

# NOTE

## INCORPORATING THE FRESH START INTO SOVEREIGN DEBT RESTRUCTURING THROUGH ODIIOUS DEBT

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INTRODUCTION .....	1644
I. THE FRESH START IN CONSUMER BANKRUPTCY.....	1645
A. (Socio)Economic Policy Rationales.....	1647
B. Morality-Based Policy Rationales .....	1650
1. <i>Debts Exempt from Discharge</i> .....	1652
II. SOVEREIGN DEBT, INSOLVENCY, AND DEFAULT .....	1653
A. What is Sovereign Debt?.....	1653
B. Sovereign Default and Recourse? .....	1655
1. <i>Sovereign Debt Dischargeability</i> .....	1658
III. THE FRESH START AS A POLICY OBJECTIVE FOR SOVEREIGNS .....	1659
A. Economic Policy Rationales for a Sovereign Fresh Start Policy .....	1660
B. Morality-Based Policy Rationales for a Sovereign Fresh Start Policy .....	1664
1. <i>International Law and Sovereign Debt</i> .....	1665
IV. THE ODIIOUS DEBT DOCTRINE .....	1667
A. The Odious Debt Doctrine as a Moral Obligation.....	1668
1. <i>The U.S. Bankruptcy Code and Odious           Debt</i> .....	1669
B. The Odious Debt Doctrine as an Economic and Legal Obligation .....	1670
C. A Possible Solution Supported by a Fresh Start Policy .....	1672
CONCLUSION .....	1676

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## INTRODUCTION

One of the glaring differences between personal bankruptcies and sovereign “bankruptcies” is the absence of a fresh start for sovereigns. This is largely because sovereigns cannot declare bankruptcy in the same way that individuals can declare bankruptcy.<sup>1</sup> A sovereign cannot enter into bankruptcy in the traditional sense—creditors and a sovereign cannot be forced to come together under an organized legal system to discharge and restructure the sovereign-debtor’s obligations.<sup>2</sup> This obviates the sovereign’s ability to declare bankruptcy in the “straightforward” manner an individual can.

Without the ability to declare bankruptcy, sovereigns currently lack the opportunity for a financial fresh start. No institution (bankruptcy court or otherwise) has the power to force the creditors and the debtor to the bargaining table, and thus no institution has the power to provide the sovereign with a fresh start like a bankruptcy judge can for an individual. While the judge’s ability to provide an individual with a fresh start is well founded in American jurisprudence,<sup>3</sup> it “appears only once in the actual text of the Bankruptcy Code [in § 1507(b)(5)].”<sup>4</sup>

All this begs the question, without an institution or a set of laws that can facilitate a sovereign’s bankruptcy proceeding, is a fresh start ever possible? I argue that it is, at least in part. This Note will unfold as follows. Section I will begin by examining how American bankruptcy law conceives of the fresh start concept. Section II will look at the problem of excessive sovereign debt and how a sovereign’s insolvency is handled when it cannot resort to bankruptcy. Section III will argue for incorporating the fresh start policy into the current sovereign debt restructuring regime. And Section IV will explore how the prac-

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<sup>1</sup> Martin Guzman et al., *Introduction to TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES XIII, XIII* (Martin Guzman, José Antonio Ocampo & Joseph E. Stiglitz eds., Columbia Univ. Press 2016) (“A fresh start for distressed debtors is a basic principle of a well-functioning market economy. . . . But there is no international bankruptcy framework that similarly governs sovereign debts.”).

<sup>2</sup> LEE C. BUCHHEIT ET AL., COMM. ON INT’L ECON. POLY & REFORM, REVISITING SOVEREIGN BANKRUPTCY IV (2013), [https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5904&context=faculty\\_scholarship](https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5904&context=faculty_scholarship) [<https://perma.cc/7JEG-3ULN>] (“[T]here is no legally and politically recognized procedure for restructuring the debt of bankrupt sovereigns.”).

<sup>3</sup> Jonathon S. Byington, *The Fresh Start Canon*, 69 FLA. L. REV. 115, 119 (2017) (“The Supreme Court began recognizing the fresh start policy by name as early as 1885.”).

<sup>4</sup> *Id.* at 118–19. The “fresh start” language appears in Chapter 15 of the Bankruptcy Code (the Code), which—ironically for this Note—is the section of the Code that deals with international bankruptcies.

tice of labelling governments illegitimate and their debts odious can serve as a mechanism for determining what debts are dischargeable, which will ultimately bring the sovereign closer to receiving a fresh start.

## I

### THE FRESH START IN CONSUMER BANKRUPTCY

The fresh start represents a few things. It is a reward provided to debtors for participating in an orderly restructuring of their debts. It is a unifying term for the set of legal mechanisms that provide debtors with this reward. And it is a policy objective supported by (socio)economic and moral rationales that advocate for providing debtors with another unburdened start to their financial life.

The United States has made the decision to provide individuals who go through bankruptcy with a fresh start.<sup>5</sup> The fresh start is just what it sounds like—a euphemism for providing the debtor with another unburdened start to their financial life.<sup>6</sup> This is provided through discharging some of the debtor's debts and restructuring others.<sup>7</sup> In short, this is the debtor's reward for working through an organized system that maximizes the creditors' returns.<sup>8</sup> Too, it is the principal (if not sole) reason that an individual goes into bankruptcy.<sup>9</sup>

In the United States' bankruptcy regime, the fresh start manifests as the right to an automatic stay and the opportunity to discharge and restructure certain debts.<sup>10</sup> The fresh start is achieved when the debtor is released from personal liability for some or all unsecured prepetition debts,<sup>11</sup> outside of a list of

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<sup>5</sup> See Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretative Theory*, 21 U. RICH. L. REV. 49, 50 (1986).

<sup>6</sup> See, e.g., Michael D. Sousa, *The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge*, 58 U. KAN. L. REV. 553, 562 (2010) ("This freedom from personal liability for pre-petition debt is known as the proverbial 'fresh start.'").

<sup>7</sup> *Id.* at 54–55.

<sup>8</sup> *Id.*; see also Byington, *supra* note 3, at 122 (noting that "a historical purpose of the fresh start was to increase assets available for distribution to creditors by giving debtors a discharge to incentivize them to cooperate").

<sup>9</sup> See Nicholas L. Georgakopoulos, *Bankruptcy Law for Productivity*, 37 WAKE FOREST L. REV. 51, 58 (2002) ("[T]he Supreme Court has elevated [the fresh start] into a fundamental policy of bankruptcy law with *Local Loan Co. v. Hunt*." (citing *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934))).

<sup>10</sup> See Byington, *supra* note 3, at 119–20.

<sup>11</sup> *Id.* This set of debt can range from strictly unsecured debt, such as credit card debt, to debt that becomes unsecured, such as debt left over from a lien-stripping. See *Discharge in Bankruptcy*, U.S. COURTS, <http://www.uscourts.gov/>

enumerated exceptions.<sup>12</sup> An automatic stay is the legal mechanism that ensures creditors do not try to collect while the debtor is in bankruptcy,<sup>13</sup> and the discharge injunction makes it impermissible for creditors to collect discharged prepetition debts “after bankruptcy, the same way as the automatic stay enjoins creditor conduct during bankruptcy.”<sup>14</sup>

The debtor receives their discharge and fresh start automatically but at different intervals, depending on the chapter of bankruptcy the debtor is filing under.<sup>15</sup> If a debtor is seeking to liquidate their assets quickly under Chapter 7, then the discharge is usually ordered four months after filing the bankruptcy petition.<sup>16</sup> If the debtor is seeking to restructure under Chapter 13, then the discharge is ordered much later, usually after the debtor’s three-to-five year plan is satisfied.<sup>17</sup>

Creditor-debtor relations involve two sets of competing rights—the creditors’ right in getting repaid and debtors’ right in ridding themselves of burdensome debt. A bankruptcy regime that starkly favors creditors’ rights will not suffice as it will alienate debtors; nor will a regime that starkly favors debtors’ rights as it will alienate creditors. The fresh start grapples with this dilemma and operates as a compromise under which debtors are rewarded once they have done enough to satisfy (in the eyes of the law) their creditors. This balanced approach, although, developed gradually. The fresh start historically existed to maximize creditor returns,<sup>18</sup> but that objective quickly tapered off<sup>19</sup> and a more balanced fresh start policy

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services-forms/bankruptcy/bankruptcy-basics/discharge-bankruptcy-bankruptcy-basics [https://perma.cc/GD76-MK74] (last visited Feb. 9, 2019).

