matter, erlassjahr.de has drafted a proposal for a debt conversion plan affecting the contested German claims. It proposes the creation of a compensation and reconciliation fund that would run under the joint administration of the two governments in conjunction with Indonesian and international human rights organisations. The scheme would require the Indonesian government to continue servicing the illegitimate claim, although the German creditors would no longer collect the payments.

In the end, the experience of the Indonesian case has shown that illegitimate debt campaigns should not consist of forcing concepts through the wall-like stubbornness and self-interest of creditors. The approach of erlassjahr.de in this case changed substantially over the two years of campaigning, and the journey's end has not yet been reached. In April 2009 NGOs from Indonesia and Germany met with the official sector, including with the military in Indonesia, and suggested an official Indonesian initiative, something for which campaigners could do no more than pave the way.

1 Erlaßjahr 2000 is the organization that preceded erlassjahr.de.

2 Erlaßjahr 2000, Eine Idee wird auf den Weg gebracht, Dokumentation der Auftakttagung, Wuppertal 1997.

3 erlassjahr.de, Philippinenbüro & INKOTA-Netzwerk, Illegitim: Handbuch illegitime Schulden, Düsseldorf 2003.

4 Eurodad, Skeletons in the Cupboard: Illegitimate Debt Claims of the G7, Brussels 2007.

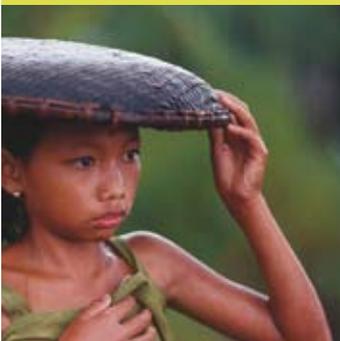
5 The details of the sale are described in the box.

6 The campaign's considerations were inspired by discussions among legal experts, which in turn had been

inspired by NGO campaigns. See documentation of 2007 workshop at Duke University, available at <http://www.law.duke.edu/journals/lcp/>

7 August Reinisch, Analysis of the Export of Warships from the Former GDR Navy to Indonesia between 1992-2004 in Terms of the Legitimacy of the German Entitlement to Payment, Vienna, 30 May 2008, available at http://www.erlassjahr.de/dev/cms/upload/presse/pk-berlin/gutachten_englisch.pdf.

8 Document on file with erlassjahr.de.



8. The Campaign for the “Jubilee Act” in the United States Congress

Mimi Lytje and Neil Watkins

Jubilee USA’s campaign in the United States against odious debt and for more responsible global lending includes the development and promotion of legislation called the Jubilee Act for Responsible Lending and Expanded Debt Cancellation in the US Congress.

If passed, the Jubilee Act would expand debt relief to up to 24 additional poor countries not currently eligible for the Heavily Indebted Poor Countries (HIPC) Initiative, require the US Comptroller General to conduct an audit of past, possibly ‘odious’ lending by the US government and advocate a framework for responsible lending in the future. The legislation was passed by the United States House of Representatives in April 2008 and cleared the Senate Foreign Relations Committee in June 2008, but failed to pass the full Senate by the end of the 110th Congress.

The act was re-introduced in August 2009 and Jubilee USA is working to secure passage by both the House and the Senate in 2010. Once passed by both Houses and signed by the President, the act becomes law. Jubilee USA is pursuing this legislation for two reasons: first, to educate the public and policymakers on ‘odious’ debt and responsible lending and second, to change official US policy on international debt. This short report provides additional background on the rationale for the legislation, its content, and its prospects for success. It is our hope that sharing our experience with the Jubilee Act initiative will be helpful to both civil society and parliaments of other countries as they develop similar campaigns.

Rationale for the Jubilee Act

In 1999, following intense public pressure from the global Jubilee movement, the G8 countries agreed to enhance debt relief for the world’s most impoverished countries. This led to the expansion of the IMF/World Bank Heavily Indebted Poor Countries (HIPC) Initiative under which 24 countries have now received debt relief.¹ This program was followed by the Multilateral Debt Relief Initiative, agreed at the G8 summit in 2005, which made it possible for eligible poor countries to receive 100 percent debt stock cancellation of eligible debts from the IMF, World Bank and other international financial institutions (IFIs).

Despite these initiatives, the world’s most impoverished nations continue to send USD 100 million each day to developed countries, IFIs and other creditors.² Furthermore, some middle income countries with large populations living in poverty do not even qualify for these debt relief programs.

The Jubilee Act seeks to address the issue of those countries that have so far been excluded from debt relief. In addition, it also addresses other debt

related policy issues, the most important of which are harmful conditionalities, the need for a framework for more responsible lending in the future and addressing the problem of odious and illegitimate debt – something which debt relief initiatives to date have not done in any way.

Summary of the Jubilee Act

As already mentioned, the Jubilee Act expands the list of countries eligible for debt cancellation to the 65 countries currently only eligible for financing from the World Bank’s soft lending arm – the International Development Association (IDA). This includes 24 more countries which are not currently eligible for debt cancellation under HIPC.

The Jubilee Act also prohibits harmful economic and policy conditions currently attached to lending and debt relief initiatives from the World Bank and the IMF. These conditions include user fees for primary health care and education, measures that compromise worker’s rights and constraints on government spending for essential health care and education.

Furthermore, the Jubilee Act calls for the creation of a framework for transparent, responsible lending in order to ensure that those countries which have benefited from debt relief do not fall back into unsustainable debt. It also addresses the problem of odious and unjust debts by requiring the US Comptroller General to undertake audits of debt portfolios where there are suspected cases of odious, onerous or illegal loans. These last two issues are described in further detail below.

A Framework for Transparent, Responsible Lending

The Jubilee Act identifies which critical measures should be undertaken to ensure that heavily indebted countries can get on track toward sustainable growth and development. It is important that both lender and borrower exercise responsible behavior in their transactions. This was acknowledged in the Monterey Consensus which stated that “debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations”³

There now appears to be a dawning realization in the current financial climate regarding the need for more financial regulation and stricter control of creditors and bad loans. In their May 2008 letter to the President of the European Commission, Jacques Delors, Jacques Santer and a number of others stressed that “the problem is a model of economic and business governance based on under-regulation, inadequate supervision and an under-supply of public goods.”

The Jubilee Act emphasizes that the external financing needs of low-income countries should

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The Capitol, Washington D.C., where Congress debated the Jubilee Act for Responsible Lending and Expanded Debt Cancellation in 2009. The Senate failed to pass the Act, but it was re-introduced and may pass in early 2010.

be met primarily through grants rather than new lending. Policies should also be developed and promoted to ensure that all creditors work together to preserve the gains of debt relief. This is especially important as there is no bankruptcy law protecting countries against free-riders or predatory companies (known as vulture funds). These companies buy poor countries' international debt obligations at a deeply discounted rate and then seek to recover the original market value through legal or other processes.

To address these concerns the Jubilee Act requires that the Secretary of the Treasury seek agreement among IFIs and the Paris Club countries for a new framework for transparent and responsible international lending to low-income countries. The new framework should guarantee greater transparency from official lenders in their credit operations. It would also ensure that parliaments, civil societies and other groups in affected countries have the opportunity to participate in loan decisions.

The goal is also to obtain international recognition and acceptance of what constitutes irresponsible lending and work towards a fair and transparent system to resolve debt disputes.

These measures are all critical in preventing the accumulation of illegitimate debt in the future. They do not, however, address the problem of existing cases of odious and illegitimate debt; for this, the Jubilee Act requires debt audits.

Odious Debt and Debt Audits

The Jubilee Act requires that an audit be undertaken of US and IFI claims in countries where there is evidence of "odious, onerous or illegal" loans, such as in the Democratic Republic of the Congo or South Africa. These audits would cover US export credit claims in these countries and wherever possible would also include debts owed to the World Bank, IMF and other IFIs and assess whether or not the investments made had produced the intended results.

Furthermore, the audits would investigate the process by which the loans were contracted, how the funds were utilized and any product created. They would also determine whether US and/or international laws were violated in the process. The audits should be planned and executed in a transparent and consultative manner, engaging both Congressional bodies and civil society groups in the countries in question.

Debt audits are a useful tool both to uncover structural and policy flaws that have led to illegitimate debt in the past and also to prevent any repetition of mistakes made. In addition, they have the ability to address the nature of certain debts, looking at joint responsibility between creditors and debtors and determining whether it is fair to collect any given debt or whether it should be cancelled on moral and legal grounds.

Audits are underway at the level of civil society in several countries in the global South and an official audit has been established in Ecuador. When passed, the Jubilee Act will require that the US undertake leadership of the audits, with the

Government Accountability Office (GAO) playing a major role.

The US Government Accountability Office

The GAO is an independent agency responsible for the fiscal and managerial accountability of the federal government. It is often referred to as the “congressional watchdog” because as well as auditing government spending it also investigates allegations of illegal and improper spending. The Comptroller General of the United States is the director of this agency. He is appointed to a 15-year term by the President from a slate of candidates proposed by Congress.

The agency takes on assignments at the request of congressional committees or subcommittees and performs audits mandated by public laws or committee reports. It may also undertake research under the authority of the Comptroller General. The agency is authorized to issue legal decisions and opinions.⁴

The agency has the expertise to analyze debt owed to the USA to see whether proper procedures were followed in the contracting of loans to poor countries and whether any legal irregularities would invalidate specific loans. This would give invaluable information regarding unsustainable and undemocratic loan processes and would provide support for audit efforts being made by countries in the global South.

Passing the Jubilee Act

The Jubilee Act has to be passed by both the House of Representatives and the full Senate in order to take effect. In April 2008 it was successfully passed by the House but encountered problems in the Senate; it was referred to the Foreign Relations Committee where it was successfully marked up and reported out of Committee. However, when it was put up for a unanimous vote which would have enabled it to be passed immediately, the legislation was blocked by a single Senator. Jubilee USA is working to ensure that this Senator does not block it a second time but meanwhile, the US elections meant that time ran out for the act to be passed by the 110th Congress and it must now be reintro-

duced in both the House and the Senate in 2009. Due to the strong support received for the act in the House last year, it is likely that the House version will be passed again, whilst the stronger opposition in the Senate may prove more difficult to overcome. Jubilee is currently working hard to win the support of the necessary lawmakers and is optimistic about the bill’s passage in the Senate by early 2010.

Lessons Learned

An important factor in working to get the Jubilee Act passed has been the extensive awareness-raising campaign Jubilee USA has led on odious debt and responsible lending. This has also meant trying to link the current situation in the USA to these issues.

Jubilee has been most effective in putting pressure on politicians for their support when we have organized grassroots campaigns and mobilized concerned constituents to call, write, and meet with their Representatives and Senators. For example, in October 2007 Jubilee USA organized a national 40-day “Cancel Debt Fast” campaign in which Jubilee supporters from across the country fasted for one day, and on that day either called or met with their Members of Congress to ask them to support the Jubilee Act. This made a big impression on Congress. We also asked supporters to write their messages to Congress on paper plates – with the message “I’m hungry for justice – Support the Jubilee Act!”. We delivered 300-400 paper plates with handwritten messages from Jubilee supporters to each Congress person’s office which served to both catch their attention and help secure these members’ votes. A little creativity and grassroots action goes a long way towards creating an impact with a policy.

The problems associated with unsustainable lending and odious debt are of a global nature and international cooperation is therefore required in tackling them. If we are to create an international framework for responsible lending and have the concept of odious debt recognized, these issues must be put firmly on the agenda of several countries.

1 March 2009.

2 Oxfam International, *The World is Still Waiting*, Oxfam Briefing Paper, No. 103, at 4.

3 Monterey Consensus on Development Assistance, 2002, para. 47.

4 See the GAO’s webpage for more info: <http://www.gao.gov/about/index.html>.



Legal case studies



9.1 The Austrian Medical Waste Project in the Philippines

Luke Espiritu

The case

In November 1996, the Philippine government entered into a Supply Contract with Vamed Engineering of Austria for the purchase of waste disposal facilities, medical equipment and related services to the amount of Austrian Schillings (ATS) 199 860 000.¹ The Project was to upgrade 26 Philippine public hospitals run by the Department of Health, with the priority being to secure modern incinerator technology for the disposal of biomedical wastes.²

The contract price was broken down as follows: (1) ATS 39 399 892 for “Related Services” pertaining to the design and detailed engineering of equipment supplied, project management, freight, insurance, pre-installation works, installation, testing and commissioning, warranty and maintenance for one year; (2) ATS 24 374 155 for the supply of medical equipment for the emergency departments of five hospitals; (3) Supply of Hoval CV1 and CV2 incinerators for waste disposal; (4) ATS 40 181 877 for the supply of medical equipment for OR, ICU and Recovery.³ Study of the above figures shows that more than 50 percent of the total contract price was devoted to the purchase, installation and maintenance of the Hoval incinerators.

The Project was financed by a buyer’s credit obtained by the Republic of the Philippines from the Bank of Austria AG to the full amount of the contract price.⁴ It must be pointed out that the Bank of Austria owns 10 percent of the technology vendor, Vamed Engineering.⁵ In 1997, the Buyer Export Credit Facility for Specific Project was signed by the Department of Finance of the Republic of the Philippines and the Bank of Austria AG.⁶

This Project was designed to modernize health services in the Philippines. The irony, however, is that the technology used poses grave health and environmental hazards. The Hoval incinerators which were installed were not only obsolete and dated back to the 1950s but also had no air pollution control devices fitted to them. Test results show that the actual incinerator emissions exceed both the range of emissions for carbon monoxide and sulfur dioxide guaranteed by the manufacturer and the Philippine limits for sulfur dioxide. In addition, some or all of the Hoval-certified emission figures already exceed the US Environmental Protection Agency’s (EPA) limits on particulate matter, carbon monoxide, sulfur dioxide, hydrogen chloride, dioxins and furans and the European Union’s standards on total dust, hydrogen chloride, sulfur dioxide, dioxins and furans.⁷ As such, sale of these Hoval incinerators would be prohibited in Austria, Vamed Engineering’s home country.

Two years after the execution of the Contract, the Philippine Congress enacted Republic Act (R.A.) No. 8749, or the Clean Air Act. This favored the use of safe and environmentally sound non-burn technologies and banned the use of incineration subject to a three-year phase out period. Within this grace period, incineration was only allowed for pathological and infectious wastes subject to monitoring by the Department of Environment and Natural Resources (DENR).⁸ The Implementing Rules for R.A. 8749 fixed the final date of the incinerator phase-out at 17 July, 2003.

The incinerators installed, or ‘dumped’, by Vamed are no longer in use and have now been banned by laws which have been implemented in order to protect the environment. However, the Philippines continues to honor its Austrian loan obligation which is payable until 2015.⁹

Debt from the Austrian Loan as odious

Given international concern for matters of environmental protection, a relevant question in this case is whether the Philippines’ debt under the Austrian loan agreement may be characterized as odious due to violation of *ius cogens*.¹⁰ Unfortunately, while there is increasing support to declare environmental harm (particularly transboundary damage) a violation of peremptory norms of *ius cogens*, this definition has not yet found general acceptance. Currently, norms of *ius cogens* are primarily reserved for genocide, torture, acts of aggression and crimes against humanity.

Instances of odious debt do not only coincide with possible violations of *ius cogens*. The concept of odious debt developed and evolved from a set of equitable considerations invoked to adjust or sever debt obligations. Traditionally, it has been applied in the context of political transitions involving debts contracted by previous governments or states.¹¹ In recent years, though, the contexts in which the concept is pleaded have expanded as an increasing number of advocacy groups and civil society organizations in developing countries call for debt relief or repudiation.

Mohammed Bedjaoui notes that “odious debt” is an umbrella term covering a range of specific debts found in the following general situations:¹²

- “(a) From a standpoint of the successor State, an odious debt can be taken to mean a state debt contracted by the predecessor State to serve purposes contrary to the major interests of either the successor State or the territory that is transferred to it;
- (b) From the standpoint of the international community, an odious debt could be taken to mean any debt contracted for purposes that are not in conformity with contemporary interna-





Protest march in Pasay City, Philippines on 5th August 2008 against the ratification of the controversial Japan-Philippines Economic Partnership Agreement. Its lack of measures on hazardous waste materials caused public outrage.

Picture: Manny Calanzo, Multi-Sectoral Magkaisa Junk JPEPA Coalition, Global Alliance for Incinerator Alternatives GAIA

tional law and, in particular, the principles of international law embodied in the Charter of the United Nations.”

Thus, one way of characterizing the Austrian debt as odious is to consider its environmental impact from the standpoint of international law. Protection of the environment is a recognized principle in international law. The 1972 Declaration of the United Nations Conference on the Human Environment¹³ mandates that the “discharge of toxic substances or of other substances and the release of heat, in such quantities or concentrations as to exceed the capacity of the environment to render them harmless, must be halted in order to ensure that serious or irreversible damage is not inflicted upon ecosystems” and the “just struggle of the peoples of ill countries against pollution should be supported.”¹⁴

Further, the Declaration acknowledges that “in developing countries most of the environmental problems are caused by under-development” and that “industrialized countries should make efforts to reduce the gap between themselves and the developing countries” towards a development that accounts for the need to safeguard and improve the environment.¹⁵

The 1992 Rio Declaration is of particular interest in this case, as obsolete technology was clearly dumped by the Austrian company Vamed when they installed the Hoval incinerators in Philippine hospitals. This Declaration pushes for States to “effectively cooperate to discourage or prevent the relocation and transfer to other States of any activities and substances that cause severe environmental degradation or are found to be harmful to human health.”¹⁶

Other agreements that focus on gaining environmental protection include the Convention on Long-Range Transboundary Air Pollution (1979), the Law of the Sea treaty (1982), the Vienna Convention for the Protection of the Ozone Layer (1985), the amended Convention on Marine Pollution from Land-Based Sources (1986), the Convention on Environmental Impact Assessment in a Transboundary Context (1991), the Convention on Biological Diversity (1992), the United Nations Framework Convention on Climate Change (1992), and the Kyoto Protocol (1997).

It may be argued, therefore, that the Austrian loan agreement financed a Project which does not conform with international law. As such, it was for an “odious” purpose and must not be enforced against the Philippines save for those portions of the debt relating to the non-incinerator components. Another point to consider is whether the Bank of Austria was aware of the “odiousness” of the loan, i.e. that the Project posed serious risks to health and the environment. According to Prof. Robert Howse, in “recent articulations of the concept of odious debt, one of the conditions for characterization of debt as odious and eligible for repudiation is that the creditor at the time at which the loan contract was made knew, or should have known, that the debt was odious, i.e. that the funds were intended for a purpose contrary to the interests of the population.”¹⁷

In this case, there are stipulations inherent in the Austrian loan contract which point to the creditor's knowledge of the odiousness. The loan contract was executed to finance a specific Supply Contract for particular services and equipment. It has already been noted that the Bank of Austria is a 10 percent shareholder in Vamed and was therefore in position to know, or should have known, that the Hoval CV1 and CV2 incinerator provided by the supplier Vamed Engineering would not pass international, in particular US and EU, standards for incinerator emissions. It should also have known that the price for these incinerators did not include air pollution control devices.

The Philippine Debt Strategy and Prospect for State Assertion of Odiousness in the Austrian Medical Waste Project

There is no single legal forum for the adjudication or settlement of claims of odiousness. They may be raised in bilateral or multilateral negotiations for debt relief; in arbitral proceedings or in domestic litigation.¹⁸ In this case, the Austrian loan agreement provides for arbitration in the settlement of disputes.¹⁹

The claim of odiousness in the case of the Austrian loan agreement may properly be asserted by the Philippine State. However, this is unlikely to happen because the consistent position of successive Philippine governments is to honor all foreign debts in order to preserve the country's credit standing. There were attempts to assail this policy with the Philippine Supreme Court, the common motivating factor behind which is to secure legal relief against odious debts. However, these attempts have met with failure.

In the Philippines, the servicing of foreign debts has become a centerpiece strategy in a cash-strapped economy dependent on foreign investments and borrowings to finance development. In the early 1950s and 1960s the Philippines attempted to industrialize through import substitution. This initially sparked off growth rates of 6-10 percent. However, this strategy was not coupled with wealth redistribution through massive land reform and the elite-dominated Philippine society, in which the majority are both poor and landless, narrowed the domestic market. This, in turn, inhibited growth and led to economic stagnation and import substitution-industrialization eventually ran aground in the late 1960s. The Marcos regime attempted to address the problem by tapping into the export market. However, this outward orientation did not progress beyond the setting-up of a few export enclaves and in order to keep the economy afloat, the regime was forced to embark on a labor-export policy. This migration of Filipino workers overseas was initially intended to be a temporary response. However, it has become a fixed institution from Marcos up to the present Arroyo administration.

The Philippines has been forced into a relationship of dependency with international capital brought in by foreign investors and international lending institutions. During the easy petrodollar

era of the 1970s, the country contracted a massive external debt which, by the end of the Marcos regime, had risen to USD 26 billion. IMF and World Bank Structural Adjustment Loans, initiated in the 1980s, further deepened both poverty and dependency.

In order to ensure automatic appropriation of funds for payment of principal and interests on loans without the need for a budgetary act of Congress, Ferdinand Marcos issued the Martial Law Presidential Decree (PD) 81 --- amending Republic Act 4860 --- PD 1177 and P.D. 1967. Constitutional challenge was raised against these decrees of the Marcos era in *Guingona vs. Carague*, 196 SCRA 221. However, the Supreme Court upheld their validity explaining that "the aforesaid presidential decrees show the clear intent that the amounts needed to cover the payment of the principal and interest on all foreign loans, including those guaranteed by the national government, should be made available when they become due precisely without the necessity of periodic enactments of separate laws appropriating funds therefore, since both the periods and necessities are impossible to determine in advance."

When President Corazon Aquino came to power in 1986, it was generally believed that she was in the best position to refuse to honor those Marcos era debts which did not redound to the benefit of the people. Instead, she decreed that the new government was committed to pay all its creditors. During her term, the Philippine government managed the country's external debt problem through a negotiation-oriented debt strategy involving cooperation and negotiation with foreign creditors. The Aquino government entered into three restructuring agreements with representatives of foreign creditor governments during the period 1986 to 1991. During the same period, three similarly-oriented restructuring agreements were executed with commercial banks. In February 1992, the Debt Negotiating Team negotiated an agreement with the Bank Advisory Committee, representing all foreign commercial bank creditors, in order to come up with a Financing Program. This Financing Program sought to retire portions of the country's pre-existing loans through: (1) the buy-back approach, which essentially pre-terminated portions of the public debt at a discount; and (2) the bond conversion scheme, which extinguished public debts by means of securing a new loan by virtue of a sovereign bond issuance, the proceeds of which in turn were used for terminating the original loan.²¹

The case of *Constantino vs. Cusia*, 472 SCRA 505, involved a taxpayer and citizens' petition to assail the validity of this Financing Program. The underlying reason behind the suit was the odiousness of the debt intended to be settled by the Program. Petitioners pointed out that the Financing Program was made available for debts which had either been fraudulently contracted or were void. These included the so-called "behest" loans, such as those pertaining to the Bataan Nuclear Power Plant, which were contracted or guaranteed fraud-

ulently during the Marcos regime. According to the petition, the agreements were void for being waivers of the Republic's right to repudiate void and fraudulently contracted loans. However, the Supreme Court denied the petition because "the Republic's right to repudiate the void and fraudulently contracted loans" is merely anticipatory.

Citizens' or Taxpayers' Assertion of Odiousness

In the absence of State action to raise claims against the odiousness of foreign debts, it is left to taxpayers and citizens to assert the odiousness of the debt from the Austrian loan in the domestic courts in order to advocate its non-enforceability. In Philippine jurisdiction, taxpayers' or citizens' suits have already been successful in gaining the nullification of government acts, laws or contracts for reason of being contrary to law, the constitution or public policy. One case in particular, that of *Oposa vs. Factoran*, GR No. 101083 30 July, 1993, appears as a precedent for any suit addressing the

problem of the environment, which is the underlying reason for the odiousness of the Philippine debt in favor of the Bank of Austria. In this case, the Supreme Court held that minors belonging to a generation can, for themselves, for others of their generation and for succeeding generations, file a class suit. This right to file on behalf of succeeding generations is based on the concept of intergenerational responsibility and the right to a balanced and healthful ecology. According to the Supreme Court, the right to a balanced and healthful ecology concerns nothing less than self-preservation and self-perpetuation, the advancement of which may even be said to predate all governments and constitutions. Furthermore, the Supreme Court declared that these basic rights need not even be written in the Constitution for they are assumed to exist from the inception of humankind. The right to a balanced and healthful ecology carries with it the correlative duty to refrain from impairing the environment.

1 USD 18 701 225 (exchange rate of 1 November 1996).

2 Contract Agreement between the Department of Health the Republic of the Philippines and Vamed Engineering for the Supply of Waste Disposal Facilities, Medical Equipment and Related Services for DOH Hospitals in the Republic of the Philippines, November 1967.

3 Austrian Project: Financing Offer by Bank of Austria AG for the Department of Health of the Republic of the Philippines presented by Vamed Engineering, February 1996.

4 *Supra*, note 2, see Preamble.

5 *Bad Medicine: The Austrian Medical Waste Project in the Philippines (A case of Toxic Technology Transfer, Greenpeace, June 2002)*.

6 Buyer Export Credit Facility for Specific Project.

7 *Supra*, note 5.

8 Section 20 of RA 8749.

9 *Supra*, note 5.

10 See Article 53 of the Vienna Convention on the Law on Treaties (1969).

11 Prof. Robert Howse, *The Concept of Odious Debt in Public International Law*, Discussion Paper No. 185 submitted to the United Nations Conference on Trade and Development, July 2007.

12 *Ibid*, at 3, citing Ninth Report on the Succession in Respect of Matters other than Treaties, 1977 Yearbook of the International Law Commission, Vol. 2 (Part 1), at 68 and 70.

13 Also known as the Stockholm Declaration.

14 Principle 6.

15 Paragraph No. 4 of the proclamation.

16 Principle 14.

17 *Supra* note 12, at 17.

18 *Ibid*, at 22.

19 *Supra*, note 6, at 11 to 12.

20 Walden Bello, *The Political Economy of Permanent Crisis in the Philippines*, 2004, at 10 to 12.

21 *Constantino vs. Cusia*, 472 SCRA 505.



9.2 The Case of Yacyretá

Maurizio De Martino

Introduction

This article deals with the complex affair surrounding the Yacyretá project and aims to discern indicia of odiousness and/or illegitimacy in the debt concerned, the nature of which is intricate and contentious. This inquiry will illustrate the facts that define the case in question and the points of law associated with the concept of odious and/or illegitimate debt, also examining these in light of more established parameters of legal theory.

Because the subject matter is complex, the factual circumstances that have emerged during the last thirty years are only provided here in summary form. For a more in-depth account, please read the ample documentation produced by both civil society and the World Bank (WB) and Inter-American Development Bank (IDB) Inspection Panels.¹

With respect to the investigation on the points of law, this article will concentrate mainly on two aspects: (a) the arguably odious and/or illegitimate debt between the two states, Argentina and Paraguay, and the international financial institutions involved; and, briefly, (b) the debt between the two states.

I. The Project

The Yacyretá dam and hydroelectric power station are part of one of the largest hydroelectric projects on the planet, embarked on by the states of Argentina and Paraguay to harness the water resources of the Paraná River on the cross-border river stretch of these two countries. The history of this multi-functional project stretches as far back as 1928, when the relevant feasibility studies were commissioned by Argentina's Dirección de Navegación y Puertos (Shipping and Ports Authority) from engineers Humberto Gamberale and Francisco Mermoz. Following these studies, in 1941, the Comisión Técnica Mixta (Mixed Technical Commission) was established, with the aim of determining what work needed to be done to improve regional river navigability and, in 1958, another commission was established to study the opportunities for exploitation of the water resources on the river stretch in question. A significant boost to the project then came in 1964, when the commission drew up a technical, economic and financial feasibility study, whose purpose was to obtain electricity in the area of the Yacyretá and the Apípe Islands. Subsequently, in 1971 the Harza-Lahmeyer y Asociados (Harza-Lahmeyer and Associates) consortium defined the location where the project would be implemented.

In August 1973, the constitution of a bilateral body was approved and in December Paraguayan President Alfredo Stroessner and Argentine Vice-President María Estela Martínez de Perón signed the Yacyretá Bilateral Treaty (hereinafter also “the

Treaty”). In December 1974, the Comisión Técnica Mixta transferred its functions and assets to the Entidad Binacional Yacyretá (Binational Yacyretá Entity) (hereinafter “EBY”), which was mandated to design, build and execute the project.

The EBY was composed of the Argentine company Agua y Energía (Water and Energy) and the Paraguayan company Administración Nacional de Electricidad (National Electricity Administration) (hereinafter “ANDE”). It derives its legal and regulatory authority from the Treaty, and in particular from the *Notas Reversales*² (diplomatic instruments associated with the Treaty), which govern the application, interpretation and execution of the Treaty.

In 1983 it became possible for EBY to outsource the *Contratos de Obras Civiles Principales* (Main Civil Engineering Works Contracts) when EBY announced the signing of a USD 1.4 billion contract for the civil engineering works assigned to the Eriday-Ute consortium (Empresas Reunidas Impregilo Dumez y Asociados para Yacyretá-Unión Transitoria de Empresas (Impregilo-Dumez United Companies and Associates for Yacyretá Joint Venture)), which was awarded the contract a full seven years after the start of the bidding process.

The hydroelectric complex in question and the energy produced are property of both states. The civil engineering works were completed in 1994, with the reservoir 76m above sea level (m.a.s.l.) and total planned capacity at 2,700 MGW.

Regarding the financial context, it is worth quoting a September 2004 interview with then-U.S. Senator Richard Lugar,³ who stated, “the Yacyretá Dam project was budgeted to cost USD 2 billion when it began in 1973, now has a debt of USD 10 billion and is still not completed.” The original cost of the project increased remarkably, to say the least, considering that its current cost would amount to almost USD 15 billion; 60 percent of this (financed by the Argentine Treasury) corresponds to the cost of the works and the rest is attributable to capitalised interests. The WB and IDB part-financed the project for an amount equal to USD 1.7 billion.^{4 5} Argentina has calculated that Paraguay owes it USD 11 billion for Yacyretá, with interest.⁶

In relations between the two states, it has been agreed that Paraguay provide 50 percent of the aforesaid hydroelectric power station's energy-generating capacity to Argentina for the latter's internal needs, following a financial tariff arrangement established by the Treaty on an annual basis. The tariff, calculated in GWH, is the ratio of all annual production costs, offsets established by the Treaty, plus the principal and interests on the debt in question. Once the debt is paid off by Paraguay, the tariff shall only include the opera-





The Yacyretá Hydroelectric Dam at the Paraná River, which runs along the Argentine-Paraguayan border. Picture: Gateway to South America

tional costs and treaty surcharges, thus excluding the costs of the original debt.

To give a historical perspective, and for the purpose of better connecting the case in question to the inquiry on the debt's odiousness and/or illegitimacy, it is worth remembering that the design, construction and management of the project in question were undertaken during a period of military dictatorships both in Argentina (under Gen. Jorge Rafael Videla from 24 March 1976)⁷ and in Paraguay (under Alfredo Stroessner).⁸

II. Factual Grounds

Twenty years after the treaty was signed, when EBY completed works on the dam's structure with the installation of the first turbine and electrical generator, there occurred a rise in the level of the Paraná River, flooding a large swathe of neighbouring rural areas. Many communities inhabiting the area were forced to evacuate and were relocated elsewhere, following a summary, and inadequate, expropriation procedure.

"To illustrate the damage suffered by the communities involved, it is worthwhile to reproduce here a few extracts from the charges drawn up by civil society⁹ against the government of Paraguay, submitted before the Inter-American Commission on Human Rights in Washington D.C.:

"It will be appreciated that this is a dam which, on the Paraguayan side directly affects 9 River Paraná coastal towns, giving an idea of the magnitude of the project. It should also be noted that those directly affected number 80 000 individuals. The area, currently flooded at 76 m.a.s.l., measures 52 600 hectares, and at 83 m.a.s.l., the area affected by the final upper level of the dam will be 107 600 flooded hectares. This means that, currently operating at the level of 76 m.a.s.l., the dam has only affected 50% of the areas it is eventually to flood, with over 55 000 hectares still to be compensated and expropriated."

The cause of the damage incurred by the population appears to be attributable to a lack of diligence among the key players in the project, who carried out the social and environmental impact assessments in an utterly deficient and inadequate manner in light of the delicate situation on the ground. In particular, this article refers here to the Plan de Acción Social (Social Action Plan) (hereinafter "PAS"), which was devised *ab origine* to reduce to a minimum those potentially negative effects of the "relocation" of the population involved, but was later found to be deficient in fulfilling its intended purpose.¹⁰ Subsequently, to increase the scope of the (obviously insufficient) PAS, a new Programa de Medio Ambiente y Reasentamiento (Environment and Resettlement Programme) was devised in 1992. It was designed to consolidate the Plan de Manejo Ambiental (PMMA or Environmental Management Programme) and the Plan de Acción para el Reasentamiento y Rehabilitación (PARR or Action Plan for Resettlement and Rehabilitation). In every case the results fell utterly short of the mark, as verified by the both the WB and IDB Inspection Panels.

In 1996, the WB Inspection Panel (hereinafter also “the Panel”) received a first inspection request concerning the Yacyretá project. According to it, part of the activities contemplated before the basin was flooded, in terms of social and environmental protection, had not yet been carried out, but this request was not pursued. In 2002, the WB Inspection Panel received a second request for inspection from a number of communities involved in completing the Yacyretá project, Federación de Asociaciones y Organizaciones de Afectados por Yacyretá de Itapúa y Misiones (Federation of Associations and Organizations of those Affected by Yacyretá) (hereinafter “FEDAYIM”), which argued that raising the level of the basin to seventy-six metres above sea level caused dramatic environmental, economic and social impacts. In these circumstances the Panel was authorised to proceed with the investigation.

In 2002, the representatives of FEDAYIM once again requested an investigation on the part of the Independent Investigative Mechanism (hereinafter “IIM”). The IDB, in September 2002, authorised this independent investigation by the Panel on the basis that new elements had emerged that were different to those brought to the attention of the WB in 1997.¹¹

At the conclusion of the proceedings, both investigative mechanisms to a large extent confirmed the claimants’ grievances; they ascertained the grave damages that the project had caused in environmental, social and economic terms and concluded that the financial institutions in question had failed in fulfilling their responsibilities, especially with respect to their monitoring role.¹²

III. Legal Grounds for Defining Odious Debt

It should be pointed out here that this case involves foreign national debt with a multilateral aspect. Thus, there are debtor states (or bodies guaranteed by states) on the one hand, and multilateral players, such as the WB, on the other hand.

Before discussing the merits of the case at hand and assessing whether the debt is odious or not, it should be made clear that the odious debt category exists predominantly in the realm of legal theory and is not mirrored by structured and developed case law that can enable a strict evaluation of applicable criteria.

Wishing to adhere mainly to the legal reasoning of the Russian lawyer Alexander Sack, who conceived of the concept of odious debt, this article will identify the three defining requisites of odious debt outlined by Sack:

- 1) Whether the debt was incurred by a despotic or dictatorial regime for the purpose of strengthening its own power;
- 2) Whether the debt was incurred in the interest of the people or to the people’s detriment, and/or to benefit the personal interests of the leaders involved; and
- 3) Whether the creditor was aware or able to understand the odious character of the legal transaction in question.¹³

Nevertheless, even when adhering to Sack’s doc-

trine, the aforementioned three requisites do not easily allow one to establish if a debt is odious because, for example, they do not clearly define: (1) when precisely a loan’s effects should be considered beneficial or detrimental to a nation; (2) what standards can be used to establish whether a creditor is aware of the odious purposes of the loan; and, lastly, (3) what level of consensus is needed to determine that a loan is virtuous. Hence, to establish whether a debt is odious, a case-by-case inquiry is necessary.

Conversely, if, as some jurists suggest, the sole requirement for qualifying a debt as odious is that the debt was made to a dictatorial regime, the answer to the previous questions would be irrelevant.¹⁴ Under this definition of odious debt, investigating how the loan was actually used becomes less decisive for the purpose of qualifying the debt as odious. The loan could then be defined as odious only because it financially supported a dictatorial regime *tout court* for the purpose of consolidating the regime and in some way enabling its continuity, or, under the principle of the fungibility of debts, when a dictatorial government becomes indebted for purposes that are beneficial to the population, but thus liberates funds for ends necessary to maintaining the status quo or for ends that are not easily traceable.

If this article adhered to the latter theory in evaluating the case at hand, further inquiry would be pointless, as the debt in question would be odious *ex se*. This article, however, will not adhere to the latter definition and will instead follow the outline proposed by Sack. Below is an analysis of the applicability of Sack’s three requisites to the instant case.

A. Should the Debt to the WB and IDB be Considered Odious?

1. Incurred by a Dictatorial Regime

Several of the legal transactions for the Yacyretá project were performed by dictatorial and authoritarian regimes in Paraguay and Argentina, with the exception of a short period of apparent democracy in Argentina in the 1970s.¹⁵ (To understand the effects of the historical periods concerned, I recommend reading the investigations conducted by the Inter-American Commission on Human Rights [IACHR])¹⁶

It can be presumed that the project aimed to consolidate the respective regimes. With respect to the Stroessner regime in Paraguay, in particular, the IACHR report provides ample information on the corruption extant during the regime’s rule. Within such a system of rampant corruption, the line between a state debt and a “personal” debt becomes almost unintelligible.