<sup>12</sup> See 11 U.S.C. § 523 (2012) (listing the exceptions to discharge).

<sup>13</sup> See 11 U.S.C. § 362 (2012) (describing automatic stays); see also ELIZABETH WARREN ET AL., *THE LAW OF DEBTORS AND CREDITORS* 67, 69 (7th ed. 2014) (explaining that the basic function of the automatic stay is to halt all collection activities in its various forms against the debtor’s property and, secondly, to punish creditors if they try to pursue collection in violation of the stay).

<sup>14</sup> WARREN ET AL., *supra* note 13, at 155.

<sup>15</sup> See *Discharge in Bankruptcy*, *supra* note 11.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* The Chapter 13 debtor’s plan is satisfied once the debtor completes the required payments under the repayment plan, which is itself approved by the court shortly after the debtor files the petition.

<sup>18</sup> See Byington, *supra* note 3, at 122 n.35 (quoting *Discussion, LAW & CONTEMP. PROBS.*, Autumn 1977, at 123, 148) (“[D]ischarge was a reward offered by the creditors to the debtors for assembling their property and not concealing anything. . . . It was thought to be a benefit to the creditors.”).

<sup>19</sup> See Hallinan, *supra* note 5, at 54–55 (discussing how “nineteenth century state legislatures . . . enacted a rich variety of laws with the avowed purpose of affording insolvent debtors some greater or lesser degree of release from the enforcement of creditors’ claims”).

emerged.<sup>20</sup> The decision to reward overburdened debtors with a fresh start is now about more than just maximizing creditor returns in the face of an insolvent debtor; in the United States, it is also about furthering socioeconomic, economic, and morally based policy objectives.

#### A. (Socio)Economic Policy Rationales

The (socio)economic rationales for offering individuals a fresh start predate America's first set of bankruptcy laws.<sup>21</sup> Arguing for the adoption of a national bankruptcy law in 1841, President John Tyler bemoaned the mounting personal debt loads causing "large numbers of our fellow citizens" to experience mental and physical anguish.<sup>22</sup> He noted that this deflating anguish was sapping many Americans' productive energies, making them less productive than they could have been, and that a fresh start could help America become more productive.<sup>23</sup>

Others shared in President Tyler's sentiment. Blackstone wrote that a fresh start propels the debtor back into "a useful member of the commonwealth."<sup>24</sup> Justice Joseph Story argued that without a fresh start, the debtor's industriousness is quelled because their future earnings are monopolized by creditors.<sup>25</sup> And Professor Mack added that society needs the fresh start policy because society needs all of its members to be productive.<sup>26</sup> Expanding on President Tyler's argument, Professor Mack also contended that if some of society's members are demotivated because of excessive debt loads,<sup>27</sup> then these

<sup>20</sup> See *infra* subparts I.A., I.B. (discussing economic and policy-based rationales).

<sup>21</sup> See Hallinan, *supra* note 5, at 56–57.

<sup>22</sup> *Id.* at 57 n.24 (quoting CONG. GLOBE, 27th Cong., 1st Sess. 134 (1841)).

<sup>23</sup> See *id.* For another example of how debt decreases the productivity of individuals and makes society worse off, see GIUSEPPE PAPARELLA, PICKER INST. EUROPE, DEBT AND HEALTH: A BRIEFING 1 (2015) (reporting that overburdened UK debtors create real social and economic costs, upwards of 8.3 billion pounds, "due to lost jobs, reduced productivity, costs of people losing their homes and for people relying more on support services").

<sup>24</sup> See Hallinan, *supra* note 5, at 57 n.24 (citing 2 W. BLACKSTONE, COMMENTARIES \*484).

<sup>25</sup> *Id.* (citing 3 J. STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 1101 (1833)).

<sup>26</sup> *Id.* (citing Edwin S. Mack, *Bankruptcy Legislation*, 28 AM. L. REV. 1, 5 (1894)).

<sup>27</sup> This Note does not presuppose that debt is inherently bad or unproductive, only that certain types of debt are (i.e., a debt that would be so excessive as to make an individual or entity unproductive or an odious debt). Historical accounts expressed here are meant to highlight a shared sentiment that debt can be bad, *not* that it is bad.

members are not incentivized to contribute towards the nation's improving productivity, which leaves society worse off. In short, a fresh start helps improve society by making more of its members productive.

From a narrower economic perspective, consider how the fresh start implicates debtors' incentives. When individuals are buried in debt, every penny they earn goes directly to their creditors. Thus, debtors can become indifferent to their level of income and decide not to seek-out more productive pursuits.<sup>28</sup> This interferes with the profit-maximizing assumption of classical economics and minimizes the positive externalities that stem from having more productive workers in the economy<sup>29</sup>—as indicated by Taylor, Mack, and Blackstone.

Further, when debtors cannot take ownership in their livelihoods, we can expect them to make economically inefficient decisions.<sup>30</sup> For example, these individuals may pursue unreasonably risky projects or investments, so as to regain their solvency.<sup>31</sup> Society could decide to (a) leave the debtor to their own devices, allowing them to continue making risky bets at their own peril, or (b) offer the debtor a remedy through bankruptcy and the fresh start.<sup>32</sup> American policymakers have decided to pursue the latter route because, collectively, the economic loss of forgiving some debt through an orderly bankruptcy process is less than allowing the individual to wallow in insolvency making ever riskier bets, and possibly getting into even more debt along the way.<sup>33</sup> A fresh start helps to mini-

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<sup>28</sup> See Georgakopoulos, *supra* note 9, at 51 ("The fresh start policy avoids the destruction of individual productivity incentives.").

<sup>29</sup> See Marianne B. Culhane & Michaela M. White, *But She Can Keep the Car? Some Thoughts on Collateral Retention in Consumer Chapter 7 Cases*, 7 FORDHAM J. CORP. & FIN. L. 471, 491 (2002) (noting that if the debtor's fresh start is structured properly, "enabling [a worker] to become and remain a more productive worker, then the benefits extend beyond the immediate parties to the economy as a whole").

<sup>30</sup> See Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 468 (1993) ("Individuals who are hopelessly insolvent will not have a stake in their futures.").

<sup>31</sup> See *id.*

<sup>32</sup> *Id.*

<sup>33</sup> See generally *id.* at 468–69 ("We could allow individuals to remain in this limbo, having little to no hope for ever extricating themselves from their financial messes. . . . But we have chosen a different path. Perhaps we have run the numbers and have concluded that the losses from a tough policy are exceeded by the gains from a softer approach. Perhaps we believe that individuals do a poor job of making decisions about low-probability events such as bankruptcy, and that these cognitive biases require corrective action by the government.").

mize the collective cost of insolvency. Therefore, it is a worthwhile economic policy.

Another argument for having a fresh start policy is that it minimizes the cost of public welfare. The logic unfolds as follows. If an individual's incentive to produce is maintained, then he will be less likely to seek out public welfare since the individual will more likely be able and willing to support themselves.<sup>34</sup> Also, and conversely, if a debtor cannot receive a discharge and thereby loses their assets, then the debtor "might rely instead on social welfare programs."<sup>35</sup> Further, a growing number of indigent debtors unable to receive a fresh start means not only growing public welfare schemes, but then also growing taxes to support it, which introduces an additional drain on society. The fresh start thus serves as a way to minimize public welfare costs by increasing one's ability and incentive to care for oneself.

A fresh start is also beneficial because it helps efficiently allocate the default risk between debtors and creditors.<sup>36</sup> Without a discharge and a fresh start, debtors would bear all of the default risk; regardless of the debtors' circumstances, they will always owe the creditor for any unpaid money under the debt contract. Additionally, if debtors bear all of the downside risk, creditors do not have as great an incentive to monitor their credit-risk because they do not bear any of the downside risk—they are always going to get repaid.<sup>37</sup> Whereas, a fresh start allows debtors and creditor to split this risk. If the risk is split, then in bankruptcy debtors and their creditors split the nonrepayment losses. Even still, some argue that since debtors are in control of making their own financial decisions, they are best able to manage the downside risk.<sup>38</sup> However, this per-

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<sup>34</sup> See Byington, *supra* note 3, at 122 n.32 ("Without the discharge, a hopelessly insolvent debtor would lose her incentive to produce, preferring instead . . . administratively costly welfare benefits." (quoting Adam J. Hirsh, *Inheritance and Bankruptcy: The Meaning of the "Fresh Start,"* 45 HASTING L.J. 175, 207 (1994))).

<sup>35</sup> *Id.* at 122 (quoting Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1402 (1985)).

<sup>36</sup> See *id.* at 123 ("Some have argued that the fresh start promotes efficient allocation of risk of loss between the debtor and the creditor . . ."); see also Georgakopoulos, *supra* note 9, at 60–61 (arguing that a fresh start leads creditors "to filter their debtors, i.e., to choose the more able and those who have better prospects, and thus allocate society's scarce capital according to productivity").

<sup>37</sup> See Georgakopoulos, *supra* note 9, at 61 ("The fresh start prevents lenders from being satisfied from the debtor's future income.").

<sup>38</sup> See Byington, *supra* note 3, at 123; *id.* at 123 n.37 (quoting Robert A. Hillman, *Contract Excuse and Bankruptcy Discharge*, 43 STAN. L. REV. 99, 126 (1990)) (positing that "debtors are in control of their financial activities and therefore are arguably in a better position to predict and avoid financial collapse or to

spective ignores those debtors that are in financial peril because of some unforeseen misfortune, which is problematic since the fresh start also exists to alleviate unforeseen hardships.<sup>39</sup>

Even still, some scholars and commentators argue that robust fresh start policies are inappropriate because they wreak havoc “on market behavior.”<sup>40</sup> This is because (1) an overly broad fresh start policy can stifle productivity as debtors may be less likely to pursue opportunities that generate positive externalities due to high interest rates; and (2) the positive externalities from a debtor’s fresh start do not necessarily outweigh the “direct ex ante costs borne by debtors” in the form of higher interest rates.<sup>41</sup>

What these critics miss though, and what this Note tries to highlight, is that the fresh start is about more than just economic rationales alone or structuring a fresh start policy that allows the market to perfectly price debt. The fresh start is also about undergirding social and moral objectives. Additionally, it is unlikely that all of these externalities could even be priced by economic models alone. As Justice Sotomayor notes, “market[s] do[ ] not price all externalities, the law does”<sup>42</sup>—which is why the law must consider the social and moral justifications for a fresh start policy as well as the economic ones.

## B. Morality-Based Policy Rationales

Morality-based rationales for offering individuals a fresh start also predate America’s first set of bankruptcy laws.<sup>43</sup> The concept of a fresh start was originally endorsed as an extension

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insure against it”); see also *id.* at n.37 (quoting A. Charlene Sullivan, *Reply: Limiting Access to Bankruptcy Discharge*, 1984 WIS. L. REV. 1069, 1071) (arguing that “risk of bankruptcy for an individual could be largely a function of personal characteristics that creditors are not particularly adept at evaluating”).

<sup>39</sup> See generally *infra* Section C.

<sup>40</sup> See WARREN ET AL., *supra* note 13, at 918 (“[P]roceduralists are fundamentally concerned with the effect of bankruptcy law on market behavior. For them, one of the key mischiefs that substantive and redistributive policies wreak in bankruptcy is distorting business incentives.”).

<sup>41</sup> See Barry E. Adler, *The Soft-Landing Fallacy and Consumer Debtors*, 7 FORDHAM J. CORP. & FIN. L. 499, 500 (2002); see also WARREN ET AL., *supra* note 13, at 918 (“The ultimate ‘proceduralist’ goal of bankruptcy is to lower the cost of credit for debtors.”).

<sup>42</sup> *Jesner v. Arab Bank, PLC*, 138 S. Ct. 1386, 1437 (2018) (Sotomayor, J., dissenting).

<sup>43</sup> See Hallinan, *supra* note 5, at 57 (“Building on a characterization of the insolvent’s default as a matter of misfortune rather than blameworthiness, [morally based rationales] focused on mercy or forbearance as the morally correct response to a financial failure and depicted collection efforts as a morally repugnant effort to inflict suffering for greedy motives.”).

of Judeo-Christian values into debtor-creditor relations. Undergirding this extension, Justice Story would later argue that leaving debtors saddled with excessive debt burdens only to serve at the behest of their creditors is “incompatible with the first precepts of Christianity; and is a living reproach to the nations of [C]hristendom.”<sup>44</sup>

Some commentators even go so far as to say that debt burdens are “chains of the soul,”<sup>45</sup> noting, though, that when society provides individuals with a fresh start it is akin to setting an individual’s soul free.<sup>46</sup> Such unfastening is especially warranted when those chains are the result of “misfortune rather than blameworthiness.”<sup>47</sup> That is because when an individual has fallen on hard times through some misfortune, society’s morally upright reaction should be to show “mercy or forbearance,” not a desire to collect debts and cause suffering only to further “greedy motives.”<sup>48</sup> Therefore, it is helpful to have the fresh start inhibit creditors’ “morally repugnant” inclinations to collect even in the face of the debtor’s unwilling and unforeseen misfortune.<sup>49</sup>

Additionally, the fresh start helps ensure that an individual’s human dignity is preserved in times of financial distress.<sup>50</sup> As mentioned above, not providing a fresh start can create a situation where an individual is only producing for the creditors’ benefits. This devalues an individual’s dignity since their self-determination is tempered by their need to fill their creditors’ pockets. A fresh start rectifies this by putting the individual “back on the road to self-determination.”<sup>51</sup> Therein, freeing the debtor from oppressive debt loads restores “the debtor’s sense of self-worth.”<sup>52</sup> This is, in and of itself, a worthy

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<sup>44</sup> *Id.* at 57 n.25 (quoting STORY, *supra* note 25, at § 1101); see also Barry Herman, *Doing the Right Thing: Dealing with Developing Country Sovereign Debt*, 32 N.C. J. INT’L L. & COM. REG. 773, 782 (2007) (tracing “the origin of the ‘fresh start’ case for debt relief back to biblical calls for periodic household debt forgiveness in the ‘Jubilee Years’”).

<sup>45</sup> See Hallinan, *supra* note 5, at 57 n.25 (quoting CONG. GLOBE, 27th CONG., 1st Sess. 318 (1841) (remarks of James Roosevelt)).

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 57.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> See Richard E. Flint, *Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor*, 48 WASH. & LEE L. REV. 515, 536 (1991) (describing Congress’ “recognition that the intrinsic value of human dignity dictates that a debtor be given an opportunity to earn a living”).

<sup>51</sup> *Id.*

<sup>52</sup> Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56, 95 (1990).

societal objective because society benefits from promoting humanitarian ideals that “makes us all better people.”<sup>53</sup>

### 1. *Debts Exempt from Discharge*

Just as society has made debts dischargeable because allowing a debtor to languish under an unbearable debt load is repugnant, society has also decided it would be equally objectionable to discharge debts that are themselves repugnant.<sup>54</sup> Society has done this through Congressional action, which included adopting a bankruptcy Code where some debts are exempt from discharge and continue with the debtor into their fresh start.<sup>55</sup> Many of these debts are exempt because society views that type of debt as repugnant.<sup>56</sup> These debts are viewed as such because society has determined that the behaviors exhibited in obtaining the debts are abhorrent. And because society does not want to reward such behavior, the Code does not allow the debtor to discharge such repugnant debts.