2. Lack of Benefits for the National Population

With regard to the lack of benefits for the national population involved, the following aspects should be highlighted:

- a) *Human rights violations suffered by the communities involved.* Progress has been made in interna-

tional law since the first theorization of odious debt. This progress has led some jurists to categorize as odious all debts incurred by governments that violate the human rights enshrined in the Charter of the United Nations and the Universal Declaration of Human rights and in the 1966 Covenant on Economic, Social and Cultural Rights. With respect to this, it is interesting to recount the proposal formulated by Mohamed Bedjaoui in relation to the 1983 Vienna Convention on Succession of States in respect of State Property, Archives and Debts:¹⁷ “From the point of view of the international community, all debts could be qualified as odious when not in conformity with contemporary international law, and more particularly with the principles of international law incorporated in the Charter of the United Nations.”¹⁸

In the event of a forced eviction due to an infrastructure development project, as in the case of Yacyretá, which contemplates land expropriation programmes and thus large-scale relocation and resettlement, a “complex form of human rights violation” may emerge, wherein the execution of these programmes becomes illegal. This would be in keeping with the holding of the Inter-American Court of Human Rights in the Velásquez Rodríguez case¹⁹ and also with the position of the United Nations Commission on Human Rights, which has in such cases spoken of “gross and systematic violations of fundamental internationally recognized human rights.”²⁰

- b) *Flawed execution of the project.* The flawed execution of projects, especially in terms of their damaging social and environmental impacts, as has been noted by the WB and IDB inspection mechanisms in the instant case.
- c) *Duration of the project.* The Yacyretá project was completed approximately ten years behind schedule.
- d) *Excessive cost of the project.* As mentioned above, the cost of the project went from the originally budgeted USD 2 billion to almost USD 15 billion. This high cost was detrimental to the citizens of both states, which were forced to pay unjustified project costs.

The excessive cost and excessive duration of the project are tightly correlated elements; it suffices to recall that the interest on the amounts necessary for execution accrues on an annual basis, meaning, naturally, that the more years pass the more interest accrues. Moreover, it is calculated at a rate of 6 percent, aside from recapitalization. According to a report by ECES, Ciencias económicas y sociales (Social and Economic Sciences), the amount attributable to interest accrued is approximately USD 700 million a year.

As if all of this was not enough, it should likewise be noted that, even if the original aim of the multi-function project was to produce electrical energy, a service of interest to the communities in question, such a “requirement” bypassed prudent forecasting and management of conflicts and of the damage that was suffered by people and the environment. The responsibility of the players is further aggra-

vated when one considers that alternative energy sources may have existed; a 1996 WB report indicated that possible alternatives for energy production were entirely ignored. The report refers in particular to the existence of ample natural gas reserves in the Salta region, discovered before the beginning of work on the dam.²¹ Moreover, Argentina’s energy needs were, at the time of the events in question, deliberately overestimated.

In sum, the project has not provided the population with the advantages contemplated but rather has caused damage to the communities involved, which have seen multiple and ongoing violations of basic human rights.

3. Creditor Awareness of the Purpose of the Loan in Question

The investigative proceedings of the WB and IDB mechanisms are useful because, by assuming the role of fact-finding body, these institutions have enabled advocates to compile information regarding due diligence and the careful assessment of creditworthiness, or lack thereof, which could have enabled creditors to forecast the negative consequences the project would cause.

Moreover, the Panels’ recommendations would have enabled the management of the credit institutions to intervene during the execution of the project, even for the purpose of taking remedial action during the course of operations (via efficient Action Plans), and to thus mitigate the negative effects caused by the Yacyretá project. Presumptively, it is improbable that such multilateral institutions did not consider the existence of dictatorial regimes with all of their obvious consequences in the countries in question. In fact, it should be added that, with respect to the project in question, in its report the WB Inspection Panel invited WB management to provide a higher level of supervision than usual regarding the corruption question.

Finally, if one takes a look at prior relations between the aforementioned financial institutions and several previously existing dictatorial regimes (for example in Chile, Romania and Nicaragua), one may observe that the WB did not hesitate to provide these regimes with financing. The decision to provide financing was made not so much for want of expertise, but due to choices that have been illustrated by the authors of the UNDP 1994 Human Development Report, which asserted that “Multilateral donors [...] seem to prefer martial law regimes, quietly assuming that such regimes will promote political stability and improve economic management. After Bangladesh and the Philippines lifted martial law, their shares in the total loans given by the World Bank declined.”

In light of the above, and adhering to the theory of odious debt as traditionally conceived, the debt in question appears to contain elements that merit defining it as odious.

IV. Illegitimacy of the Debt

According to some jurists and advocates, in current international law odious debt theories cannot rise to the rank of doctrine, or at least certain key

elements of the doctrine must still be clarified. As a result, even proponents of the odious debt doctrine hesitate to define it as a new “general and consistent practice of states,” especially considering that no international or domestic court has ever identified the odiousness of a debt as a legal basis for declaring an obligation by a sovereign state null and void.

The complexity of the case at hand does not help put advocates in a position where they can unquestioningly refer to the general category of odious debt (given, moreover, the non-bilateral nature of the debt in question). Thus, in this article, I shall also refer to general principles of law recognised by civilised nations and considered sources of international law²² to assess whether the debt in question may be characterised as illegitimate. Below, this article will identify a few such principles applicable to the case at hand, namely corruption, good faith, clean hands, and gross disparity.

Corruption is a practice condemned by the entire international community, as is made clear in all of the main public international law treaties. In the case at hand, corruption acquires particular importance because it enabled a non-democratic regime to profit from its own dominant position without providing any benefit to the population from a debt incurred in the name of the state.

Furthermore, the results of the investigations undertaken by both the WB and IDB Panels could constitute, whether at the preparatory stages of the project or in the outcome (in forecasting the aforesaid resettlement programme), a veritable charge that the duty of good faith was violated, given that the financing bodies had awareness, even though not clearly expressed, of the military dictatorships existing in both countries. Such knowledge could have forecast the fateful effects that the project brought about.

Good faith should furthermore be read jointly with the Anglo-Saxon clean hands principle, according to which any party who so much as requests credit must come to such a request with clean hands, that is to say, being aware of having entirely fulfilled its own role as a contracting party and, especially, fulfilling the criteria of good faith. This principle, it should be noted, has been recognised in jurisprudence.²³ A case in which corruption is suspected when the contractual relationship from which the debt originated is formed (such suspicion must emerge where governments are recognised as dictatorial regimes) could constitute a case where the aforementioned principle can be invoked fruitfully.

Inasmuch as it constitutes one of the fundamental pillars of the general principles of international law, good faith can be invoked in cases of illegitimate debt and must govern the preparatory, conclusive, and interpretative phases of every contract, on the basis of the classic brocard, *pacta sunt servanda*. Good faith is emphasised by all courts, be they national or supranational, and constitutes a fundamental pillar on which the UNIDROIT principles are based. It should not only be considered in the case of a violation by one of the signatories to an agreement, rather it should govern

the behaviour of both parties, such that it may be invoked even in the case of co-responsibility.

Lastly, the case at hand can also be approached from the point of view of gross disparity, that is the disparity between services forming the basis for the signing of the contract. When the debt contract is signed in a manner contrary to morality, i.e. liable to condemnation by a large part of international public law doctrine, the debt may be found to be illegitimate.

In light of the foregoing general legal principles, it appears that some indicia of debt illegitimacy may be invoked in the case at hand, with all of the attendant consequences.

A. Illegitimate Elements in the Relationship between Argentina and Paraguay

Paraguay's particular geographic position has made it a privileged partner for both Brazil and Argentina. Because it possesses one of the Southern Cone's most significant hydroelectric reserves, Brazil and Argentina have, via bilateral treaties, built the Itapúa and Yacyretá hydroelectric power plants, assuming almost the full cost of financing. Paraguay, however, does not seem to have received the benefits it expected from past transactions. Hence, one of the priorities set forth by Paraguayan President Lugo has been to recover hydroelectric sovereignty, or, perhaps, to eliminate the disproportion in benefits within the legal relationship at issue through a renegotiation of the related contracts.²⁴

Although the matter warrants a more in-depth examination, certain aspects of the long-standing affair will be described here, so as to extract any evidence of illegitimacy in the debt that Paraguay has towards the Argentine Treasury, specifically the scope and effects deriving from the 1973 Treaty and the 1992 Notas Reversales, which governed the financial aspects of the Yacyretá project.

The Yacyretá hydroelectric power station generates 15 percent of the Sistema Interconectado Argentino (Interconnected System of Argentina). Argentina avails itself of 50 percent of the energy strictly allocated to it while it draws the remaining 50 percent from Paraguay's production quota share, which the latter cedes almost entirely to Argentina (with the exception of 1 percent) at a pre-established tariff that is not in keeping with the market price. It follows that Paraguay is not free to fully avail itself of the energy source in question.

The tariff was determined through the 1992 Notas Reversales at USD 0.03 per KWH to be calculated from the start date of energy generation until 2048, a figure which is updated on the basis of the provisions of Chart 2 of Annex 3 of the Treaty (currently it appears to have been revalued at USD 0.04 per KWH).

Nevertheless, it is established in the Nota Reversal in question that from the first instance of energy generation and for the subsequent ten years, the tariff is fixed at USD 0.00175 per KWH, as “payment on account corresponding to compensation for transfer of energy, compensation by reason of flooded territory, damages and income.”

In substance, EBY's debt (and Paraguay's, for its share) with the Argentine Treasury will be wiped out gradually with the "sale" of energy at the pre-established price.

Over the last few years, however, the financial statements deriving from what is governed by the *Notas Reversales* has seen a rise in disputes among the contracting parties. The Paraguayan Ministry of Foreign Affairs has questioned the effectiveness and validity of the 9 January 1992 *Notas Reversales*, because the latter, according to Paraguay's representative bodies, did not go through the appropriate ratification process during voting on the matter in 1995. The Foreign Ministry's representative, as reported by the press on 27 December 2008, presented a report on the management of the hydroelectric power station and concurrently proposed the convening of a round table to discuss the effectiveness and legal validity of the *Notas Reversales* in question.

The Argentine state asserts that the 1992 *Notas Reversales* are to be considered in force, given that an ambassador extraordinary and plenipotentiary signed them, such that Article 7 of the 1969 Vienna Convention on the Law of Treaties might be invoked.²⁵ It is therefore unclear whether the agreement referred to in the *Notas Reversales* has been through a proper ratification process.

At the same time, it is necessary to recall that the Yacyretá Treaty was ratified by Law n. 443 of December 1973 in Paraguay, under the provisions of Article 180, Section 6 of the Constitution of the Republic of Paraguay. By means of this legislative act, were also ratified the Treaty's annexes or *adenda* (among them, one recorded with a letter C, entitled, *Bases financieras y de prestación de los servicios de electricidad de Yacyretá* (Financial and Performance Basis for Yacyretá Electricity Services) and other *Notas Reversales*. Furthermore, the same process was adopted for successive, additional protocols and associated deeds. This same process did not occur or cannot be considered to have been properly completed for the 1992 *Notas*. It would appear of interest here to recall the provisions of Article 44, Section 3 of the 1969 Vienna Convention, which contemplates the "Separability of treaty provisions" and, thus, invalidating, terminating, or suspending a single clause of the treaty, only where conditions mentioned therein prevail.

With reference to the provisions of the aforementioned Vienna Convention, other sections characterising the case at hand may be examined (not exhaustively) to determine how respective grievances may be arbitrated. In fact, Argentina should have the right to invoke Article 26 (*pacta sunt servanda*) and possibly Article 45 (acceptance) of the Convention, whereas Paraguay, could, in turn, request suspension under the provisions of Article 60, Section 3, Letter B, of the same Convention, where "the violation of a provision essential to the accomplishment of the object or purpose of the treaty" occurs.

Article 60 contains the principle *inadimplenti non est adimplendum* (on the necessarily mutual nature of obligations) and, thus, theoretically, is ap-

propriate for discerning potential non-fulfilment scenarios committed by one or the other contracting party, and the occurrence of circumstances that may have arisen and modified the contractual balance:

a) *Error in accounting for costs by EBY*. In particular the head of the Oficina de verificación general del Paraguay (Office of General Verification of Paraguay) has asserted that approximately USD 2 billion in costs invested in this project may not have been supported with "the necessary legal and administrative documents."²⁶ The result would appear to be that the economic aspects of the Treaty might need reconsideration to ascertain grave irregularities or breaches by one of the contracting parties, and/or potential unjust enrichment.

b) *The excessive cost of the project, and the resulting financial burden of accumulated interest, which has also been due to the slowness of work*. Under certain laws, in such a case rescission could be invoked due to the excessive cost of the contractual provisions still to be fulfilled.²⁷

c) *The price of the energy sold by EBY to the Argentine state*. It would be necessary to establish, via a third party, whether the price of energy is in fact in line with market prices and, in any case, equal respect for the rights in the contract in question. Furthermore, to evaluate the presence or lack of good faith by the parties, it would be useful to draw on what emerged from an *interpelación legislativa* (legislative interpellation), Resolution n. 371, with requests for clarification to an EBY representative. From this report it emerges that the Argentine companies acquire energy from EBY at a lower price compared to that set out in the *Notas Reversales*, by virtue of subsidies that the Argentine government grants said businesses.

d) *Exacting interest on the part of Argentina*. Contrary to the provisions of the Treaty and the 1992 *Notas Reversales*, it appears that as of the signature of the 1992 *Notas Reversales*, Paraguay has also been paying interest, according to certain sources, at exorbitant rates,²⁸ calculated in accordance with rates in force in the 1980s.

e) *The limited right Paraguay enjoys to exploiting energy resources*. The circumstances that have arisen have failed to put into practice what is established in the Yacyretá Treaty, where Article 13 establishes that "[t]he energy produced for hydroelectric use referred to in Article I shall be divided into equal parts between the two countries, each being granted preferential acquisition rights for the energy that is not used by the other country for its own consumption."

One might infer from the above reference that the states preserve their sovereignty in all that concerns the exploitation of their own natural resources. This guideline rests on United Nations General Assembly pronouncements²⁹ from which one may conclude that states are free to bind themselves in matters related to the exploitation of natural resources, and nevertheless preserve the right to release themselves from related obligations where circumstances arise that require this for the sake of the public interest.

f) *Corruption*. Without entering into the details of any potential criminal proceedings, it would not seem defamatory to recount how the entire Yacyretá project has been characterised as a “monument to corruption.”³⁰ The legal effects of corruption are multiple and recognised under general principles of law cited above, in particular with reference to Article 50 of the Vienna Convention.³¹

Nonetheless, the possibility of putting the *indicia* developed heretofore into a *thema decidendum* (that is, an object and parameter of review) could be significantly weakened if the debt swap for which a pre-agreement was reached between the Kirchner Presidency (Argentina) and Nicanor Duarte Frutos (Paraguay) and announced on 19 December 2006, came into force for all legal purposes.

The debt swap agreement was supposed to have entered into force in 2007 and established “the exchange of debt for 11,000 million dollars for 8,000 gigawatts of energy per year for 40 years,” following passage in the respective Parliaments (which occurred for Argentina and not for Paraguay). If this agreement were ratified by the Parliament of Paraguay, a novation in the legal relationship in question would occur, resulting in the substitution of the previous obligation with that borne of the new relationship.

All in all, the long-standing Yacyretá project has many critical issues³² of a legal nature; nevertheless, rescission can only occur with political will from both countries.

With respect to these issues, the role of EBY is hardly useful, especially when one considers its peculiar nature, which *de facto* entails placing limitations on the sovereignty of the weaker contracting state. In fact, EBY has been able to avoid efficient and necessary checks, including from those who are not only empowered to carry them out, but also entitled to do so. This circumstance is connected to the constitution of the *fuero binacional* (bilateral venue), as established in the treaty. On this matter, it suffices to recall that Law 1161 was proposed in the Paraguayan Congreso Nacional (parliament) in 1997, aiming specifically to bring an end to the *fuero binacional*. This law obliged the ANDE (Paraguayan counterpart to EBY) to request from the bilateral bodies all technical, financial, economic and legal documentation related to the management of the project and to answer directly to the Congreso Nacional in matters pertaining to requests for “reports concerning the bilateral bodies,” which were then to be assessed by the Contraloría General de la República. Nevertheless, Law 1161 was filed away for fear of an appeal on grounds of unconstitutionality.

1 See generally *Sobrevivencia*, <http://www.sobrevivencia.org>; *International Rivers*, <http://www.internationalrivers.org>; *Yacyretá.INFO*, <http://yacyreta.info/www>; The Inspection Panel, <http://www.inspectionpanel.org>.

2 *Notas Reversales* between the then-Ambassador of Paraguay, Dido Florentin Bogado, and the Argentinian Minister of Foreign and Cultural Affairs, Guido di Tella, January 1992 (copy on file with author).

3 See *La Republica*, www.republica.it/.../048acq40948.html.

4 The WB part-financed this project with a series of loans: Argentina Yacyretá Hydroelectric Project (Loan 1761-AR, 1979, USD 250 million), Argentina Electric Power Sector I Project (Loan 2998-AR, 1988, USD 250 million), Argentina Second Yacyretá Hydroelectric Project (Loan 3520-AR, 1992, USD 300 million), Argentina SEGBA V Power Distribution Project (Loan 2854-AR, as modified in 1994, USD 138 million), Paraguay Reform Project for Water and Telecommunications Sector (Loan 3842-PA, 1995, USD 46,500,000).

The IDB part-financed the Yacyretá project with the following loans: Loans 346/OC-RG (USD 210 million), 555/OC-RG (USD 250 million) and 583/OC-RG (USD 250 million), today fully disbursed for the construction of the main electromechanical works. A further loan (760/OC-RG, USD 130 million) was granted for a project associated with environmental protection and the “resettlement” programme.

5 The Japanese and US Ex-Im Banks have contributed about USD 1 billion, Canada’s Export Development Corporation lent CAD 86.4 million (USD 72.9 million) in 1987 to purchase four hydroelectric turbines from Canadian General Electric.

6 In 2006, amid concerns about energy shortages in Argentina, President Nestor Kirchner vowed to study the feasibility of finishing the works by 2008. A few months later, the governments of Paraguay and Argentina reached an agreement to cancel Paraguay’s debt of USD 11 billion by having smaller countries supply Argentina with 8,000 GWH per year during forty years in exchange. See the last part of this article.

7 Videla imposed martial law. Under his dictatorship thousands

of opponents to the regime were illegally imprisoned, tortured, and executed. What became known as the Dirty War began. The consequences of these violations of human rights were: 2,300 political murders, over 10,000 politically-motivated arrests, and the “disappearance” of 30,000 people.

8 In 1954, Stroessner overthrew President Federico Chávez through a coup d’état, with the support of the Partido Colorado, the army and major landowners. He then brought about a dictatorial regime, banning any kind of political and social dissent and submitting the press to an extremely rigid form of censorship. His deference to U.S. multinationals and the Brazilian coffee oligarchy (to whom he went as far as selling border land, in breach of his own country’s laws) ensured him a constant flow of foreign capital, which he used together with the proceeds of smuggling (which Stroessner himself called “the price of peace”) to feed a vast system of corruption and ensure loyalty from the army.

9 Plaintiffs: Jorge Olegario Urusoff, Organización No Gubernamental Tayí (Tayí NGO), FEDAYIM NGO (Federación de Asociaciones y Organizaciones de Afectados por la Represa de Yacyretá de Itapúa y Misiones), all from the town of Encarnación, Itapúa Department, Republic of Paraguay.

10 The plan contemplated: (a) achieving a functionally efficient resettlement of the population residing in the affected areas; (b) minimising the potentially negative impacts of relocation; (c) bringing about favourable conditions for the independent development of the new settlements, as well as harmonious integration with their respective surroundings.

11 Below, by way of example, follow some extracts from the claims submitted by FEDAYIM:

a. The houses along the bank of the 4 settlements in Encarnación flood every time it rains. The floods are linked – according to a causal nexus – to the dam. The people living in these areas are many.

b. Many houses of the families living along the urban settlements, between level 76 and level 83, are regularly flooded after rains, and haven’t received any assistance from the EBY.

- c. Many families have not been compensated for damage suffered due to repeated flooding even though they had lived in these houses since 1980.
- d. Some houses and lots in Villa Candida have been damaged by the flood coming from the Potiy Stream. The flood is causally related to the dam. EBY has acknowledged the damage but makes the compensation conditional on the completion of the project.
- e. In Encarnación and in the communities built by EBY or with EBY's support, the wells are contaminated. WB personnel have been negligent in not promptly identifying violations of environmental policies on the part of the IDB.

12 World Bank Inspection Panel – elements of responsibility identified:

Environmental Compliance:

The environmental assessment finally arranged in 2003 by EBY consultants, following invitation from the WB, has proven to be significantly lacking as far as environmental themes tied to the project are concerned. Failure to comply with OD 4.01. The environmental assessment for the second phase of the Yacyretá project has shown to be inadequate in terms of consideration for urban and semi-urban environmental problems. The management did not comply with OP 4.01. The Panel notes that that no conflict resolution mechanism has been contemplated, thus again constituting a violation of OD 4.30.

The Panel holds that OD 4.30 has been breached by the WB also in regards to the failure to inform and consult with the populations involved in rebuilding the relocation settlements. The Panel considers that the WB has violated OD 4.30 inasmuch as it did not ensure that EBY considered alternative resettlement options. Furthermore, it considered the measures aimed at re-establishing income and savings among the individuals concerned inadequate. The Panel notes that monitoring of the Resettlement on the part of the WB has been inadequate with regards to two aspects: 1. In not having monitored quality in the design, construction and implementation of the resettlement programmes; 2. In the inadequate consultation with the population concerned, in violation of paragraph 29 of OD 13.05. The Panel invites the WB to prepare monitoring that is qualitatively better than usual with regards to the corruption question.

Inter-American Development Bank Panel:

The cause of the floods of the urban inlets is indirectly tied to the construction of the dam and directly connected to the Yacyretá Project as a whole. The increase in population density in the areas surrounding the project had not been forecast, in the Panel's opinion because of negligence in administration. An adequate urban, social and environmental impact assessment would have prevented the various aforementioned critical factors. There was no active participation on the part of the population involved. Clear participatory mechanisms should have been contemplated to jointly establish any solutions for resettlement. Loan 760/OC-RG aimed at the execution of the Plan Maestro de Manejo Ambiental (PMMA - Global Environmental Management System) and the Plan de Acción de Reasentamiento y Rehabilitación (PARR- Action Plan for Resettlement and Rehabilitation), aiming to improve environmental and living conditions for the populations involved. The Panel holds that said aim was not achieved. Among the various recommendations issued by the two mechanisms at hand, it is interesting to point out the following: (1) "That the IDB take into consideration the non-fulfilment of policies by EBY with a view to stimulating the latter to comply with established rules"; and (2) "That EBY and the Paraguayan Government improve their 'diplomatic' relations."

- 13 It is considered that another requirement exists: the presence of an expression of popular consent. This latter standard was introduced by a current of legal doctrine that is closer to Sack, under jurist Jeff King and the Centre for International Sustainable Development Law at McGill University in Canada.
- 14 "Much of this renewed interest in odious debt enlists the terminology, but not the actual content, of the conventional doctrine. An odious debt, à la Alexander Sack, called for a loan-by-loan analysis. Some of the recent commentators are prepared to assume that all odious regimes behave odiously all the time and therefore all of their debts must be odious. The emphasis is thus placed on the odious nature of the

regime, not on the circumstances surrounding each loan. All loans to a dictatorial regime are thus presumptively odious and liable to repudiation if the regime collapses." Buchheit, Gulati & Thompson, *The Dilemma of Odious Debts*, 56 *DUKE LAW JOURNAL* 1201, 1222 (2007).

- 15 The last military dictatorship in Argentina ended in 1983.
- 16 IACHR, Country Reports, Paraguay 1987 and 2001, Argentina 1980, available at <http://www.IACHR.oas.org>.
- 17 See generally Committee for the Abolition of Third World Debt, <http://www.cadtm.org>.
- 18 This proposal by Mohamed Bejaoui did not become part of the convention and the convention has not been ratified up to now.
- 19 Velásquez Rodríguez Case, Inter-Am.Ct.H.R., Judgment 29.6.1988 (Ser.C) n. 4. paras. 150 and 158.
- 20 UNHCR, Forced Evictions and Human Rights, Fact Sheet No. 25, May 2006, available at <http://www.unhcr.org/refworld/ca/tegoria/REFERENCE,OHCHR,,479477435,0.html>.
- 21 "[T]he combined-cycle gas alternative looked better technically and economically in the face of uncertain demand since it could be implemented in small increments closely matched to demand." WB, 1996, at 14; "By 1982, the actual demand for electricity was already lagging 25 percent behind the original forecast, and there was no sign of a swift demand recovery. There was no longer the same urgency to build Yacyretá." Id. at 14 and 16.
- 22 Statute of the International Court of Justice, Article 38.
- 23 See *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, 2 August 2006 (ICSID Case No. ARB/03/26).
- 24 See Cécile Lamarque, *Fernando Lugo y los desafíos de Paraguay*, 13 June 2008, available at <http://www.cadtm.org>.
- 25 Vienna Convention on the Law of Treaties, Article 7, provides: 1. A person is considered as representing a State for the purpose of adopting or authenticating the text of a treaty or for the purpose of expressing the consent of the State to be bound by a treaty if: (a) he produces appropriate full powers; or (b) it appears from the practice of the States concerned or from other circumstances that their intention was to consider that person as representing the State for such purposes and to dispense with full powers. 2. In virtue of their functions and without having to produce full powers, the following are considered as representing their State: (a) Heads of State, Heads of Government and Ministers for Foreign Affairs, for the purpose of performing all acts relating to the conclusion of a treaty; (b) heads of diplomatic missions, for the purpose of adopting the text of a treaty between the accrediting State and the State to which they are accredited; (c) representatives accredited by States to an international conference or to an international organization or one of its organs, for the purpose of adopting the text of a treaty in that conference, organization or organ.
- 26 See *Les Amis de la Terre*, http://www.amisdelaterre.be/article.php3?id_article=108; Transparency International, <http://www.transparency.org>, 2005 report.
- 27 According to Article 1467 of the Italian Civil Code: "In contracts for continuous or periodic performance or for deferred performance, if extraordinary and unforeseeable events make the performance exceedingly burdensome, the party who owes such performance can demand a dissolution of the contract, on the grounds that it has become exceedingly burdensome."
- 28 Interpelación legislativa, Resolución n. 371.
- 29 Resolución n. 1803 (XVII) of 14 December 1962; Resolución n. 3021 of 1974 (Declaration on the Establishment of a New Economic Order); Resolución n. 3281 (XXIX) of 12 December 1974, Charter of Economics Rights and Duties of State.
- 30 Yacyretá, otra vez bajo sospecha de corrupción, *CLARIN*, 22 May 2005, available at <http://www.clarin.com/suplementos/zona/2005/05/22/z-980988.htm>.
- 31 Vienna Convention, Article 50: "If the expression of a State's consent to be bound by a treaty has been procured through the corruption of its representative directly or indirectly by another negotiating State, the State may invoke such corruption as invalidating its consent to be bound by the treaty."
- 32 One critical issue is the scant transparency in all operations, and, in particular, in the underlying documentation, access to which is a source of friction between the two states.



9.3 The Inga Dam Debt in The Democratic Republic of the Congo

Eve Tessera and Renaud Vivien
with contributions by Elena Marquez and José Mukadi

Introduction

This study concerns the most well-known of the “white elephants” in the Democratic Republic of the Congo (DRC):¹ the Inga dams built during the Mobutu regime (1965 to 1997). Thanks to the Congo River these dams offered exceptional hydroelectric features and promised the capacity to provide electricity to a large part of the population of the DRC. Despite the enormous hopes raised, however, the Inga dams revealed themselves to be a vast financial black hole, detrimental to the Congolese population. While only six percent of the Congolese population today has access to electricity, the financing for these dams has generated enormous foreign public debt, the repayment of which weighs on the DRC’s budget and burdens its future. Responsibility for this terrible failure rests on several players: the Mobutu regime, obviously, but also foreign research departments, lenders, and concessionaires.

I. The Inga Dam: Chronicle of a Failure Foretold

The Inga hydro-electrical dam is situated in the DRC, on the Congo River, in the Lower Congo province, near the town of Matadi. This dam, given its exceptional hydraulic features, offered the possibility of supplying a large amount of electricity to the DRC’s industry and its population.

A. Feasibility Studies

In October 1963, a memorandum of understanding was signed between the Société italo-Congolaise de développement industriel² (SICAI) and the Congolese government, which entrusted the SICAI with the task of studying the necessary economic conditions for the construction of the first plant for the Inga dam, planned to possess a capacity of 300MW.

SICAI prioritised the establishment of an iron plant expected to give rise to a series of associated businesses over the installation of export-based alumina industries favored by the then European Economic Community (EEC). It was the opinion of SICAI that was favoured by international institutions, namely the United Nations Economic Commission for Africa (ECA) and the United Nations Special Fund.³

B. Building the Inga I and II Projects and Associated Industries

The first Inga power plant, equipped with six turbines each having a capacity of 50MW, entered service in 1972. Simultaneously, several associated industrial projects were built to justify the gigantic dam. These projects, however, were serious failures in every case and brought significant economic consequences. For example, the Maluku

iron plant was set up on 28 March 1972 to process iron ore from Banalia. The functioning of the plant, however, was disastrous and ruinous, in particular because it produced products that were not competitive and were inappropriate in relationship to existing demands. The factory only worked at 10 percent capacity until its failure in 1992.

In another example, the National Cement Works (CINAT), founded in 1970, was capable of producing 1000 tonnes of cement per day but never reached comparable production levels. Notably, the German concessionaire, Klöckner-Anlagen, which had promised to hand the factory “turnkey” over to the Congolese state, did not have any experience in the field of cement plant construction and thus contributed to the catastrophic consequences suffered by the project. The plant, furthermore, counted on only 3 million zaires in capital. This dearth of capital was a burden from the start of production onward. Rapid losses forced CINAT to resort to incurring debts, which were then transferred to the state of Zaire (now the DRC) to avoid bankruptcy.⁴

Finally, when Mobutu decided to launch the Inga II plant, put into service in 1982, he also began construction on the very high voltage, 1700 kilometre Inga-Shaba electric line linking Inga to Moanda, which seemed to lack an underlying need. Initially contemplated to cost 250 million dollars, the line cost nearly USD 1 billion and resulted in new set backs due to the constructors’ absence of know-how, the particularities of Congolese soil, an underestimation of technical difficulties, and leakages of transported energy caused by the long distances travelled by the energy and the high amount of precipitation in certain regions.⁵ In addition to the associated industries’ substandard capacities, the dams themselves went through serious malfunctions, leading to evermore costly revisions and repairs.

C. A Failure on Several Levels

In terms of efficiency, the Inga dams are a failure by reason of the tremendous underutilisation of their hydroelectric capacities, estimated at only 25 percent of their total yield. Despite construction of the dams, the DRC’s national ratio for electricity service is one of the lowest in the world – six percent in urban areas and one percent in rural areas.⁶ According to UNESCO, “in many rural areas of the country today, petrol generators are still the only source of electricity. At nightfall, it is not rare for some popular districts of Kinshasa to be plunged into darkness, forcing the residents to use candles or hurricane lamps.”⁷

D. Parties Responsible for this Debacle

Several players took part in the different projects. On the one hand, SICAI, which provided consult-



ing engineers for Inga I and Inga II, was entrusted with overseeing the work on behalf of the DRC. Beyond evaluating bids, its role was paramount, as during the project it was entrusted with overseeing the proper execution of works and compliance with standards and clauses noted in the bid-book. Moreover, it was responsible for initiating the service trials after completion of the work. The DRC⁸ was the prime contractor for the Inga works. The concessionaires were responsible for the execution of the contracts and the functioning of the plants. Lastly, foreign lenders, national banks, and international institutions financed the projects, despite the financial crisis of 1986 and suspected fraudulent manoeuvres by the Mobutu regime.

II. Illegal Debt

This article examines the grounds for re-evaluating the contracts concluded by the Congolese government in the Inga context, with the goal of forming objections to the repayment of the related debts.⁹ The instant study encountered a material difficulty when it was not possible to obtain copy of the legal documents related to the projects. This obstacle was partly circumvented through reliance on the multiple references made to the contracts in the literature related to the projects. This literature has enabled a study of the legality of the debts contracted by the Congolese government; however, the analysis remains indirect (i.e. based on references made in the literature) and, therefore, has been made to a certain extent *in abstracto*. In addition to this difficulty, other factors complicated a practical approach to the case. For instance, the existence of a broad assortment of economic and financial players, both public and private, and the resulting multiplicity of contracts¹⁰ made it difficult to achieve a rigorous and thorough understanding of the legality of the credits granted.

In addition, procedural issues have arisen in the context of challenging the dams' debt. On the one hand, as a consequence of jurisdiction or arbitration clauses, the competent court before which any legal action can be lodged may differ from contract to contract. In the absence of such clauses or other specific rules determining the competent court, the case must be assigned to the place of execution of the contract or the place of the immovable property on which the loan is secured, which would be the DRC in this case. The competent court then determines applicable law, in the absence of any express choice by the parties. Thus, by reason of the uncertain nature of the applicable law, this article cannot do more than offer some legal avenues based on the principles and ideas of international law and Latin and Germanic law¹¹ in the context of contract law.

On the other hand, as in any proceeding, a party in a given case must show a justified interest to engage the responsibility of the other party's contractual liability or to contest the validity of a contract. There does not seem to be any difficulty with respect to finding a justified interest in the this case, as this article is based on the hypothesis of an appeal formulated by the current Congolese government, which is a party to the contracts ac-

ording to the principle of continuity of obligations in international law.

Lastly, it should be noted that questions around the statute of limitations could constitute a genuine obstacle, especially if one bases the legal arguments on French law, which has recently been the object of a reform that drastically reduces time limits.¹²

Three focus areas were chosen for discussion in this article with respect to the formation of the contracts: (a) the pre-contractual obligation to inform; (b) the question of the validity of the contracts; and (c) compliance with the duty of good faith in carrying out the contracts.

A. Duty to Inform and Advise on the Part of Financial Institutions

Foreign, European, and international banking institutions made loans for a project which was labelled "risk."¹³ It therefore appears evident that these institutions made themselves liable for various breaches and grave negligence.

It is generally accepted that banks are subject to several pre-contract obligations that make it possible for their clients to provide informed consent. As a professional, a banker is subject to the duty to inform, which may be extended to a duty to advise for uninformed clients. From this duty to advise, French jurisprudence deduces a veritable duty of banks to warn their clients of the risks of indebtedness arising from the granting of the loans in question.¹⁴ The creditor must even refuse to allow the debtor to draw beyond reasonable limits. Thus, liability may be triggered if a bank approves credits in excess of a customer's ability to repay.¹⁵ A borrower is labelled as an informed borrower based on the borrower's actual personal knowledge and thus this status cannot be automatically surmised from the borrower's capacity as a professional or company manager.¹⁶ It is therefore even possible for heads of state, when ill-advised, to be characterised as uninformed borrowers.

It appears that throughout the Inga process the lenders showed an absence of diligence and caution toward their client, the DRC. From the outset, the Inga projects involved enormous operational risks, wagering on the chances of the debt being paid back and *de facto* seriously jeopardizing the Congolese economy. Despite worrying signs, such as the government's hurry to complete the work without complying with the schedule of milestones,¹⁷ its inability to repay the debts¹⁸ and even the absence of financial control on the part of the Société Nationale d'Electricité (SNEL), the banks consistently supported these projects.¹⁹ If certain banks acknowledged technical errors, they never admitted any responsibility for the growth of the debt.²⁰ At no time did the banks raise questions regarding the lack of thoroughness in the initial studies made by the construction companies and foreign research sections (SICAI)²¹ or regarding their financial commitments in a project that was eminently political.²² Due to the above oversights, the banks participated in aggravating the country's monetary and financial situation.²³

Following the lead of the EEC, international financial institutions also took part in these oversized projects. The EEC was the source of an initial feasibility study on the Inga project, which concluded that construction of the dam had to be linked to the development of aluminium-exporting industries to justify the projected wattage. Despite criticisms expressed by the European Commission, the SICAI approach, which advocated an iron plant in lieu of other associated industries, was preferred by the Congolese government. In 1968, the European Commission once again detailed the deficiencies in the Zairian dossier for the Inga II project.²⁴ Nevertheless, it granted abundant financing, even accepting significant overruns,²⁵ while the inappropriate nature of the Inga project and its questionable usefulness were no secret.²⁶ The World Bank granted a loan for USD 13 million and the European Development Fund financed the power lines, the Inga I transformer station, and the scattering station.²⁷ Finally, Inga II was also financed by the European Development Fund and the European Investment Bank, which turned a blind eye to overruns in the early assessments.²⁸

Due to the breach of pre-contractual obligations to inform and advise on the part of financial institutions, the Congolese state could argue that it suffered harm directly linked to these breaches and invoke the institutions' liability,²⁹ thus obtaining damages that could contribute to the reduction or even the cancellation of outstanding debts.

B. Validity of the Contracts

1. Contractual Imbalance: A Cause for Invalidity

It is alleged that the Inga dam generated much greed given the colossal economic and financial advantages offered under its operational conditions. Furthermore, the contracts concluded with the concessionaires are said to be questionable at the level of reciprocal balance and liability clauses.

Four conditions are essential for an agreement to be valid: (1) the consent of the party that commits itself; (2) the party's capacity to take on legal obligations; and (3) a definite object and a legal cause.³⁰ Thus, the existence of a cause must be shown; the latter can be defined as each contracting party's consideration. French civil law³¹ understands the cause as the performance of the contract as intended by the parties, which is to say the personal interest of each co-contracting party. The subjective cause is not explicitly defined in the contract but it is inferred from the circumstances surrounding the conclusion of the contract and the nature of the contract. Consideration must not be illusory from the outset, as may be the case in the event of an exception clause that creates a significant imbalance between the rights and obligations of the parties to the contract.³² A wholly imbalanced contract or a contract without any consideration must be declared null and void.

It appears that the contracts concluded with the concessionaires within the context of the Inga

dam contained patent imbalances. It is difficult to point to a specific contract that is voidable for lack of cause, because, unfortunately, the loan agreements were not available to us for more exhaustive study. Nevertheless, the lack of performance of the contract as intended by the parties or the absence of actual consideration may constitute a powerful argument with which to object to any oppressive contract, which is to say any contract that was significantly imbalanced from the outset.