For example, the Code exempts from discharge: (i) debts acquired through various forms of fraud;<sup>57</sup> (ii) debts incurred as a result of the debtor’s “willful and malicious” injurious actions against another;<sup>58</sup> (iii) unpaid domestic support obligations;<sup>59</sup> (iv) fines or penalties payable to a governmental institution that arose more than three years before the petition was filed;<sup>60</sup> and (v) outstanding student loans.<sup>61</sup>

Nondischargeable (repugnant) debts can be partitioned into three categories: (1) familial obligations; (2) debts owing to governmental entities and entities providing educational loans; and (3) debts resulting from unfair debtor conduct vis-à-vis their creditors.<sup>62</sup> The first exemption exists because providing

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<sup>53</sup> *Id.*

<sup>54</sup> See generally Hallinan, *supra* note 5, at 138; see also Flint, *supra* note 50, at 537 (describing that Congress’ decision to exempt certain debts from discharge exemplify a “moral dimension” to discharge laws).

<sup>55</sup> See 11 U.S.C. § 523 (2012) (enumerated list of exceptions to discharge).

<sup>56</sup> See generally Hallinan, *supra* note 5, at 138.

<sup>57</sup> See 11 U.S.C. § 523(a)(2)(A) (2012) (exempting debts incurred through false pretenses or representation); see also 11 U.S.C. § 523(a)(4) (2012) (exempting debts incurred through (i) acting in a fraudulent manner while a fiduciary, (ii) embezzling, or (iii) larceny).

<sup>58</sup> See *id.* § 523(a)(6); see also § 523(a)(9) (exempting debts incurred from driving while intoxicated and killing or injuring someone).

<sup>59</sup> See *id.* § 523(a)(5).

<sup>60</sup> See *id.* § 523(a)(7).

<sup>61</sup> See *id.* § 523(a)(8) (notwithstanding, in exceptional circumstances the debtor can have their student loans discharged if they prove that an undue hardship would result without a discharge).

<sup>62</sup> See Flint, *supra* note 50, at 539–41.

for one's family is "beyond question"<sup>63</sup> and a "universal sentiment."<sup>64</sup> The second exemption exists for two reasons: (a) unpaid taxes or fines continue into the fresh start because of the sheer political power of the sovereign, little or no moral justifications exist for this exemption; and (b) educational obligations remain because easily allowing discharge would "restrict the availability of future funds," which is "commutatively unjust."<sup>65</sup> For the third exemption, the moral rationale for why these debts are nondischargeable is a bit more obvious than the others. In deciding to not allow the debtor to discharge debts resulting from unfair debtor conduct,<sup>66</sup> Congress determined that the debtor's abhorrent actions justified favoring the creditor rather than rewarding the debtor with a discharge.<sup>67</sup> Therefore, even though bankruptcy generally permits discharge that is not always the case.

## II

### SOVEREIGN DEBT, INSOLVENCY, AND DEFAULT

#### A. What is Sovereign Debt?

Sovereign debt is debt taken out at the national level, not the state or local level.<sup>68</sup> It is usually obtained through issuing bonds in national and international capital markets.<sup>69</sup> The bonds are usually unsecured and payable over a set number of

<sup>63</sup> *Id.* at 539.

<sup>64</sup> *Id.* at 539 n.102 (quoting H.R. REP. NO. 57-1698, at 3 (1902)).

<sup>65</sup> *Id.* at 540; *see also id.* at 540 n.106 ("[s]tating that nondischargeability of [student loans] was necessary because rising number of bankruptcies by students who had such loans posed a 'threat to the continuance of educational loan programs.'") (quoting REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. 1, at 177 (1973)); *id.* at 540 n.108 ("[An individual who] abuses, exploits, or 'free-rides' on some system which is advantageous to himself and to others, knowing that his abuse may bring about the limitation or abandonment of the scheme . . . , is commutatively unjust to all those who might in future have enjoyed the benefits of the original scheme." (quoting JOHN FINNIS, *NATURAL LAW AND NATURAL RIGHTS* 184 (1980))). Relative to other exempt debts, the student-loan exemption is an outlier because it is not a repugnant debt in-and-of-itself like other debts exempt from discharge; instead, it is not dischargeable because Congress is afraid that everyone will just start declaring bankruptcy so that they can discharge their student loans.

<sup>66</sup> These include "obligations which are founded in fraud, false financial statements, willful torts, and breach of fiduciary duty, among others." *Id.* at 541; *see, e.g.*, 11 U.S.C. § 523(a)(2), (a)(6) (2012).

<sup>67</sup> *See* Flint, *supra* note 50, at 541 n.114.

<sup>68</sup> Will Kenton, *Sovereign Debt*, INVESTOPEDIA (June 22, 2018), <https://www.investopedia.com/terms/s/sovereign-debt.asp> [<https://perma.cc/4KS8-YRTU>]; *see also* Simon Johnson & James Kwak, *National Debt for Beginners*, NPR PLANET MONEY (Feb. 4, 2009), <https://www.npr.org/templates/story/story.php?storyId=99927343> [<https://perma.cc/W8GG-LNRS>].

<sup>69</sup> *See* Kenton, *supra* note 68.

years.<sup>70</sup> Sovereigns use this capital to, for example, invest in education, infrastructure, military, and social programs.<sup>71</sup>

Sovereigns usually raise debt from both domestic and international creditors.<sup>72</sup> When a sovereign sells debt to foreign creditors, the debt is typically denominated in a reserve currency (e.g., the dollar or pound).<sup>73</sup> Issuing debt in nondomestic currency effectively raises the cost of debt by adding an exchange-rate risk, but it often also allows the sovereign to raise more money. Creditors to sovereign borrowers include both domestic and international “banks, other financial corporations, hedge funds, pension funds, union funds, foreign and municipal governments, and individual investors, to name a few.”<sup>74</sup>

Sovereign debt shares many similarities with debt instruments common in other commercial and consumer contexts. First, sovereign debt is usually unsecured. Unlike a mortgage secured by a physical home or a corporate credit facility secured by a company’s inventory,<sup>75</sup> sovereign debt is “more like credit card debt or a college loan than like a mortgage.”<sup>76</sup> This makes owning sovereign debt a riskier proposition.

Furthermore, the debt could be more akin to credit card debt or a college loan depending on what the sovereign spends the proceeds on. If the sovereign is investing in productive ways, such as investing in education or infrastructure, then the debt is closer to a college loan. Also like a college loan, sovereign debt is similarly nondischargeable. Contrastingly, if the sovereign spends new capital unproductively, to for example clothe the nation’s leader, then the debt is closer to credit card debt.

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<sup>70</sup> See Johnson & Kwak, *supra* note 68 (“A bond is a promise to pay money in the future; for example, a 10-year bond is a promise to pay a flat amount (the face value) in 10 years, and a percentage of that flat amount each year until then. When a government issues bonds, investors bid to buy those bonds, [which sets the interest rate the government must pay]; the amount of money they pay is therefore the amount that the government raises.”).

<sup>71</sup> See Luca Ventura, *Percentage of Public Debt to GDP Around the World 2018*, GLOBAL FINANCE (Dec. 17, 2018), <https://www.gfmag.com/global-data/economic-data/public-debt-percentage-gdp> [<https://perma.cc/X4C6-67NV>].

<sup>72</sup> See *id.*

<sup>73</sup> Salim Furth, *What Debt Crisis? A Default Primer for Governments*, HERITAGE FOUNDATION (July 24, 2012), <https://www.heritage.org/budget-and-spending/report/what-debt-crisis-default-primer-governments> [<https://perma.cc/ZAZ3-M7N4>].

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

Additionally, sovereign debt is similar to other types of debt because it too is priced at an interest rate that represents the risk/return trade-off to investors.<sup>77</sup> When a bank decides to lend, they must balance the probability of nonrepayment with the interest rate required to justify lending. However, when that same bank decides to lend to a sovereign, it must also consider the additional risk that the sovereign might purposefully inflate its currency to decrease its nominal debt load.<sup>78</sup> This risk though is partially alleviated if sovereigns issue their debt in reserve currencies, as reserve currencies' institutions are less likely to manipulate their currencies, which allows creditors to offer better terms.