In particular, consideration may turn out to be illusory when it is deprived of all substance by clauses that create various exceptions in the event of non-fulfilment of the contract's essential obligation.³³ The many agreements concluded in the Inga context between Zaire and foreign companies are thought to have been drawn up in such a way that they released the construction companies and technical assistants from a significant part, if not all, of their liability,³⁴ thus transferring the risks either to the Zairian state or to foreign public banks.³⁵ This observation could apply both to the case of the Maluku iron and steel works³⁶ and the contract concluded between Klöckner-Anlagen and Zaire for the CINAT cement works.³⁷

2. Corruption, Embezzlement, and the Legality of the Contracts

The validity of bank lending or commercial contracts may be called into question by reason of their illicit nature, particularly if the creditors were aware of the embezzlement or illicit end-use of the funds.

The validity of a contract requires the existence of a licit cause, i.e. a cause that complies with the national and international public order.³⁸ The notion of public order may be defined as the state of welfare characterised by peace, public safety, and security. It is evident that corruption and financial crimes are widely combated on the international level due to the serious harm they inflict against public safety and democracy.³⁹ As a result, knowing that the cause of a loan agreement may be understood as the end-use of the borrowed sums, any utilisation made illicit by reason of embezzlement, money laundering, or corruption would render such a contract null and void.⁴⁰ Moreover, the illicit cause results in the nullity of the contract even where the other party to the contract was unaware of it.⁴¹

In the Tinoco arbitral decision, which involved a dispute between Great Britain and Costa Rica,⁴² the arbitrator, William Howard Taft, chief justice of the U.S. Supreme Court from 1921 to 1930, took into consideration that the bank had not shown that the end-use of the money paid was legitimate. This case serves to illustrate that banks have a responsibility in terms of the legal use of funds.⁴³

A system of institutionalised corruption existed in Zaire and Mobutu himself was the primary recipient of public funds within this system. In 1997, his fortune was estimated at USD 8 billion, around two-thirds of Zaire's foreign debt at the time. It seems that withdrawals from state assets were a constant and abundant source of enrichment for

the Mobutu clan. These withdrawals consisted of presidential allocation,⁴⁴ illicit transfers to foreign personal accounts and mysterious expenses.⁴⁵ This system of corruption was notorious and was denounced by the IMF itself. Erwin Blumenthal,⁴⁶ a representative of the IMF, described the mafia-like practices of the “Zairian political-commercial bourgeoisie”. It is thus clear that from 1979 the regime’s principal lenders, which were very close to the IMF, would have been perfectly aware of the fraudulent practices of the regime and the risks involved in continuing to lend to it.⁴⁷

It seems undeniable that in the Inga dam context numerous contracts contributed significantly to the personal enrichment of Mobutu and his close collaborators. According to the Office des biens mal acquis (Office of Ill-Gotten Gains or OBMA), the former Congolese president profited significantly from the project, receiving a significant commission on its total value.⁴⁸ Moreover, it is possible to observe that all the Inga projects systematically required subsequent extensions of credit following an initial estimate. By way of example, when Mobutu launched work on the Inga II plant and construction of the high-voltage electric line linking Inga to Moanda, the project ended up costing nearly USD 1 billion, four times the initial amount.

If it were definitively proven that these embezzlements were made for the personal benefit of Mobutu, it would be possible to contest the validity of the loan agreements, as the perfectly ill nature of their cause would have then been revealed.

If a court finds either an ill cause or the absence of a cause, the sanction is nullity of the contract, which results in the return to an *ab initio* legal status for the contracting parties, implemented by way of restitutions, where possible. In practice, for the borrower, the cancellation of a loan agreement leads to restitution of the remaining owed capital and, for the lender, the restitution of interest already received. Clearly, proceedings for a declaration of invalidity are only advisable if the interest already paid exceeds the remaining capital owed, or if one adds compensation obtained following tort proceedings against the creditors.

3. Concluding and Executing the Contracts in Good Faith

The concessionaires in the present case are thought to have breached their duty of good faith in executing the construction contracts, consequently rendering themselves contractually liable.

Good faith governs contractual relations both in national⁴⁹ and international law.⁵⁰ Good faith is in opposition to “a situation in which the execution would become impossible or deprived of meaning because of negligent or voluntary inaction, or even by actions”.⁵¹ The concept of good faith contains, in particular, the obligation to abstain from making undue profit from the other party.

A recent decision handed down by the International Centre for Settlement of Investment

Disputed (ICSID), regarding a dispute between the Cameroon government and the German firm Klöckner, demanded a duty of candour in contractual performance. The company in question had built a «turnkey» fertiliser factory in Cameroon that was only operational for a few months before closing down permanently. The Cameroon government then refused to pay for delivery. The ICSID found that the company had not treated its partner with “full candour.”⁵² Furthermore, the arbiters noted that the German company had never publicly reconsidered a feasibility study showing that construction would be profitable, although in the course of the years following this study, it had been proven inaccurate by unfavorable market developments of which the firm was aware.

Bad execution and the absence of candour among companies were allegedly present during construction of the Inga I plant, which very quickly required costly repairs and refurbishment.⁵³ Furthermore, fewer than ten years after Inga II entered service, several turbines were stopped following malfunctions and numerous faults occurring on the equipment and infrastructure. As described above, the concessionaires in charge of executing the projects in connection with the dam would be responsible for poor execution contributing to the wholly unsatisfactory functioning of the plants.

With respect to the Maluku iron and steel works, an international consortium had contented itself with “selling an industrial plant, technical assistance and raw materials to a project for which it was already foreseeable, even before it was completed, that it had only very scant chances of success.”⁵⁴ In fact, the Finsinder company never carried out its obligation to import iron through Italy, the products were absolutely uncompetitive and inadequate in relation to the demand and the company was only operational up to 10 percent of its capacity until its bankruptcy in 1992. With respect to the CINAT national cement works, the project suffered considerable losses both because of a lack of adequate capital and an evident absence of experience in the field of cement works construction on the part of the concessionaire. The German company Klöckner-Anlagen concluded an agreement with the state to hand over the factory “turnkey” despite the evident lack of experience of the company in the field of building cement works. Furthermore, because of problems with inadequate capital, the company quickly suffered considerable losses forcing the Zairian state to contract debts.⁵⁵ Finally, during Inga’s second phase and construction on the Inga-Shaba line, the Constructeurs Inga-Shaba Consortium (CIS), made up of Morrison-Knudsen, International Engineering, Fishback and Moore, was awarded the tender⁵⁶ one year before the series of feasibility studies were begun.⁵⁷ This project resulted in another failure most likely caused by the numerous factors described above.

Because any breach of the duty of good faith or the duty of candour is to be read as a failure to comply with, or partial breach of, the contract, private

businesses may be held civilly liable under contract law for breaching these duties. The sanctions for any failure to comply are compensation for the wronged party.⁵⁸ This compensation may contribute to the diminution or even cancellation of the outstanding debt contracted with concessionaires.

Conclusion

There exist several legal grounds on which to contest the validity of the loan agreements or to show the civil liability of the parties involved under contract or tort law in the Inga dam projects. Furthermore, it has been shown that such proceedings could lead to compensation payments by irresponsible lenders and thus to the diminution or even cancellation of the debts incurred. While this article could not provide an exhaustive study

of the Inga projects, the analysis of the debt surrounding the Inga dams that could be provided is necessary in light of several current issues. First, one must consider the clear correlation between the financing of the Inga dams and the current state of Congolese foreign public debt. Between 1973 and 1979, this debt multiplied by four, going from USD 1.4 billion to USD 4.5 billion. Servicing for foreign public debt in 2009 still represents 14 percent of the DRC's total budget, that is 369 billion Congolese francs.⁵⁹ Lastly, at a time when plans for two new plants under the name Inga III and Grand Inga are making an appearance, it is of utmost importance to rigorously confront the donors with their responsibilities to avoid running the risk of depriving the country of all future foreign investment.

1 The expression "white elephant" refers to a gigantic loan taken out by a government for the construction of an enormous industrial project that creates market openings and contracting opportunities for Western companies. These projects are characterised by a total absence of cost effectiveness and financial discipline and in the end serve only the interests of Western companies and a handful of individuals in positions of power, who find extremely profitable business and contracting opportunities.

2 SICAI is governed by the IRI (Industrial Reconstruction Institute), a quasi-governmental holding which controlled Italian state participation in industrial activity.

3 See SICAI report of 29 October 1964. This report substitutes the development of iron and steelworks in the Congo, intended to engender the creation of a series of associated businesses, with the establishment of export-based alumina industries. It is thought that SICAI bet on the existence of iron ore without knowing the location and the quality of the ore.

4 Claude Willame, *ZAIRE, L'ÉPOQUE D'INGA, CHRONIQUE D'UNE PRÉDATION INDUSTRIELLE*, at 110 (L'Harmattan, Paris).

5 *Id.* at 122.

6 Press Release n° 2007/409/AFR, World Bank, World Bank Approves a Grant of USD 296.7 million for the Development of Regional and Domestic Power Markets, available at <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/CONGODEMOCRATICEXTN/0,contentMDK:21351576~pagePK:1497618~piPK:217854~theSitePK:349466,00.html>.

7 UNESCO, *The Promise of the River Congo*, *THE UNESCO COURIER*,

March 2006, available at http://portal.unesco.org/en/ev.php-URL_ID=32169&URL_DO=DO_TOPIC&URL_SECTION=201.html.

8 La Société Nationale d'Electricité (SNEL) was founded in 1970, while the Inga works were underway. At the outset, management of the Inga project was monitored by the study department of the Office of the Presidency.

9 For another illustration, the reader may consult: Maud Perdriel-Vaissière, *Oil-Backed Loans in Congo Brazzaville: Potential Legal Remedies Using the Odious Debt Concept in the French Legal System* (in the present publication).

10 It was not possible to analyse the contracts, as they were unobtainable.

11 One can consider that Congolese law draws from the French Civil Code and French case law.

12 The law that reformed statutory limitations in civil affairs established new limitation periods; the statute of limitations in ordinary law is set to thirty years for real property and five years for personal or movable property cases.

13 "Considerable financial means have to be put in place to restore not only the economic potential of the remote provinces but also to perfect the reequipment of industries of transformation in order to give them back their competitiveness." Commission of the EEC, proposal of financing, Ref: 666/VIII/FED/69-F, at 28, February 1969.

14 Cass, ch mixte (Mixed Chamber of the Court of Cassation), 29 June 2007, n. 05-21.104, Cass ch mixte, 29 June 2007, n. 06-11.673, Cass, com, 8 January 2008: *Juris-Data* n. 2008-042240.

- 15 Cass, com, 11 December 2007, Juris Data n. 2007-041922.
- 16 Cass, ch mixte, 29 June 2007.
- 17 Initially, the power station was to start up with three turbines having a capacity of 50 MW each, with the option to increase the number of turbines according to actual needs. After his 1965 coup, Mobutu decided to start up the station with six turbines and not three as contemplated, with no justification and with the support of SICAI, which issued a second, favorable report despite the risk that demand would be disproportionate in relation to the expected supply. In fact this precipitancy was extremely risky because of the uncertainties regarding the rentability of Inga.
- 18 Since 1971, with the start-up of Inga I, Zaire had already shown its inability, or perhaps even its badwill, with respect to the assimilation of the dossier of loans granted.
- 19 Let us note, for example, participation by the Belgian Société Générale de Banque (USD 167 million), the German bank Kreditanstalt für Wiederaufbau (USD 93 million), the BFCE and Crédit Lyonnais (USD 54 million), the Austrian bank Kontroll Bank (USD 12 million), the Italian bank ICIPU (USD 15 million) and U.S. banks (USD 16 million). See Willame, *supra* note 5, at 116 and 117.
- 20 "Our role is to secure a profit on our loans, to be repaid, not to analyse the mechanics of under-development, which is a matter that falls within the competence of national and international cooperation, of donor and aid institutions who are supposed to correct imbalances." Interview with a senior EEC official, *supra* note 15, at 215.
- 21 At the time when Mobutu seized power, the UN Special Fund sent a review team mission to study Inga's economic and financial problems and to examine the problems associated with the increase in electrical energy needs in Leopoldville province; however, there is evidence showing a demonstrable lack of objectivity, as those who undertook the studies were the very promoters of the Inga project. As far as SICAI was concerned, it behaved as the scientific cachet for decisions by those in power.
- 22 During the hearings of the U.S. Senate sub-committee that was set up following the Inga-Shaba affair, all opinions followed the political line set by the State Department Assistant Secretary for African Affairs.
- 23 "The indebtedness of private banks in fact occurred in conditions of anarchy as they were acting in a monetary and financial system which had collapsed in 1971 and for which there was practically no regulation. They also concealed the fact that making their loans profitable, in the case of Zaire, meant high interest rates and substantial profits. The terms and conditions of bank loans granted Zaire were in fact a lot more favorable there than anywhere else in Africa." World Bank, Zaire : Current Economic Situation and Constraints, at 37, Washington, D.C., May 1980.
- 24 See Willame, *supra* note 4, at 55.
- 25 If it is true that Zaire agreed to be liable for all financial overruns linked to the project, it quickly found itself overtaken by growing demands. Thus, in April 1972 the government made a new application for USD 1.3 million that the EEC approved. See Commission of the EEC, *supra* note 16, at 60.
- 26 *Supra* note 4.
- 27 See Willame, *supra* note 4, at 53.
- 28 *Id.*, at 55.
- 29 On the basis of article 1382 of the French Civil Code.
- 30 Article 1108 of the French Civil Code.
- 31 Article 1131 of the French Civil Code.
- 32 French consumer law deems this type of clause to be unwritten, which is to say null and void.
- 33 Court of Cassation, Commercial Chamber, 18 December 2007.
- 34 Willame, *supra* note 4, at 78.
- 35 These publicly-owned banks were Ducreux in Belgium or Hermès in Germany. *Id.*, at 94.
- 36 The agreements concerning the Maluku factory did not contain clauses regarding liability, neither for the construction company nor for the technical assistants. Amicable settlements were systematically contemplated, meaning that the parties would rely on arbitration held without formal procedures by a special committee that would include a majority of representatives from Italian companies and would meet in Geneva, although the legal owner was 100 percent Zairian. See Willame, *supra* note 5, at 78.
- 37 The company, which had no experience in the field of cement works construction, stated that it assumed no liability for direct or indirect personal or material damage occurring during both the assembly and placing into service of the cement works, even where said damage was precisely caused by its staff. An annex to the contract contradicted the very terms of the main contract on a crucial point: in the contract, it was specified that Klöckner agreed to supply the materials to assemble the factory and place it in service; however, in the annex the company only agreed to oversee the assembly stage and the placing into service stage; the assembly remained the responsibility of Zaire. See Willame, *supra* note 4, at 94.
- 38 Article 53 of the Vienna Convention on the Law of Treaties; Article 1133 of the French Civil Code.
- 39 Numerous international conventions condemn corruption. Furthermore, Article 147 of the Congolese Criminal Code and Article 433-1 of the French Criminal Code contemplate criminal penalties for this offence. Lastly, in the opinion of the World Bank itself, "good governance and the elimination of corruption are essential" to reducing poverty.
- 40 Paris Court of Appeal, 10 September 1993.
- 41 Court of Cassation, 1st Civil Chamber, 7 October 1998.
- 42 Frédéric Tinoco seized power through a coup in 1917 and remained in power until August 1919. In the months of June and July 1919, the Royal Bank of Canada issued several cheques to the Tinoco government, which went toward Tinoco's personal enrichment. When the government fell, the new government promulgated a law rendering all transactions made by the previous regime invalid.
- 43 Great Britain v. Costa Rica, (1923) 2 Ann. Dig. 34-38 and 176 ("The case of the Royal Bank depends not on the mere form of the transaction but upon the good faith of the bank in payment of money for the real use of the Costa Rican Government under the Tinoco regime. It must make out its case of actual furnishing of money to the government for its legitimate use. It has not done so.").
- 44 Officially 15 to 20 percent of the state's operating budget.
- 45 About 18 percent of the budget, according to the World Bank in 1989 went toward "other goods and services" often for sumptuary expenses or for the purchase of military equipment. World Bank, Structural Adjustment Facility Policy Framework Paper.
- 46 Although the Zairian Central Bank was drained by the leaders in power in numerous instances, in 1978 the IMF decided to place one of its representatives there. In July 1979, he hurriedly decided to leave his post following the death threats he received from some of Mobutu's generals.
- 47 The chairman of the DRC Audit Office stated in April 2004: "30 percent of the DRC's debt is estimated to have contributed to corruption. Who has pocketed it? The donors and the loan recipients." Statement made in the author's presence in April 2004, in Kinshasa, during the DRC's international summit on odious debt.
- 48 Damien Millet, La dette de Mobutu, 16 September 2004, available at <http://www.cadtm.org/spip.php?article 2171>.
- 49 Article 1134 of the French Civil Code ("obligations between the parties must be executed in good faith").
- 50 Article 26 of the Vienna Convention.
- 51 Robert Kolb, LA BONNE FOI EN DROIT INTERNATIONAL PUBLIC, at 278 (puf 2000).
- 52 Klöckner Industrie-Anlagen GmbH et al. v. United Republic of Cameroon and Société Camerounaise des Engrais (ICSID Case No. ARB/81/2), 2 ICSID Reports 9.
- 53 José Mukadi, Historique de la mise en route du barrage d'Inga, 21 December 2006, available at <http://www.cadtm.org/spip.php?article2338>. In 1982, Inga I underwent its first refurbishment of plants two and three, which had never had any repairs and had to be placed out of service and dismantled by SNEL, thus creating the necessity to assume new debt.
- 54 See Willame *supra* note 4, at 78.
- 55 *Id.*, at 110.
- 56 Other outsourced companies then joined the project: the Italian consortium Gruppo Industrie Elettro-Meccaniche per Impianti All'Estero (GIE), Sadelmi, and the Swedish company Allmänna Svenska Elektriska Aktieföretaget (ASEA).
- 57 See Willame, *supra* note 4, at 120.
- 58 On the basis of Article 1147 of the French Civil Code.
- 59 République Démocratique du Congo, Ministère du Budget, available at <http://www.ministeredubudget.cd>.



Two Cases of Suspected Illegitimate Debt in Ecuador

9.4 The Drinking Water for Guayaquil Project and the Marcel Laniado de Wind Hydropower Plant

Maurizio De Martino

Introduction

This article will provide two examples of “development aid” that were supposed to benefit the Republic of Ecuador: the *Drinking water for Guayaquil* (Agua potable para Guayaquil) Project¹ and the *Marcel Laniado de Wind Hydropower Plant*.²

The decision to treat the two cases jointly in this article was based on the observation that the projects have traits in common. For instance, the two projects have common elements in the area of financing, more specifically in connection with the involvement of a number of international financial institutions whose actions shall be the subject of following sections.

Furthermore, private interests have prevailed excessively over public interests in both cases. The latter problem is related to the projects’ distorted aims and their final outcomes, which had the effect of producing, on the one hand, unjustified damage to local populations and, on the other, unjust enrichment of third parties. The precise identification of these third parties will not form part of the discussion here. Instead, this article will identify a number of irregularities, i.e. acts or omissions which indicate that the projects possess illegal or illegitimate aspects.³

I. The Drinking Water for Guayaquil Project

In spite of the good intentions of the multi-purpose Drinking Water for Guayaquil Project, access to drinking water continues to be an endemic problem for the town of Guayaquil, especially for its outer suburbs.⁴ Before the implementation of the project, the drinking water supply services were run by two local companies: Empresa Provincial de Agua Potable del Guayas (EPAP-G) and Empresa Municipal de Alcantarillado de Guayaquil (EMAG), both of which had long been burdened with administrative, technical and operational problems that were further aggravated by rapid and disorderly urban growth.

This state of affairs forced the new Ecuadorian government of president Sixto Durán Ballén to incur debts to build a new potable water treatment plant, a new sanitary sewage and rainwater drainage system, and new hydrocleaners, all within the scope of a specially drawn-up master plan. This project’s implementation contemplated two phases: (a) construction work to improve infrastructure, awarded to COMINTRAC, a consortium of Spanish companies; and, simultaneously, (b) privatisation of the drinking water administration system in the town of Guayaquil, awarded to INTERAGUA, a subsidiary of International Water Services (Bechtel). The Spanish government, the Inter-American

Development Bank (IDB),⁵ the World Bank,⁷ and the Argentine government, via the Banco de Galicia y Buenos Aires, provided numerous loans for Drinking Water for Guayaquil. These loans will be discussed in the following sections.

A. Spanish Credit

Fifty percent of the Spanish credit consisted of a FAD (Development Assistance Financing) credit, which is a concessional credit. The remaining part consisted of a trade credit disbursed via the Banco Exterior de España.

The total cost of the works undertaken by the Spanish companies reached USD 50.69 million, while the financing in question totalled USD 69.95 million, to which one must add the cost of insuring the financing through the official Spanish export credit agency (CESCE). Out of the total credit received from Spain, USD 50.69 million was tied to the acquisition of goods and services of Spanish origin by the Ecuadorian government, whereas the remaining USD 19.25 million was for local costs.

Of the credits mentioned above, which fell within the scope of a financial protocol signed between the two countries on 14 September 1989, the only one still in force is the one granted via the Instituto de Crédito Oficial del Reino de España, which has been subject to examination by the Comisión para la Auditoría Integral del Crédito Público (CAIC) of Ecuador, and amounts to USD 34973520,8 in addition to the aforementioned insurance costs.

1. The Pre-Contractual Stage

First, one must take into account that Ecuador decided to engage in this series of legal transactions in an evident state of need, considering that the transactions involved an essential public good – namely, drinking water – for a town suffering a water crisis with no easy solution in sight. Thus, the motives that led the government of Ecuador to incur the debt (indeed, a “tied debt”) discussed in this article and to take on a series of burdensome contractual obligations, can be all too easily understood.

The incomplete nature of the internal administrative and legislative process that the Ecuadorian state underwent to make it possible to take on the debt in question tends to demonstrate the existence of a practice inconsistent with safeguarding the public interest.

Via Decree No. 1701-A, enacted on 1 August 1990 by the then president of Ecuador, the necessary resources were assigned to Empresa Provincial de Agua Potable de Guayas (EPAP-G) to implement the new drinking water plant. Following a series of further acts of a legislative and administrative nature passed via Memorandum SCP-92-107,⁹



specific conditions were made for the approval of the credit in question via Oficio 92-16613 of 9 November 1992, signed by the president of the Junta Monetaria (Monetary Board) and addressed to the Ministry of Finance and Public Credit.¹⁰ A post facto examination by CAIC revealed facts from which it can be deduced that the recommendations of the Junta Monetaria and other provisions were not complied with.¹¹

In any case, following the 23 November 1992 trading authorisation from the president of Ecuador, the loan agreement between Ecuador and Spain was signed. The works contract, as mentioned, was awarded to a Spanish company and the related obligations were fully backed by the government of Ecuador.

2. Contractual Agreements and Other Crucial Elements

CAIC was in a position to examine the entire loan agreement signed between the two states in question. It focused on the scope of certain contractual terms (cited below) for the purpose of highlighting any iniquitous characteristics of the relevant obligations placed upon Ecuador.

Clause 6, comma IV: via this clause the creditor is granted the faculty to suspend disbursement of the credit, if the debtor defaults on payment of any amount deriving from the contract in question or from any other contract existing between the ICO and the debtor state.

It seems excessive to make this contract conditional on fulfilment, not specifically defined, of independent binding agreements. In any case it may be considered an excessive abuse of the provision regarding a guarantee of fulfilment.

Clause 15: This clause grants the creditor the ability to request early termination of a contract, if Ecuador were to unilaterally declare a moratorium on a debt it has with the Spanish public sector, and is therefore particularly burdensome for Ecuador.

Such a contractual provision forces Ecuador to renounce any legitimate demand towards a creditor that might emerge from the particulars of the contracts existing between the two states. All things considered, even in this case, we are leaving the area of merely intra-contractual matters, to aggravate the position of Ecuador, which evidently does not have the full enjoyment of its own rights and is forced to be subjected to the dominant position of the creditor.

Clause 18: This clause contemplates that the amount used to reimburse the creditor shall be exempt from local taxes.

Clause 20: The contract is governed by Spanish law and the jurisdiction is given to the Courts of Madrid.

It should be reasserted that this is a matter concerning “tied credit,” a long-criticised problem which is a subject of concern among numerous international bodies and consensuses, such as the Monterrey Consensus (United Nations 2002) and OECD (DAC-2001). In particular, CAIC considered that such a practice jeopardizes the quality of aid, inasmuch as the beneficiary country is denied the chance to enjoy the knock-on effects

of the benefits of the disbursements made as well as the opportunity to freely choose the executors of the works to be contracted, including among local public and private bodies.

3. Illegitimacy or Indicia of Illegitimacy of the Spanish Credit

No elements were identified in the credit granted by Spain that enable a definitive characterisation of the debt as entirely illegitimate. Although the presence of the above-cited clauses, the existence of incomplete administrative and regulatory processes, and the nature of tied credit fit within a very fragile local context (i.e., the Ecuadorian government was subscribing debt in an evident state of necessity, of which the Spanish creditor may have taken advantage), it is considered that such elements cannot invalidate the entire contract, but could at best be the subject of a reduction to a fair contractual balance.

It should be said that in such cases it is always difficult to overcome legal arguments that aim to legitimise the full validity and effect of the contract, such as the consent granted by the debtor, the nature and cause of the contract itself, acceptance on the debtor’s part, and any statute of limitations.

In response to such arguments, one might invoke general principles of law that address cases where a debtor refuses to comply with a given obligation. These principles, which are adopted by national legal systems, are generally considered one of the sources of public international law, as contemplated by Article 38 of the Statute of the International Court of Justice.¹² Even more pertinent to the case at hand are the UNIDROIT Principles of International Commercial Contracts, which codify legal principles shared by various national legal systems in contractual affairs so that they may be applied to contracts in international law (including those between states, or states and private bodies).

One of the fundamental principles expressed is the principle of good faith, which occupies a very central position in current legal thought and in European and transnational codification processes. In fact, the appeal to good faith is so paramount, that assessing the content of a contract is increasingly less a matter of elements of structure of the case (will and cause) and increasingly more about a general good faith provision understood as a “principle for controlling and limiting contractual freedom.”¹³ The pre-eminence given to good faith is, furthermore, present in the Principles of European Contract Law. All things considered, the freedom to contract is widely acknowledged,¹⁴ but is balanced by the value placed upon contractual good faith, which must assume a mandatory character.¹⁵

In addition, it is also useful here to mention the principle of reasonableness (integral to and defined in the Principles of European Contract Law), which is derived from common law and might equate to good faith in civil law, with the difference that reasonableness should be understood as an express demand of practical reason while good faith governs the conduct of the practical reason. If good faith intervenes by generating obligations,

reasonableness pertains to the manner of implementation according to which the obligations themselves are best put into practice.¹⁶ The concept of gross disparity (excessive benefit or unfair advantage) is derived from this frame of reference. More specifically, pursuant to Article 3.10 of the UNIDROIT principles:

A party may avoid the contract or an individual term of it if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage. Regard is to be had, among other factors, to (a) the fact that the other party has taken unfair advantage of the first party's dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack of bargaining skill, and (b) the nature and purpose of the contract. (2) Upon the request of the party entitled to avoidance, a court may adapt the contract or term in order to make it accord with reasonable commercial standards of fair dealing.

In the case at hand the urgent needs criterion is identifiable in the debtor state, for which the aforementioned clauses were inserted in the contract, which in turn have given an undeniable advantage to the creditor in terms of excessive benefit obtained and from the actual cost of the credit (these are assessments that require more detailed information). Nevertheless, it is not clear whether the debtor government may fully avoid fulfilment of its own obligations in such cases; rather, the government may at most request a rebalancing of the existing contractual positions.

B. Multilateral Credit with International Financial Institutions

The project in question has developed within the context of a questionable process of privatisation of the water supply service, which has proven entirely deficient, inadequate and pernicious (as noted by civil society and by CAIC in its last investigation). The project has brought advantages only to the private company that was awarded the thirty-year contract to manage the service.

In particular, CAIC focused on IDB credit No. 1026-EC-OC of 16 October 1997. The main purpose of this credit was: cooperation to execute a private-sector franchise programme for drinking water services for the purpose of efficiently running, maintaining and administering the relevant systems. The World Bank also intervened in this context, as it had made some loans to Ecuador conditional on the process of privatising essential public goods, which in effect (with the Law of Modernisation of the State, Privatisations and the Provision of Public Services on the part of Private Initiative) initiated said process of privatisation.¹⁷

An analysis of the loan in question illustrates that the main purposes of the relevant contract were: (a) to release the potable water and sewage services of Guayaquil in franchise to a private body within a twenty-one-month term as of the start of the Consultoría Integral (Integral Consultancy); (b) to reduce Empresa Cantonal de Agua Potable y Alcantarillado de Guayaquil's (ECAPA-G)¹⁸ staff in compliance with the requirements of Ecuado-

rian law for the purpose of facilitating the transfer of services to the private operator; and (c) to improve conditions for the distribution of drinking water services to the city's outskirts.

The model and the structure of the loan may be outlined thus:

1. The IDB draws up and initiates the proposal for the loan to the government, which then signs the relevant contract.
2. The Ministry of Finance and the Economy supplies ECAPA-G with the funding for the execution of the project.
3. Prior to disbursement of the loan, the IDB and ECAPA-G coordinate an action plan, and plan for the set-up of an Execution Unit for the EPU project.
4. IDB and EPU coordinate the execution of the loan.
5. ECAPA-G, in cooperation with the IDB, establishes the Unidad de Concesión (Unit of Concession or UC) and entrusts the execution of the project to the latter.
6. The UC grants the franchise for operation of the water system to the INTERAGUA Company without any requirement for said company to make an investment to begin operations.

In sum, the conditions placed for the granting of the credit and the setting up of the complex operation have gradually divested Ecuadorian public bodies of any relevant decisional and economic power in the matter. It is notable that following its investigation CAIC stated: "The conditions established for disbursement damaged national sovereignty inasmuch as the State renounced its rights to autonomously decide on matters that were of its own exclusive incumbency."¹⁹

The international financial institutions involved also interfered with the domestic regulatory framework, as the IDB considered that the new ECAPA-G was weak in structure and that it was thus essential to carry out structural regulatory reform. To overcome said problem, the government established, via an executive order, the Comisión Temporal de Modernización del Sector de Agua Potable y Saneamiento (Temporary Commission for Modernisation of the Potable Water and Sanitation Sector), which comprised a group of technical experts and consultants who developed a wide-ranging programme of sector reform to determine the new scope for participation by the private sector in activities that traditionally fell within the principle jurisdiction of national and local government.

The most significant result of these complex reforms was that ECAPA-G became merely a controlling and supervising body that directly managed the service and all related expenses and obligations²⁰ regarding the concessionaire Interagua, which was in breach of the Ley de Regimen Municipal (Municipal Organic Law).

CAIC alleged that the privatisation of the sector in question, as it was carried out, breached the Constitution of the Republic of Ecuador, specifically Article 61, which gives the state sole authority to manage water resources, among others, and

Article 171, which contemplates the primacy of the constitution in the hierarchy of sources of law.

One of the effects of said reform was the application of a patently high tariff on the part of the concessionary company, a change that was created by the contract and made profitability for the concessionary company prevail to the detriment of the efficiency and quality of the service.²¹

For the same purpose, there was a disproportionate cut to ECAPA-G staff²² via two different corporate operations: (1) voluntary set-aside and (2) external decentralised bargaining.

This complex operation was planned and carried out to make an essential service efficient and, thus to ensure the protection of a fundamental right, namely the right to water. Nevertheless, the service provided by the company in question, again according to CAIC and involved civil society, is the source of a series of inefficiencies and of adverse environmental, social and economic effects. Due to space limitations these problems are discussed only in part here:

- a) The failure to extend services to intentionally identified urban areas with low-income residents.
- b) Public health problems: cases of respiratory disease and, in the year 2005, cases of hepatitis, due to a failure to treat the water. The Civic Committee to Control Corruption and the Office of the Ombudsman went as far as concluding that the water was unfit for human consumption.²³
- c) Economic impacts: tariffs have increase by approximately 188.89 percent; ECAPA-G²⁴ has revealed that INTERAGUA suspended water supply service to 32 204 Guayaquil families, and about 98 585 families are unable to pay for the service.

The above problems occurred while the municipality was unable to intervene to resolve such grievances because it had conferred all decision-making powers to the concessionary company. In light of the situation described by CAIC, this debt demonstrates notable elements of illegitimacy, such as:

- a) Breach of the constitutional requirements and ordinary laws of the country receiving the loans (Ecuador), due to the conditionality policies put in place by international financial institutions.
- b) Lack of benefits: The factual elements, illustrated above, show that renunciations to sovereignty and massive interference in state prerogatives were not mitigated by any benefit in favour of the municipality or the local population, considering the scarce, even damaging, provision of the service.
- c) Breach of the principle of contractual good faith.
- d) Existence of elements of gross disparity or, at least, of excessive and unjustified advantage on the part of the private company. In this case it seems evident that supervision by the IDB was entirely inadequate and that the IDB breached its guidelines.

Furthermore, it is difficult to argue that the IDB was entirely detached from relations between local authorities and the concessionary company, INTERAGUA. In particular, it is relevant to note that on 28 September 2005 the ombudsman (De-

ensoría del pueblo) drew up a public document, Expediente defensorial No. 314-dasl, in which it declared that International Water Service Guayaquil Interagua C. Ltda. (INTERAGUA) was guilty of having supplied water unfit for human consumption to a sector of the suburb west of Guayaquil; was guilty of not having fulfilled the obligation to provide and maintain drinking water services in the city of Guayaquil; was guilty of having violated numerous fundamental human rights, such as the right to health, nutrition, and quality of life; was liable to compensate affected citizens for any damages suffered; and was guilty of having breached Article 32 of the Organic Consumer Protection Law, which ratifies the obligation to supply efficient, quality, and continuous basic services. In light of these points, the credit in question, IDB No. 1026-EC-OC of 16 October 1997, contains elements of illegitimacy, although an in-depth analysis is still necessary to determine the degree of co-responsibility among the parties involved.

With reference to the conditionality policies, it appears difficult to draw a clear line separating “legitimate” and “illegitimate” conditions. The difficulties presented, contrary to what is claimed by legal doctrine,²⁵ are not completely cured by the fact that member states allegedly have the option to enjoy development aid programmes or not (states are assumed to be free to opt for other sources of funding), or that states manifest their consent to the various stages of the programmes. A more in-depth analysis of the matter would be interesting, especially considering that in 2005 the World Bank made its new guidelines on conditionality public. These are based on the so-called good practice principles: (a) ownership by the beneficiary government; (b) coordination between the beneficiary government and the various creditors; (c) customization to assess the beneficiary’s performance; (d) criticality in the choice of actions to approve; and (e) transparency in progress reviews.

The IDB has also tried to take a position on conditionality policies with its Office of Evaluation and Oversight (OVE).²⁶ The OVE starts from the Bank’s Country Strategy and analyses the performance of certain countries²⁷ that evidently had some conditionality practices imposed upon them. Its working proposal document for 2007 (Office of Evaluation and Oversight Annual Report 2005–2006 and Working Plan and Budget Proposal for 2007) establishes: “the Bank should be aligned to a new business model based on results and risk management.” Moreover, it provides: “(i) improvements are needed in the design stage of projects to develop better results frameworks, to gather baseline data and to establish/strengthen borrowers’ monitoring and evaluation systems with a view to continue with the progress of projects in terms of achieving results; (ii) is necessary to promote links between the Bank and borrowers’ information systems, to improve the results of information at country, sector and project level; (iii) risks at country and projects level have to be more explicitly defined, prioritised and managed over the loans’ cycle, and (iv) greater

supervision is required for dealing with initiative risks and projects' implementation problems." Although these new developments took place subsequent to the case at hand, it is interesting to note the implicit self-criticism on the part of international financial institutions with regard to previously adopted conditionality practices for loans, such as those affecting the case in question.

II. Marcel Laniado de Wind Hydropower Plant

A. Factual Grounds

The subject of this analysis is the 92,998,004,000 Italian liras (USD 58,489,311)²⁸ bilateral aid credit released in 1995 by the Italian government for the construction of the Marcel Laniado de Wind hydropower plant, undertaken by the Ansaldo-Impregilo-Icic Fiat-Equidor consortium of Italo-Ecuadorian companies.

A few phases of this complex affair are discussed below.²⁹

First, footnote three in the introduction referred to the Jaime Roldos Aguilera (JRA) water-agricultural-health project, which in its first phase (1982)³⁰ contemplated construction of a dam approximately 130 kilometres north of the coastal town of Guayaquil. This plan was based on planning and pre-feasibility studies completed in 1976 by the U.S. consulting firm Tippet, Abett, MacCarty-Stratton (TAMS), with the participation of various other international consultancy firms. During the second stage of the project the Commission for the Development of the Guayas River Valley (CEDEGE) decided to study the possibility of exploiting the reservoir created by the dam and available waterfall for hydropower, adding a hydro-power plant to the integrated JRA system project. The project for the construction of the plant, on which competitive bidding exclusively for Italian companies was based, called by CEDEGE in 1991, was completed in 1984 and then reviewed in 1988 by the Idroservice consultancy firm (Brazil).

The project contemplated the building of a 130MW hydropower plant, powered by two 66MW Francis turbines, adjacent to the Daule Peripa Dam, which would have been supplied thanks to adjustments to the latter's discharge chute no. 2, converted into a load conduit for the turbines, suitably reinforced and protected. The construction of power facilities, an access road, laboratories and offices, and an accommodation complex to house about 1,000 workers were also contemplated.

The project for the construction of the Daule Peripa hydropower plant became part of the list of projects in the 1990-1992 Italo-Ecuadorian cooperation programme. There was a subsequent expression of interest from the Italian government, which agreed to insert the project into the aforementioned cooperation programme, such that the Ecuadorian government, through CEDEGE, opened an invitation for tenders reserved solely for Italian companies.