Even with these nuances in mind, when the sovereign is satisfying its obligations under the debt agreement their debt is indistinguishable from any other type of commercial or consumer debt. However, when the sovereign defaults, the differences between sovereign debt and commercial or consumer debt become starkly apparent. The next section highlights these differences.

## B. Sovereign Default and Recourse?

When a sovereign debtor defaults, it is saying that it cannot or will not pay its contractual debt obligations.<sup>79</sup> When a company or consumer defaults, they are saying the same thing. However, what makes the sovereign default context different is the lender's recourse options. A corporate lender can go to the appropriate court, receive a judgment, a writ, and then levy against the defaulting company's assets;<sup>80</sup> or a consumer lender can obtain garnishment on future income.<sup>81</sup> But, if the sovereign defaults, the lender's self-help and forced-collection options are limited.

It is unlikely that the sovereign's lender would be able to do either of the things corporate or consumer lenders can: levy on the debtor's assets or garnish the debtor's future income.

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<sup>77</sup> *Id.*

<sup>78</sup> *Id.* This is effectively nonrepayment under another guise.

<sup>79</sup> *Id.* For example, Russian revolutionaries decided to simply repudiate all old Tsarist debts in 1918. Eric Toussaint, *The Russian Revolution, Debt Repudiation, War and Peace*, COMM. FOR THE ABOLITION OF ILLEGITIMATE DEBT (July 12, 2017), <https://cadtm.org/The-Russian-Revolution-Debt> [<https://perma.cc/YP4C-TEWW>].

<sup>80</sup> See WARREN ET AL., *supra* note 13, at 40–41 (explaining the process secured creditors go through to repossess assets).

<sup>81</sup> See *id.* at 42–46 (explaining the process unsecured creditors go through to get repaid).

These opportunities are foreclosed because (1) “few sovereign assets (including future income streams) are located in foreign jurisdictions, and a sovereign cannot credibly commit to hand over assets within its borders in the event of a default”; and (2) “there are legal principles [such as sovereign immunity] that protect sovereign assets even when they are located in foreign jurisdictions.”<sup>82</sup>

However, the concept of sovereign immunity, which historically protected a sovereign’s assets abroad, has eroded recently. Under the old rules sovereigns needed to explicitly waive their immunity, but now a court may hear any case involving a sovereign as a party if the sovereign “suspend[s] payments on debt contracts that call for payment in the United States.”<sup>83</sup> Furthermore, when sovereign debtors raise money they routinely agree to bond covenants that waive their right to sovereign immunity. Thus, the defense of sovereign immunity is not as harsh as it once was.<sup>84</sup>

And creditors are willing to utilize these newfound rights. When Argentina defaulted on its debt, U.S.-based hedge fund Elliott Management found some success litigating over repayment in courts.<sup>85</sup> The hedge fund first went to U.S. and U.K. courts to obtain judgments holding that it was entitled to payment on the defaulted debt it owned.<sup>86</sup> Once it had these judgments in hand, the hedge fund went to Ghana and seized an Argentinian Navy Ship.<sup>87</sup> In conjunction with other collection tactics, this created enough pressure for the hedge fund and

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<sup>82</sup> Ugo Panizza, Federico Sturzenegger & Jeromin Zettelmeyer, *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LITERATURE 651, 653 (2009).

<sup>83</sup> *Id.* at 653 (mapping out the changes in sovereign immunity law, which began with “the Foreign Sovereign Immunities Act (FSIA) of 1976, which allows private parties to sue a foreign government in U.S. courts if the complaint relates to commercial activity”). Courts have since decided that issuing foreign bonds in the United States constitutes such commercial activity. Additionally, “[t]he United Kingdom adopted similar legislation in 1978 and many other jurisdictions have followed suit.” *Id.* (citing Lee C. Buchheit, *Sovereign Immunity*, 7 BUS. L. REV. 63–64 (1986)); Lee C. Buchheit, *The Sovereign Client*, 48 J. INT’L AFFAIRS 527–40 (1995); IAN BROWNIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* (6th ed. 2003)).

<sup>84</sup> *Cf. id.* at 653 (noting that the principle of sovereign immunity still makes it difficult for creditors to collect once they obtain a judgment; attachment proceedings are difficult to win because FISA exempts many foreign assets from attachment).

<sup>85</sup> See Joe Weisenthal, *A Hedge Fund Has Physically Taken Control of a Ship Belonging to Argentina’s Navy*, BUS. INSIDER (Oct. 4, 2012), <https://www.businessinsider.com/hedge-fund-elliott-capital-management-seizes-ara-libertad-ship-owned-by-argentina-2012-10> [<https://perma.cc/6BBA-PB9N>].

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

Argentina to ultimately agree to a \$2.4 billion settlement on the defaulted bonds.<sup>88</sup>

Even with that being said, it generally remains difficult for most creditors to collect on defaulted sovereign debt. Most creditors will not make the Machiavellian moves that a hedge fund might to collect. And sovereign immunity still protects most assets from attachment.<sup>89</sup> Therefore, since creditors cannot rely on a formal bankruptcy proceeding to get repaid, the creditors face a binary choice: negotiate a settlement or litigate.<sup>90</sup>

This binary that sovereign-debtor's creditors face is unlike the choice commercial or consumer creditors face; sovereign's creditors do not have the third option to work out repayment in bankruptcy. There is no international bankruptcy institution and a sovereign is unlikely to submit to another nation's bankruptcy regime.<sup>91</sup> Subsequently, a sovereign's creditors are more limited in how they can collect (litigation or negotiation) and in their abilities to successfully collect if they decide to litigate and end up winning.

At first, litigation may seem like the more fruitful avenue to recover because sovereign debtors cannot use the power of the automatic stay to stay pending litigation like the debtor in Chapter 7 or 13. Too, the sovereign cannot use the threat of bankruptcy as leverage to get creditors to not file suit and instead negotiate a settlement. Further, because the sovereign debtor cannot use the bankruptcy laws as leverage vis-à-vis creditors, the sovereign does not have the power to get dissident creditors to agree to a settlement plan,<sup>92</sup> making settlement all the more difficult and litigation all the more appealing.

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<sup>88</sup> See Renae Merle, *How One Hedge Fund Made \$2 Billion from Argentina's Economic Collapse*, WASH. POST (Mar. 29, 2016), [https://www.washingtonpost.com/news/business/wp/2016/03/29/how-one-hedge-fund-made-2-billion-from-argentinas-economic-collapse/?noredirect=on&utm\\_term=.20470969168e](https://www.washingtonpost.com/news/business/wp/2016/03/29/how-one-hedge-fund-made-2-billion-from-argentinas-economic-collapse/?noredirect=on&utm_term=.20470969168e) [<https://perma.cc/B8NX-KR6H>] (The hedge fund bought the debt with a face value of \$617 million for \$117 million. And, Argentina ultimately got the ship back—even before they settled with the hedge fund.).

<sup>89</sup> See *supra* note 85; see also Lee C. Buchheit & G. Mitu Gulati, *Responsible Sovereign Lending and Borrowing*, U.N. Doc. UNCTAD/OSG/DP/2010/2, at 7 (Apr. 2010), [https://unctad.org/en/Docs/osgdp20102\\_en.pdf](https://unctad.org/en/Docs/osgdp20102_en.pdf) [<https://perma.cc/JB62-8TUP>] (“Typically, only property that is used for a commercial purpose by the foreign state may be seized and even then certain types of property (such as foreign central bank reserves) often enjoy special immunities.” Once a creditor has a judgment, they are going to have a hard time levying “against the sovereign’s property held abroad.”)

<sup>90</sup> See BUCHHEIT & GULATI, *supra* note 89, at 6–7.

<sup>91</sup> *Id.* at 7.