On 8 and 9 August 1991, the CEDEGE board summoned leading Italian companies so they

might take part in the DP/CI-0-2-91 bid for tenders in association with Ecuadorian companies for the construction of civil engineering works, manufacturing, supply and assembly of the components for the Daule Peripa Hydropower Plant and transmission line. CEDEGE received bids from two Italian consortia, however, the first invitation to tender was declared as not having received a response and closed by CEDEGE on 30 October 1991 because the bids were considered inadequate. It was then decided that the invitation should be renewed.

In the meantime, the power plant project had been assessed by the Italian Government General Directorate for Development's (DGCS) central technical unit, which had initiated a pre-evaluation of the project based on the scarce information available at the time. The Ecuadorian government had asked the Italian government to participate in financing the project with a USD 80.6 million mixed-credit, composed of a USD 41.6 million aid credit and an export credit.

Once the procedure for renewing the invitation to tender for the construction of the plant was complete, CEDEGE received only two bids from the same consortia mentioned above. On 9 April 1992, the CEDEGE board, following the renewed invitation to tender, DP/CI-0-2-91, awarded the tender to the Ansaldo-Impregilo-Icic-Equidor Consortium, having considered its bid the most suited to national and institutional interests. The CEDEGE board, in a meeting on 3 December 1992, ratified the contractual award for construction of the Daule Peripa hydropower plant to the consortium led by Ansaldo for a revised, total amount of 142 726 799 617 Italian lira (USD 102 644 228)³¹ plus 56 665 016 502.77 Ecuadorian sucres (USD 27 722 611).³²

Page five of the private contract signed by the consortium (led by Ansaldo) and CEDEGE reads: "the execution of this contract is financed with resources issuing from a cooperation agreement with the Government of the Republic of Italy, for the part relating to the foreign currency component, and with resources derived from the State budget, for the part relating to the local currency component." The granting of an aid credit on the part of the Italian government was thus a step that affected the validity and efficacy of the contract between the winning consortium of Italian companies and the Ecuadorian government, even though the Italian government had not signed any binding agreement with the parties to the contract, but had expressed a potential interest in the project.

Indeed, on the date set for the signature of the contract, it is not certain that the DGCS's central technical unit had undertaken a technical and economical assessment of the project, which was then to be discussed by the DGCS Steering Committee, as contemplated by the internal procedures of the Ministry of Foreign Affairs for the granting of assistance loans to countries with which Italy has ongoing development cooperation programmes (in application of Law 49/87). Furthermore, it being a matter involving a mixed credit, a positive approval would also have been necessary from the

Italian export credit agency, Servizi Assicurativi del Commercio Estero (SACE), for the trade credit component, together with a positive solution to the sixth renegotiation of the debt then occurring between Ecuador and the creditor governments in the Paris Club.

During 1993 a profound internal restructuring process began for the DGCS. This restructuring involved significant budget cuts and a complete redefinition of the priorities of Italian development cooperation, be it bilateral or multilateral. In the two subsequent years, following drastic cuts, Italian cooperation prioritised intervention in the poorest highly-indebted countries, favouring interventions in agricultural, social, and basic service sectors over those involving large infrastructure. Latin American middle-income countries, including Ecuador, became a secondary priority for Italian development cooperation, which, faced with an overall reduction in available funds, chose to strengthen work in the poorest countries, particularly in Africa, where over half of Italian aid was destined in 1995.

At the same time, in those years the Ecuadorian government was going through especially critical economic and financial straits, largely due, among other things, to the high levels of foreign debt that the country had taken on to finance the infrastructure work on the multipurpose JRA project. The country's foreign debt on 31 December 1993 was as high as USD 13.4 billion, almost as much as the country's gross national product, then at USD 14.4 billion. In 1994, Italy was Ecuador's principal bilateral creditor, with overall credit amounting to 22 percent of Ecuador's debt to the Paris Club.

It should also be noted that in 1988 the Italian government had taken part in the financing and commissioning of a World Bank and United Nations Development Programme (UNDP) study, involving Italian experts, entitled Ecuador's Energy Situation, published in 1991. The results of this study emphasised several economic and management aspects that should have been considered during the assessment of the project, as these aspects would have affected the proper outcome of the assignment of cooperation funds. Among these aspects was the poor capacity of the local counterparty to maintain existing hydropower plants, which emerged at the time of the study following serious sedimentation problems in the central reservoir at Paute (the largest hydropower plant in the country built by the consortium's flagship company Ansaldo, a bidder for construction of the Daule Peripa plant) the capacity of which had been significantly reduced precisely because of the inadequate maintenance of the reservoir.

In light of the facts, it may be presumed that between mid-1993 and 1995, the Italian companies consulted the competent bodies for the approval of the aid credit, acting in their own best interest. The most obvious consequence of not consulting the competent bodies would have been a failure to get the credit approved, which could have led to the potential invalidation of the plant construction contract. In turn, this would have led Ecuador to need

to renew an invitation to tender, and this time the invitation would not just have been open to Italian companies, but also to international companies.

The 22 December 1994 steering committee approved a 92 998 004 000 Italian lira aid credit for the Daule Peripa hydropower plant, and on 19 May 1995 a funding agreement was signed between the representatives of the two governments. The signature of the financial agreement between the Republic of Ecuador and Mediocredito Centrale followed on 22 November 1995 in Rome. The aid credit was financed by the Italian government at a rate of 1 percent, paid back over thirty years, with around twelve years' forbearance, becoming enforceable with the signature of the agreement.

B. Current Effects of the Daule Peripa Dam

The Italian government should have considered the environmental and social impacts of the dam, given that the hydropower plant was to be part of precisely that infrastructure complex. Now, after a site visit and the CAIC report, it emerges that the construction of the dam almost completely blocked the water flow of two rivers, causing substantial downstream impacts, which were never considered in the budget. Upstream, the area flooded stretches almost 100km north of the dam. According to the CAIC report, after the flood 14 965 peasants, inhabiting eight villages situated in the flooded area, were forced to abandon their land, and sixty-three communities remained cut off. According to Ecuadorian civil society organisations working in the area, 50 000 people have been directly or indirectly affected by the artificial basin.

Those local communities, left isolated by the reservoir's endless stretches of water, continue to live in conditions of extreme poverty. Their dwellings have not been rebuilt; they live without access to electricity and mostly without drinking water, healthcare or roads, in makeshift dwellings, forced to cultivate the infertile land left after the creation of the reservoir, which produces only about one-fifth of the food generated by productive land. As noted in the CAIC report, the index of people without access to basic services among communities around the reservoir is among the highest in the country, between 70 and 90 percent.

C. Legal Grounds

1. Breaches

To conclude that the debt in question is illegitimate, it is necessary to outline the breaches allegedly committed by the Italian government.

a. Italian Law No. 49 of 26 February 1987

Law No. 49 of 26 February 1987, New Framework for Italy's Cooperation with Developing Countries, contains guidelines that are relevant to the instant case.

In light of the legal points noted above, the economic and political conditions of the Ecuadorian government, and the conditions affecting the communities involved in the multi-purpose project, it is fitting to cite Article 1.2 of Law 49/87, which es-

establishes that “[development cooperation] aims to fulfil basic needs, the first among which are safeguarding human life, food self-sufficiency, valuing human resources, preserving the environmental heritage, implementing and consolidating endogenous development processes and the economic, social and cultural growth of developing countries.”

b. World Bank Guidelines

World Bank Guidelines, Directive 4.00 (Operational Directive 4.00: Annex A), issued by the World Bank in 1989 and subsequently included in Directive 4.01 of 1999 on environmental impact assessment is relevant in the instant case.

Although this directive is not directly binding and does not expressly concern the construction of dams, the Italian government, starting from the premise that the plant is tightly connected to the project at hand, should have verified the impacts when fulfilling its due diligence responsibilities. In particular, it should have reviewed the environmental and social impact assessment, requiring that any breaches be remedied before funding the hydropower plant. It is important here to recall that, under Point 1, Annex A of Directive 4.01, both the dams and hydropower plants are projects that fall into category A and thus require a complete environmental impact assessment to be undertaken during the preparation of the project, before its finalisation, and closely tied to the feasibility study.

Moreover, one must note that the Italian government has not duly considered the implementation of the necessary mitigation and compensation measures to make amends for the failure to consult with the populations directly and indirectly affected by the project (Article 19 OD 4.01 and Articles 5, 8 and 9 of the World Bank OD 4.30), for the inadequate compensation, where paid, to those forced to abandon the area (Articles 5, 8 and 9 of World Bank OD 4.30), and for the failure to build basic social infrastructures for the communities affected.

In sum, the government may have breached internationally recognised practices that were necessary for the proper execution of the project.

2. Excessive Increase in Costs and the Possibility of Fraud

In April 1990, the overall cost of the plant was quoted at USD 124 900 239.18, USD 79 858 199.05 of which was an expense of the state. In Ecuadorian Ministry of Finance Memorandum No. SCP-95-555 of 25 October 1995, however, the cost of the project is recorded as amounting to USD 214.8 million. Such an increase in cost does not appear to be justified, especially considering the failure of the project to achieve its goals.

For the purposes of assessing the illegitimacy of the debt, it should be considered that according to CAIC’s final report, the Marcel Laniado De Wind hydropower plant never worked at a rate greater than one-third of its full capacity.

According to the CAIC report: “the average power generated in the last 8 years has been 75.8MW, clearly showing the over-dimensioning of the 3 turbines that function at 30% of their own capac-

ity. Thus there was no reserve volume or sufficient capacity to install three units.” The decision to build a third turbine might have been justifiable given the emergency situation the country was going through, but not in the long term.

Approximately two months after the signature of the Financial Convention between the Republic of Ecuador and Mediocredito Centrale on 22 November 1995 in Rome, the Consortium led by Ansaldo signed the first ancillary contract with CEDEGE to increase each turbine from 65 to 71MW. A second ancillary contract was subsequently signed for the construction of a third 71MW unit, at an increase of approximately USD 100 million. Now, after a few site visits by CAIC representatives, it has emerged that the technical description of the turbines actually indicated: “a nominal capacity of 65MW with a 54.82-metre-drop and a nominal flow of 132.5-cubic metres per second which contradicts the technical features in ancillary contracts No. 1 and 2 of 71MW, and matches the capacity established in the original contract.” But, even more serious is what comes next in the report: “in the event of the event being proven, it would constitute a grave data violation and a swindle, for not having delivered the equipment specified.”

The abovementioned circumstances deserve an accurate, definitive ascertainment of the circumstances that would enable the debtor to invoke principles of international law, such as good faith, clean hands, and, in particular, the possibility of fraud. Regarding the latter it should be recalled that the 1969 Vienna Convention on the Law of Treaties provides in Article 49: “If a State has been induced to conclude a treaty by the fraudulent conduct of another negotiating State, the State may invoke the fraud as invalidating its consent to be bound by the treaty.”

Where such legal principles, for reasons of the Italian government’s lack of mastery, control or capacity to be made a defendant, cannot be applied to the case at hand, Article 3.8 (fraud) of the UNIDROIT Principles of International Commercial Contracts 2004 might be invoked. It provides that: “A party may avoid the contract when it has been led to conclude the contract by the other party’s fraudulent representation, including language or practices, or fraudulent non-disclosure of circumstances which, according to reasonable commercial standards of fair dealing, the latter party should have disclosed.”

In addition, especially with respect to the outsourcing company, Italian Civil Code, Article 2041 on unjust enrichment could be invoked. It provides that when a party has enriched itself without just cause, to the detriment of another, it is required within the limits of said enrichment, to indemnify the other for the correlative reduction in capital.

It remains obvious that an examination of swindling or fraud would seem to be the most pertinent; however, further legal issues must still be answered, such as questions pertaining to statutes of limitations, jurisdiction and the competent courts for holding a trial. In fact, one of the problems commonly associated with illegitimate debt

is precisely that of identifying a competent body to judge potentially illegitimate conduct. There is a need for the creation of transparent and impartial arbitration mechanisms or, better still, the granting of further competence to existing arbitration

mechanisms, such as UNCTAD's, as has been stated by Cephias Lumina, the independent expert designated by the United Nations Human Rights Council, precisely on the subject of foreign debt and human rights.³³

- 1 See also Informe de auditoría integral crédito, BID 1026 OC-EC, Agua Potable y Saneamiento, Signed 16 October 1997; Programa de Concesión al sector Privado de los Servicios de Agua Potable y Alcantarillado de Guayaquil, August 2008 (unpublished).
- 2 For the sake of candour, it should be noted that the author visited the communities that live in the vicinity of the aforementioned hydropower plant to provide them with legal support in analysing and assessing the damage they suffered as a result of the project.
- 3 Lastly, another trait shared by the two cases in question has a functional character: the hydropower plant was planned within the scope of the wider, multi-purpose Jaime Roldos Aguilera (JRA) project, which was completed in the country's western region by the Commission for the Development of the Guayas River Valley (CEDEGE). CEDEGE was established in 1965 to study and plan operations for economic and social development in the Guayas Valley, in the coastal region, and later to exploit the waters of the rivers Daule and Peripa. CEDEGE's initial idea was to have an agrarian development project, and provide both flood protection and water to the town of Guayaquil and other centres in the region.
- 4 "Guayaquil, the largest city in Ecuador, with a population of 2.5 million inhabitants, has had difficulties in providing adequate drinking water services and a sewage system for its inhabitants. In early 1990, its systems were on the verge of collapse. Bad financial management, the maintaining of inappropriate investments and a history of nepotism brought down public companies. Indebtedness and the inability to provide basic services to the wave of communities that emerged unplanned following construction of the ring road is drastically evident today: only 64 percent of the population has access to the drinking water service and only 46 percent has had access to the sewage system. In this scenario, poor communities in Guayaquil are the worst hit. With such low levels of cover, marginal communities have been almost entirely excluded from the official water network." Inversión Social: red de vigilancia ciudadana, <http://www.inversion-social.ec/wp-content/uploads/2007/06/casoecuadorcspg.doc>.
- 5 It is estimated that from the early 1980s to the date of IDB Loan Agreement EC/1026, funding has been released amounting to USD 166 million.
- 6 1978 loan (Guayaquil suburban sewage systems) and 1997 loan (Guayaquil drinking water).
- 7 Loan 2774 EC and 1010 EC.
- 8 Other data on the credit: (a) Ecuador is the guarantor for the debt assumed by EPAP-G towards the Spanish Instituto de Crédito Oficial (ICO); (b) the payment deadline must occur in thirty years with same being deferred into forty-one quarterly instalments; and (c) a ten-year forbearance period is contemplated.
- 9 This document was signed by Rodrigo Correa in his capacity as Minister for Public Credit and addressed to the Minister of Finance, Mario Ribadeneira.
- 10 Among these conditions were: a renegotiation of contract commissions and their management; the signing of an agreement between CONADE, the Ministry of Finance, and EPAP-G to monitor the contract; and, finally, a trust agreement with the Ecuadorian Central Bank to cover sufficient costs of the credit.
- 11 Indeed, evidence is lacking that the aforementioned trust agreement actually took place; that the relevant legal framework was in general respected, in particular Article 129 LOAFYC; and that the sums disbursed by the state via the Central Bank were then effectively added.
- 12 See also UNCTAD Discussion Paper No. 185, UNCTAD/OSG/DP/20007/4 (July 2007) ("Among the sources of international law recognized in Article 38 of the Statute of the International Court of Justice are "the general principles of law of civilized nations". These are principles common to a wide range of the world's legal systems. Equitable limits to contractual obligations in such systems have included illegality, fraud, fundamentally

- changed circumstances, knowledge that an agent is not properly acting on behalf of the contracting principal and duress.").
- 13 G. Vettori, DIRITTO DEI CONTRATTI E «COSTITUZIONE» EUROPEA. REGOLE E PRINCIPI ORDINANTI, at 14b (2005).
- 14 See Article 1.102 of the Principles of European Contract Law; Article 1.1 of the UNIDROIT Principles ("The parties are free to enter into a contract and to determine its content.").
- 15 Article No. 1.7 of the UNIDROIT Principles; Article 1.201 of the Principles of European Contract Law.
- 16 See V. Castro, preface, PRINCIPLES OF EUROPEAN CONTRACT LAW.
- 17 In this framework, administering the water in Guayaquil Municipality facilitates the necessary fusion of Guayaquil potable water and sanitation into a single company by establishing Empresa Cantonal de Agua Potable y Alcantarillado de Guayaquil (ECAPA-G). This fusion occurred in February 2006 under the aegis of the World Bank, which had established its conditionality policies.
- 18 See footnote 8
- 19 CAIC, Final Report, Informe de Auditoría Integral Crédito, BID 1026 OC-EC Agua Potable y Saneamiento, signed 16 October 1997, at 25.
- 20 Among which, the following are of particular importance: (a) To study, prepare and develop complete masterplans for drinking water and rain and sewage water disposal systems; to prevent and control contamination of water resources; and to carry out all types of deeds and contracts permitted by law. See Decree-law No. 08, 16 November 1994, R.O. No. 569 (law establishing ECAPA-G).
- 21 Application of the current tariff structure by ECAPA-G and INTERAGUA aims to ensure profitability for the private operator, according to payments per consumption, without taking into account the population's capacity to pay and the different standards of efficiency required to provide the service.
- 22 See Loan Agreement, Article 1026/OC-EC, Annex A, Description, Transformation of ECAPA-G, section a(i), Reducing staff and mitigating social costs, at 2.
- 23 See Letter from Food and Water Watch and signatories to Riley Bechtel, with a copy to President Rafael Correa, INTERAGUA, the Multilateral Investment Guarantee Agency-MIGA, and the United States House of Representatives Committee on Foreign Relations and Financial Services (9 November 2007).
- 24 Oficio AG-2008-11195, ANNEX No. 8, 1 April 2008 (addressed to the economist Alberto Acosta, President of the National Constituent Assembly, signed by Luis Chiriboga Parra, Mayor of Guayaquil).
- 25 J. Gold, INTERPRETATION: THE IMF AND INTERNATIONAL LAW (The Hague 1996); E. Denters, LAW AND POLICY OF IMF CONDITIONALITY, at 104 et seq.
- 26 See generally Office of Evaluation and Oversight, <http://www.iadb.org/ove/>.
- 27 The countries are Costa Rica, Haiti and Honduras.
- 28 Exchange rate of 22 November 1995 (<http://www.oanda.com/convert/classic>).
- 29 As far as the rest is concerned, please see the report: Il progetto di Daule Peripe-Le reponsabilità italiane nel debito illegittimo (The Daule Peripe project—Italian responsibility in illegitimate debt) by Campagna per la riforma mondiale, with the collaboration of Centro Legale pro Afrodiscendenti and Indigeni-Onlus (CLAI).
- 30 The first phase was financed by the IDB via a USD 320 million credit.
- 31 Exchange rate of 3 December 1992 (<http://www.oanda.com/convert/classic>).
- 32 Id.
- 33 "Real and concrete support is also urgently needed at the international level for a fair, transparent and independent debt arbitration mechanism and for universal guidelines on responsible financing." UN Expert urges Countries to Acknowledge Shared Responsibility for Debt, Drawing Lessons From Norway and Ecuador, 12 May 2009, available at [http://www.unog.ch/unog/website/news_media.nsf/\(httpNewsByYear_en\)/608F2E43C1113C26C12575B400461840?OpenDocument](http://www.unog.ch/unog/website/news_media.nsf/(httpNewsByYear_en)/608F2E43C1113C26C12575B400461840?OpenDocument).



Sweden's case of Illegitimate Debt

9.5 The Three Liberian Coast Guard Ships

Charles Abrahams

Introduction

In 1979, the Swedish Export Agency, Eksportkreditnamnden, (EKN) granted the State shipbuilding company, Karlskronavarvet AB, an export credit guarantee in respect of the sale of three coast guard vessels sold to the Government of Liberia for the sum of USD 6.44 million. Together with interest of USD 1.8 million, the total sum amounted to USD 8.24 million. The Swedish Bank, PK Banken, financed the transaction. At the time, the Swedish shipbuilding industry was experiencing a decline, while the Government of Liberia had become increasingly unpopular due to claims of rampant corruption and human rights violations. Subsequent thereto, the Government of Liberia defaulted on its repayment to PK Banken who, in turn, looked to EKN for full payment of the loan. By 2008, the loan with interest amounted to nearly USD 30 million.¹

This paper questions whether the export guarantee was illegitimate on the grounds that the Swedish Government intended to boost the fortunes of a declining industry by way of exports to Liberia, knowing full well that Liberia was faced with very serious political and economic challenges at the time. Similarly, it questions whether the interest of more than triple the capital sum is legally illegitimate and whether also the subsequent actions of the Swedish Government to finance the cancellation by using its official aid money is morally illegitimate.

This paper intends to answer these questions by briefly looking at the state of the shipbuilding industry in Sweden at that time. It looks at the role played by Sweden's export credit agency, EKN, and the various products it offered. It considers a brief overview of the situation in Liberia at that time, particularly with regard to allegations of corruption and human rights violations. The paper then moves on to consider what is meant and understood by the term 'illegitimacy of debt' and assesses the loan and export credit guarantee in that context. It provides a brief analysis of political, legal and moral considerations that might deem the debt to be illegitimate. This paper concludes by making the argument that, based on the notion of illegitimacy, the export credit guarantee provided by EKN was illegitimate.

The Swedish Shipbuilding Industry

The rise of the Swedish shipbuilding industrial power had its origin in the early nineteenth century when there was an increased demand for ships due to increasing demand for imported consumer goods² and, simultaneously, a decreasing supply from Finnish shipyards to meet the expanding demand for ships in Sweden. The shipbuilding sector grew significantly after the end of the Second

World War, and by 1974 the industry employed 39 000 people.³

However, the 1970s brought many changes in international trade conditions which had a negative effect on Sweden. The 1973-74 oil crisis and the subsequent decline in international business activity affected Sweden more drastically than many other countries. At that time, Sweden's problems also included tougher competition from other regions of the world; a dysfunctional wage formation that led to problems of high inflation and an inhospitable business climate due to high taxes. The Swedish Government responded to the situation by providing extensive subsidies to suffering industrial sectors, such as steel and shipbuilding. However, these measures were not altogether successful, since they only temporarily preserved employment levels and did nothing to ease structural problems within the economy, which were to cause inflation as well as unemployment. In this regard, Sweden's official export credit agency played a most important role in the government's response to the economic downturn.

The Role of Eksportkreditnamnden

Swedish National Export Credits Guarantee Board Eksportkreditnamnden (EKN) was established more than 75 years ago as the official export credit agency of Sweden. It is directly answerable to the Ministry of Foreign Affairs, derives its power from applicable ordinances and receives formal instructions from the Swedish Government every year in its directive.⁴ Its board and director general are appointed by Government.

EKN functions in the same way as an insurance company and its relations with companies and banks are conducted on a commercial basis. The oil crisis of the 1970s, Sweden's suffering industrial sectors and the new markets of the developing world provided the necessary conditions for EKN to play a key role in the Government's policy of exporting its way out of its domestic crisis.

Export credit finance is the mechanism by which finance is made available for contracts of any nature, i.e. the supply of equipment, the provision of services or the performance of civil contract works in the buyer's country.⁵ Finance can either be made available as supplier credit or buyer credit.⁶ Export credit insurance, in turn, is designed to either cover a particular export contract or provide for global cover, which covers all the order of an exporter.⁷ The risk covered is for non-payment, which could either be of a commercial or political nature. Commercial loss can result from the inability of a buyer to meet its obligations to an exporter, because of its insolvency, bankruptcy or severe financial position. Political loss arises through the occurrence of some event



in the buyer's country which hinders or prevents it from meeting its obligations towards the supplier.⁸ However, unlike export credit insurance, export guarantee plays an important role in the provision of clean financial guarantees to the banks. These rely on the guarantees to provide funds for export finance facilities.⁹ In the case of insurance, suppliers of the goods assigned to banks insurance policies held by suppliers. However, with policies being assigned to banks, they in turn still need to be satisfied that the suppliers of the goods do not pose a credit risk.¹⁰ As a result, most systems offer guarantees to the banks for the full amount of the exposure, though a small element of risk to the buyer, or recourse against the supplier, will be left with the banks.¹¹

The Three Coast Guard Ships

From the information available it appears that in 1979, the Government of Liberia ("Liberia") entered into a supply agreement with the Swedish Shipbuilding company, Karlskronavarvet AB ("Karlskronavarvet"), whereby Karlskronavarvet sold to Liberia three coastguard ships for the sum of USD 8.24 million.¹² The agreement was initially concluded with the Liberian Ministry of Defence but it was later changed to the Government of Liberia.¹³ This provides credence to the claim that the ships were used for military purpose since a 1991 report on Swedish arms exports claimed that the ships were armed with Browning 12.7mm machine guns.¹⁴

It was a material term of the supply agreement that Liberia would pay 15 percent whilst it would obtain loan finance from PK-Banken for the remaining 85 percent. From the information available it appears that the loan financing was obtained from Swedish bank, PK-Banken. With the supply agreement signed and the loan secured, Karlskronavarvet made an application to EKN on 12 July 1979 to guarantee the loan of PK-Banken. Karlskronavarvet applied for a guarantee of 90 percent of the total loan amount, paying a premium of 62396 Swedish Kronen¹⁵.

Shortly after securing the guarantee, Liberia took possession of the ships. However, Liberia subsequently defaulted on its loan obligations to PK-Banken and, as a result, EKN had to effect payment of the full amount outstanding to PK-Banken. Since then, Liberia has been indebted to EKN, effectively, being indebted to the Swedish State.

Legitimacy under international law

While, on the face of it, it appears that the loan and guarantee agreements were legally concluded, legality does not necessarily equate with legitimacy. Before the legitimacy of the Liberian debt and guarantee are considered, it is important to understand what is meant by the term 'legitimacy', in particular its understanding under international law. Legitimacy has been described as 'that space between international law and international politics'.¹⁶ In order to understand the concept, it has to be distinguished from legality and lawfulness. By way of example, it is said that, though there are

contrary views, the 1999 NATO armed intervention in Kosovo was illegal under international law but it was widely regarded as legitimate.¹⁷ In contrast, the 2003 Iraq invasion could be regarded as both illegal and illegitimate. The legality of an action or a policy may be assessed by reference to legal texts, case law and precedents, and challenges and appeals may be raised as part of the adjudicative process, whilst legitimacy is fluid and changing – it depends on perceptions and outcomes.¹⁸ Legitimacy relates to the justification and acceptance of political authority. Legitimate decisions are based on democratic participation whereby affected persons have the opportunity to raise their voices. When legitimacy is separated from democratic participation, it risks being exposed to ideological and self-concerned manipulation.¹⁹

The concept of legitimacy in international law is one that bridges the legal and the political. This is precisely what is referred to by the use of the term, 'illegitimate debt'. Although it has legal dimension, 'illegitimate debt' denotes a political concept with normative value, rather than being a mere formalistic legal term, as will be explained more fully below.

Liberia

The sale of the three coast guard ships took place at a particular time in Liberia's history. With the death in office of President William Tubman in 1971, Liberia began to change. Tubman's 'Open Door' economic policy brought a great deal of foreign investment at a heavy price, as the divide widened between the prospering Americo-Liberians (benefiting from such investment) and the rest of the population.²⁰ Following Tubman's death, his long-serving Vice President, William Tolbert, assumed the Presidency. Under Tolbert, Liberia continued to move along a road to development that relied on private enterprise.

However, Liberia remained essentially the province of a tightly knit oligarchy.²¹ For all the attempted liberalisation of the previous two decades, the upper levels of Government and the economy were still controlled by about a dozen interrelated Americo-Liberian families.²² Because Tolbert was a member of one of the most influential and affluent Americo-Liberian families, everything from cabinet appointments to economic policy was tainted with allegations of nepotism.²³ The Tolbert era was marked by the exclusion of indigenous representation and his nepotism was such that he was accused of running Liberia as if it was his private property. For example, he made his brother, Stephen Tolbert, his Minister of Finance, while his daughter, Willie Mae Tolbert, became a board member of the Bank of Liberia. His son-in-law, Tonieh King, was appointed Commissioner for Immigration and another son-in-law, Captain Jehu Richardson, became Captain of Air Liberia and Member of the Board.²⁴ In addition to unbridled nepotism, the Tolbert administration failed to bring corruption under control. High officials committed fraud in the letting of Government contracts, involved themselves in questionable real estate acquisitions, charged

personal expenses to Government accounts, used Government property for private use, evaded taxes and customs fees and engaged in other illegal practices.²⁵

A new and optimistic four-year development plan went into effect in 1976, but the world recession took a heavy toll on Liberia.²⁶ As foreign markets abroad and prices for Liberian commodity exports declined, the cost of imported energy rose steeply.²⁷ Liberia was barely able to maintain a positive growth rate in the late 1970s, when a drop in the output of iron ore was offset by rising ore prices.²⁸

The Coast Guard Ships and the Rice Riots

In 1979, the year in which the sale of the three coast guard ships occurred, Tolbert's Minister of Agriculture, Florence Chenoweth, proposed to cabinet an increase in the subsidised price of rice from USD 22 for a 100-pound bag to USD 26.²⁹ Her rationale was that the increase would serve as an inducement for rice farmers to stay on the land and produce food for themselves and for sale, instead of leaving to work for wages in the cities or on the rubber plantations.³⁰ However, political opponents noted that Chenoweth and the Tolbert family were large-scale rice farmers and stood to profit handsomely from the price increase.³¹

In protest, the Progressive Alliance of Liberians (PAL), founded in the United States in 1974 by Gabriel Baccus Matthews, called for a peaceful demonstration in Monrovia and, on April 14, about 2 000 activists were assembled to march on the Executive Mansion.³² However, widespread looting ensued, resulting in forty demonstrators being killed and damage to private property was estimated at more than USD 40 million.³³ The cumulative effect of Liberia's woes resulted in its foreign debt at the end of the decade standing at USD 744 million and the budget deficit at more than USD 100 million.³⁴

A Case of Illegitimate Debt?

As is evident from the above, the sale of the three coast guard ships took place at a time when Liberia was experiencing one of its most severe political and economical challenges. Liberia was also in the grip of increased political instability marred by nepotism and corruption. These are factors which Karlskronavarvet, PK-Banken, and EKN invariably would have taken into account when entering into the supply agreement, the loan agreement and in providing the export credit guarantee. In providing its guarantee, EKN would have had to make a judgment on the risk and soundness of the sale to the Liberian Government. By its very nature, the guarantee provided by EKN is none other than a form of political risk insurance that helps multinational enterprises and lenders mitigate risk through insurance against adverse government actions or war, civil strife, and terrorism.³⁵

In making this insurance available, EKN still needed to be certain that the political risk posed by Liberia was such that it would not amount to any potential default in respect of the loan repay-



Street scene in Monrovia, Liberia. Picture: war.change.org



School class in Monrovia. Picture: United Christian Academy

ment. This, in turn, would have depended on the type of information available to EKN on the political situation in Liberia to make that assessment. The presence of inconsistent information amongst Karlskronavarvet, PK-Banken and EKN was likely to affect the probability of a default on the part of Liberia. In anticipating such an eventuality, the question is whether any one of the three parties was in a better position to know of the political and economic risk in Liberia? Of the three parties, certainly EKN stood in a better position than either of the other two. The reason being that EKN was essentially set up to assist the Swedish Government with securing financial solutions for exports for Swedish products, i.e. Sweden's shipping industry exporting its way out of its decline with the support of EKN. With the kind of public information available on Liberia being what it was, EKN should certainly have foreseen that the political and economic risks faced by Liberia may have had implications for its ability to honour its payments under the loan agreement with BK-Banken. Yet, despite that, it proceeded to provide a guarantee to PK-Banken for the loan to Liberia, which, under normal due diligence considerations, may have raised serious questions with regard to its viability.

Whether the guarantee to PBK-Banken can be regarded as illegitimate depends on our understanding of illegitimate debt.

Even though the concept has an earlier history, the notion of illegitimate debt was proposed by debt campaigners in 1998, arising out of the Jubilee Call for Debt Cancellation in Rome, and was subsequently adopted by the Latin American and Caribbean Jubilee 2000 Movement in the Tegucigalpa Declaration³⁶ and in the Canadian Ecumenical Jubilee Initiative.³⁷

For many campaigners there was a need for a concept that went beyond issues that could be addressed by the traditional concept of the 'odious debts' doctrine. Such a concept would take account of the political and social realities of countries in the South. It would also consider questions of justice in the relationship between the lenders and the borrowing regime, and the people of the borrowing country. Such an approach provides the basis for an expanded extra-legal approach to the notion of illegitimate debt as opposed to a narrow, strictly legal approach. Just as the factors that determine legitimacy in international law (i.e. perceptions, outcomes, democratic considerations, justification and acceptance of political authority) are broader than those that define legality, so the factors that determine illegitimate debt are broader than the narrow consideration of whether debts have been legally concluded and, if so, the traditional legal defences that might be raised as a consequence.

Thus, it can be said that the notion of illegitimate debt is based on broad political, legal and moral considerations.³⁸ From a political point of view, it is clear that Sweden was motivated by its own economic situation when EKN granted the guarantee in respect of the sale, despite the political reality in Liberia at the time. The confluence of

Sweden's need for economic exports together with Liberia's abnormal political situation, negates the view that this particular transaction constituted a normal commercial transaction at that time.³⁹ At a minimum a higher degree of due diligence would have been required by EKN before providing the loan, which, on the information available, does not appear to have been the case.

From a legal point of view, it is highly questionable whether the interest that EKN has charged of more than USD 22 million over the last 30 years is legally legitimate. At the time of concluding the loan agreement, interest on loans was governed by the Interest Act of 1975. Parties are free to agree on another rate as long as it is not unfair.⁴⁰ Since fairness is a consideration that is taken into account in Swedish law in matters pertaining to interest, it appears on the face of the information available that there may be an arguable case that interest thrice in excess of the capital sum would be regarded as unfair and therefore the contract may be regarded as legally illegitimate.⁴¹ It is also morally questionable whether it can be said that the man-

ner in which the Swedish Government had gone about canceling the debt of Liberia, is in itself illegitimate. On 17 April 2008, the Paris Club confirmed that given that Liberia had reached its Decision Point under the enhanced HIPC Initiative, several Paris Club creditors agreed on a bilateral basis to grant additional debt relief to Liberia.⁴² Following this in November 2008, the Swedish Government cancelled 67 percent of the debt owed by Liberia to it.⁴³ It appears that the Swedish Government financed the cancellation with money from its official aid budget, despite the fact that, based on the report referred to above, the ships were armed with machine guns and were used for military purpose. This is contrary to the OECD guidelines on Official Development Assistance (ODA) which excludes military assistance from being reportable as ODA.⁴⁴

Based on the aforesaid considerations, it is argued that, given the information available, the loan agreement and guarantee could be regarded as illegitimate, not only from a political and moral point of view, but from a legal point of view as well.

1 <http://www.eurodad.org/whatsnew/articles.aspx?id=402&item=3329>.

2 Christina Kjellson, Swedish shipbuilding in the early nineteenth century, available at <http://www.hnsa.org/conf2004/papers/kjellson.htm>.

3 *Id.*

4 <http://www.ekn.se/templates/StandardPage.aspx?id=836>.

5 Dunn A et al, What Is Export Finance? International Borrowing, Negotiating And Structuring International Debt Transactions, D. C.), Editor Daniel D. Bradlow, International Law Institute, Washington 3rd edition 1997, at 291.

6 *Id.*

7 *Id.*, at 290.

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.*

12 This information was obtained from the Karlskronavarvat AB's application to EKN dated 12 July 1979 for export credit guarantee.

13 *Id.*

14 "Slutrapport om svensk vapenexport", Henrik Westander. Utgiven av Svenska Freds- och Skiljedomsföreningen 1991.

15 Around USD 14 500 (in 1979).

16 Anthony D'Amato, On the Legitimacy of International Institutions, No. 12/07, SSRN (2007).

17 Legality and Legitimacy in International Order, United Nations University, Policy Brief Number 5, 2008. However, there are contrary views among legal scholars on this issue which, for reasons of space, will not be discussed here.

- 18 Id.
- 19 Id.
- 20 Peter Dennis, A Brief History of Liberia, at 2 (2006), available at <http://www.ictj.org/static/Africa/Liberia/BriefHistory.pdf>.
- 21 The Tolbert Presidency, available at http://www.globalsecurity.org/military/library/report/1985/liberia_1_tolbertpresidency.htm.
- 22 Id.
- 23 Supra 11, at 2.
- 24 Heneryatta Ballah, Ethnicity, Politics and Social Conflict: The Quest for Peace in Liberia, at 60 (2003), available at <http://forms.gradsch.psu.edu/diversity/mcnair/2003/ballah.pdf>.
- 25 Supra 12.
- 26 Id.
- 27 Id.
- 28 Id.
- 29 Rice Riots, available at: http://www.globalsecurity.org/military/library/report/1985/liberia_1_riceriots.htm.
- 30 Id.
- 31 Id.
- 32 Id.
- 33 Id.
- 34 Id.
- 35 See Daniel Wagners Expert Commentary on defining political risk, available at <http://www.irmi.com/expert/articles/2000/wagner10.aspx>. The first distinction that must be made is between firm-specific political risks and country-specific political risks. Firm-specific political risks are risks directed at a particular company and are, by nature, discriminatory. For instance, the risk that a government will nullify its contract with a given firm or that a terrorist group will target the firm's physical operations are firm-specific. By contrast, country-specific political risks are not directed at a firm, but are countrywide, and may affect firm performance. Examples include a government's decision to forbid currency transfers or the outbreak of a civil war within the host country.
- 36 Tegucigalpa Declaration, Latin American and Caribbean Jubilee 2000 Platform (1999), available at www.oikoumene.org/en/resources/documents/wcc-programmes/public-witness-addressing-power-affirming-peace/poverty-wealth-and-ecology/finance-speculation-debt/27-01-99-tegucigalpa-declaration.html.
- 37 Joseph Hanlon, Defining illegitimate debt and linking its cancellation to economic justice, Open University (2000), at 13, available at www.kirkensnodhjelp.no/Documents/Kirkens%20N%c3%b8dhjelp/Publikasjoner/Temahefter/Defining%20illegitimate%20debt.pdf.
- 38 See the chapter on Defining Illegitimate Debt in this publication.
- 39 This statement is made with caution as no sufficient information is available to determine whether EKN applied sound commercial principles in providing the guarantee.
- 40 Whincup M, Contract Law & Practice, The English System with Scottish, Commonwealth and Continental Comparisons, 5th edition (2006), at 383.
- 41 Since the author did not have the benefit of considering the loan agreements, this statement is based on the assumption that the interest is excessive.
- 42 Paris Club Press Release, 17 April 2008 at <http://www.clubdeparis.org/sections/communication/archives-2008/liberia5796/viewLanguage/en/downloadFile/PDF/PDF>.
- 43 Forum Syd Press Release, 12/12/2008.
- 44 Is it ODA, OECD Factsheet November 2008 at <http://www.oecd.org/dataoecd/21/21/34086975.pdf>.