<sup>92</sup> *Id.*

Nonetheless in practice, given the complexities, cost, and uncertainty of litigation, the sovereign's creditors generally do not pursue litigation as their primary route to secure repayment.<sup>93</sup>

So, although one may think creditors would be inclined to litigate given the debtor's lack of leverage, they actually often decide to negotiate instead. But negotiation is particularly difficult for the sovereign debtor because even if it is able to get some creditors to agree to a settlement of claims, it is still faced with the difficulty of settling all claims by *all* creditors, a collective action problem which the bankruptcy regime facilitates. The bankruptcy regime does this largely by predetermining those debts that are dischargeable and those that are not. Therefore, the difficulties involved in negotiating and litigating sovereign debt repayment are exacerbated by the fact that there are no clear laws or rules on what sovereign debt is dischargeable. This is something that this Note argues can change; it can change by adopting the already existing odious debt doctrine.<sup>94</sup>

### 1. *Sovereign Debt Dischargeability*

As evident above, a key advantage of bankruptcy and the fresh start is the ability to discharge debt. Some commentators, however, argue that a sovereign debtor cannot discharge debts; therefore, sovereign bankruptcy is pointless. They submit that a sovereign cannot have dischargeable debts in the same way as a chapter 7 petitioner because a sovereign can never liquidate.<sup>95</sup> Yet, that would suggest that only Chapter 7 debtors can discharge debts, which is untrue, since debtors in Chapter 11 and 13 can also discharge debts. Their debts are discharged by virtue of the bankruptcy plan—debts that are not paid-off during the life of the plan are discharged.<sup>96</sup>

Even then, one could argue that the difference between a Chapter 7 proceeding and a Chapter 11 or 13 proceeding is that all creditors are present to vote on the plan in the latter

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<sup>93</sup> *Id.*; see also *infra* subpart II.B (identifying the difficulty sovereigns' creditors have at actually levying on sovereign assets. If they are abroad, the assets might be immune from attachment, and if they are domestic, it is very unlikely that a domestic court will allow a creditor to levy against state assets.).

<sup>94</sup> The odious debt doctrine is not a formally adopted doctrine (i.e., within a multilateral treaty), although it is a very popular doctrine among academics and commentators concerned about mitigating nation-states' debt burdens. See ODETE LIENAU, *RETHINKING SOVEREIGN DEBT: POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE* 4, 8, 65 (2014).

<sup>95</sup> See Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds*, 53 *EMORY L.J.* 929, 938 (2004).

<sup>96</sup> See *Discharge in Bankruptcy*, *supra* note 11.

chapters. And because all creditors can vote on the plan, they therefore collectively agree on what debt is ultimately discharged. Thus, there is no creditor notice issue. Too, there is a neutral arbiter, the bankruptcy judge, that approves the plan for fairness. Conversely, the sovereign does not have this option because the sovereign is not presenting a bankruptcy plan that is vetted by a bankruptcy judge and voted on by all creditors; therefore, the sovereign cannot have dischargeable debts.

However, the issue with this argument is that it rests on the assumption that bankruptcy law and a bankruptcy court are necessary for dischargeable debts to exist. True, the bankruptcy court is the institution that ensures that all relevant parties receive notice<sup>97</sup> and that vets the plan for fairness.<sup>98</sup> And bankruptcy law provides ex ante notice about which debts are dischargeable and which are not. Thus, without the bankruptcy courts and law, creditors would not have notice about which debts could be discharged, and therefore, could be treated unfairly by the debtor and other creditors.

As this Note will show below, however, these tripartite concerns, (i) ex ante notice about which debts are dischargeable, (ii) ex post notice that debts may be discharged, and (iii) a fairness assessment, can all be satisfied without a bankruptcy court and law. They can be satisfied by adopting specific policies and institutions that together serve a similar purpose.<sup>99</sup>

### III

#### THE FRESH START AS A POLICY OBJECTIVE FOR SOVEREIGNS

“The absence of a fresh start for sovereign debtors can have a particularly pernicious effect on economic and social development.”<sup>100</sup>

—Jeffrey D. Sachs

The policy justifications favoring a fresh start for private debtors are just as persuasive when applied to sovereign debtors. Many of the arguments outlined above about how the fresh start alleviates economic and moral concerns for the individual also apply to the sovereign. Beyond these, the sovereign

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<sup>97</sup> See 11 U.S.C. § 342 (2012) (providing that notice must be given to all relevant parties).

<sup>98</sup> See John A. Gilchrist, “Fair and Equitable” Plan of Reorganization: A Clearer Concept, 26 CORNELL L. REV. 592, 592 (1941).

<sup>99</sup> See generally *infra* subpart IV.C.

<sup>100</sup> Jeffrey D. Sachs, *Resolving the Debt Crisis of Low-Income Countries*, 2002 BROOKINGS PAPERS ON ECON. ACTIVITY 257, 260 (2002).

faces additional macroconcerns that the individual does not. Therefore, as this section will showcase, sovereign debtors face even more economic and moral threats from excessive debt burdens than individual debtors.

The popular practice when discussing sovereign debt restructuring is to analogize it to Chapter 11.<sup>101</sup> While this analogy is productive and enlightening, it is not completely inclusive of “how the principles of bankruptcy should translate to the case of sovereign borrowers.”<sup>102</sup> This is because to aptly and completely translate bankruptcy principles we must look beyond Chapter 11 alone and include a more consumer-oriented perspective of these bankruptcy principles. This includes looking at the fresh start policy as conceptualized within the consumer, noncorporate, bankruptcy context.

#### A. Economic Policy Rationales for a Sovereign Fresh Start Policy

Many of the same microeconomic concerns that plague individuals burdened by heavy debt loads also plague sovereigns burdened by heavy debt loads. Like an individual debtor, a sovereign’s productivity suffers under an onerous debt burden.<sup>103</sup> For example, when a sovereign is heavily indebted, tax revenue that would be better spent on productive investments in education or infrastructure will instead go to servicing the sovereign’s debt. As a result, the sovereign’s productivity potential is diminished as funds are spent on less productive means, rather than more productive means.<sup>104</sup>

Another concern that stems from a burgeoning sovereign debt load is the lessening availability of public goods. In the face of increasing debt payments, the sovereign may need to

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<sup>101</sup> See, e.g., Patrick Bolton & David A. Skeel Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured*, 53 EMORY L.J. 763 (2004); Benjamin J. Cohen, *A Global Chapter 11*, 75 FOREIGN POL’Y 109 (1989); Alice de Jonge, *Returning to Fundamentals: Principles of International Law Applicable to the Resolution of Sovereign Debt Crises*, 36 SUFFOLK TRANSNAT’L L. REV. 1, 16 n.57 (2013); Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956 (2000); Ruben Sklar, Comment, *Renegotiation of External Debt: The Allied Bank Case and the Chapter 11 Analogy*, 17 U. MIAMI INTER-AM. L. REV. 59 (1985).

<sup>102</sup> Schwarcz, *supra* note 101, at 971 (quoting Jeffrey D. Sachs, *Do We Need an International Lender of Last Resort* 8 (Apr. 20, 1995) (unpublished manuscript), <https://pdfs.semanticscholar.org/d6d4/2c0e0bb01258e89cf3ef99e2d17434ac863e.pdf> [<https://perma.cc/34TU-Q6PH>]).

<sup>103</sup> See António Afonso & João Tovar Jalles, *Growth and Productivity: The Role of Government Debt*, 25 INT’L REV. ECON. & FIN. 384, 385, 393 (2013).

<sup>104</sup> See ROBERT A. ISAAK, *THE GLOBALIZATION GAP: HOW THE RICH GET RICHER AND THE POOR GET LEFT FURTHER BEHIND* 152–53 (2004).

cut public goods, such as “health, police, and fire services,” to service its debt.<sup>105</sup> Not only is this undesirable for individual citizens, it is troublesome for macroeconomic-stability.<sup>106</sup> In the extreme, if citizens are not getting essential services from their government they may be more inclined to overthrow their government.<sup>107</sup> This is bad from the citizens’ perspectives as they have to deal with the deleterious effects of instability and bad from the creditors’ perspectives since creditors are less likely to get repaid in times of upheaval.