9.6 Potential Legal Remedies Using the Odious Debt Concept in the French Legal System

Maud Perdriel-Vaissière

Introduction

On 17 January 2009, shortly before passing away under mysterious circumstances, Bruno Jacquet Ossebi, a Franco-Congolese journalist, published an article in a French-based Congolese online newspaper, *Mwinda.org*. Entitled “Oil for a Handful of Dollars,”¹ this article reported that the Republic of the Congo and the French group BNP Paribas were about to transact a deal involving an oil-backed USD 100 billion loan. The report was significant given that, to benefit from International Monetary Fund (IMF) and World Bank (WB) programmes, the Republic of the Congo had agreed on several occasions to no longer resort to this type of financing.

What are oil-backed loans? How does the practice of using oil-backed loans aggravate the indebtedness of the Republic of the Congo? What legal remedies can be used to tackle this phenomenon? This paper will attempt to answer these many questions.

I. Presentation of the Facts

A. What Are Oil-Backed Loans?

An oil-backed loan is a loan granted by a private creditor (bank or buyer of crude oil) to a public entity (state or public company) that is secured with future oil production.² In other words, a sovereign borrower pledges forthcoming barrels of crude oil as collateral for a loan. The debt is thus secured against the collateral and, if the borrower defaults, the creditor takes possession of the oil and can sell it to satisfy the debt by regaining the amount originally lent to the borrower.

Developed by oil trading companies during the 1970s, this technique for securing loans underwent a swift boom due to the combined effect of Northern countries’ marked energy dependence and developing countries’ significant financing needs. Tired of the conditions imposed by multilateral funding agencies, states that are rich in natural resources, such as the Republic of the Congo, Iraq, and Angola, but poor in other areas, saw it as a means of quickly satisfying their liquidity needs.

B. Oil-Backed Loans or Financing for Underdevelopment

Although there is nothing illegal about this technique per se (it is neither more nor less than a contract), the conditions under which these secured loans take place constitute a serious constraint to the development of Southern economies. Oil-backed loans create an environment that favours corruption and bad governance of public resources,

because, in such arrangements, sovereign borrowers are not bound to indicate the end-use of the borrowed funds or to account for their use.³

This problem is aggravated by the fact that the oil prices secured by creditors are generally significantly lower than the market price. In other words, thanks to the pre-financing technique, a private creditor can acquire a much higher quantity of oil than it could have purchased on the market with the identical investment. The combination of these two factors accelerates both the pillage of Southern economies’ oil resources and their accumulation of debt.

C. Oil-Backed Loans in Congo Brazzaville⁴

In 1985, while the price of oil was tumbling, the Republic of the Congo found itself short of funds and was no longer able to honour its debts. Having met with refusal from the IMF, which made aid conditional on democratisation of the country and good governance of public revenues, General Denis Sassou Nguesso decided to turn to oil-backed loans and found, in the French oil company Elf (now Total) in particular, a partner he could rely on.

Notably, Elf is not the only oil company to have enriched itself on the Republic of the Congo’s debt. The U.S. company Occidental Petroleum (Oxy) and the Italian group ENI (via its subsidiary Agip) benefited widely from the practice of securing loans with oil. Similarly, several banks, many of them French, took part in these operations: Crédit Agricole, Société Générale, Crédit Lyonnais, and Banque Paribas (now BNP Paribas). Large oil brokerage companies, such as Glencore or even Trafigura, also made enormous profits by organising the sale of oil on behalf of contracting parties.

Aside from the details of each specific oil-backed loan, the scheme is substantially the same in every case. First, one or several offshore companies receives a loan at preferential interest rates from a bank or buyer of crude oil. Then, these offshore companies lend to the sovereign state at significantly higher rates. The difference between the interest rates is ultimately collected by the original creditor, while the representatives of the regime and their close associates receive a juicy commission, as do various other middlemen. This arrangement is designed in such a way that the offshore company appears as the sole debtor for the loan and, thus, shelters the country, in this case the Republic of the Congo, from criticism by the IMF.

According to the IMF, nearly seventy-five percent of loans contracted by the Congolese government between 1995 and 2000 were secured with oil.⁵ To benefit from the Heavily Indebted Poor Countries (HIPC) programme,⁶ the Republic of the Congo has agreed on several occasions since 2001 to no



longer rely on oil-backed loans.⁷ In reality, however, this agreement has not been respected. In a judgement by the British High Court of Justice that was made on a dispute between the Republic of the Congo and one of its creditors, the firm Kensington International Ltd.,⁸ it was revealed that from 1999 to 2003 the state oil company Société nationale des pétroles du Congo (SNPC) concluded a series of oil-backed loans with Glencore amounting to USD 200 million.⁹ Similarly, in March 2006, a U.S. federal court received a complaint against SNPC, its director, and the BNP Paribas group in which Kensington International Ltd. claimed that between 1999 and 2004 SNPC agreed to a series of secured loans with BNP reaching a value of nearly USD 650 million.¹⁰

Given the volume of liquidity generated by these loans, it is legitimate to question the end-use of the funds. Apparently, these loans were not assigned to the renovation of social and health infrastructure, although such infrastructure is cruelly lacking in Congo Brazzaville. This lack of infrastructure is evidenced by the significant number of schoolchildren who continue to receive their lessons while sitting on the ground due to a lack of sufficient tables and benches. It is also evident in a health sector that has not fared better. For instance, in the country's only large hospital (Centre hospitalier universitaire de Brazzaville), where it is common knowledge that patients are transported on people's backs because the lifts have been out of use for years, only the morgue operates at full tilt.¹¹ Further, over half of the population lacks access to drinking water and electricity cuts are an everyday occurrence. Finally, Congo Brazzaville remains one of the few countries in the world with no asphalt road network; three quarters of all roads are deteriorated for want of maintenance, and rural roads are often unusable, leaving many villages cut off.

According to the IMF, "rather than contributing to the welfare of the Congolese population, the proceeds from oil-collateralised borrowing may have been used to finance combat operations during the civil war."¹²

There are also strong reasons to believe that part of the funds and commissions resulting from secured loans were used to enrich Denis Sassou Nguesso and his family, which have together built a considerable fortune throughout the world.¹³ A police investigation conducted following a complaint filed by Association Sherpa and two other NGOs in 2007, established that the Congolese ruling family owns 112 bank accounts and eighteen properties in France.¹⁴

In late 2004, the total outstanding debt for the Republic of the Congo was about USD 9.25 billion, four percent of which pertained only to debt secured with oil (i.e., USD 378 million).¹⁵ Interestingly, these figures do not take into account the SNPC debts.¹⁶

II. Application of the Law

The debt secured on Congolese oil fits the criteria of odious debt:¹⁷

- It was contracted without the full consent of the Congolese population.
- It was used contrary to the interests of the Congolese people.
- The private creditors could not ignore the odious destinations of the funds.

Is it therefore illegal? And, if so, what legal arguments can be used to support this claim?

The following paragraphs will focus on possible civil remedies (tort and contract litigation), the intention of which is less to sanction private creditors than to identify legal means that make it possible to lighten Congo Brazzaville's debt.

In theory, contracts that link a state or public authority to a private entity are state contracts and as such are subject to international law. But it happens frequently in loan contracts that parties elect to have their contracts governed by private law.¹⁸ Such cases, be they contractual or extra-contractual, must be settled using the rules of private international law for determining the competent jurisdiction and the applicable domestic law.

In this article, which is based on French law, I rely on the following points:

In contractual disputes: The loan contracts are subject to French law (choice-of-law clause) and the parties recognise French courts as having jurisdiction over disputes arising from the contracts' execution (forum selection clause).

In extra-contractual torts: By virtue of Article 2 of the Brussels I Regulation of 22 December 2000, the courts of the state of the territory where the defendant is domiciled are competent. Therefore, if the action was directed against a French company, French courts would be competent. French courts would then apply their own choice-of-law rule, which provides that in matters involving extra-contractual liability the law of the place where the tort was committed (France) or the law of the place where the damage occurred (Congo Brazzaville) are both applicable. French law could therefore be applied.

A. Nullity of the Oil-Backed Loan Contracts Due to the Illegitimacy of the Cause

Under Article 1131 of the French Civil Code, "[a]n obligation without cause or with a false cause or with an unlawful cause may not have any effect." All agreements must have a lawful cause on pain of nullity. The cause must not be "prohibited by law" or "contrary to good conduct [or] public policy" (Article 1133 of the French Civil Code).

The lawfulness of the cause is assessed subjectively and depends on the motivations that led each party to conclude the contract. The relevant case law also speaks of "impulsive and determining cause"¹⁹ (i.e. the reason that led a party to enter a specific contract—the real, and sometimes hidden, motivation).

It is not necessary for the unlawful motive to have been known to both parties for the nullity to take effect. In fact, since a judgement rendered by the First Civil Chamber on 7 October 1998, French judges consider that a contract may be cancelled for unlawful cause, even where one of the

parties to the contract was not aware of the unlawful nature of the motives of another party to the contract. Furthermore, the cause of a contract is likely to be unlawful when the operation contemplated constituted a criminal offence.

In the present case, on the Congolese side the subjective cause of these agreements consists in the end-use of the borrowed funds, that is to say the personal and illicit enrichment of Denis Sassou Nguesso and his family. Such acts are criminally reprehensible (illegal taking of interest, embezzlement of public funds, breach of trust, corruption). One can find a strong condemnation of corruption in a judgment issued by the Paris Court of Appeals on 10 September 1993: “Whereas under French law, [...] contracts tending to corruption or peddling of influence are cancelled due to the immorality or unlawfulness of the cause and the object, whereas a contract the cause or object of which is the exercise of peddled influence via the payment of bribes is, as a result, contrary to French international public policy, as well as to ethics in international affairs, as conceived by the greater part of the states in the international community.”²⁰

The burden of proof regarding the unlawful nature of the cause is on the claimant and may be fulfilled through various means. The unlawfulness of the cause is sanctioned by nullity, which is to say retroactive abrogation of the contract. In practice, in matters involving loans, for the borrower cancellation of the contract results in the restitution of the remaining capital owed and for the lender it results in the restitution of interests already received. The unlawfulness of the cause is a nullity of public interest (i.e. an act that violates a rule of public order) that may be invoked by any person who has standing to sue.

Unlawful cause is a useful remedy in several regards. First, it is not necessary to produce evidence that the private creditor was aware of the end-use of the funds for the contract to be cancelled.²¹ Second, the action is not reserved exclusively for the parties to the contract; thus, action by Congo’s creditors is possible,²² as is action by the Congolese population. Naturally, the Congolese population has an interest in requesting the cancellation of a contract the effect of which was to aggravate state debt while mortgaging the country’s oil resources. Lastly, the sanction is effective because it ultimately puts the parties in the same situation they were in before the conclusion of the contract, i.e. things return to the position they would have been in if the loan agreement had not taken place.

B. Contractual Liability of Banks for Granting Abusive Loans

Banks must comply with their duty to warn, which consists of warning uninformed borrowers about the risks involved in loans and indebtedness. This obligation is the fruit of a judicial decision. In a judgement dated 27 June 1995, the First Civil Chamber of the Court of Cassation ruled that “lenders did not justify, nor even did they allege having warned borrowers on the significance



Funeral of Franco-Congolese journalist Bruno Jacquet Ossébi, who is believed to have been murdered after accusing a French bank of reaching an illegal financing agreement with the Société Nationale de Pétrole du Congo. An anti-corruption activist, Ossébi was also involved in the complaint which Transparency International brought before a French court accusing President Denis Sassou-Nguesso and two other African leaders of illegally amassing property in France. Picture: Reporters sans frontières

of the indebtedness that would result from these loans; what the court of appeal has been able to deduce is that the credit institutions had failed in their duty to advise and triggered their liability towards the Garcia spouses.²³

Can the Congolese government be considered an uninformed borrower? Does the mere fact that it has applied several times for loans suffice to make it an informed borrower? This question has to be linked to the issue of good faith in excessive indebtedness. The Court of Cassation, applying the principle that a presumption of good faith is always present, does not automatically view a debtor who has abused the recourse to credit as having acted in bad faith. Thus, by analogy one may consider that a debtor applying for a new loan while already heavily indebted is not necessarily an informed debtor.²⁴ On the contrary, it may even be that banks have an enhanced duty to warn in these particular cases, which may result in a duty to refuse the requested loan. Some decisions go as far as implying that banks open themselves to liability when they conclude excessively risky contracts. For example, in a judgment rendered on 12 July 2005, the Court of Cassation clearly stated that a bank's liability results from its failure to verify financial standing and granting the credit; thus it follows from this holding that the bank should have refused the loan.

The failure to comply with the duty to warn (and, more specifically, the granting of a manifestly excessive loan)²⁵ constitutes a breach of contract for which the bank is responsible under Article 1147 of the French Civil Code (breach of the duty of good faith). This is a contractual liability; thus, only the borrower may seek remedies for the harm caused by the bank's breach of its duty to warn, a harm consisting in the loss of the opportunity to avoid excessive indebtedness.²⁶ It follows that in the present case only an action brought by the Congolese government or SNPC would be admissible. Such a case could force the Republic of the Congo's private lenders to compensate the Congolese government through the payment of damages (Article 1142 of the French Civil Code). In principle, the damages must cover the cost of the harm; however, in a case involving a loss of opportunity, the recovery must perforce be partial. The damages paid could not be equal to the advantage provided by the opportunity to avoid excessive indebtedness had this opportunity been seized.²⁷

What must happen when a contractual breach harms a third party? It has been accepted, since a judgment rendered by the Plenary of the Court of Cassation on 6 October 2006, that a third party to a contract may invoke, based on the law of torts,²⁸ a contractual breach as soon as that breach has caused her prejudice. In such cases, any contractual breach is sufficient to establish an intentional tort, such that the third party is not obliged to provide evidence of a distinct wrong (i.e. does not have to show that it suffered a special prejudice, distinct from the contractual breach). In accordance with this case law, any third party affected by oil-backed loans could have the ability to com-

mence proceedings, provided that the breach committed by the private creditor caused that third party harm. In the present case one could argue that the population suffered damage due to the failures of the banks.²⁹ Provided that a plaintiff presented evidence of the damage suffered and demonstrated a causal link between the damage and the failure of the bank, the bank would be bound to compensate the prejudice by paying damages. Again, for the same reasons described above, this reparation would likely only be partial, because the prejudice suffered by the Congolese population consists in the loss of an opportunity, i.e. the opportunity to avoid being subjected to the burden of debt.

Although it is difficult to conceive of an action by the Republic of the Congo based on contractual breaches, one can envision the possibility of an extra-contractual proceeding commenced by Congolese citizens. Such an action could be successful, provided that judges recognise that: (1) the Congolese government or SNPC was an uninformed borrower; (2) the loans were manifestly excessive in relation to the country's financial standing and, thus, the banks should have refused to grant them; and (3) the Congolese citizens have standing. With this triple proviso, this remedy offers interesting potential and has the further advantage of avoiding debates on the end-use of the funds.

The two grounds discussed above may only be implemented where the oil-backed loan was concluded directly between a private creditor and the Congolese government or SNPC. As we have seen, however, in most cases parties have the ability to hide inside complex financial schemes to conceal the nature of their transactions. In cases where transactions are not transparent or clear, banking legislation offers interesting possibilities for seeking solutions.

C. Breaches of Banking Regulations

Under Article L. 562-1 of the French Monetary and Financial Code, credit institutions feature among those professional institutions subject to the anti-money laundering regulations (AMLR). Therefore, these institutions are bound by the obligation to act with due diligence.

First, under Article L.563-1 of the Monetary and Financial Code, "[t]he financial entities or the persons referred to in Article L.562-1 shall, before entering into a contractual relationship or assisting a client with the preparation or execution of a transaction, confirm the identity of the co-contracting party through production of any probative document. [...] They determine the true identity of the persons with whom they enter into a contractual relationship or who request their assistance with the preparation or execution of a transaction when it appears to them that those persons might not be acting on their own behalf [...]."

Next, Article L.563-3 of the Monetary and Financial Code imposes a duty on banks to proceed with

a special examination of operations with a nominal or total amount in excess of EUR 150 000, appearing under unusually complex conditions and not appearing to be economically justified or to have a lawful cause. In cases fitting this description, the financial entity has a duty to find out from the client the origin and end-use of the amount, the object of the transaction, and the identity of the person who is to benefit from the transaction.

In the present case, it appears legitimately possible that the banks failed to comply with due diligence obligations. More specifically, if the banks had applied the due diligence obligations to which they were legally bound, they would not have proceeded with the transactions. A professional breach of this type constitutes a violation that triggers banks' civil liability. If it appears that by failing to comply with its obligations under the AMLR, a creditor caused prejudice to a third party, the party may invoke the bank's civil liability on the basis of Article 1382 of the French Civil Code. In the instant case it is possible that the Congolese population suffered prejudice due to the breaches committed by banks, said prejudice consists of

the loss of the opportunity not to be subjected to the burden of debt. Supposing that the claimants present evidence of the damage suffered and the causal link between the damage and the failures committed by the banks, the banks would be bound to compensate the harm through the payment of damages. Nevertheless, for the same reasons explained above, such reparation could only be partial.

The latter action is substantially similar to the previous action discussed; however, this action is distinguishable from the former because it involves no debate on the quality of the borrower, as the AMLR regulations are applicable regardless of this point.

Conclusion

Civil litigation under French law offers interesting possibilities for relieving Congo Brazzaville's debt. Nevertheless, any potential legal action against the Republic of the Congo's private lenders should not serve to make one forget the personal liability of Congolese dignitaries for the accumulation of debt.³⁰

1 pétrole contre poignée de dollars: on gagerait toujours le pétrole au Congo, Mwinda Press, available at http://monde.fil-info-france.com/bruno_ossebi_journaliste_assassine_congo.htm.

2 This article restricts itself to the subject of oil-backed loans, but this type of secured loan can also be used with other resources, such as cotton, gas, or even customs revenue.

3 See International Monetary Fund (IMF), *Assessing Public Sector Borrowing Collateralized on Future Flow Receivables*, points 57 to 59, June 2003, available at <http://www.imf.org/external/np/fad/2003/061103.pdf>.

4 This article gives only a brief overview of the broad phenomenon of oil-backed loans in Congo Brazzaville. For a more in-depth account see: François-Xavier Verschave, *NOIR SILENCE : QUI ARRÊTERA LA FRANÇAIFRIQUE?* (Les Arènes 2000); Loïk Le Floch-

Prigent, *AFFAIRE ELF, AFFAIRE D'ETAT : ENTRETIENS AVEC ERIC DECOUTY* (Le Cherche Midi 2001); François-Xavier Verschave, *L'ENVERS DE LA DETTE* (Agones 2001); Global Witness, *Time for Transparency: Coming Clean on Oil, Mining and Gas Revenues*, March 2004; Xavier Harel, *AFRIQUE, PILLAGE À HUIS CLOS: COMMENT UNE POIGNÉE D'INITIÉS SIPHONNE LE PÉTROLE AFRICAÏN* (Fayard 2006); Yitzhak Koula, *PÉTROLE ET VIOLENCES AU CONGO-BRAZZAVILLE: LES SUITES DE L'AFFAIRE ELF* (L'Harmattan 2006).

5 IMF, *Report on the Republic of the Congo*, at 33 (unpublished report) 2001.

6 Congo Brazzaville is a candidate for the Heavily Indebted Poor Countries (HIPC) initiative, a programme that enables eligible states to benefit from a substantial reduction of debt.

7 For example, the Republic of the Congo agreed: "For reasons of sound debt management and taking into account its par-

- ticularly onerous nature, the government will not contract any new oil collateralized debt." Republic of the Congo: Letter of Intent, point 7, 3 May 2002.
- 8 Kensington International Ltd. is an American fund specialised in buying very low-priced debts from Southern countries. As it speculates on Southern countries' debt, this fund is also called a "vulture fund."
 - 9 "Complex pre-financing schemes were concluded, such as the USD 200 million Glencore/SNPC scheme with banks, whereby funds were provided to SNPC and repayment was made by the utilization of oil cargo." (§101) *Kensington International v. Republic of the Congo*, High Court of Justice, London, 28 November 2005.
 - 10 *Kensington International Ltd v. SNPC*, Bruno Itoua, BNP Paribas S.A., U.S. District Court, Southern District of New York, March 2006.
 - 11 Life expectancy at birth does not go beyond fifty-two, while the infant mortality rate is eighty-one percent. Source: IMF, 2005.
 - 12 IMF, Report on the Republic of the Congo, at 39 (unpublished report) 2001.
 - 13 See Comité catholique contre la faim et pour le développement, *Biens mal acquis... profitent trop souvent. La fortune des dictateurs et les complaisances occidentales*, March 2007, available at http://www.ccfid.asso.fr/ewb_pages/d/doc_1641.php.
 - 14 This complaint questions how an important number of assets were acquired in France by Messrs. Denis Sassou Nguesso, Omar Bongo Ondimba and Tédoro Obiang, and members of their entourage. The case is still pending.
 - 15 IMF, Republic of the Congo: Enhanced Heavily Indebted Poor Countries (HIPC), April 2006.
 - 16 *Id.*
 - 17 See Jean Merckaert, *Des cadavres dans le placard : Les préfinancements pétroliers français au Congo-Brazzaville*, 30 January 2007.
 - 18 Bernard Audit, *TRANSNATIONAL ARBITRATION AND STATE CONTRACTS* (1988).
 - 19 For example, the cause of a loan agreement is illegitimate when it is contracted to enable a wife to flee with her lover. See Cass. req., 17 April 1923 : DP 1923, jurispr. at 172.
 - 20 CA Paris, 10 Sept. 1993 : Rev. crit. DIP 1994, at 349, note V. Heuzé ; Rev. arb. 1994, at 359, note D. Bureau ; RTD com. 1994, at 703, obs. Dubarry and Loquin.
 - 21 The claimant, however, must bring the evidence of the unlawful nature of the end-use of the funds, which, considering the murky environment in which oil-backed loan operations take place, may be difficult to establish.
 - 22 This option is most probably not the best one, given that the creditor will seek nullity to get its own loan repaid. Nevertheless, one may consider that it is in the interest of Congo Brazzaville to satisfy its creditors as quickly as possible.
 - 23 Cassation. 1st civ., 27 June 1995: Defrénois 1995, art. 36210, note D. Mazeaud ; JCP E 1996, II, 772, note D. Legeais ; RTD com. 1996, at 100, note M. Cabrillac.
 - 24 See Guy Raymond, commentary number 259, *CONTRATS CONSUMMATION* n° 11, November 2008.
 - 25 A loan's excessiveness is considered on a case-by-case basis, taking into account the financial standing of the borrower and the amount of the loan.
 - 26 Loss of opportunity consists in the current and certain disappearance of a favourable contingency. See Cass. Civ. 1st 21 November 2006: Bull. civ I , n° 498.
 - 27 See Cass. Civ. 1st, 16 July 1998: Bull. civ I , n° 260.
 - 28 Under Article 1382 of the Civil Code : "Any action whatsoever by a man causing someone else damage binds the one by whose fault he has managed to repair it."
 - 29 It is also possible that a Congolese creditor suffered a prejudice as a result of a breach committed by a bank. But such an action is not of interest in the context of the present discussion, as the damages awarded would be intended for this single creditor. Nevertheless, as indicated above, one may consider that it is in the interests of Congo Brazzaville to satisfy its creditors as quickly as possible.
 - 30 One may question how the Republic of the Congo managed to reach the decision point within the enhanced HIPC initiative on March 2006. The decision point is the point at which the IMF decides that a particular country is admissible for relief and the international community commits to bringing the country's debt back to the agreed viability threshold. This happens when the country has made sufficient progress towards fulfilling certain criteria or has fulfilled them. When a country reaches the decision point, it can immediately receive provisional relief on the payable servicing of its debt. Nevertheless, to receive the full and irrevocable reduction of its debt under the HIPC Debt Initiative, the country must: (i) continue to provide evidence that it is properly executing programmes supported by the IMF (ii) satisfactorily execute the basic reforms agreed at the decision point, and (iii) adopt and execute the PRSP for at least a year. When a country has fulfilled this criteria, it may reach its completion point. Creditors must now grant it the full debt relief promised at the decision point. Source: IMF; see also, Xavier Harel, *AFRIQUE, PILLAGE À HUIS CLOS: COMMENT UNE POIGNÉE D'INITIÉS SIPHONNE LE PÉTROLE AFRICAÏN*, at 80-81 (Fayard 2006) (commenting on the role played by France in the taking of this decision).



Financing the Crime of Apartheid

9.7 What Are the Legal Defenses?

Charles Abrahams

Introduction

On 27 April 1994, the African National Congress (ANC) won South Africa's first democratic election, ushering in a new democratic government. At the same time the new democratic government assumed approximately USD 14.6 billion in public foreign debt obligations that had been incurred by the former apartheid government.¹ This chapter will discuss the legality of this debt, though it has been paid in full.

Apartheid was declared a crime against humanity in 1977 by the United Nations General Assembly, which adopted the International Convention on the Suppression and Punishment of the Crime of Apartheid. The Convention declared apartheid a crime against humanity and all participants of the apartheid system (organizations, institutions, or individuals) criminals.²

The General Assembly repeatedly warned transnational corporations and banks against providing financial assistance to the apartheid government. For instance, in Resolution 31/33 (1976) the General Assembly expressed its conviction that such forms of collaboration were a principal factor in the perpetuation of the policies of apartheid and called upon all states to cease all new foreign investment in and financial loans to South Africa, as the General Assembly considered that this would constitute an important step toward the elimination of apartheid.

It was common knowledge among foreign banks and transnational corporations that by making investments and extending loans to apartheid South Africa they were perpetuating the policies of apartheid. The General Assembly directly addressed itself to foreign banks, transnational corporations, and other organisations with respect to this issue, urging them not to, inter alia, invest in apartheid South Africa, as such forms of assistance made them "accomplices in the inhuman practices of racial discrimination, colonialism and apartheid perpetrated by this regime."³ In resolution 35/32 (1980), for instance, the General Assembly described such forms of collaboration as constituting "a hostile act against the oppressed peoples of southern Africa and a contemptuous defiance of the United Nations and of the international community."

This article explores whether the democratic South African government could raise any legal defenses, either under international or domestic law, for refusing to pay these public foreign debts (referred to as "the Apartheid Debts" in this article), given that these debts amounted to the financing of a crime against humanity. This article will first consider the nature of the Apartheid Debts, i.e. whether they were bilateral, multilateral, or

commercial state debts and credits, and to which foreign banks, multinational corporations, and multilateral institutions, if any, they were owed. The article will then proceed to discuss what laws, whether domestic or international, govern the legal instruments with which these debts were contracted. Lastly, it will consider whether the financing of the apartheid government constitutes a defense against the repayment of the debt under domestic or international law, and whether any other defenses may be available for refusing to pay the Apartheid Debts.

I. The Nature of the Apartheid Debts

The Apartheid Debts consist almost exclusively of foreign commercial loans and sovereign bonds.⁴ Sovereign bonds can be classified as either international bonds issued by a government in an international financial centre, such as New York, London, or Tokyo, under foreign law, or domestic bonds, issued in the debtor country under domestic legislation. International bonds are typically not denominated in the currency of the issuer, while domestic bonds are denominated either in foreign or in local currency. Eurobonds are a specific category of international bonds, namely bonds that are issued in a country other than the one in whose currency the bond is denominated. They are often U.S. dollar denominated bonds issued in a European jurisdiction (e.g., England, Germany, or Luxembourg), hence the name.⁵ New York law and English law are by far the most popular laws for governing the issue of international bonds, though Luxembourg law (for Brady bonds), German law, and, more recently, Japanese law and Italian law (for Argentine debt) have also played a role.⁶

The following paragraphs consider a few examples of loans contracted and bonds floated by the South African government during the apartheid regime.⁷

Shortly after the Sharpeville Massacre in 1960 a consortium of ten banks lead by Chase Manhattan provided the apartheid government with USD 40 million in rescue loans. Sixteen years later, in 1976, at the time of the Soweto Student Uprising, South Africa raised a further loan of USD 110 million from a consortium of international banks to balance its payments deficit. Citibank, Morgan Guaranty, First Chicago and Deutsche Bank each provided USD 25 million, while Credit Suisse White Weld provided the remaining USD 10 million.⁸

In 1980, South Africa issued a public bond of DM 120 million on the Eurobond market. This loan was managed by Dresdner Bank, Commerzbank and Kreditbank International of Germany, together with other banks from Britain, Switzerland, and the United States.⁹ German exports to South



Africa increased from DM 3.4 billion in 1975 to DM 6.1 billion in 1989¹⁰ and Hermes guarantees for exports to South Africa increased from DM 2.3 billion in 1976 to more than DM 7 billion in 1994.¹¹ 76 percent of all German exported capital was imported by only two South African public corporations, namely ESCOM (Electricity Supply Commission) and SASOL (South African Oil Limited).¹² The companies supplying those capital goods were Brown, Boveri & Cie. (Mannheim), the Siemens Group, the Mannesmann Group, the GHH-MAN Group, the German Babcock Group (affiliate of Hoechst Group), Linde AG (affiliate of Airbus) and L & C. Steinmüller (affiliate of Klöckner & Co Group).¹³ The banks that insured export credits with Hermes Insurance AG were: Ausfuhr Kreditgesellschaft, Dresdner Bank, Bayerische Vereinsbank and Kreditanstalt für Wiederaufbau.¹⁴

Between 1982 and 1984, Union Bank of Switzerland (UBS/SBG), Swiss Bank Corporation (SBC), and Credit Suisse (CS) were among the most active lead managers, together with German banks, when it came to syndicated loans to the apartheid government.¹⁵ Between 1980 and 1985, the liabilities of the South African public authorities toward Swiss banks increased by about CHF 1.5 billion.¹⁶ In 1984, South Africa signed a CHF 70 million loan with Union Bank of Switzerland, followed by a USD 115 million bond issue floated on the Eurobond market in January and March of that year. In 1984, Soditic, a Swiss bank, helped the bantustan of Transkei to raise USD 5.3 million.

For South Africa's democratic government to raise legal defenses with respect to the above loans and bonds, it would first have to ascertain whether international or foreign domestic law is applicable, which foreign courts have jurisdiction (should foreign domestic law be applicable), and whether any legal defenses are available. In effect, the government must ascertain which foreign court has personal and subject matter jurisdiction over the loan or bond instrument.

II. The Applicable Laws and Jurisdictions

From the few examples given above, it is evident that the loans and bonds are of a commercial nature. Thus, it is likely that the domestic law of the home country where the credit bank is located governs them.

Given that there is no supranational statute or court that governs sovereign borrowing, nearly every international legal agreement contains a governing law or choice-of-law clause. In the case of the United States, both federal and New York State courts accept consent jurisdiction in the form of contractual submissions to their jurisdiction. Under U.S. law, international bond issues by a sovereign, and a subsequent default, are almost always considered commercial activities, regardless of the purpose of the issue, or the reason behind the interruption of payment.

International sovereign bonds are typically issued under fiscal agency agreements or trust structures. Under a fiscal agency agreement, a fiscal agent is appointed by the issuer, while a trust

deed or trust indenture is a contract between the issuer of a bond and a trustee, which is created for the benefit of the bondholders.¹⁷ The trustee represents the interests of bondholders and owes fiduciary obligations to the bondholders as a group. The trust deed vests in the trustee certain powers and duties to enforce the issuer's obligations and bondholders' rights.¹⁸ Should a default occur, the trustee has primary responsibility for enforcing the remedial provisions of the contract.¹⁹ In addition, if the bond is to be listed, the stock exchange may require a trustee to be appointed. Because the trust structure tends to be more expensive than the fiscal agency arrangement, most international sovereign bonds governed by New York and English law are issued under fiscal agency agreements.²⁰

Any dispute arising under any of the loan or bond instruments, such as the 1976 syndicated loan of USD 110 million by Citibank, Morgan Guaranty, First Chicago, Deutsche Bank and Credit Suisse White Weld, or the 1980 public bond of DM 120 million²¹ issued on the Eurobond market, managed by Dresdner Bank, Commerzbank, and Kreditbank International of Germany, together with other banks from Britain, Switzerland and the United States, would require a court before which to bring the action to determine the enforceability of the choice-of-law clauses. Once personal jurisdiction is established, a court would proceed to enquire whether it has subject matter jurisdiction with respect to the instruments. In the case of U.S. law, although federal district courts are courts of limited jurisdiction, they have a specific statutory grant of subject-matter jurisdiction over civil actions against foreign states when the foreign state does not have a defense of sovereign immunity.²²

Given that loan and bond instruments generally contain default clauses, a default in payment on any of these instruments may result in litigation against the government of South Africa. The question that remains is whether any legal defenses are available to the government, in particular whether the financing of the apartheid government constitutes a defense.

III. A Possible Legal Defense

It is doubtful that a broad defense based on financing apartheid would be a successful defense for non-payment. Although presently apartheid is considered a *ius cogens* violation of international law on par with slavery and genocide, it is doubtful that was the case at the time it was practiced in South Africa. The Apartheid Convention was adopted by the General Assembly, and was not a resolution of the Security Council, nor was it adopted by Western governments.²³

To the contrary, many Western governments encouraged commerce with the government of South Africa during apartheid. The United States government's policy of Constructive Engagement encouraged commerce and investment with apartheid South Africa. In October 1986, the U.S. Congress passed the Comprehensive Anti-Apartheid Act, which set out the United States' policy toward

the government of South Africa.²⁴ The European Community (EC) adopted a voluntary code of conduct, suggesting principles that should apply to member states' companies with operations in South Africa. The British government had a similar policy to the European Community, which it promulgated in 1974. Switzerland did not have any policy barring commerce and investments with apartheid South Africa, while the government of the Federal Republic of Germany encouraged its corporations to follow the voluntary EC code of conduct.

The Apartheid Convention itself covers acts that are outlawed under international law and some acts that are violations of *ius cogens*. These acts include: extra-judicial killing; infliction of serious bodily or mental harm: torture or cruel, inhuman, or degrading treatment; the deliberate imposition on a racial group or groups of living conditions calculated to cause its or their physical destruction in whole or in part; exploitation of the labour of members of a racial group or groups, by submitting them to forced labour; the division of the population by racial lines by the creation of separate reserves and ghettos; the prohibition of mixed marriages; the expropriation of property belonging to a racial group or groups; and the institution of measures calculated to prevent a racial group from participating in the political, social, economic and cultural life of a country, in particular by denying the group or groups basic human rights or freedoms.

As a component of apartheid, forced labour is a *ius cogens* violation. It is a modern variant of slavery. Forced labour was designed to make and maintain the Black South African population as a labour pool to be dominated and exploited. Genocide, which was also a component of apartheid in South Africa, is a *ius cogens* violation as well. Genocide is defined in part as deliberately inflicting on a group conditions of life calculated to bring about its physical destruction in whole or in part. Furthermore, other acts, such as extra-judicial killing, torture, arbitrary detention, sexual assault, and cruel, inhuman and degrading treatment, also form *ius cogens* violations as components of apartheid.

It follows that any loan or bond floated for the purpose of committing any of the above acts would be contrary to international law. Thus, the loans that financed the export of an entire ammunition plant to South Africa in 1979 by Rheinmetall, a German company, would certainly be considered illegal and invalid under both international and German domestic law. In 1979, Rheinmetall, a top producer in the German armaments industry with factories in Düsseldorf and Unterlüss, under fraudulent export declarations, exported a complete ammunition factory to South Africa to manufacture the 155mm extended range projectiles needed by South Africa.²⁵ It applied for a license to export a plant to Paraguay, using a fictitious company, "Sudamerika Paraguay Exportacion-Importacion." Once the exported plant reached port in Brazil, the freight was re-loaded onto a ship bound for Durban, South Africa.²⁶ The plant, which was located in Pretoria, began opera-

tions in 1979, and by 1985 it was fully automated with central controls run through a video monitor system.²⁷ Even after a criminal investigation was launched against Rheinmetall in 1980, the company openly trained members of the South African Defence Force in the use of certain artillery systems on its Unterlüss test range.

The loan that financed the export of ammunition by Rheinmetall violated the United Nations compulsory arms embargo. In 1977, the Security Council called for an arms embargo against South Africa, invoking Chapter VII of the United Nations Charter.²⁸ Resolution 418 required that all member states cease the provision of arms and related materials, as well as the granting of licenses to manufacture military materials to South Africa.

Another loan for which a successful defense may be raised is the USD 5.3 million that the Swiss bank, Soditic, helped the bantustan of Transkei to raise in 1984. In 1976, Transkei was granted independence by an act of the South African Parliament,²⁹ followed by Bobhuthatswana, Venda, and Ciskei, called the TBVC states. The United Nations adopted a number of resolutions calling for the non-recognition of the TBVC states.³⁰ The Security Council subsequently endorsed the call for non-recognition by the passing of resolutions 402 of 1976 and 407 of 1977. Although Switzerland was not a member of the United Nations at that time,³¹ it can be argued that the loan violated customary international law. The grant of independence to the TBVC states was aimed at destroying the territorial integrity of South Africa and was a violation of the right to self-determination of the majority of South African people.