Outside of the more direct negative effects, sovereigns may also have to contend with long-term social disadvantages, such as a brain drain, if their debts become too large. When sovereign debt loads get too large, economies begin to falter.<sup>108</sup> As they do, debt loads become harder to contain, pushing the sovereign deeper into crisis.<sup>109</sup> If debt burdens become too hard to contain, drastic austerity measures may be taken.<sup>110</sup> These measures often have negative economic side effects, as recently seen in Greece<sup>111</sup> and Argentina.<sup>112</sup> And one such (long-term) negative effect, as Greece recently learned, is the inauguration of a countrywide brain drain.<sup>113</sup>

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<sup>105</sup> *Id.* at 153.

<sup>106</sup> *See id.*

<sup>107</sup> *See id.*

<sup>108</sup> *See* Furth, *supra* note 73.

<sup>109</sup> *See id.*

<sup>110</sup> *Id.*; *see also* Mehreen Khan, Jim Brunsten & Kerin Hope, *Debt Relief Deal Gives Greece Hope After Years of Austerity*, FIN. TIMES (June 22, 2018), <https://www.ft.com/content/bee7ec5a-7625-11e8-b326-75a27d27ea5f> [<https://perma.cc/9ST5-AKLS>] (explaining how after eight years of austerity, Greece is finally moving beyond its previous sovereign debt default).

<sup>111</sup> *See* Chris Baynes, *Greece Bailout Programme Finally Comes to an End—But Country Faces Decades of Austerity*, INDEPENDENT (Aug. 19, 2018), <https://www.independent.co.uk/news/world/europe/greece-eurozone-bailout-programme-end-alexis-tsipras-euro-europe-debt-austerity-a8498501.html> [<https://perma.cc/T3F2-TY5G>] (showing that Greece has and will continue to face stark austerity measures because of its default).

<sup>112</sup> *See* Jerome Roos, Editorial, *Argentina’s IMF Bailout Rekindles Painful Memories of Past Crises*, AL JAZEERA (Sept. 9, 2018), <https://www.aljazeera.com/in-depth/opinion/argentinas-imf-bailout-rekindles-painful-memories-crises-180907051253079.html> [<https://perma.cc/32Z6-DSCW>] (highlighting how once again Argentina is facing negative economic effects from austerity measures imposed as a result of large debt loads before it has even recovered from the 2001–2002 default-induced economic crisis).

<sup>113</sup> *See* VLASIOS SARANTINOS, CTR. FOR EMP’T STUDIES RESEARCH, UNIV. OF W. ENG., BRISTOL, GREECE: THE ECONOMIC CRISIS AND THE BRAIN DRAIN 1 (2012), [http://www2.uwe.ac.uk/faculties/BBS/BUS/Research/CESR/July\\_2012\\_Sarantinos.pdf](http://www2.uwe.ac.uk/faculties/BBS/BUS/Research/CESR/July_2012_Sarantinos.pdf) [<https://perma.cc/3N6B-RWSK>] (showcasing that the failure of Greek austerity measures has led to a sustained economic crisis that “inaugurat[ed] . . . the ‘Greek Brain Drain’”); *see also* Natasha Lycia Ora Bannan, *Puerto Rico’s Odious Debt: The Economic Crisis of Colonialism*, 19 CUNY L. REV. 287, 293–94 (2016)

As noted, excessive levels of sovereign debt hinder productivity growth, in part because they “decreas[e] investment and consumption resulting in less employment and lower output growth.”<sup>114</sup> Although economists seem to agree that some sovereign debt is beneficial,<sup>115</sup> there is debate over when exactly sovereign debt goes from a productive to an unproductive amount.<sup>116</sup> Whatever the threshold, economists agree that when debt loads become too large economic growth does not just slow, it grinds to a halt.<sup>117</sup>

One of the reasons that productivity and economic growth slow when debt burdens are too high is because in times of financial strain, the debtor is likely not using their assets in the most productive ways.<sup>118</sup> Like the individual debtor in financial distress, the sovereign is also likely to use their assets in less productive and riskier ways so as to try to pay off their debts.<sup>119</sup> When in a financial bind, sovereigns are more likely

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(explaining how Puerto Rico’s austerity measures have led citizens to leave the country “to seek employment in the United States”).

<sup>114</sup> Afonso & Jalles, *supra* note 103, at 384.

<sup>115</sup> See Paul Krugman, Opinion, *Debt is Good*, N.Y. TIMES (Aug. 21, 2015), <https://www.nytimes.com/2015/08/21/opinion/paul-krugman-debt-is-good-for-the-economy.html> [<https://perma.cc/UPT5-78LN>]; see also Christina Checherita-Westphal & Philipp Rother, *The Impact of High Government Debt on Economic Growth and its Channels: An Empirical Investigation for the Euro Area*, 56 EUR. ECON. REV. 1392, 1403 (2012) (finding that sovereign debt helps to facilitate long-term economic growth up to certain point).

<sup>116</sup> See, e.g., Checherita-Westphal & Rother, *supra* note 115, at 1403 (concluding that the relationship between sovereign debt and growth is concave, which means that after a certain amount of debt (around 90%–100%), long-term growth rates begin to slow and decrease as new debt is accumulated); see also Anna Gelpern, *Bankruptcy Backwards: The Problem of Quasi-Sovereign Debt*, 121 YALE L.J. 888, 926 (2012) (“[T]here exists a theoretical point of overindebtedness. . .”).

<sup>117</sup> See Carmen M. Reinhart & Kenneth S. Rogoff, *Growth in a Time of Debt*, 100 AM. ECON. REV. (PAPERS & PROC.) 573, 577 (2010) (examining “the experience of 44 countries spanning up two centuries” and finding “that across both advanced countries and emerging markets, high debt/GDP level (90 percent and above) are associated with notably lower growth outcomes”). Slowing economic growth is not bad just because the country is not growing wealthier at a consistent rate, but also because it slows technological and medical progress, which hurts a country’s citizens. See Emily F. Mancina, *Sinners in the Hands of an Angry God: Resurrecting the Odious Debt Doctrine in International Law*, 36 GEO. WASH. INT’L L. REV. 1239, 1240 (2004) (highlighting a 1989 UNICEF report that showed a correlation between high developing country debt loads and rising child mortality rates).

<sup>118</sup> See Brad Setser, *The Political Economy of the SDRM*, in OVERCOMING DEVELOPING COUNTRY DEBT CRISIS 317, 323 (Barry Herman, José Antonio Ocampo & Shari Spiegel eds., 2010) (noting that “a fresh start would allow resources that would otherwise go to debt service to be redirected toward social and growth-enhancing expenditures”).

<sup>119</sup> See Stephen J. Choi et al., *Political Risk and Sovereign Debt Contracts* 14 (John M. Olin Program in Law & Econ., Working Paper No. 583, 2011), [https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1369&context=law\\_](https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1369&context=law_)

to use state assets in riskier ways so as to lower their chances of default. Like in the consumer context, incorporating a fresh start into sovereign restructuring could help alleviate the concern that assets will be used in riskier ways.

Additionally, a fresh start is a necessary component of any effective sovereign restructuring regime because without it there are “large negative-sum games.”<sup>120</sup> That is, creditors with divergent interests are fighting each other and the debtor for whatever repayment they can gain, and the debtor becomes occupied fighting off numerous collection attempts instead of trying to recover from financial instability. This avoidable infighting leads to “large negative-sum games” played by creditors and the debtor.<sup>121</sup> Here, a cost that the bankruptcy regime avoids is instead paid for by society. This showcases how, when collective societal costs are not considered in determining whether to incorporate a fresh start, society ends up paying the ultimate price.<sup>122</sup>

Moreover, the credit risk allocation concerns mentioned above in the personal debtor context continue to apply in the sovereign debtor context. When creditors do not share the downside risk with debtors, they are less likely to monitor their credit exposure as it relates to this debt and debts of this type.<sup>123</sup> The same outcome is true when creditors do not share

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and\_economics [https://perma.cc/99EE-YJGC] (arguing that there is a risk that “[sovereign] debtors can take on more debt and invest it in risky projects with the expectation that they will receive the benefits if [a] good [outcome] occurs and will share the losses with foreign creditors if [a] bad [outcome] occurs”).