A third category of loans for which a defense may be raised, albeit with difficulty, is the German export credit loans. As mentioned earlier, the German government provided credit insurance for bank-financed export transactions to apartheid South Africa through the German State Export Guarantee Programme administered by Hermes Kreditversicherungs-AG acting as an agent for the German government. Because all of the export credit was imported by two of South Africa's state corporations, ESCOM and SASOL, plant and buildings under the control of both corporations were declared national key points under the South African National Key Points Act. The Act allowed the Minister of Defense to declare any building or installation a "national key point," thereby requiring the owner to take special security precautions. Such security precautions included the organization of all-white military reserve units and the storing of weapons and communications equipment. It may very well be that some loans obtained through export credit were used for the purpose of purchasing arms and ammunition pursuant to the National Key Points Act.

Conclusion

The few examples discussed above are not exhaustive. Nonetheless, they are representative of the broad spectrum of debts incurred by the apartheid government. While a broad defense based on

the financing of apartheid may be met with difficulty, the government of South Africa may find some defenses in international law. It remains to

be seen how domestic courts in the United States, Germany or Switzerland would deal with such defenses should such disputes come before them.

- 1 Of the debts assumed by the new democratic government, USD 5.4 billion consisted of public authorities' debts, USD 2.8 billion of the central government's debts, and USD 9.1 billion of debts contracted by state corporations.
- 2 Article II of the International Convention on the Suppression and Punishment of the Crime of Apartheid defined apartheid as: [s]imilar policies and practices of racial segregation and discrimination as practiced in southern Africa, shall apply to the following inhuman acts committed for the purpose of establishing and maintaining domination by one racial group of persons over any other racial group of persons and systematically oppressing them:
 - a. Denial to a member or members of a racial group or groups of the right to life and liberty of person:
 1. By murder of members of a racial group or groups;
 2. By the infliction upon the members of a racial group or groups of serious bodily or mental harm, by the infringement of their freedom or dignity, or by subjecting them to torture or to cruel, inhuman or degrading treatment or punishment;
 3. By arbitrary arrest and illegal imprisonment of the members of a racial group or groups;
 2. Deliberate imposition on a racial group or groups of living conditions calculated to cause its or their physical destruction in whole or in part;
 3. Any legislative measures and other measures calculated to prevent a racial group or groups from participation in the political, social, economic and cultural life of the country and the deliberate creation of conditions preventing the full development of such a group or groups, in particular by denying to members of a racial group or groups basic human rights and freedoms, including the right to work, the right to form recognized trade unions, the right to education, the right to leave and to return to their country, the right to a nationality, the right to freedom of movement and residence, the right to freedom of opinion and expression, and the right to freedom of peaceful assembly and association;
 4. Any measures, including legislative measures, designed to divide the population along racial lines by the creation of separate reserves and ghettos for the members of a racial group or groups, the prohibition of mixed marriages among members of various racial groups, the expropriation of landed property belonging to a racial group or groups or to members thereof;
 - 5 Exploitation of the labour of the members of a racial group or groups, in particular by submitting them to forced labour;
 6. Persecution of organizations and persons, by depriving them of fundamental rights and freedoms, because they oppose apartheid.

Article III of the Convention described who would be held responsible for committing the acts outlined in Article II. It provides:
International criminal responsibility shall apply, irrespective of the motive involved, to individuals, members of organizations and institutions and representatives of the state, whether residing in the territory of the state in which the acts are perpetrated or in some other state, whenever they:

 - a. Commit, participate in, directly incite or conspire in the commission of the acts mentioned in article II of the present Convention;
 2. Directly abet, encourage or cooperate in the commission of the crime of apartheid.
- 3 Report of the Special Committee Against Apartheid in South Africa, U.N. Doc. A/35/22, at 104 (1980).
- 4 South Africa did not have multilateral debts at the end of apartheid. In 1976 it was no longer eligible for loans from the World Bank. In 1983, due to the U.S. Gramms Act, South Africa could no longer access loans from the International Monetary Fund (IMF).
- 5 Sturzenegger et al., *Has the Legal Threat to Sovereign Debt Restructuring Become Real?*, at 13.
- 6 *Id.* at 14.
- 7 It is not possible to provide a comprehensive overview of all loans contracted with apartheid South Africa due to the lack of publicly available data.
- 8 Madörin et al. *Apartheidschulden: Der Anteil Deutschlands und der Schweiz* (1999). English translation by Gottfried Wellmer and Elaine Griffiths published by Jubilee 2000 South Africa, at 9.
- 9 *Id.* at 58.
- 10 DM 3.4 billion = EUR 1738392396, DM 6.1 billion = EUR 3118880475 (EUR 1 = DM 1.95583).
- 11 DM 2.3 billion = EUR 1175971327, DM 7 billion = EUR 3579043168 (EUR 1 = DM 1.95583).
- 12 *Supra* note 8 at 57.
- 13 *Id.*
- 14 *Id.*
- 15 *Id.* at 72.
- 16 *Id.*
- 17 Y. Liu, *Collective Action Clauses in Sovereign Bonds*, at 1, available at <http://imf.org/external/np/leg/sem/2002/cd-mfl/eng/liu.pdf> (last accessed on 8 March 2009).
- 18 *Id.* at 2.
- 19 *Id.*
- 20 *Id.*
- 21 EUR 61355026 (EUR 1 = DM 1,95583).
- 22 G. Weitz et al., *Selected Issues in Sovereign Debt Litigation*, at 575, in *INTERNATIONALBORROWING, NEGOTIATING AND STRUCTURING INTERNATIONAL DEBT TRANSACTIONS* (Daniel D. Bradlow ed., International Law Institute, 3rd ed.).
- 23 General Assembly Resolutions are not binding, while Security Council Resolutions are binding.
- 24 The Comprehensive Anti-Apartheid Act, 22 U.S.C. §§ 5000-5116 (1988).
- 25 H. Lohrscheid, *Waffenhandel vor Gericht: Im Prozeß gegen Rheinmetall scheint die Justiz überfordert*, TAZ (Berlin), 28 May 1986.
- 26 *Id.*
- 27 Signe Landgren, *EMBARGO DISIMPLEMENTED: SOUTH AFRICA'S MILITARY INDUSTRY*, at 88-95 (Oxford University Press 1989).
- 28 Security Council Resolution, *The Question of South Africa*, S/RES/418, 4 November 1977.
- 29 Status of Transkei Act 100 of 1976.
- 30 J. Dugard, *INTERNATIONAL LAW: A SOUTH AFRICAN PERSPECTIVE* (Juta & Co. 1994).
- 31 Switzerland has maintained a policy of neutrality for hundreds of years and only became a member of the United Nations on 10 September 2002.



9.8 Baby Doc's Odious Debts and Haiti's Legal Defences

Sandrine Giroud

Introduction

Haiti is the least-developed country in the western hemisphere. Comparative social and economic indicators show that Haiti has fallen behind other low-income developing countries since the 1980s. Haiti now ranks 148th out of 179 countries in the United Nations Human Development Index.¹ In practical terms, this means that 54 percent of Haitians live on less than one dollar a day and 78 percent on less than two dollars a day.²

The situation is not likely to improve soon considering the terrible year Haiti had in 2008. Soaring world prices for food and fuel, together with a series of four consecutive hurricanes that destroyed much of Haiti's infrastructure, have left the country in need of great support.

In April 2006, Haiti was added to the list of Heavily Indebted Poor Countries (HIPC) and became eligible for the HIPC Initiative of the World Bank (WB) and the International Monetary Fund (IMF). In June 2009 Haiti was granted USD 1.2 billion in debt relief by reaching the completion point under the enhanced HIPC Initiative. The HIPC Initiative and the Multilateral Debt Relief Initiative (MDRI) both resulted in debt service savings (USD 265 million and USD 972.7 million, respectively).³ Nevertheless, Haiti still had to honour a debt service reaching USD 58 million in 2008, which, for the most part, goes back to the Duvaliers' dictatorship.⁴ Indeed, having started with a total outstanding debt of USD 43 million in 1972, Haiti's total outstanding debt had reached almost USD 750 million by the end of the reign of Jean-Claude Duvalier in 1986.⁵

In light of these facts, the present article will analyse whether Haiti has a legal claim to the cancellation of the debts resulting from Baby Doc's era. The analysis will focus on the potential legal arguments that Haiti has under international law, leaving to others the task of supporting these arguments with figures and other evidence.

I. Haiti's Debts: A History Spanning Almost Two Centuries

Three layers, related to three fundamental periods of Haitian history, have defined Haiti's external debt over the years. The first period (A) goes back to Haiti's independence from France in 1804, and to the bitter cost that came with it in the form of "independence debt." The second episode (B) refers to the devastating and brutal dictatorship of the Duvaliers – father and son – that lasted nearly thirty years and left the treasury's coffers empty (if not full of odious debts). Lastly, the third period (C) resulted from the political turmoil Haiti endured during the 1990s, which led the international community to impose an embargo on the country.

A. The Independence Debt

In 1804, Haiti gained its independence from France, becoming the first black republic in the world. The new state, however, started off with a heavy burden to carry. Because both France and the United States refused to recognise its independent status, Haiti was forced, in 1825, to give 150 million francs-or to France to gain recognition and to repay slaveholders for their losses. In 1838, the indemnity was brought down to 90 million francs-or. The last instalment of this enormous debt was not paid until the beginning of the 20th century. To repay the "independence debt," Haiti had to take loans, followed by more loans. Though initially intended for the development of the country, these loans were mostly used to pay off the "independence debt", when the initiators of the loans did not misappropriate them.

B. Baby Doc's Debts

Although the "independence debt" placed a heavy burden on Haiti, much of the country's current debt did not originate in the 19th century, but from the Duvaliers' dictatorship, especially from the time of Jean-Claude Duvalier (better known as "Baby Doc"), who was in power from 1972 to 1986.

In their multiple bank accounts in Switzerland, the United Kingdom, the United States and France, the Duvaliers held ever-increasing fortunes. In addition, Jean-Claude Duvalier owned a castle in Val d'Oise, France, two apartments in Paris, two in Neuilly, France, a condominium in the luxurious Trump World Tower in New York, and a yacht in Miami.⁶ According to Transparency International, Jean-Claude Duvalier likely embezzled between USD 300 and 800 million during his dictatorship.⁷

Jean-Claude Duvalier's regime coincided with a period of rampant growth in Third World debt. This period of unprecedented credit availability propelled by the oil crisis of the 1970s allowed Haiti to contract numerous loans with western banking institutions. Unfortunately, the debt crisis of the 1980s left Haiti unable to service its debt and with nothing to show in exchange for it, given that most of the loans were used by Jean-Claude Duvalier and his family for personal purposes.

When Jean-Claude Duvalier's dictatorship ended in 1986, several lawsuits were launched in different countries to investigate the possible illegal use of public funds by the Duvalier family. One of these proceedings led the Swiss government, on 12 February 2009, to confiscate the assets of Jean-Claude Duvalier that were located in Switzerland (approximately CHF 7 million) and return them to Haiti.⁸ This decision is being appealed and the final decision is still pending at the time of



writing. It is important to note, however, that the Swiss case remains an exception, as most of the attempts to recover Jean-Claude Duvalier's assets have so far failed.

C. Embargo

A succession of governments and coups d'état followed Jean-Claude Duvalier's departure. In 1991, the international community attempted to put the democratic development of Haiti back on track with the imposition, through the UN, of an embargo aimed at restoring ousted President Jean-Bertrand Aristide. This embargo inflicted a strong blow on the country's already weak economy.

Though Aristide was quickly restored to office, the scepticism of the international community did not vanish. Doubts as to the legitimacy of Aristide's election in 2000 led the WB and the Inter-American Development Bank (IDB) to suspend most grants to Haiti. After Aristide left the country in 2004, the reengagement of international financial institutions remained conditioned on Haiti's payment of arrears owed to them.

II. Baby Doc's Odious Debts

With the above historical overview in mind, I now turn to the question of the legitimacy of Haiti's external debt. For reasons of conciseness, I will focus on the debts accumulated under Jean-Claude Duvalier's regime, in particular on the multilateral loans entered into with the WB and the IMF.

A. Nature of the Debts

Two main reasons explain the flow of foreign money to the Duvaliers' dictatorship. The first reason is geopolitical. Lying just across the Windward Channel from Cuba, Haiti was able to take advantage of political tensions during the Cold War. François Duvalier made clear that his loyalty to the United States was for sale and, in return, he received official loans to support his dictatorial regime.⁹

The second reason was of an economic nature. Following the first oil crisis in 1973, huge amounts of petrodollars flooded western banking institutions at a time when industrialised countries' demand for credit was depressed. Western banking institutions quickly found a new market for these petrodollars in the developing world. Benefitting from these new funds, many developing countries, such as Haiti, took the opportunity to contract loans to "officially" industrialise their economies. They borrowed heavily from banking institutions at relatively low interest rates, accumulating unprecedented levels of debt.

The 1980s, however, brought a dramatic shift in the economic policies of industrialised countries. As a reaction to rapidly unfolding inflation in the United States, global interest rates were increased. Worldwide, the total debt of developing countries increased by 1,500 percent between 1965 and 1980.¹⁰

According to the WB and the UN Office on Drugs and Crime (UNODC), Jean-Claude Duvalier may have stolen the equivalent of 1.7 to 4.5 percent of Haiti's GDP every year he was in office.¹¹ While the

country's debt amounted to approximately USD 40 million in 1970, by 1987, the first full fiscal year after Jean-Claude Duvalier's departure, it was USD 844 million, or 60 percent of the amount owed in 2004. Although estimates vary, it is alleged that the Duvalier family took USD 900 million in multinational and bilateral loans for their own purposes.¹²

The people of Haiti have neither benefited from these funds nor received them back, despite advocacy efforts. On the contrary, they have directly suffered from the ill-use of these loans, which helped fund the brutal regime put in place by Jean-Claude Duvalier to support his luxurious lifestyle through, for example, (1) the financing of repression forces and (2) the looting of the treasury's coffers.

1. Financing of the Paramilitary Forces

On 5 December 1980, the IMF gave Jean Claude Duvalier USD 22 million in aid. Within weeks, USD 20 million were withdrawn from the Haitian government's account. According to the IMF, USD 4 million went directly to fund the *Milice de Volontaires de la Sécurité Nationale* (MVSN) – a militia force, also known as *Tontons Macoutes*, responsible for as many as 30,000 killings during the Duvalier years. The remaining USD 16 million seemingly disappeared into Duvalier's numerous personal accounts. In a report, the IMF almost euphemistically defined "excessive unbudgeted spending as the most important cause of Haiti's financial crises."¹³

2. Looting of the Treasury's Coffers

From at least 1975 onward, Jean-Claude Duvalier set up a system of extra-budgetary accounts provided with funds from the Public Treasury and revenues from public institutions. By doing this, Duvalier and his family allegedly misappropriated up to USD 70 million from the state.¹⁴

Additionally, it is attested that Haiti's budget contained several items that, despite their misleading names, were headed toward Jean-Claude Duvalier's pockets. This system provided Duvalier with allowances amounting to approximately USD 8 million, coming from contributions to "Social Assistance," the item named "Without Justification," and other budget items.¹⁵

B. Odious Debts

When analysing potential defences available to annul part or all of the "odious" debts contracted by Duvalier with multinational institutions (i.e., the WB and the IMF), we need to consider: (1) the forum available to address this issue; (2) the legal nature of the relationship from which the debts arose, and, finally, (3) the existing legal arguments that support debt cancellation.

1. Available Forum

In their Articles of Agreement, both the WB and the IMF have provisions concerning the ability to institute legal proceedings and have legal proceedings brought against them.¹⁶ However, both institutions enjoy general immunities from adju-

dication in national courts.¹⁷ Therefore, litigation before domestic courts seems improbable.

It is very likely, though, that the loan agreements contain an arbitration clause.¹⁸ In that case, Haiti could bring its case before an arbitral tribunal constituted by arbitrators chosen by the WB or the IMF, respectively, and Haiti itself.¹⁹

The WB Inspection Panel (WBIP) could also, though only to a very limited extent, constitute an appropriate forum for claims brought by a claimant regarding “an act or omission by the Bank [concerning] its operational policies and procedures.”²⁰ It is the first body established before which parties can seek to hold an international organisation accountable for its actions. Nevertheless, considering the limited references to human rights in the WB’s operational policies, the scope of action possible within the WBIP appears to be very narrow, and perhaps even inexistent when it comes to questioning the “odious” character of the loans contracted by Haiti.²¹

2. Nature of the WB and IMF Loans

Any loan agreement entered into by the WB and its members must be made in accordance with the Articles of Agreement and the Bank’s Loan and Guarantee Regulations. Such agreements usually contain a so-called de-nationalisation clause. The WB’s official view (also shared by most commentators)²² is that, therefore, such agreements are governed by international law.²³ This conclusion is also supported by the status of the WB as a subject of international law.²⁴ The same conclusions hold true for IMF loans.²⁵

Due to the international law nature of the loan agreements concluded by Haiti with the WB and the IMF, any argument in support of cancelling part or all of the debts contracted under these agreements must be found in international law.

3. Available Defences

a. The Traditional Odious Debts Defence

In international public law, there exists a widely accepted presumption that debts incurred by a state pass on to the succeeding state.²⁶ This assumption, however, may lead to morally unjustifiable results. Scholars and practitioners have long tried to come up with creative solutions to solve this dilemma, which burdens the future of new states. The traditional doctrine of odious debt is one of these proposed solutions.²⁷

From a purely legal point of view, the doctrine of odious debt does not rest on a stable foundation.²⁸ The absence of international instruments, lack of recent state practice, inconsistent *opinio iuris*, and controversy among scholars all shed doubt on the doctrine’s existence under international law, all the more so in cases dealing with a change of government and not with state succession.²⁹ Nevertheless, the debate is still very much alive, as discussions on the cancellation of the debts incurred under Saddam Hussein’s dictatorship show.³⁰

As stated by Bryan Thomas, “[t]here is little doubt that some portion of developing country debt con-



The Duvalier Foundation in Port-au-Prince, Haiti on 14th April 2007. As a rule, former dictatorial clans can preserve their political and economic influence beyond regime changes. Picture: Keystone



Woman selling rice in Port-au-Prince, Haiti. Picture: Reuters/Eduardo Munoz

tracted with the World Bank is odious. Because World Bank officials were often well aware of the end-uses of their loans, subjective awareness of odious lending may be relatively easy to establish. World Bank officials have, in recent years, essentially confessed that much of the post-war lending was odious.³¹ This case, however, seems more difficult to make regarding IMF loans.³²

Under the doctrine of odious debt, debts that are incurred by an undemocratic regime, without the consent of the population, and against its interests cannot be reclaimed if the lender was aware of these deficiencies. This is even truer when the money borrowed was used to commit serious human rights violations. In light of the facts described above, the doctrine of odious debt undoubtedly applies to the debts incurred by Jean-Claude Duvalier when he was in power.³³ Nevertheless, taking into consideration the controversial nature of this doctrine, this defence strategy appears rather weak.

b. The Private Law Defence

Some scholars and practitioners have tried to come up with defences that originate in private law.³⁴ Private law defences, however, are confronted with one major obstacle: they require that the legal relationship that created the “odious” debt, i.e., the loan agreement, be subject to private law, i.e., domestic law. But, multinational loan agreements – such as those contracted by Duvalier – or bilateral state-to-state agreements are international law agreements against which private law defences are useless, absent the existence of an equivalent defence in international law.³⁵

It is true that precedents exist in international law that provide justification for the non-performance of treaty obligations, freeing the debtor state of its responsibility, such as state of necessity, impossibility, force majeure, or similar concepts.³⁶ These grounds, however, only refer to ex-post events that justify the termination of a binding agreement, and do not refer to the “odious” nature of the debt at the time the agreement was concluded.

It should be noted that ideas have been expressed regarding the application of agency law to the relationship between a government, a population, and a third party (i.e., the lender).³⁷ Again, this would amount to an application by analogy of a theory arising from domestic law, which has not yet proven convincing under international public law.

c. The Vienna Convention Defence

The 1969 Vienna Convention on the Law of Treaties (Vienna Convention) provides certain grounds for the invalidation of a treaty, but none of the grounds mentioned from Article 46 to 52 (invalidity of treaties) of the Vienna Convention apply to the debts contracted by Jean-Claude Duvalier.³⁸

Furthermore, it is worth noting that the Vienna Convention only applies to states and that the 1986 Vienna Convention on the Law of Treaties between states and international organisations or between international organisations, which provides the same grounds for invalidating treaties, is

not yet in force.³⁹ Therefore, any defence arising out of the Vienna Convention regarding the invalidity of a loan agreement must be recognised under other sources of international law, such as customary international law.

The principle stating that the violation of a norm of *ius cogens* invalidates a treaty, such as that provided in Article 53 of the Vienna Convention, arguably forms part of customary international law and, as such, extends beyond the Vienna Convention.⁴⁰ Thus, Article 53 seems to offer a valid defence against the obligation to repay the loan debts contracted under Duvalier's presidency, as will be explained below.

d. The *Ius Cogens* Defence

Based on the principles contained in the Vienna Convention, particularly Article 53, some scholars and practitioners have argued that loan agreements that contribute to a *ius cogens* violation are invalid.⁴¹ This echoes the position taken by Special Rapporteur Mohammed Bedjaoui, who suggested that debts that are not contracted in conformity with international law should be considered odious and thus invalid.⁴² To meet this test, however, one has to establish a causal link between the loan and the *ius cogens* violation at the time the loan was contracted.

Although the boundaries of the *ius cogens* concept are debated, the current consensus seems to include the outlawing of wars of aggression, the prohibition of crimes against humanity, genocide, torture, slavery and apartheid, and the protection of the right to self-determination.⁴³ Accordingly, the numerous gross violations of human rights committed under Duvalier's regime (murders, summary executions, torture, forced disappearances,

etc.) should be considered violations of the rules of *ius cogens*.⁴⁴ The financing of the MVSN with IMF loans shows that such loans directly contributed to the persecution of the Haitian population and, as such, amounted to *ius cogens* violations.⁴⁵

Based on the above, the *ius cogens* defence appears to be the most convincing argument in support of not repaying the loans contracted during Jean-Claude Duvalier's regime.

Conclusion

Jean-Claude Duvalier's dictatorial regime caused much suffering to the Haitian population. For the most part, the debt constituting the heavy economic burden resting on Haiti today originated from the many loans Jean-Claude Duvalier contracted with the WB and the IMF. Duvalier used these loans to maintain his dictatorship, exploit the Haitian population, and fill his pockets. These loans contributed to a regime of torture and other grave human rights violations.

There do not exist many available defences in international law against the obligation to repay these loans. Although scholars have proven creative in this area, many of the theories put forward have not passed the test of being recognised in international law. Thus, the *ius cogens* defence appears to be the most promising, given that it is in line with the trend in international law to enforce the consequences of *ius cogens* violations – be it through recognition of responsibility, allocation of damages, or invalidation of treaties. One could, therefore, reasonably submit before an arbitral tribunal that the multilateral loans contracted by Jean-Claude Duvalier while he was in power ought to be considered “odious debts,” and hence obtain a judgment that these loans are invalid.

1 UN Human Development Index 2006, updated in 2008.

2 WB, Haiti Country Brief, available at <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/HAITIEXTN/0,,contentMDK:21040686~pagePK:141137~piPK:141127~theSitePK:338165,00.html>.

3 WB News Release No. 2009/451/LAC, Washington D.C., 30 June 2009, available at <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/0,,contentMDK:22232346~pagePK:146736~piPK:226340~theSitePK:258554,00.html>.

4 Mark Schuller, Break the Chains of Haiti's Debt, at 11 (Jubilee 2006); see also, World Bank Estimated Debt Service Payment – Haiti, available at <http://web.worldbank.org>.

5 WB estimate, available at <http://ddp-ext.worldbank.org/ext/DDPQQ/member.do?method=getMembers&userid=1&queryid=135>.

6 Eurodad, The Time for Debt Cancellation is Now! Haiti: Fact Sheet on Illegitimate Debt, at 5 (2006).

7 World Bank & United Nations Office on Drugs and Crime, Stolen Asset Recovery Initiative (StAR) Report 2007, at 11. Note, however, that differences and even inconsistencies exist among the different figures advanced by the sources examined.

8 Press Release, Swiss Federal Office of Justice, Handover of Duvalier assets to Haiti ordered; Lawful origin of assets could not be proven (12 February 2009), available at <http://www.news.admin.ch/message/?lang=en&msgid=25272>. The Swiss Federal Office of Justice (FOJ) considered the Duvalier family a criminal organisation. Consequently, it applied to it the provisions of the Swiss Criminal Code on the confiscation of criminal organisation assets, which pro-

vides for the reversal of the burden of proof, i.e., the Duvalier family had to prove the legal origin of the funds. Because the Duvalier family failed to do so, the FOJ decided to confiscate the assets and to return them to Haiti. For more details on the Duvalier case and the confiscation of assets in Switzerland, see Sandrine Giroud-Roth & Laurent Moreillon, *Restitution spontanée de fonds bloqués à des États défaillants: les cas Duvalier et Mobutu*, *Aktuelle Juristische Praxis/Pratique Juridique Actuelle* 3/2009, at 275-287.

- 9 Schuller, *op. cit.*, at 3.
- 10 *Id.*
- 11 WB & UNODC, *op. cit.*, at 11.
- 12 Schuller, *op. cit.*, at 4.
- 13 James Ferguson, *PAPA DOC, BABY DOC: HAITI AND THE DUVALIERS*, at 70 (Blackwell 1987).
- 14 Report of the Bank of the Republic of Haiti, Testimony of Leslie Delatour, 15 January 1987.
- 15 *Id.*, Testimony of Eddy Avin.
- 16 WB Articles of Agreement, Art. VII(2) and (3); IMF Articles of Agreement, Art. IX(2) and (3).
- 17 Sigrun Skogly, *THE HUMAN RIGHTS OBLIGATIONS OF THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND*, at 34 (Cavendish 2001).
- 18 For instance, Section 10.01 of the International Bank for Reconstruction and Development (IBRD) General Conditions Applicable to Loan and Guarantee Agreements (dated 1995, amended 2004).
- 19 Because the loans examined were contracted with international organisations and not with private investors, the Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965 (ICSID Convention) is not applicable.
- 20 The WB Inspection Panel was established by Resolution No. IBRD 93-10 and Resolution No. IDA 93-6, 22 September 1993. The WBIP responds to complaints by affected people who believe that the WB has caused or will cause them harm as a result of a failure by the WB to follow its policies and procedures in a project supported by a WB loan, credit, guarantee etc. A complaint to the WBIP would have to focus on the specific project financed by the "odious" loans and on the harm that resulted, or will result, to people or the environment in the design, appraisal, and implementation of the project. The conditions under which the loan is granted to a borrowing government are not usually within the purview of the WBIP; however, in a number of cases petitioners have alleged human rights abuses resulting from a WB-financed project and, hence, from the failure of the WB to comply with its policies. For more information on this issue, see Inspection Panel Investigation Report Chad-Cameroon Petroleum and Pipeline Project (Loan No. 4558-CD); Petroleum Sector Management Capacity Building Project (Credit No. 3373-CD); and Management of the Petroleum Economy (Credit No. 3316-CD) of 17 July 2002, which explains in paragraph thirty-five: "It is not within the Panel's mandate to assess the status of governance and human rights in Chad in general or in isolation, and the Panel acknowledges that there are several institutions (including UN bodies) specifically in charge of this subject. However, the Panel is obliged to examine whether the issues of proper governance or human rights violations in Chad were such as to impede the implementation of the Project in a manner compatible with the Bank's policies."
- 21 For an extensive analysis of the WBIP's scope of action, see Skogly, *op. cit.*, at 182-185.
- 22 See August Reinisch, *STATE RESPONSIBILITY FOR DEBTS: INTERNATIONAL LAW ASPECTS OF EXTERNAL DEBT AND DEBT RESTRUCTURING*, at 51-54 (Böhlau 1995); Skogly, *op. cit.*, at 29.
- 23 For instance, Section 10.01 of the IBRD General Conditions Applicable to Loan and Guarantee Agreements (dated 1995, amended 2004) provides that rights and obligations incurred in the agreement are enforceable in accordance with their term notwithstanding the law of any state to the contrary.
- 24 Skogly, *op. cit.*, at 64-71.
- 25 *Id.*
- 26 Ernst Feilchenfeld, *PUBLIC DEBTS AND STATE SUCCESSION* (Macmillan 1931).
- 27 For a detailed presentation of the concept of odious debts, see Robert Howse, *The Concept of Odious Debt in Public International Law* (UNCTAD 2007), available at http://www.unctad.org/en/docs/osgdp20074_en.pdf.
- 28 See Sabine Michalowski, *The Doctrine of Odious Debts in International Law*, at 1.1 Does International Law Recognise the Doctrine of Odious Debts in its Traditional Formulation?, in the present publication. See also, Sabine Michalowski, *UNCONSTITUTIONAL REGIMES AND THE VALIDITY OF SOVEREIGN DEBT: A LEGAL PERSPECTIVE*, at 41-43 (Ashgate 2007); Lee Buchheit et al., *The Dilemma of Odious Debts*, 56 *Duke L. J.* 1201, 1228 (2007).
- 29 *US v. Iran*, Iran-US Claims Tribunal Case No. B36, Award No. 574-B36-2, 3 December 1996 (indicating that the concept of odious debt was limited exclusively to cases of state succession).
- 30 The decision to grant Iraq substantial debt reduction was reached as part of a Paris Club deal that in no way took account of considerations related to those underlying the doctrine of odious debts.
- 31 Bryan Thomas, *The Odious Debt Doctrine and International Public Policy: Assessing the Options*, in *CISDL Working Paper: Advancing the Odious Debt Doctrine*, at 12 (2003), available at <http://www.cisd.org/pdf/debtentire.pdf>. Thomas also points out that "World Bank loans have not been sold on the secondary market, so the forensic problems involved in applying the odious debt doctrine to private lending may be less acute with IFI [International Financial Institution] lending. Indeed, World Bank loans may offer a promising test case for the resurrection of the doctrine of odious debts." *Id.*
- 32 *Id.* IMF loans are intended to serve a strictly macroeconomic function, i.e., to correct balance of trade problems. Consequently, IMF officials have less direct involvement in the end-uses of loans. Their awareness of odious end-uses may thus be difficult to establish.
- 33 See Amnesty International, *Haiti: Les visages de la répression* (1985); Inter-American Commission on Human Rights, *Annual Reports: 1971-1987*; Patrick Lemoine, *FORT-DIMANCHE, FORT-LA-MORT* (Fordi 9 2006). The IMF also reported on the ill-use of the loans by Jean-Claude Duvalier. See Ferguson, *op. cit.*, at 70.
- 34 Buchheit et al., *op. cit.*, at 1230.
- 35 For example, the *lex mercatoria*, as a set of norms, contains rules that are known under domestic systems but have also become generally recognised principles of international commercial relations. The violation of these norms implies a finding of liability with the resulting allocation of damages.
- 36 Reinisch, *op. cit.*, at 62-74.
- 37 Jeff King, *The Doctrine of Odious Debt under International Law: Definition, Evidence and Issues Concerning Application*, in *CISDL Working Paper: Advancing the Odious Debt Doctrine*, at 36-40 (2003), available at <http://www.cisd.org/pdf/debtentire.pdf>.
- 38 These articles contain the possibility of invalidating a treaty based on several grounds: provisions of internal law regarding competence to conclude treaties (Art. 46), specific restrictions on authority to express the consent of a state (Art. 47), error (Art. 48), fraud (Art. 49), corruption of a representative of a state (Art. 50), coercion of a representative of a state (Art. 51), and coercion of a state by the threat or use of force (Art. 52).
- 39 Art. 1 Vienna Convention.
- 40 Art. 53 Vienna Convention. Treaties conflicting with a peremptory norm of general international law ("*ius cogens*").
- 41 Michalowski, *op. cit.*, at 69-95.
- 42 Mohammed Bedjaoui, *Ninth Report on State Succession of States in Respect of other Matters than Treaties*, Document, A/CN.4/301, at para. 173. Although the ICSID Convention does not apply in the present case, it is noteworthy to point out the Phoenix case of 15 April 2009 (ICSID Case No. ARB/06/5, §78), in which the ICSID Arbitral Tribunal, in paragraph 78, wrote: "To take an extreme example, nobody would suggest that ICSID protection should be granted to investments made in violation of the most fundamental rules of protection of human rights, like investments made in pursuance of torture or genocide or in support of slavery or trafficking of human organs."
- 43 See Sabine Michalowski, *The Doctrine of Odious Debts in International Law*, at 2. Odiousness of Debts Because of a Violation of International Law, in the present publication.
- 44 Note that the nullity of the loan agreements depends on the time when these violations were recognised as part of *ius cogens*, that is whether they were recognised as such at the time the agreements were concluded.
- 45 Ferguson, *op. cit.*, at 70.



9.9 Repudiation of Debts with Several Banks by the State of Paraguay

Sabine Michalowski

1. Summary of the Facts

From 6 November 1979 to 7 February 1989, i.e. during the period of the Stroessner dictatorship in Paraguay, Gustavo Gramont Berres, a Paraguayan career consul, held the position of consul at the Consulate of Paraguay in Geneva. A presidential decree, Decree No. 39 808 of 27 May 1983 signed by Stroessner, granted him the rank of Ambassador on a special mission at the Paraguayan Consulate in Geneva.

Based on the presidential decree of 27 May 1983, the Minister of Finance in Paraguay by letter of 22 May 1986 addressed to all interested parties, confirmed that the Ambassador Gramont Berres was an authorised representative of the Paraguayan Government entrusted with large powers to carry out measures and to assume and sign documents related to the carrying out of development projects in Paraguay. To that effect, the Minister asked every person, institution and organisation to give Gramont Berres the largest possible cooperation in the course of his mission. This special delegation of powers to Gramont Berres was confirmed by Resolution No. 1205 of 10 October 1986, signed again by the Minister of Finance. By the tenor of that Resolution, Gramont Berres was charged with the gestation, presentation and negotiation of financial operations destined to finance investment projects related to the social and economic development of the country, and had the power to sign on behalf of the Minister of Finance and/or his government all documents that were necessary in the context of these operations.

On 23 May 1986, a Paraguayan company, Rosi SA (R SA), concluded with MAT, an Italian company, a contract for the construction of a fruit conservation factory in Paraguay. By letter of 30 April 1986 emanating from the Paraguayan Ministry of Finance and Ministry of Commerce, the directors of R SA were assured that their project was regarded as high priority in the context of the governmental policy to invest in the agro-industrial domain. On 20 January 1987, Lapachos de San Isidro SA (L SA), another Paraguayan company, concluded a contract with PH, another Italian company, for the construction of a pharmaceutical factory in Paraguay. To finance the two projects, syndicates of several banks were created, the Overland Trust Bank (OTB) acting as agent of the banks in both cases.¹

Notes Financing Agreements were signed between R SA and Overland Trust Bank (OTB) on 31 May 1986, and between L SA and OTB on 23 March 1987. The Agreements made the payment of the loans subject, *inter alia*, to the receipt of a guarantee, duly signed by the Government of Paraguay. Gramont Berres signed said guarantees, for R SA on 5 June 1986 and for L SA on 1 Septem-

ber 1987. Both guarantees stipulated that he was duly authorised to bind the state of Paraguay with regard to guaranteeing the loans, made Swiss law applicable, contained a jurisdiction clause in favour of Swiss courts; and a waiver of Paraguay's sovereign immunity. Gramont Berres showed the president of OTB the decree that made him Ambassador on a special mission as well as the note of the Finance Minister of 22 May 1986.

Regarding the project of L SA, the Minister of Finance of Paraguay issued a note on 6 April 1987 which referred to the Notes Financing Agreement signed on 23 March 1987 to confirm that L SA could export all the currency necessary in order to make payment to the banks. This note was confirmed by a note of 18 October 1988 signed by a different Minister.

On 22 August 1986, OTB and several other banks signed a Supplementary Agency Agreement regarding the financing of the loan to R SA and on 25 June 1987 regarding the loan to L SA.

For both projects, the contracts were amended to reflect an increase in costs, which resulted in additional loans and made amendments necessary to the guarantees issued by Paraguay. On 8 April 1987, Gramont Berres signed a document called Addendum to the Guarantee issued by Paraguay on 5 June 1986 (regarding loans made to R SA). This document states that Gramont Berres acted as an agent of Paraguay pursuant to Decree 39 808 and Resolution 1205 of the Minister of Finance. That Resolution had been presented to the director of OTB. On 10 March, Gramont Berres signed an Addendum to the Guarantee given by Paraguay (regarding loans made to L SA). In a letter of 18 October 1988, the Minister of Finance made reference to the guarantee contained in the addendum of 12 February.

In a contract between R SA and MAT of 14 June 1988, the latter agreed to deliver various raw materials and equipment to R SA. As form of payment, on 14 June 1988, R SA emitted two promissory notes, one for the capital and one for the interest payments. The surety on those notes stated that the Republic of Paraguay guaranteed their payment. This was signed by Gramont Berres and the notes had the stamp of the Paraguayan Embassy in Switzerland.

The R SA project came off the ground, but the factory never started to operate. The L SA project was never carried out. While parts of the materials were delivered, they were blocked for obscure reasons in different Paraguayan ports. Both R SA and L SA did not meet their repayment obligations. The banks turned to the Paraguayan state to demand repayment of the loans, based on the guarantees signed by Gramont Berres.

Stroessner was ousted in 1989. In September 1990, Paraguay expressed the view that the state



was not bound by the agreements signed by Gramont Berres as he had not been duly authorised to bind the state. When the banks initiated proceedings in Swiss courts against Paraguay, the Government of Paraguay argued that Swiss courts did not have jurisdiction in Paraguay. The main issues before the Swiss courts were thus the validity of the guarantees issued by Gramont Berres in the name of the Republic of Paraguay, and whether Swiss courts had jurisdiction over the matter.

2. Validity of the Guarantees Issued by Gramont Berres

In order to determine whether or not the guarantees signed by Gramont Berres bind the Republic of Paraguay, it is essential to determine whether or not he either acted as a duly authorised agent of the country, or at least with apparent authority. In this respect, two questions arise. First, to what extent was it relevant to the validity of said guarantees that Gramont Berres' activities in relation to the guarantees were later regarded as criminal and fraudulent by a Paraguayan criminal court? Second, were the guarantees invalidated by the fact that the prerequisites of Paraguayan law concerning financial operations by the state were not complied with?

2.1. Did the Acts of Gramont Berres Bind the Republic of Paraguay?

2.1.1. Arguments of the Republic of Paraguay

In December 1992, a criminal court convicted Gramont Berres to seven years' imprisonment for embezzlement, and the falsification and abusive use of public instruments. Gramont Berres was also held civilly liable for the harm caused by his abuse of office. These convictions were confirmed by the Paraguayan Supreme Court.

At the time when the guarantees were signed, Gramont Berres was the president of R SA and L SA; his wife (and niece of President Stroessner), was vice-president of R SA. Almost all the shares of both companies belonged to the couple. According to the Paraguayan Supreme Court, Gramont Berres had falsified the documents and fraudulently obtained guarantees in order to mislead the banks so that they would make loans to the two companies controlled by him. The Supreme Court came to the conclusion that the Paraguayan state had not issued any valid guarantees regarding the loans made to R SA and L SA. In the light of Gramont Berres' criminal conviction, the Paraguayan Government accused the banks of a violation of their duty to exercise due diligence.

The Attorney General of Paraguay indicated that the note of the Minister of Finance of 6 April 1987 had been falsified. As proof, he produced a copy of the same note from the Paraguayan archives which did not contain the words "guaranteed by the Republic of Paraguay," leading him to conclude that those words must have later been added by Gramont Berres himself.

2.1.2. Position of the Swiss Courts²

The Federal Tribunal first of all relied on the fact that Gramont Berres had been recognised as consul



The Swiss Federal Court

of Paraguay in Geneva by the Swiss Foreign Office. This presupposes that the formalities of Articles 11 and 12 of the Vienna Convention on Consular Affairs had been complied with. For the Tribunal, it followed that those who came in contact with Gramont Berres could legitimately assume that he was duly authorised to deal with them.

From the perspective of consular law, even the designation of Gramont Berres of 27 May 1983 by the President of Paraguay as Ambassador on a special mission and the precisions given by the Minister of Finance on 22 May 1986 regarding the nature of his functions were not of a nature to cause *a priori* the distrust of the Europeans dealing with him. Article 17(1) of the Vienna Convention on Consular Relations envisages that under certain circumstances a consular official can, in a state in which the sending state does not have a diplomatic mission, be charged with carrying out certain diplomatic acts.

The Swiss Federal Tribunal came to the conclusion that even if Gramont Berres had not acted with actual authority, Paraguay at least had to assume the apparent authority with which he signed the guarantees. As apparent authority is based on trust, the Tribunal stressed that it requires that the third party, i.e. the banks, could in good faith rely on the existence of authority. According to the Tribunal, this was the case because of the note issued by Paraguay's Minister of Finance on 6 April 1987 with regard to L SA's project, which was issued a few days after the signing of the Notes Financing Agreement and of the guarantee by Gramont Berres. As the Notes Financing Agreement specifically referred to the need of a guarantee by the Republic of Paraguay, the Minister of Finance cannot be said to have been ignorant of the existence of such a guarantee. The note was accordingly held to confirm without ambiguity that the guarantee was assumed by Paraguay.

The allegation of falsification of the note made by the Attorney General of Paraguay was not regarded as proven. The First Instance Tribunal of Geneva stressed that the note alleged to be authentic ends with a comma, while the one alleged to be falsified ends with a full stop, which made it more likely that the latter was the original and unchanged version of the note. It also suggested that it is easier to falsify a document by suppressing a part than by adding it, thereby implying that it is more likely that the note submitted by the Attorney General, rather than that used by Gramont Berres, was falsified. Even if the note of 6 April 1987 had been falsified, according to the Tribunal this would not have any particular relevance, as the note of 10 October 1988, which confirmed the earlier note, contains the same formulation regarding the guarantee by Paraguay. The authenticity of that note had not been questioned by the Republic of Paraguay.

While the above only expressly applies to the project entered into by L SA, the First Instance Court of Geneva, when reconsidering the issue, argued that the two projects had been designed according to the same financing scheme and that there were no reasons to believe that what

applied to one of them did not also apply to the other. Based on these observations, the Tribunal concluded that Gramont Berres had acted as an authorised agent of the Paraguayan Government. As the projects which formed part of the guarantees fit into the government's policy of developing industries in the national territory, the state had an interest in their realisation. The Tribunal took Paraguay's argument that the special powers vested in Gramont Berres by the past government are not valid, as internal law had been disregarded, to mean that Paraguay impliedly accepted that the then government had, in fact, vested these powers in him.

2.2. Non-compliance with Internal Paraguayan Law

According to Paraguayan law, the state cannot give a guarantee unless strict procedural requirements are adhered to: The Committee of the National Economic Council consisting of the President, the Minister of Finance, the President of the Central Bank, the Minister of Agriculture and the Secretary of Economic Planning decides whether and for which purpose to issue a guarantee. A decree of executive power determines the official who is authorised to sign the guarantee after the adoption of an ad hoc law by the national Congress. To carry out the operation, an economic opinion by the Central Bank is necessary, again after the adoption of an ad hoc law by the national Congress. Lastly, it is necessary to receive the legal opinion of the Prosecution Office of the Republic about the exequatur of the contract on Paraguayan territory. It seems uncontroversial that this procedure was not followed.

2.2.1. Arguments of the Republic of Paraguay

Paraguay argued that Gramont Berres could not validly bind the country, as its internal laws had not been complied with. The banks were accused of a violation of their duty to exercise due diligence, as they could or should have known that the state could not bind itself financially on the basis of a presidential decree and a resolution of the Minister of Finance.

2.2.2. Position of the Swiss Courts

The Swiss courts rejected these arguments. In analogy with Article 177 of the Conflict of Law Act (Loi fédérale sur le droit international privé), if one of the parties to an arbitration convention is a state or a state-controlled enterprise, that party cannot invoke its own internal law to call into question whether a case can be subject to arbitration, or to challenge its own capacity to be a party to an arbitration. Abundant jurisprudence in the context of international arbitration shows that arguments based on violations of internal law are systematically rejected and that in the international context, contractual relations are governed by the principles of good faith and *pacta sunt servanda*. The agreements signed by Gramont Berres therefore bind the state of Paraguay according to Article 32(1) of the Law of Obligations (Code des Obligations), even though they did not comply with the

prerequisites that the Constitution of Paraguay requires in such cases.

3. Sovereign Immunity and the Jurisdiction of Swiss Courts over the State of Paraguay

3.1. Arguments of the Republic of Paraguay

Paraguay argued that Swiss courts had no jurisdiction over the Republic of Paraguay and could therefore not make the state party to judicial proceedings or issue decisions against the state without the state's consent. While the guarantees at issue contained a foreign jurisdiction clause in favour of the jurisdiction of Swiss courts and furthermore a waiver of sovereign immunity on the part of Paraguay, these guarantees were not valid. The clauses that relate to jurisdictional issues were thus equally void and could not give Swiss courts jurisdiction over the Republic of Paraguay.

3.2. Position of the Swiss Courts

The Swiss Federal Tribunal started its discussion with some general considerations on its understandings of the law on state immunity. In this respect, it referred to its own jurisprudence, which, since 1918, had adopted a restrictive concept of state immunity.³ It does not regard state immunity as an absolute principle, but rather sees it as only applicable with regard to issues that involve acts of foreign states that must be regarded as *iuris imperii*. Acts *iuris gestionis*, on the other hand, do not benefit from state immunity. Into which of the two categories a state act falls in an individual case depends on the nature of the operation and here, in particular, on whether it can only be carried out by a public authority exercising its sovereign powers, or whether it can equally be undertaken by private parties. According to the Tribunal, acts such as the taking up of loans by the state or the Central Bank as well as other commercial activities have to be regarded as *iure gestionis*⁴ to which diplomatic immunity does not attach.

Applying these considerations to the issue at hand, the Tribunal argued that the guarantees of the bank loans are commercial activities and therefore must be classified as *iure gestionis*. Accordingly, Paraguay cannot rely on sovereign immunity in this respect. The question of whether Paraguay had validly waived its sovereign immunity was therefore regarded to be irrelevant, given that Paraguay did not enjoy immunity in this matter that could be waived. However, this was only a theoretical issue, given that the Tribunal moreover considered the guarantees, including the waiver of sovereign immunity, to be valid and binding.

On 3 September 2004, after proceedings in several Swiss courts, the Civil Chamber of the Court of Justice of the Canton of Geneva issued a judgement against Paraguay, requesting the state to pay a total of CHF 36.7 million, and EUR 30.7 million to several banks because of the guarantees issued by Gramont Berres.

4. Presidential Decree 6295, Repudiating the Debt

On 26 August 2005, Paraguay issued a Decree in which it postulates its official position with regard

to the Swiss judgments. The Decree rejects the judgment of the Swiss Court that obliges the state to pay off the above-mentioned sum. In order to justify this position, the Decree refers to the statements and reports issued by various public authorities in Paraguay which all came to the conclusion that Paraguay should reject the payment of the debt. This was because Paraguay never waived its sovereign immunity;⁵ the Swiss Courts arbitrarily tried to hold the Republic of Paraguay liable for the debts of private companies;⁶ the guarantees could not bind the state, as the internal legal requirements for issuing valid guarantees had not been met⁷ and Gramont Berres was not authorised to represent the Republic of Paraguay and to issue guarantees in its name;⁸ crimes cannot give rise to legal obligations;⁹ Gramont Berres acted in collusion with the banks that now demand payment from Paraguay;¹⁰ and the illegitimacy and illegality of the documentation produced by Gramont Berres makes the documentation unusable in legal proceedings against the government.¹¹

The Presidential Decree concludes that from all this it follows that the debt that was the subject of the decision “constitutes a spurious and illegitimate debt whose recognition is inadmissible because of its illicit origin. It regards the Swiss judgement against the state of Paraguay as a clear case of denial of justice because of its manifest arbitrariness and obvious injustice.”¹²

5. Legal Analysis

To present a legal analysis of this case is rather difficult, as the main material that is available both with regard to the exact facts of the case and the legal arguments of the various parties involved stems from the judgments of the Swiss courts. The Presidential Decree of 2005 and a few newspaper articles contribute some additional material, but contain little information with regard to the relevant facts of the case. Unfortunately, the criminal court judgment against Gramont Berres, which might have shed some light on some of the important issues, is not available.

5.1. Sovereign Immunity and the Jurisdiction of Swiss Courts Over the State of Paraguay

The analysis of the Swiss courts in this respect seems to be without flaws and nothing needs to be added.

5.2. Did the Acts of Gramont Berres Bind the Republic of Paraguay?

5.2.1. Actual Authority

If Gramont Berres had acted with actual authority to sign guarantees on behalf of Paraguay, these would, in principle, be binding for the state. The question of whether a state official acted with actual authority is usually governed by the domestic law of that state,¹³ even if the legal problem at issue is otherwise governed by the law of a different country. Thus, it would depend on the law of Paraguay whether or not Gramont Berres had the legal authority to sign guarantees that bind the state. At

first sight, one could think that such authority could be based on the Stroessner decree which made him Ambassador on a special mission, or on the various notes issued by Paraguayan Ministers which authorised him to sign documents on behalf of the state related to development projects to be carried out in Paraguay. However, according to the Constitution of the Republic of Paraguay, actual authority to validly carry out such acts cannot be conferred on an individual by a Minister, nor even by the President himself. Instead, several formal requirements need to be complied with which, in this case, were clearly ignored. Gramont Berres therefore did not have actual authority to bind Paraguay in the transactions at issue. The lack of compliance with the internal law of Paraguay resulted in Gramont Berres not acting with actual authority.

5.2.2. Apparent Authority

The question of whether Gramont Berres acted with apparent authority is more complex. Apparent authority means that an agent, without being vested with actual authority, carries out a transaction in the name of a principal; that the other party could and did in good faith rely on the appearance of authority to act for the principal; and that the principal has some responsibility for the fact that it appeared that the agent had authority to act on its behalf.¹⁴

When signing the guarantees, Gramont Berres acted on behalf of the state of Paraguay, not in his own name. According to the Swiss tribunals' findings of fact, he showed the president of OTB the presidential decree as well as the ministerial notes that gave him vast powers to represent the state in the context of development projects, including that of signing relevant documents. He thus clearly attempted to give the impression that he was duly authorised to represent the state.

What is more difficult to establish is whether it is the banks or the Republic of Paraguay who should bear the consequences of the lack of actual authority. There is fundamental disagreement between the Republic of Paraguay and the Swiss court on this issue. To summarise the two positions briefly, Paraguay was of the view that the banks did not act with due diligence regarding the lack of authority and the non-compliance with internal Paraguayan law. The state also strongly relied on the fact that the relevant acts of Gramont Berres were later found to be fraudulent and gave rise to a criminal conviction.

The Swiss tribunals, on the other hand, argued that Paraguay contributed to the appearance that Gramont Berres acted with authority, in that he was officially recognised as consul of Paraguay in Switzerland; the President of the State issued a decree making him Ambassador for special affairs; several notes issued by Paraguayan Ministers conferred on Gramont Berres the power to sign documents with regard to developmental projects; by letter of 30 April 1986 emanating from the Paraguayan Ministry of Finance and Ministry of Commerce, the directors of R SA were assured that their project was granted high priority in the

context of the governmental policy to invest in the agro-industrial domain; and the note of the Minister of Finance of Paraguay of 6 April 1987 confirmed that L SA could export all currency that was necessary in order to make payment to the banks. In the light of the foregoing, it is indeed difficult to argue that Paraguay did not contribute to the creation of the appearance that Gramont Berres was an authorised representative of the state.

The Attorney General of Paraguay alleged that the note of the Minister of Finance of Paraguay of 6 April 1987 had been falsified by Gramont Berres, in that he was said to have added the words "guaranteed by the Republic of Paraguay." However, as the First Instance Tribunal of Geneva stressed, a note of 10 October 1988 whose authenticity had not been questioned by the Republic of Paraguay, confirmed the earlier note and contains the same formulation regarding the guarantee by Paraguay. Moreover, the falsification of that one note would not change the conclusion discussed above that officials of Paraguay created an appearance that Gramont Berres was authorised to represent the state concerning the guarantees signed by him.

One question that might nevertheless be raised is that of the extent to which Gramont Berres appeared to be authorised to carry out the particular transactions at issue, i.e. to sign guarantees of loans on behalf of the state. None of the official documents that conferred powers on him specifically refers to this matter. However, it could be argued that Resolution No. 1205 of 10 October 1986, signed by the Minister of Finance and confirming, *inter alia*, that Gramont Berres had the power to sign, on behalf of the Minister of Finance and/or his government, all documents that were necessary in the context of operations destined to finance investment projects related to the social and economic development of the country, might be understood to create an appearance of the power to sign guarantees on behalf of the Paraguayan state with regard to loans that financed such projects.

Nevertheless, a possible way of reaching the conclusion that the guarantees did not bind Paraguay might be to demonstrate that the banks could not in good faith rely on the appearance of authority. With regard to the question of whether the banks failed to apply due diligence with regard to Gramont Berres' authority to sign the guarantees on behalf of Paraguay, the answer depends on the due diligence standards that are applicable to this kind of transaction.¹⁵ The Swiss tribunals were clearly of the view that the banks could in good faith rely on the documents that conferred authority on Gramont Berres and had no reason to carry out any further inquiries in this respect. Whether this is true might, to some extent, depend on whether there were any suspicious elements about the range of powers vested in him that should have prompted the creditors to carry out further investigations.

An issue that was not at all considered in the Swiss judgments and with regard to which it is not clear whether Paraguay in fact raised it, is to what extent more stringent due diligence standards could apply because of the specific circumstances

of the transactions. One could think here, in particular, of the fact that Gramont Berres was the majority shareholder of both companies whose debts he committed the republic of Paraguay to guarantee. Thus, the question is to what extent this fact should have been detected by the banks and raised suspicions with regard to his role in the transactions, which might have raised the due diligence standards. Furthermore, one might argue that the fact that the Stroessner regime was a dictatorship and as such particularly prone to corruption might have raised the level of due diligence to be applied by the banks.¹⁶

Another issue to be discussed is the relevance of non-compliance with internal Paraguayan law in the context of apparent authority.¹⁷ The Swiss courts relied here on the widely applied principle that a state party cannot invoke its own internal law to question that an action was invalid, or to challenge its own capacity to be party to an arbitration. With regard to the former, Article 46(1) of the Vienna Convention on the Law of Treaties, though only for the situation of treaties between states, holds in Article 27 headed “Internal law and observance of treaties”:

A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.

This rule is without prejudice to article 46. Article 46, in turn, stipulates that:

1. A State may not invoke the fact that its consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent unless that violation was manifest and concerned a rule of its internal law of fundamental importance.

2. A violation is manifest if it would be objectively evident to any State conducting itself in the matter in accordance with normal practice and in good faith.

Thus, in analogy with the provisions of the Vienna Convention on the Law of Treaties, Paraguay could only rely on the lack of authority under Paraguayan constitutional law if it could be established that this violation of internal law was objectively evident to the banks in line with the requirements of Article 46(2). In the particular context of the Vienna Convention, an invalidity of a treaty under this provision is such a rare occurrence that most textbooks do not even discuss it. As stated by Aust, the form in which the provision is drafted (may not invoke ... unless) emphasises “the exceptional character of the cases in which this ground might be invoked.”¹⁸ In *Cameroon v. Nigeria*, the International Court of Justice had to decide, *inter alia*, whether a treaty concluded by the Nigerian Head of State was invalid on the grounds that Nigeria’s Supreme Military Council had not ratified it as required by the Nigerian Constitution. While the Court accepted that “[t]he rules concerning the authority to sign treaties for a State are constitutional rules of fundamental importance,”¹⁹ it did not regard the violation as manifest. In response to Nigeria’s argument “that Cameroon knew, or

ought to have known, that the Head of State of Nigeria had no power legally to bind Nigeria without consulting the Nigerian Government”, the Court noted “that there is no general legal obligation for States to keep themselves informed of legislative and constitutional developments in other States which are or may become important for the international relations of these States.”²⁰ While this case concerns the specific case of a treaty between states and of the action of a Head of State to whom the assumption of being vested with powers to adopt a treaty applies,²¹ it shows the restrictive approach of the Court when applying the exception in Article 46.

Some early arbitration cases that discuss the validity of obligations that were incurred by state organs acting *ultra vires*,²² however, might support an argument that transactions that were not taken up in compliance with the domestic constitutional law of the state party could be invalid under international law. In one case, for example, the President of Venezuela had authorized the Venezuelan consul in New York to enter into certain contracts. The tribunal held that the validity of the contracts depended on whether the President who had issued an authorization with an “anticipatory all powers clause,” had himself the power to enter into such contracts. Given that under the Venezuelan Constitution the legislature had the exclusive competence to conclude contracts in the particular subject matter, the contract was found to be *ultra vires* and the claim against Venezuela was rejected.²³

Similarly, in the *Tinoco* case,²⁴ a cabinet member of the Tinoco Government of Costa Rica had entered into a concessionary contract with a foreign corporation. The contract was then authorized by the President and approved by the Chamber of Deputies. Taft, the U.S. Chief Justice who was the arbitrator in that case, argued that the validity of the contract had to be determined according to the law of Costa Rica in existence at the time of its making. The contract contained provisions concerning taxes, so that, according to the Costa Rican Constitution, the approval of both Houses of Congress, not just that of the Lower Chamber, was required. As the senate had not approved (or disapproved) the contract, it was invalid, and Taft took it for granted that the nullity of the contract based on domestic constitutional law had the effect of invalidating the contractual claim of the international concessionary.²⁵ Based on these cases, it would seem as if Paraguay might be able to invoke Gramont Berres’ lack of authority based on non-compliance with its own constitutional law.

However, other cases make the prospect of successfully relying on such non-compliance rather unlikely. In a case in which a U.S. Consul in India had appointed a lawyer to render legal services to the United States, and in which the U.S. Government refused to pay the fees on the grounds that the Consul had not been authorized to employ the lawyer on behalf of the government, the tribunal decided that:

Whatever at the outset was the authority of the United States Consul to employ an attorney at the

expense of the United States Government, it is plain from the correspondence referred to above that that government was perfectly aware ... of Hemming's employment in a prosecution initiated solely for its benefit, that it did not object in any way whatever during the progress of the case to the steps taken by its Consul but appeared implicitly at all events to approve of those steps and of Hemming's employment. This Tribunal is, therefore, of the opinion that the United States is bound by the contract entered into, rightly or wrongly, by its Consul for its benefit and ratified by it.²⁶

In another case, *Aboilard*,²⁷ a concessionary contract entered into between a French company and several Haitian Secretaries of State in the name of the Haitian Government, was later repudiated by that government on the grounds that it had not been submitted to the legislature and was therefore void under domestic law. The tribunal accepted the invalidity of the contract under domestic Haitian law. However, it held that while the contract itself could therefore not produce any legal effects, Haiti was internationally liable for the repudiation of the contract, because the government was responsible for the legitimate expectations created by government officials in the validity of the contract. In a case in which the Venezuelan government declared

a contract to be void on the ground that it had not been submitted by the executive for legislative approval as required by the country's Constitution, it was held that this omission should not be ascribed to the other party to the contract, but rather to the Venezuelan executive to whom the compliance with said formality corresponded.²⁸

Based on these cases it could be argued that the reasons for the invalidity of the obligations lie with Paraguay and that the Paraguayan state can accordingly not escape liability, even if the guarantees were to be regarded as invalid under domestic law. Indeed, with respect to apparent authority, it seems to be decisive whether the other party was acting in good faith with regard to the representations made by the state. In order to be able to rely on good faith, the other party must have trusted in the appearance of original authority or of ratification. It must further have applied reasonable care in order to ascertain the authority of the state official, and the amount of care required seems to depend on the expertise of the creditor and the importance and the subject matter of the contract.²⁹ The outcome of Paraguay's challenges to the validity of the loan agreements based on unconstitutionality would then depend on the good faith of the country's creditors.

1 In both cases, an Italian insurance company also guaranteed the loans. While in the cases discussed in this paper, the banks sued not just the Republic of Paraguay, but also the insurance company, for the purposes of this paper the role of the insurance company is not relevant and will therefore not be taken into account in the analysis.

2 References to the Swiss decisions refer to the decision of the Swiss Federal Tribunal of 20 August 1998, BGE 124 III 382; First Instance Court of Geneva of 23 October 2003 (JTPI/12153/2003) (unpublished); the decision of the Court of Justice of Geneva of 3 September 2004 (C/9970/1995) (unpublished).

3 BGE 124 III 382, at 388.

4 *Id.* at 389.

5 Report of the Ministry of Foreign Relations: Informe DM/No.49/2009 of 29 June 2005.

6 Legal Department of the Treasury: Dictamen No.800 of 14 July 2005.

7 Controlaria General de la República: Dictamen C.G.R. No.2850 of 14 July 2005; Declaration No.21 of the Senate of Paraguay of 23 July 2005.

8 Attorney General: Dictamen P.G.R. 427/05 of 29 July 2005.

9 *Id.*

10 *Id.*

11 Supreme Court of Paraguay: Informe NP No.117 of 4 August 2005.

12 Presidential Decree 6295, at 6.

13 DICEY, MORRIS & COLLINS ON THE CONFLICT OF LAWS, Volume 2, Rule 162 (Sir Lawrence Collins ed., Sweet & Maxwell: London, 14th ed. 2006); Stone, EU PRIVATE INTERNATIONAL LAW, at 299-300 (Edward Elgar: Cheltenham, Northampton 2006). This also seems to have been assumed by the English Court of Appeal in *Marubeni v Mongolian Government* [2005] EWCA Civ 395, [2005] 1 WLR 2497, at 2508-2509 per Carnwath LJ with regard to state representatives.

14 For U.S. agency law see in Buchheit, Gulati & Thompson, The Dilemma of Odious Debts, 56 DUKE LAW JOURNAL 1201, at 1240 (2007).

15 The issue of due diligence standards in a comparable context

are discussed in Buchheit, Gulati & Thompson, *op. cit.*, at 1239-1245 (2007).

16 For similar arguments see also Carranza, Plunder and Pain: Should Transitional Justice Engage with Corruption and Economic Crimes?, INTERNATIONAL JOURNAL OF TRANSITIONAL JUSTICE, Vol. 2, 310-330 (2008); and Buchheit, Gulati & Thompson, *op. cit.*, at 1245.

17 The following draws heavily on Michalowski, UNCONSTITUTIONAL REGIMES AND THE VALIDITY OF SOVEREIGN DEBT: A LEGAL PERSPECTIVE, at 178-185 (Ashgate, Aldershot 2007).

18 Aust, MODERN TREATY LAW AND PRACTICE, at 253 (Cambridge University Press: Cambridge 2000).

19 Cameroon v. Nigeria, ICJ decision of 10 October 2002, at para. 265.

20 *Id.*, at para. 266.

21 Article 7(2)(a) of the Vienna Convention on the Law of Treaties.

22 Beales, Nobles and Garrison (US v. Venezuela), as summarized in Meron, Theodor; 'Repudiation of ultra vires state contracts and the international responsibility of states', (1957) 6 ICLQ 273-289; Great Britain v. Costa Rica (1923), Reports of International Arbitral Awards, Vol. 1, 371. For a discussion of these cases see Meron at 274-275.

23 Beales, Nobles and Garrison (US v. Venezuela), as summarized in Meron (1957), at 279-280.

24 Great Britain v. Costa Rica (1923), Reports of International Arbitral Awards, Vol. 1, 371.

25 *Id.*, at 397-398.

26 Hemming (GB) v. US (1920), Reports of International Arbitral Awards, Vol. 6, 51, at 53. See also Shufeldt (US v. Guatemala), Annual Digest and Reports of Public International Law Cases, 1929-1930, Case No.110, 180; Davies (USA) v. Mexico (1927), Reports of International Arbitral Awards, Vol. 4, 139.

27 Aboilard (France v. Haiti), (1905) 1 Revue de Droit International Privé et de Droit Pénal International, 893.

28 Rudloff (US v. Venezuela) (1903), as summarized by Meron (1957), at 285.

29 Meron (1957), at 288-289.





Conclusions by the editors

First, we wish to emphasize that our conclusions reflect the points of view of civil society campaigners who are not legal experts, but who have been working for a number of years on the issue of illegitimate and odious debt. Moreover, the conclusions primarily reflect the editors' point of view which may differ from the individual opinions of the authors of this book.

As Charles Abrahams states in Chapter 1, the results of our legal case studies confirm that the concept of illegitimate debt can be associated with certain norms and rules in domestic and international law, which may be then invoked as a legal basis for non-payment or debt repudiation. The expansive concept of illegitimate debt, though it does include legal considerations, is first and foremost a political concept which also relies greatly on moral considerations. The results demonstrate, though, that most of the cases here are considered not only illegitimate and odious, but also illegal, because they breach contracts and regulations and violate international treaties, as well as peremptory norms and general principles of international law.

1. Summary of the legal remedies by the authors

1.1 Medical waste incinerators in the Philippines: intergenerational responsibility

Luke Espiritu considers the environmental impact in connection with the debt created by the sale of Austrian medical waste incinerators to the Philippines. He refers to a number of international environment treaties to prove that the sale of this equipment was made in breach of existing laws and regulations. He also argues that the Bank of Austria was in a position to know that the equipment would not pass international standards for incinerator emissions. As a legal remedy for the case he proposes legal action by citizens, if the state is not willing to raise claims. In Philippine jurisdiction, citizens' suits have been filed and have resulted in the nullification of government acts, laws or contracts which are contrary to law, the constitution or public policy. In Philippine case law there also exists the interesting concept of intergenerational responsibility which means that people can file class suits on behalf of the well-being of their own and succeeding generations.

1.2 Yacretá in Paraguay: general principles of international law

Maurizio De Martino points out the lack of due diligence and corruption in the case of the Yacretá dam. Better due diligence would have enabled the creditors to foresee the negative consequences of the project, especially as dictatorial and authoritarian regimes were involved. For his legal argu-

mentation he relies on the general principles of law, especially good faith, gross disparity, clean hands and also 'inadimplenti non est adimplendum' (one has no need to respect its obligation if the counter-party has not respected its own). Moreover, he shows that there exist illegitimate relationships not only between the North and the South but also within the South. In the relationship between Paraguay and Argentina, the former has lost sovereignty over energy resources and is selling energy at below market price to the latter.

1.3 Inga in the DRC: Lack of due diligence, contractual imbalance, good faith and unlawful cause

In the case of the Inga dam project in the Democratic Republic of the Congo, Eve Tessera accuses the banks involved of a total absence of due diligence, especially with regard to their duty to inform and advise. According to French case law on uninformed customers, a bank has a legal obligation to caution its customers by reason of their financial standing and the risks of indebtedness arising from the granting of the loan in question. Tessera also observes a patent contractual imbalance, especially as the construction companies and technical assistants were released from all liability. Thus, all the risks involved in the project were transferred to the former Zairian State and the foreign banks. In addition, the poor execution of the Inga dam project constitutes a breach of the duty of good faith and a failure on the part of the German concessionaire to comply with the contract. Moreover, Tessera points out that the validity of a contract requires the existence of a legal cause which complies with national or international public order. The cause of a loan agreement may be understood as the end-use of the borrowed sums. In the case of the Inga dam it is undeniable that many contracts contributed to the personal enrichment of dictator Mobutu and his entourage. This renders such contracts null and void.

1.4 Drinking water in Guayaquil/Ecuador: Breach of UNIDROIT principles

In the case of the modernization of the drinking water facilities in the Ecuadorian city of Guayaquil, Maurizio De Martino argues that Ecuador was in a state of emergency because Guayaquil was suffering a water crisis and the lenders (a Spanish consortium of private companies and the World Bank [WB]) exploited this situation. For his legal remedy, he refers to the UNIDROIT principles of international commercial contracts, where it is said that one party may avoid a contract if the other party has taken unfair advantage of the first party's dependence, economic distress or urgent needs. Although the UNIDROIT principles are

not binding rules, they are generally accepted as a source of law by arbitration tribunals. Moreover, De Martino is convinced that the conditionalities of the WB regarding privatisation breached the constitution of Ecuador. In his eyes, these elements combine to make the underlying contracts highly questionable.

1.5 Laniado de Wind in Ecuador:

Breach of UNIDROIT principles and unjust enrichment

De Martino also investigated the case of the Marcel Laniado de Wind power plant (as part of the Daule Peripa dam), about 130 km north of Guayaquil. He believes that the Italian Government did not proceed in accordance with existing regulations and did not demonstrate necessary consideration of the possible environmental and social impacts when it financed this project. He also points out the excessive increase in costs and the possibility of fraud. For De Martino, there are a number of possible legal avenues to pursue, which include the breach of Italian guidelines on development cooperation and breaches of WB guidelines. Furthermore, it has been proved that the equipment delivered did not correspond to the technical features in the original contract. Besides invoking some general principles of international law, such as that of good faith, De Martino believes that the most promising avenue to pursue is that of possible fraud. Once again he refers to the UNIDROIT principles of international commercial contracts, where it is said that one party may avoid a contract when it has been led to cancel the contract due to the other party's fraudulent behaviour. He also refers to the Italian civil code regarding unjust enrichment.

1.6 Swedish Coast Guard Ships in Liberia:

Lack of due diligence, excessive increase of costs

Charles Abrahams explains that at the time of sale of three Swedish coast guard vessels to the government of Liberia, the Swedish shipbuilding industry was experiencing a decline, whilst the government of Liberia had become increasingly unpopular due to claims of rampant corruption and human rights violations. He concludes by making the argument that, based on the notion of illegitimacy, the export credit guarantee provided by Sweden's export credit agency Eksportkreditnämnden (EKN) was illegitimate. EKN should have foreseen that the political and economic risk faced by Liberia may hold implications for its ability to honour payments under the loan agreement with BK-Banken. A higher degree of due diligence would have been required by EKN before providing the loan, which according to Abrahams seems not to have been the case. Moreover it is highly questionable as to whether the interest of more than USD 22 million that EKN has charged over the last 30 years is legally legitimate.

1.7 Oil-backed loans in Congo Brazzaville:

Unlawful cause, duty to warn, breach of banking regulations

In the case of the oil-backed loans of the Republic of Congo (Congo Brazzaville), Maud Perdriel-Vaissière sees two possible civil remedies based

on French law – tort and contract litigation. She hereby follows the same line of argument as her Sherpa colleague and co-author, Eve Tessera. Perdriel-Vaissière argues that there is nullity of the oil-backed loan contracts due to the illegitimacy of the cause. According to French Civil Code, all agreements must have a lawful cause on pain of nullity. In this case, the end-use of the borrowed funds was the personal enrichment of President Nguesso and his family. In French law, unlawful cause is a useful remedy, as according to Perdriel-Vaissière, it is not necessary to produce evidence that the private creditor was aware of the end-use of the funds in order for the contract to be cancelled. Moreover, legal action is not reserved exclusively to the parties to the contract. The second possible legal avenue is the contractual liability of banks in the granting of abusive loans. Banks must comply with their duty to warn, which consists of warning uninformed borrowers about the risks involved in loans and indebtedness and refusing the requested loan if the risks are deemed too great. According to French case law, any third party affected by oil-backed loans is entitled to file a suit, if the breach committed by the private creditor caused that third party harm. A third legal avenue concerns the breaches of banking regulations.

1.8 The Concept of Illicitness and the Case of Multilateral Loans in Ecuador

Ramiro Chimuris carves out the concept of illicitness as a legal category, distinct from illegitimacy, which could serve to mitigate the tension that exists between the importance of binding legal instruments and nonbinding legal instruments within challenges to the legitimacy of foreign public debt. He suggests that general legal principles, such as those that are recognized by major legal systems and form the basis of international law, could reach a level of importance similar to that of binding legal instruments in developing arguments to challenge the legitimacy of debt.

After defining the distinction between illicitness and illegitimacy, Chimuris writes about the nullity of contracts under international law and under the Calvo Doctrine, concluding that an agreement made in violation of fundamental rights guaranteed by the constitution of a country or by the norms of international human rights law should be considered null. The author then discusses when individuals can be subjects of international law and how investors have become new subjects of international law within the arbitration system of the International Centre for the Settlement of Investment Disputes (ICSID).

Lastly, the author brings some of the abovementioned theoretical discussions into a practical context through a discussion of Ecuador's public debt audit. He explains that auditors found breaches of internal law and international conventions, interference with national sovereignty, and acts contrary to various legal doctrines in Ecuador's history of multilateral foreign debt. The contracted obligations that served as the basis of Ecuador's foreign debt, Chimuris concludes, suffered from

illicitness in the cause (motive to enter into a contract) and in the object (subject matter of the obligations). Thus, they are not enforceable.

1.9 Apartheid in South Africa: Violation of binding international agreements

In 1977, the United Nations General Assembly declared apartheid a crime against humanity. Nevertheless, in the case of South Africa's apartheid debt, Charles Abrahams argues that a broad defence based on the financing of apartheid would have been difficult based on international law, because the "International Convention on the Suppression and Punishment of the Crime of Apartheid" was not a resolution by the Security Council, nor was it adopted by Western governments. As apartheid debt consisted almost exclusively of foreign commercial loans and sovereign bonds, Abrahams sees the opportunity to file a claim in a domestic court, wherever a direct link between any given loan and the violation of binding international agreements and regulations can be established. He cites several examples, such as that of the German company Rheinmetall, who presumably violated the United Nations compulsory arms embargo during that period.

1.10 Multilateral debts in Haiti:

Peremptory norms of international law (*ius cogens*)

The only legal case study which refers exclusively to peremptory norms of international law (*ius cogens*) concerns the debt accumulated during the regime of 'Baby Doc' Jean-Claude Duvalier in Haiti. Sandrine Giroud provides evidence that Duvalier stole enormous amounts of public money and that he financed the 'Tontons Macoutes' paramilitary organization, which killed thousands of people, with aid credits. As most of the loans came from the WB and the International Monetary Fund (IMF), she argues that it is very likely that these loan agreements included an arbitration clause. If this be the case, it would be possible for Haiti to bring its contentions before an arbitral tribunal consisting of arbitrators from the WB, the IMF and Haiti itself. Giroud holds that the scope of action of the WB Inspection Panel appears rather narrow, given its limited references to human rights. For Giroud, the most promising legal remedy lies in the *ius cogens* approach. It is evident to her that the numerous human rights violations during the regime of Jean-Claude Duvalier should be considered as *ius cogens* violations. The principle stating that the violation of a norm of *ius cogens* invalidates a treaty, such as that provided in Art. 53 of the Vienna Convention, forms part of customary international law and, as such, extends beyond this Convention that only refers to states but not to international organisations. Thus, Art. 53 offers a valid defence against the obligation to repay the debts contracted under Duvalier's regime.

1.11 Gramont Berres and the debt of Paraguay:

Possible lack of due diligence

In the case involving several private banks against the State of Paraguay, Sabine Michalowski

agrees with the Swiss Federal Court that even if the former consul of Paraguay in Geneva, Gustavo Gramont Berres, did not act with actual authority, Paraguay at least had to assume the apparent authority with which he signed the guarantees for the contracts. A crucial question in the dispute between Paraguay and the banks, which was arbitrated by the Swiss courts, is whether a country or state may invoke its own internal law to question whether or not an action was invalid. Paraguay says yes; the Swiss courts say no. After referring to different case laws for and against the position of Paraguay, Michalowski concludes by saying that with respect to apparent authority the deciding factor is whether the other party acted in good faith regarding the representations made by the state.

2. Main points of discussion

The results of the case studies allow us to identify the following legal avenues for addressing illegitimate and odious debt:

Promising legal avenues

- Lack of due diligence and the duty to inform and warn.
- Breach of general legal principles such as good faith.
- Breach of domestic law and constitution.
- Breach of international treaties, principles and guidelines.
- Violation of *ius cogens* norms as a part of customary international law.
- Fraud and corruption.

Although there is a general consensus among the legal experts in this book regarding the existence of legal avenues in the field of illegitimate and odious debt, they have different opinions as to their applicability. We have selected and commented on the most important areas of dissent as well as other points which have arisen in the authors' mutual reviews of their respective articles and in their discussions at a meeting organized by the editors in June 2009.

2.1 Risk distribution and creditor responsibility

One fundamental question which arises in all the cases is that of distribution of risk between lender and borrower. In recent years there have been increasing calls for stronger creditor co-responsibility. But where does creditor responsibility end and that of the borrower begin? This question can be illustrated with the case of the Inga dam in the DRC and that of Gramont Berres in Paraguay.

The Inga dam case highlights the notion of responsibility surrounding debt. The duty to inform and warn as explained by Eve Tessera (and Maud Perdriel-Vaissière in Chapter 9.6) was questioned by other authors, as it could not be expected that the then dictator Mobutu would have acted any differently, had he been informed about the potential unsustainability of the loan agreement. Of course this doesn't mean that these authors believe that the lenders were therefore under no obligation to inform. While it is clear that a causal link must be

established between the failure to inform and the damage caused, the problem remains that there still exists the possibility that informing could have prevented the damage. A more basic question comes up here: Should we trust a dictator and should we give loans to such a regime? Many civil society organizations today agree that all loans to dictatorial regimes should be considered illegitimate and odious.¹

A further question is, under what circumstances can a creditor be held accountable for an unsustainable loan? Is an unsustainable debt automatically an illegitimate and illegal debt? The criteria of IMF and WB for assessing debt sustainability under the multilateral debt relief initiatives focus almost entirely on the ability of debtor countries to repay their debts², whereas Cephas Lumina defines ‘sustainability’ as the ability of a country to pay back its debts without violating basic social and human rights. This broader definition of “sustainability”, which aims at showing debt as an impediment to development, has not yet made its way through the financial world and into legal regulation. However, we – as part of civil society – fully support Lumina’s view and consider any debt which is paid back to the detriment of the poorest as unsustainable. As it is clear that Lumina’s use of the term ‘sustainability’ differs from that of IMF and WB, this difference should be made more explicit in the theoretical debate. Namely, why should a sustainable loan be defined as a “loan sustaining development” rather than a “loan that can be repaid”? And, most importantly, on what legal grounds should lenders be liable for the ‘development-friendliness’ of their loans? These questions can and should also be answered on the legal level.

In our case studies the authors clearly see a responsibility of the creditor in cases where there is a lack of due diligence: if abusive loans have been granted and damaging conditions imposed on the borrowers. This does not, however, absolve the borrowers from all responsibility. As sovereign countries and on the basis of their constitutions they are obliged to avoid taking out loans which are not sustainable for their populations, i.e. loans which violate social and human rights, as defined by Lumina. Nevertheless, it is an obligation for every creditor to make risk assessments which conform to existing guidelines and rules before granting loans. In the Mobutu case it must have been obvious for the private banks involved that any lending was at the very least a high risk. However, it is the task of a court or arbitration tribunal to decide whether or not these banks behaved with the necessary prudence.

Sabine Michalowski points out that if Paraguay’s challenges to the validity of the loan agreements were rejected based on the argument of unconstitutionality, the outcome would then depend on the good faith of the country’s creditor, i.e. the private banks. The Swiss tribunals concluded that Berres had acted, if not with actual authority, at least with apparent authority, when he signed the guarantees for the contracts in the name of the State of Paraguay. The banks could therefore, according

to the Swiss courts, rely on the fact that Berres had acted with the authorisation of the State of Paraguay. Furthermore, the guarantees for the contracts in question were signed by Berres on behalf of the State of Paraguay at a time when due diligence rules were not widely implemented. The banks also had no way of knowing that Berres would later be sentenced and jailed in Paraguay. On the other hand, it is a fact that Paraguay was a dictatorial regime at that time and Berres the major shareholder in the two Ecuadorian companies which profited from the contracts with the banks. It can be argued that the banks must have known these facts. Should they therefore have abstained from granting loans? Clearly, there are strong and valid arguments both for and against the banks.

2.1.1 Due diligence

Many of the case studies in this book mention lack of due diligence and propose arguments to establish responsibility on the side of the lenders. As far as the private sector is concerned, at the beginning of the new millennium a large number of countries still showed deficiencies in the ‘know-your-customer’ (KYC) policies for banks. KYC policies in some countries had significant gaps and in others were non-existent.³ Meanwhile, the Basel Committee on Banking Supervision has formulated broad supervisory standards and guidelines and recommends statements of best practice in banking supervision in the expectation that member authorities and other nations’ authorities will take steps to implement them through their own national systems, whether in statutory form or otherwise. The purpose of the committee is to encourage convergence toward common approaches and standards. It will then be easier for judges and arbitrators to decide whether a bank has acted with the necessary due diligence in a particular case. However, due diligence regulations regarding loans should not only refer to the assessment of risk but also to possible violations of human rights and social norms.

International Financial Institutions such as the WB and IMF have often been accused in the past of having breached statutory duties and of causing great damage to populations. Furthermore, their frameworks are still challenged by many developing countries and NGOs and their arbitration procedures are criticized for not being independent and transparent.

2.1.2 No creditor responsibility in the systemic approach?

When Alexander Sack formulated his doctrine of odious debt in 1927, one of his criteria for determining the odiousness of a debt was that the creditor knows that the loans will be used contrary to the interests of the population. Charles Abrahams says that today, the expansive concept of illegitimate debt marks a shift away from lender countries having to take responsibility or co-responsibility. According to the position of civil society groups, as Abrahams recalls, an argument based on illegitimate debt in its broadest sense implies that there

is no need for creditor awareness and by implication creditor responsibility, as the whole system of indebtedness is brought into question. However, it is not clear how this systemic approach can be practically applied in concrete cases of illegitimate debt. When a creditor has acted in good faith, it is hard to see how a country could repudiate its debt and file a claim. However, if the case studies in this book are at all representative of cases of illegitimate and odious debt, it would be rather naïve to believe that creditors are never aware of anything.

2.2 Sovereign states versus foreign courts

Can a contract between a given sovereign state and other states, international financial institutions or foreign private banks be invalidated when this contract contravenes internal laws and the constitution of this state? Does a sovereign state have the obligation to accept foreign courts and their rulings?

Ramiro Chimuris follows the line of the Ecuadorian Debt Audit Commission in contractual conflicts by refusing any contract that violates internal law and by rejecting any judgement from a foreign court against a sovereign state. Chimuris elucidates that this apparent disregard for customary international law is actually historically rooted in the official Latin American opposition to the UN convention in 1964 on the settlement of investment-related disputes between States and nationals of other States. According to a public statement given by a Latin American representative during these negotiations, the planned International Centre for the Settlement of Investment Disputes of the World Bank would institutionalize a structural lender bias of sovereign debt management.⁴

Not surprisingly, in the case of the private banks against Paraguay, the Swiss courts relied on the widely applied principle that a state cannot invoke its own internal law to question whether an action was invalid or to challenge its own capacity to be party to arbitration. These opposing opinions refer both to articles of the Vienna Convention. Because these articles are so important in this discussion we will quote them once again (see also Sabine Michalowski's chapter on Paraguay):

Art. 27

"A party may not invoke provisions of its internal law as justification for its failure to perform a treaty."

Art. 46

"1. A State may not invoke the fact that its consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent unless that violation was manifest and concerned a rule of its internal law of fundamental importance.

2. A violation is manifest if it would be objectively evident to any State conducting itself in the matter in accordance with normal practice and in good faith."

Although not yet in force, the 1986 Vienna Convention on the Law of Treaties between States and International Organizations or between Interna-

tional Organizations adopts the same formulation in its Art. 27 and 46.⁵

It seems that Art. 46 leaves a door open for a country to invalidate a contract which violates internal law, if there is clear evidence of the violation and if the violation concerns a very important rule of law. This, however, is a rare occurrence as Michalowski points out in her Paraguay chapter. Nevertheless, it seems that Chimuris and other legal experts in South America see sufficient legal grounds in the Vienna Convention to invalidate those contracts which contradict internal law and constitution. Moreover, as Michalowski shows, there have been a number of judicial decisions in the past which would favour the position of Paraguay. However, these decisions were made before the Vienna Convention came into effect. The various judicial decisions show that the chance for success of a claim can differ from one jurisdiction to another.

Chimuris is clear in his position that a country should not be bound to accept foreign judges and arbitrators as this would be an interference with the sovereignty of the state. However, as other legal experts argue, contracts are made with free consent. One example is that of the 2012 and 2030 bonds issued by former Ecuadorian president Gustavo Noboa in 2000. He issued these bonds to refinance the so-called Brady bonds issued in 1994, after the country had defaulted on its debt the year before, and they are governed by New York law, with Ecuador subject to jurisdiction in New York courts. In this case, would Ecuador have been free to choose jurisdiction in its own country? And if so, why did Ecuador choose not to take that option? As we don't know all the facts of this case, we must leave the answer to those who are better informed. However, we are convinced that in an unjust economic and financial system the parties in a contract, especially if the debtor is located in the South, are not on equal footing, as explained later in this chapter. It will be more difficult (and expensive) for a country in the South to obtain new loans if it wants the condition that jurisdiction is not in the creditor's country.

The sovereignty approach is so far limited to some doctrines from the South, where some jurists of debtor countries have intellectual or practical affiliations to debt repudiation by debtor states. The merit of Chimuris' contribution is that he points to infringement on sovereignty as a third legal source of debt contestation, a legal source which has been little discussed internationally.

In our view, it can be argued that the low popularity of the sovereignty approach lies less in any conceptual flaw than in the political reluctance of Northern creditor governments to seriously consider this approach within the UN General Assembly. Understandably, this also leads to a reluctance among Northern legal scholars to oppose those positions most common among judges, governments and parliaments regarding 'free' contracting of debts and of repayment or restructuring modalities. One fact that the case studies in this book clearly show is that there exists a need to develop the law, giving emphasis to the material aspects of

specific cases, i.e. the need to go beyond identifying the sources of the law and to move towards assessing their applicability. However, this is a very difficult task because long-term international relations and geo-strategic interests are, to a noticeable degree, opposed to such a development of law.⁶

2.3 Variable contract elements, external jurisdiction

There are, apart from conditionalities such as privatization, two structural issues within the sovereignty approach, namely the contracting of variable elements (floating interest rates) and that of external jurisdiction. The Calvo doctrine explained in this book states that sovereignty in its broadest sense is a prerequisite for the validity of

multilateral, bilateral, or transnational contracts. Opponents of the concept of systemic illegitimacy of debt contracts maintain that by virtue of having signed a contract Southern governments have freely agreed to, for example, variable interest rates and Northern jurisdiction. On the other hand, promoters of the concept claim that there are several factors which force debtors into disadvantageous contracts, e.g. crony capitalism, lack of information, the pressure to raise capital etc. A number of pros and cons are summarized in the table below. At the very least, the counter-arguments show that purist contractualism in current debt management is a convenient illusion. Of course, any of these contra-arguments can be questioned.

	Pros	Cons
Floating interest rates	Trend of interest rates is unforeseeable for both lender and borrower (e.g. the rise in interest rates which occurred due to Reagan's arms race policy)	Northern lenders are used to extrapolating trends of interest rates and can finance the aggregation and evaluation of large data sets. ⁷ Any variable contract element ⁸ produces a highly unstable economic situation in Southern countries and at the same time a very secure and convenient income for the North. The contract, therefore, is highly imbalanced and may be regarded as legally void.
High interest rates because of the choice to have jurisdiction in the South ⁹	Risk-related market rates	Investment environment with higher transaction costs and lower (but still fair) rates of return on investment due to lower cost of living. Lenders systematically underestimate substantial economic risks to investment in the South and pass them on to Southern debtors, namely the risks of developing a market system (as opposed to betting on future returns). Given the high risks, they should either bear part of them or not invest in the South. However, the thirst for investment opportunities always wins and there is also periodically the need to invest in 'sub prime areas'. In these instances, lenders then claim a return on their investment that equals Northern standards, i.e. imposing abusive terms of trade in lending, and pass on the related risk-taking to the Southern debtors. Investment behavior tends towards speculative as opposed to entrepreneurial; aimed at financial gain rather than implementation of the projects being financed. The banking crisis has shown that this behavior leads to socialization of losses and privatization of proceeds. This is true for the North, but even more so between North and South.
Jurisdiction in the North	Agreed condition allowing for lower interest rates, as the risk of a Southern jurisdiction ruling in favour of debtors is ruled out. Northern jurisdiction has more experience and know-how in case of contractual conflicts.	The creation of further instability, as there is a pluralisation of jurisdictions the state needs to understand and to reflect in the contract. Even Northern agents are not always up to this task. This can force borrower states to accept unconstitutional contract elements. It makes debtors convenient prey to abusive contract enforcement if the debts are 'securitized' and subsequently speculated with or bought by a vulture fund and claimed in court.
'Free' contracting	The official agents acted out of free will, as equal parties in a contract.	Pure contractualism deliberately neglects case material of legal consideration (abusive terms of trade). Crony capitalism in the South is a reality. Northern lenders are part of this system, as the giving hand of corruption they supply the bribe, e.g. commission payments for public procurement. Southern officials are entangled in conflicts of interest; they may have public positions and simultaneously commit passive bribery or own companies that profit from a contract which is clearly against the public interest.

One could ask why there should be objection to floating interest rates when borrowers can profit from low interest rates just as well as lenders from high ones. However, the point is that first, any contractual element which is variable for at least one party, be that floating interest rates, foreign currency payments, commodity prices or other, makes the contract a speculative investment for the lender and a high risk loan for the borrower. Second, while the lender has commercial interests and is able to bear high volatility-related losses on his investment, the borrower has public interests and can bear only moderate losses, or stands to lose the ability to provide public services and infrastructure. Consequently, the argument against floating interest rates and other variable contract elements is not that a sovereign borrower cannot profit of slumping interest rates, but that the risk of soaring interest rates is a sufficient reason to disapprove of floating interest rates in sovereign debt contracts.¹⁰ It therefore seems pertinent to ask what real consequences these debated issues have on development and poverty; fair contractual symmetry between lender and borrower is only one part of the story and whether there exists reasonable symmetry between risk and benefit of loans is an equally important – but untold – part.

It is true for any jurisdiction that obligations assumed under pressure are null and void. There also exists a small number of legal remedies for countries which have been forced into disadvantageous and unfair contracts. We mention, for example, the principles of good faith and equity, the violation of public order and the UNIDROIT Principles of International Commercial Contracts. Some legal experts doubt that sovereign governments are never able to protect their interests in contractual relations so loan agreements should therefore be regarded as void. In our own view, it is both impossible and imprudent to judge on a general level; a pure contractualistic view is perhaps too optimistic and does not take enough consideration of the multiple pre-contractual factors, or if the borrowers, after unconvincingly mimicking poor inexperienced governments, which have been cheated, smugly default on their debt, turning out to be abusive borrowers who eat the cake, but don't pay for it. It is of utmost importance to lead this debate based only on in-depth case experience, without drawing foregone conclusions; unfortunately, even Northern NGOs display poor sensitivity here.

2.4 Partially odious debts?

Another question raised by the authors is how we should take the eventual benefit of a project funded by questionable loans into account. Do these loans remain illegitimate, despite the fact that they have partly benefited a country and its people? There is, for example, the impact of the Yacyretá dam at the border of Paraguay and Argentina. Maurizio De Martino believes that when a project violates human rights, any benefit becomes almost irrelevant. Jürgen Kaiser, on the other hand, holds that one should take benefits into account when assess-

ing a debt. He believes that there are debts which can be considered partially odious, such as the case of the coast guard ships sold by the former German Democratic Republic to Indonesia during the Suharto regime.

2.5 *Ius cogens* – a promising approach

It has been noted in this book that one legal avenue makes the assessment of creditor responsibility and benefits unnecessary; in cases where there is a violation of peremptory norms of international customary law (*ius cogens*), the decision depends on neither creditor responsibility nor enjoyed benefits. Therefore, notwithstanding contract law based approaches and some practical reasons, *ius cogens* seems a very promising legal avenue in cases of illegitimate and odious debt. Both international courts and domestic courts should take *ius cogens* violations into account, not only in conflicts between states but also between states and international organisations and even private individuals.

The argument against a *ius cogens* approach lies in the fact that there is still an open debate on the question as to whether or not the protection of human rights should also be regarded as a peremptory norm. Moreover, protection of the environment does not currently fall under *ius cogens*.

2.6 Direct versus indirect impact of loans

In her introductory chapter on international law, Sabine Michalowski points out that loans which have at least an indirect effect on human rights violations committed by regimes should be regarded as odious and thus void, unless it can be proved that the loans did not have such an effect.¹¹ Clearly, this is an important statement because it is often difficult to prove a direct link between a specific loan and a human rights violation. Most of the case studies in this book endeavor to establish such a link. The link is established when a loan breaches an embargo or a binding convention, as Charles Abrahams shows in the chapter on South Africa. However, according to Michalowski, this would not even be necessary when it comes to those (dictatorial) regimes which are corrupt and violate human rights. But what of those democratically elected governments which have fallen prey to disadvantageous and unfair contracts or contracts which are not sustainable from a human rights point of view? We believe that regardless of the nature of a regime, a loan-by-loan debt audit would be the best solution in order to avoid any arbitrariness and to give the country or state the necessary legitimation for any later debt repudiation. Moreover, we believe that the transition to a democratic regime should not prejudice the right to question the legitimacy of new debts. It is the legitimacy of the debt that counts, nothing else.

3 Lessons learned from this book

The broad definition of illegitimacy presented by Charles Abrahams encompasses most legal and moral considerations of illegitimate debt, including the systemic approach. It was the challenge

of this book to explore how this broad concept could be put into practice. The legal experts have shown in their case studies that a number of legal avenues and forums do exist and that private and international law approaches can be combined.

From a practical point of view we suggest therefore that the focus be more on these legal avenues, rather than dedicating too much time and energy on further discussing the whole concept of illegitimate debt.

We also believe, however, that the systemic approach deserves further research and conceptual work in order to explore possible avenues. In June 2009, 45 representatives of NGOs from around thirty countries from both South and North met in Collevocchio, Italy and developed a new charter, 'Transforming the International Financial System: Sovereign, Democratic and Responsible Financing'. This charter points the way for a systemic change.

We also conclude that the sovereignty approach deserves further research, especially to raise a better understanding of it outside South America. We fear though, that this nationalistic approach may never be widely accepted on an international level; the choice of jurisdiction will almost certainly always favour either the lender or the borrower. The solution to this dilemma could be a new Fair and Transparent Debt Arbitration Process, as proposed by Charles Mutasa in this book. This would not only be an alternative for the very much criticized arbitration mechanisms of the International Financial Institutions and the Paris Club but also for bilateral and commercial conflicts. It would de-

pend on both parties of a loan agreeing to adopt such an arbitration clause.

It is also worth noting that some domestic laws, such as Philippine and French law, offer possibilities for the population, which is not a party to a concrete contract, to file a claim when the content of the contract could harm others (and even future generations). Further research should therefore investigate whether the law in other countries also has such provisions.

The case studies in this book show that there are quite a number of possible legal avenues which could be used by debtor countries either to file a law suit or to negotiate debt restructuring and cancellation with the creditors. The question arises as to why so many countries opt to pay their debts regardless of possible alternatives. Literature on illegitimate and odious debt suggests that unilateral debt repudiation may come at a high cost, potentially cutting off future access to international financial flows, so this is seen as perhaps not the best way to proceed.

On the other hand, as long as there is a lack of state practice and a lack of binding regulations regarding illegitimate and odious debt it is unlikely that lenders will accept some kind of common ruling or mechanism. We need more state practice and case laws if we want the concept of illegitimate and odious debt to become a generally accepted legal doctrine. We hope therefore that civil society groups will continue their efforts in organizing (official) debt audits and in encouraging their countries to take political and legal measures against illegitimate and odious debt.

Max Mader and André Rothenbühler

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1 At the International Study and Strategy NGO-Meeting on Illegitimate Debt in Quito/Ecuador in September 2008 the participants agreed that the illegitimacy of a regime is a sufficient basis to declare loans to such a regime as illegitimate.

2 See endnote 11 of Lumina's chapter in this book.

3 Bank for International Settlements, Customer due diligence for banks, October 2001. Available at: www.bis.org/publ/bcbs85.htm.

4 See endnote 38 in Chimuris' chapter and subheading 1.8 of the introduction in this book.

5 Vienna Convention on the Law of Treaties between States and International Organizations or between International Organizations of 1986. Available at: untreaty.un.org/ilc/texts/instruments/english/conventions/1_2_1986.pdf

6 In Switzerland on 21 April 2009 Mark Pieth, a well-known professor for penal law, filed a complaint against the Office of the Federal Attorney for neglecting its duty to investigate material aspects in the Mobutu case on stolen assets. He also co-authored the draft for the amendment bill of the Swiss Act on the mutual international legal assistance in penal law. In this sense, he refused to confine himself to doing his academic duties.

7 Bohoslavsky 2009, Sovereign Insolvency, Abusive Lending, and the Distribution of Losses. The Spanish Yearbook, forth-

coming, p. 24 states differences in skills and resources even among Northern lender groups.

8 Cf. supra Perdriel-Vaissière's description of the debt service with future revenues of raw material, banned by the IMF, yet still practiced.

9 Bohoslavsky, 2009, at 22.

10 The participants at the global civil society meeting 'Towards Sovereign, Democratic, and Responsible Finance' in Collevocchio/Italy in June 2009 agreed that if variable interest rates are chosen, rates should be given a reasonable and fair upper limit which must be stated in the contract.

11 Michalowski shows that this legal position has been relevant since the second half of the 20th century; from the Nuremberg trials to the apartheid claims. Unfortunately, in July 2009, the competent New York court abolished this reversal of the burden of proof of an indirect link in favor of the banks which had financed the apartheid system and upheld only the charge against the industry which had supplied security equipment, because it assessed the link between supply of arms and human rights violations as sufficiently direct. This abrogation of indirect links was contrary to the jurisdiction of the Nuremberg trials which had extended it to the banks, assessing their behavior as clear aiding and abetting.



Existing Arbitration Mechanisms

Arbitration belongs to alternative methods of dispute settlement and lies between mediation and public jurisdiction. Basically all existing arbitration mechanisms, based on their statutes, can also make legally binding decisions regarding debts, be they unpayable or illegitimate. Kunibert Raffer points out that it is important to know what mandate they have, i.e. to whom they belong (for example to the creditors). There exist many different national and international arbitration mechanisms. The following chart gives an overview of some of the most important ones:

Permanent Court of Arbitration, The Hague (PCA)	The PCA is part of the International Court of Justice in the Hague. Its mediation efforts address disputes between states and disputes between private and public institutions.
United Nations Commission on International Trade Law (UNCITRAL)	UNCITRAL has developed a model law that provides uniform rules for the conciliation process to encourage the use of conciliation and ensure greater predictability and certainty in its use. This model law was adopted by the UN General Assembly in January 2003.
International Centre for the Settlement of Investment Disputes (ICSID)	The ICSID is part of the World Bank and offers, on the basis of a convention that all member states of the Bank have to comply with, a wide range of arbitration procedures for disputes between states and private investors.
World Bank Inspection Panel	The primary purpose of the Inspection Panel is to address the concerns of people who may be affected by Bank projects and to ensure that the Bank adheres to its operational policies and procedures during the design, preparation and implementation phases of projects. The members of the Inspection Panel are appointed by the Board for non-renewable periods of five years.
International Chamber of Commerce (ICC)	The ICC offers several services for commercial dispute resolution, one is the International Court of Arbitration. In the year 2008, ICC arbitration took place in 50 countries and involved arbitrators of 74 different nationalities.
London Court of International Arbitration (LCIA)	The LCIA is one of the longest-established institutions for commercial dispute resolution. Although based in London, the LCIA is an international institution, providing, according to its website, impartial administration of dispute resolution proceedings for all parties, regardless of their location, and under any system of law.
American Arbitration Association (AAA)	The AAA provides services to individuals and organizations wishing to resolve conflicts out of court. Its role in the dispute resolution process is to administer cases, from filing to closing. The AAA provides administrative services in the United States, and abroad through its International Centre for Dispute Resolution (ICDR).
Dispute settlement within the World Trade Organization (WTO)	Settling disputes is the responsibility of the Dispute Settlement Body, which consists of all WTO members. The Dispute Settlement Body has the sole authority to establish panels of experts to consider cases, and to accept or reject the panels' findings or the results of an appeal. It monitors the implementation of the rulings and recommendations, and has the power to authorize penalties when a country does not comply with a ruling.
OSCE Court of Conciliation and Arbitration	The Court of the Organization for Security and Co-operation (OSCE) was established in 1995 by the Convention on Conciliation and Arbitration. It provides a mechanism for the peaceful settlement of disputes between states. The Court is based in Geneva. Currently, thirty-three states are party to the Convention.
Cour Commune de Justice et d'Arbitrage (CCJA)	Part of OHADA, the organization for the harmonisation of African commercial law, the CCJA serves as a court of appeal and organizes and controls the proper functioning of arbitration processes.

European Court of Arbitration

The European Court of Arbitration is the branch of the European Centre of Arbitration which promotes arbitration and administers domestic and international arbitration. Its territory is Europe, including Eastern Europe, the Mediterranean, the Middle East and the Black Sea countries.

Commercial Arbitration and Mediation Center for the Americas (CAMCA)

CAMCA provides commercial parties in the Americas with a forum for the resolution of private commercial disputes and is designed to be consistent with the North American Free Trade Agreement (NAFTA).

Sovereign Debt Restructuring Mechanism Proposal of the International Monetary Fund (IMF)

The proposal was rejected during the 2003 World Bank/IMF Spring meetings. The Sovereign Debt Dispute Resolution Forum (SDDRF) would have acted as a new dispute resolution forum for disputes among creditors or between creditors and debtors.

Other Types of Alternative Dispute Resolution

Private judging (A retired judge is appointed by parties in dispute to preside over a “private trial”)

Rent-a-judge (hiring arbitrators [often retired judges] to hear a case)

Med-Arb (A form of arbitration in which the arbitrator starts as a mediator but can impose a binding decision in the event of a failure of mediation.)

Mini-trial (Each side presents a limited version of the case before an independent neutral as they would at trial. Once the trial has concluded, the neutral does not render a decision but instead works with the decision-makers independently with the aim of facilitating a settlement.)

Summary jury trial (A mock trial is held and a jury is selected and presented with the evidence that would have been used at a real trial. The parties are required to attend the proceeding and hear the verdict of the jury. After the jury delivers its verdict, the parties are required to once again attempt a settlement before going to a real trial.)

Early neutral evaluation (Early neutral evaluation is a process that often occurs early in the pre-trial stage. A neutral is retained by the parties and counsel to assess the strengths and weaknesses of their case and provide assistance in finding common ground in the dispute.)

Neutral expert fact finding (A neutral fact finder conducts an independent investigation into the cause of the disagreement. The fact finder will interview both sides, gather additional information, and then present findings and possible solutions to the parties.)

For a complete list of ADR institutions see The American Society of International Law (ASIL):
www.asil.org/arb1.cfm.



Legal Instruments that can render a loan

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Legal argument (Case context)	Chapters in this book or reference texts	Type of loan
Absence of due diligence (Unlawful cause, foreseeable end use of contracted loan is against public order)	Tessera (Congo Kinshasa)	Multilateral (EEC, WB), Commercial (several European commercial banks – Société italo-Congolaise de développement industriel SICAI)
Absence of due diligence (Unlawful cause, foreseeable end use of contracted loan is against public order – personal enrichment of government agents)	Perdriel-Vaissière (Congo Brazzaville)	Commercial (French commercial banks, French and Italian oil companies, Swiss resource brokerage companies)
Absence of due diligence (negligent technical and economical assessment of the project, questionable public tender)	De Martino (De Wind)	Bilateral (Ecuador – Italy) / Commercial (Ansaldo-Impregilo-Iciss Fiat-Equidor consortium)
Breach of International Treaties and national constitutions	Chimuris (Illicitness)	Multilateral (WB, IDB)
Clean Hands (lender knows about corruption of borrower's agents)	De Martino (Yacyretá)	Multilateral (WB, IDB), Bilateral (Argentina – Paraguay), Commercial (Impregilo-Dumez)
Environmental harm as Human Rights violation (linked to forced resettlement)	De Martino (Yacyretá) De Martino (De Wind)	Multilateral (WB, IDB), Bilateral (Argentina – Paraguay), Commercial (Impregilo-Dumez) Bilateral (Ecuador – Italy)
Environmental harm as Human Rights violation (right to class actions or individual complaints sovereigns or international bodies)	Espiritu (Philippines)	Commercial (Department of Finance of the Republic of the Philippines, the Bank of Austria AG, Vamed)
Fraud and Corruption (as foreseeable element of the performance of the contract)	Tessera (Congo Kinshasa)	Multilateral (EEC, WB), Commercial (several European commercial banks, Société italo-Congolaise de développement industriel SICAI)
Fraud and Corruption (fraudulent over-equipment, over-pricing)	De Martino (De Wind)	Bilateral (Ecuador – Italy)
Fraud and Corruption (power to act)	Michalowski (Paraguay)	Commercial (Paraguay – Swiss Banks)
Fraud and Corruption (power to act)	De Martino (Yacyretá)	Multilateral (WB, IDB), Bilateral (Argentina – Paraguay), Commercial (Impregilo-Dumez)
Good faith (of the lender not to lend, if non-performance is foreseeable)	Tessera (Congo Kinshasa)	Multilateral (EEC, WB), Commercial (several European commercial banks, Société italo-Congolaise de développement industriel SICAI)
Good faith (of the lender not to lend, if non-performance is foreseeable)	De Martino (Guayaquil)	Bilateral (Ecuador – Spain/Argentina), Multilateral (IDB, WB)
Gross disparities / Imbalance of contract	De Martino (Yacyretá)	Multilateral (WB, IDB), Bilateral (Argentina – Paraguay), Commercial (Impregilo-Dumez)
Gross disparities / Imbalance of contract	De Martino (Guayaquil)	Bilateral (Ecuador – Spain/Argentina), Multilateral (IDB, WB)
Gross disparities / Imbalance of contract (Excessive interests)	Abrahams (Liberia)	Bilateral (Liberia – Sweden)
Gross disparities / Imbalance of contract (illegal contractual exceptions in case of non-performance)	Tessera (Congo Kinshasa)	Multilateral (EEC, WB), Commercial (several European commercial banks, Société italo-Congolaise de développement industriel SICAI)
Gross disparities / Imbalance of contract (Protraction of implementation, exorbitant excess costs and interest)	De Martino (Yacyretá)	Multilateral (WB, IDB), Bilateral (Argentina – Paraguay), Commercial (Impregilo-Dumez)
Violations of UN Security Council Resolutions	Abrahams (Apartheid)	Commercial (South Africa – European commercial banks, German industry)
Violations of <i>ius cogens</i> (lenders violating <i>ius cogens</i> lose all claims)	Giroud-Roth (Haiti)	Multilateral (WB)

Note: Most modern sovereign debt contracts are issued under US (New York) and UK laws. The importance of Japanese and German contract law has diminished dramatically since 2001.

contract null and void, in part or as a whole

Binding legal instruments *Non-binding guidelines	Case Law, legal fora
French Civil Code Art. 1382 (duty to inform and advise) French Monetary and Financial Code Art. L.563-1, L.563-3	Mixed Chamber of the Court of Cassation, 29 June 2007, n. 05-21.104, Cass ch mixte, 29 June 2007, n. 06-11.673, Cass, com, 8 January 2008: Juris-Data n. 2008-042240, Cass, com, 11 December 2007, Juris Data n. 2007-041922, Cass, ch mixte, 29 June 2007
French Civil Code Art. 1133 (duty to inform and advise) French Civil Code Art. 1147 (breach of the duty of good faith) French Civil Code Art. 1142 (compensations) French Monetary and Financial Code Art. L.563-1, L.563-3	Kensington International Ltd v. SNPC, Bruno Itoua, BNP Paribas S.A., U.S. District Court, Southern District of New York, March 2006 / Kensington International v. Republic of Congo, High Court of Justice, 28 Nov 2005 / French First Civil Ch 7 Oct 1998, First Civil Ch Court of Cassation 27 June 1995 (duty to warn) / First Civil Ch Court of Cassation 12 July 2005 (failure to verify financial standing) / First Civil Ch Court of Cassation 16 July 1998 (part compensations)
Italian law	
Vienna Conv. 1969 Art. 46 and 53 / *WB operative guidelines (resp. intl. obligation of states that extend to intl. financial institutions) / *ICSID Statutes Art. 68	Olmos v. Martinez de Hoz, Criminal and Correctional Federal Court No. 2 no. 14467 2000 / Olmos v. Fernando de la Rúa and Domingo Cavallo, Criminal and Correctional Federal Court No. 8 no. 17718.
	Inceysa Vallisoletana S.L. v. Republic of El Salvador, 2 August 2006 (ICSID Case No. ARB/03/26)
Covenant on Economic, Social and Cultural Rights *Article 19 OD 4.01 and Articles 5, 8, 9 of the World Bank OD 4.30 (consultation, compensation) Italian Law No. 49 of 26 February 1987 (projects must safeguard basic human needs and rights)	Velásquez Rodríguez Case, Inter-Am.Ct.H.R., Judgment 29.6.1988 (Ser.C) n. 4. Request for inspection / WB ICSID and IBD Independent Investigative Mechanism
United Nations Framework Convention on Climate Change (UNFCCC), among others Republic Act (R.A.) No. 8749 (Clean Air Act)	Oposa v. Factoran, G.R. No. 101083 July 30, 1993 (Intergenerational self-preservation and self-perpetuation)
Vienna Conv. Art. 53 (against the international public order)	Paris Court of Appeal, 10.9. 1993. (embezzlement, money laundering, or corruption invalidates a contract) / Court of Cassation, 1st Civil Chamber, 7 October 1998 (even if lender did not know)
Italian Law, Vienna Conv. 1969 Art. 49 / Unidroit Article 3.8 (fraud)	
Vienna Conv. 1969 Art. 7 (sov. agency)	Swiss Federal Court BGE 124 III 382, at 388 / Supreme Court of Paraguay: Informe NP No.117 of 4 August 2005 / Presidential Decree 6295 / Cameroon v. Nigeria, ICJ decision of 10 October 2002 Beales, Nobles and Garrison (US v. Venezuela) 1957 / Great Britain v. Costa Rica (1923), Reports of International Arbitral Awards, Vol. 1, 371 and several more
Vienna Conv. 1969 Art. 50 (Invalidation of the contract, if lender has bribed or otherwise corrupted the borrower's agent)	
French Civil Code Art. 1134 (Good faith) / French Civil Code Art. 1147 (compensation) / Vienna Conv. Art. 26	Klöckner Industrie-Anlagen GmbH et al. v. United Republic of Cameroon and Société Camerounaise des Engrais (ICSID Case No. ARB/81/2), 2 ICSID Reports 9
Unidroit Art. 1.7 Principles of European Contract Law Art. 1.201 (good faith as mandatory contract element)	Guayaquil v. International Water Service Guayaquil Interagua C. Ltda. (INTERAGUA), Ombudsman (Defensoría del pueblo), Expediente defensorial No. 314-dasl
Vienna Conv. 1969 Art. 60 III B (violation of a provision essential to the accomplishment of the object or purpose of the treaty, <i>inadimplenti non est adimplendum</i>)	
Unidroit Article 3.10 (prohibition to take unfair advantage)	
Swedish Interest Act of 1975 (Prohibition of excessive interests)	
French Civil Code Art. 1131 (performance of the contract not as intended by the borrower)	Court of Cassation, Commercial Chamber, 18 December 2007 (illicit contractual exceptions in the event of non-fulfilment of the contract's essential obligation)
Italian Civil Code Art. 1467 (excessively burdensome duties)	
Security Council Resolution, The Question of South Africa, S/RES/418, 4 November 1977 (arms trade embargo) Security Council Resolution 402 of 1976 and 407 of 1977 (non-recognition of the TBVC states) U.S. Comprehensive Anti-Apartheid Act, 22 U.S.C. §§ 5000-5116 1988 *EEC voluntary code of conduct 1974	Sakwe Balintulo et al. v.; Daimler AG, Ford Motor; Company, Fujitsu Ltd, General; Motors Corporation; International Business Machines Corporation, And; Rheinmetall Group AG U.S. District Court; Southern District Of New York
Vienna Conv. 1969 Art. 53	ICSID Phoenix Action v. The Czech Republic No. ARB/06/5 9th April 2009



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The book combines theory on the concept of odious debt with an in-depth legal analysis of nine cases. According to the results of the case studies, the following legal avenues are promising instruments for contesting illegitimate and odious debts:

- Lack of due diligence and the duty to inform and warn.
- Breach of general legal principles, such as good faith.
- Breach of domestic laws and national constitutions.
- Breach of international treaties, principles and guidelines.
- Violation of *ius cogens* norms as a part of customary international law.
- Fraud and corruption.

This publication is a timely contribution to the increasingly influential debate on sovereign debt relief and illegitimate debt. The UNCTAD program on responsible lending and illegitimate debt, launched in November 2008, tackles exactly the issues and stakeholder views addressed in this book.

The book not only includes independent opinions of legal experts and non-governmental organizations, but also offers their joint conclusions and major points of dissent. The intensive exchange among the contributors that helped shape this groundbreaking work started at the International Conference on Odious Debt in Berne in 2007 and continued into 2009, when the authors participated in a meeting to mutually review and discuss their case studies.

Aktion Finanzplatz Schweiz is a charitable organization registered in Switzerland. It is financed by its members and by grants from international foundations. We work both in Switzerland and, as facilitators and observers, in the Global South. AFP coordinates coalitions of NGOs addressing the problem of stolen assets and is a member of the debt relief network Eurodad. Our three-year program on odious debts aims at improving the understanding of binding legal instruments in international and private law as a tool for debt auditing and arbitration that complements the renegotiation and cancellation of debt.