<sup>120</sup> See Martin Guzman & Joseph E. Stiglitz, *Creating a Framework for Sovereign Debt Restructuring That Works*, in *TOO LITTLE, TOO LATE*, *supra* note 1, at 3.

<sup>121</sup> See *id.* at 3–4 (discussing fresh starts and comprehensive bankruptcy laws as protecting both creditors and debtors from the “chaos” of having to fight each other for dividends); *Positive-Sum Game*, ENCYCLOPEDIA BRITANNICA, <https://www.britannica.com/topic/positive-sum-game#ref1189339> [https://perma.cc/J4E4-59Q2] (last visited Feb. 17, 2019) (“The term *negative-sum game* describes situations in which the total of gains and losses is less than zero, and the only way for one party to maintain the status quo is to take something from another party.”).

<sup>122</sup> See also *supra* subpart I.A (explaining how without a fresh start the individual debtor is forced to rely on welfare for subsistence with society paying the ultimate price—a price that could have been avoided). Likewise, when the sovereign does not have a fresh start, a price that could have been avoided exists and society again pays the price.

<sup>123</sup> This is particularly troublesome since it introduces additional systemic strain on the financial system. When credit risk is wholly or largely transferred away from creditors, the outcome is additional systemic risk. See Luigi Spaventa, *Subprime Crisis and Credit Risk Transfer: Something Amiss*, VOX CEPR POLY PORTAL (Sept. 6, 2007), <https://voxeu.org/article/subprime-crisis-and-credit-risk-transfer-something-amiss> [https://perma.cc/J4HR-3DYM] (highlighting that transferring credit risk away from creditors (the banks) to a counterparty (the market) was a contributing factor to the recent subprime mortgage crisis) (“[The

the downside risk with the sovereign debtor—the creditors are less likely to monitor their assumed risks. This is particularly troublesome here because in distressing times it is harder for creditors to collect from sovereign debtors than individual debtors.<sup>124</sup> Therefore, by initiating a fresh start policy in the sovereign context, credit-risk would be allocated more efficiently between the creditor and the debtor nation.<sup>125</sup> This is something that is good for continued macroeconomic stability.

## B. Morality-Based Policy Rationales for a Sovereign Fresh Start Policy

As with the socioeconomic rationales, the morality-based rationales for providing a fresh start to private debtors are also applicable to sovereign debtors. This section will highlight the morality-based policy reasons for why a sovereign should be eligible for a fresh start.

Sovereigns, like private debtors, could feel hopelessly indebted. In such situations, the morally upright reaction may be to free (at least in part) the sovereign from those debts. In an international community of sovereigns, when one sovereign is depressed by ravaging debts, others could benefit from discharging debts because “the promotion of humanitarian values . . . ‘makes us all better [sovereigns].’”<sup>126</sup> In an increasingly interconnected world, sovereigns are the trustees of our globalized humanity and their sustainability should be considered since our national and individual interests are connected to the interests of other nations.<sup>127</sup>

Additionally, the Judeo-Christian rationale for providing a sovereign with a fresh start follows the same rationale as applied to individual debtors.<sup>128</sup> Those espousing this philosophy argue that overburdening sovereigns with debt is akin to a

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notion that] distribution [of credit risk] to non-bank players . . . would alleviate the systemic consequences . . . is not what has happened.”)

<sup>124</sup> See Christian Kersting, *Combating the Financial Crisis: European and German Corporate and Securities Laws and the Case for Abolishing Sovereign Debtors' Privileges*, 48 TEX. INT'L L.J. 269, 313 (2013).

<sup>125</sup> See Georgakopoulos, *supra* note 9, at 61 (arguing for the introduction of a fresh start policy because it “motivates creditors to help the debtor, to innovate in the methods of reviewing their debtor’s performance, and to refine the contractual provisions of loans. All these effects lead to ever more increased productivity.”).

<sup>126</sup> See Tabb, *supra* note 52, at 95 (applying the rationale used to argue for forgiving individual debts to argue for forgiving sovereign debts).

<sup>127</sup> See Eyal Benvenisti, *Sovereigns as Trustees of Humanity: On the Accountability of States to Foreign Stakeholders*, 107 AM. J. INT'L L. 295, 295–97 (2013).

<sup>128</sup> See Gelpert, *supra* note 116, at 928 (highlighting how the fresh start policy applied to sovereigns comes from the Jubilee movement, which invokes the biblical concept of “Jubilee” in advocating for the abolishment of excessive debt loads).

“form[ ] of slavery which [is] new and more subtle than those of the past[.]”<sup>129</sup> The debt loads allow rich nations to dominate poorer nations, which is not only an “abuse of power [but also a] denial of human dignity.”<sup>130</sup> The introduction of a fresh start would serve to remedy this indignity by freeing the sovereign from unduly serving its creditors’ interests.

### 1. *International Law and Sovereign Debt*

Parts of the international community also support the notion that excessive debt burdens are an affront to human dignity, and thus an “obstacle . . . [to] the realization of human rights.”<sup>131</sup> High debt loads necessitate high service payments, which stymie a sovereign’s ability to provide “human rights-related public services.”<sup>132</sup> Further, human rights are squashed because excessive sovereign debt burdens lead to decreased food security, increased inequality, and increased poverty levels.<sup>133</sup>

This failing arguably conflicts with Article 28 of the UN’s Universal Declaration of Human Rights.<sup>134</sup> The Article provides that, “[e]veryone is entitled to a social and international order in which the rights and freedoms set forth in this Declaration can be fully realized.”<sup>135</sup> A sovereign servicing its excessive debt burden instead of providing human rights-related public services is “inconsistent with this entitlement.”<sup>136</sup> And some argue that the sovereign-debtor and its creditors (and

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<sup>129</sup> See *id.* (quoting Pope John Paul II, *Incarnationis Mysterium: Bull of Indication of the Great Jubilee of the Year 2000*, § 12 (1998), [http://www.vatican.va/jubilee\\_2000/docs/documents/hf\\_jp-ii\\_doc\\_30111998\\_bolla-jubilee\\_en.html](http://www.vatican.va/jubilee_2000/docs/documents/hf_jp-ii_doc_30111998_bolla-jubilee_en.html) [<https://perma.cc/Z2Q2-ZG9C>]).

<sup>130</sup> *Id.*; see also generally JOHN PERKINS, *CONFESSIONS OF AN ECONOMIC HIT MAN* (2004) (arguing that richer nations continue to loan money to developing nations through development loans that end up stifling developing nations both politically and economically).

<sup>131</sup> See Cephias Lumina (Special Rapporteur 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), *Rep. on Promotion and Protection of All Human Rights, Civil, Political, Economic, Social and Cultural Rights, Including the Right to Development*, U.N. Doc. A/HRC/11/10, ¶ 24 (Apr. 3, 2009) [hereinafter *Human Rights Report*].

<sup>132</sup> See *id.* The UN has declared that all persons have a human right to certain public services such as education and health care. See U.N. GAOR, 3d Sess., 183d plen. mtg. at 71, U.N. Doc. A/810 (Dec. 10, 1948), G.A. Res. 217 (III) A, Universal Declaration of Human Rights (Dec. 10, 1948), art. 25.1 (asserting that “[e]veryone has the right to . . . medical care and necessary social services”), art. 26.1 (asserting that “[e]veryone has the right to education”).

<sup>133</sup> See *Human Rights Report*, *supra* note 131, ¶¶ 28, 30.

<sup>134</sup> *Id.* ¶ 52.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

thereby the creditors' sovereigns as the Declaration's signatories) are violating international customary law by allowing creditors to be paid rather than citizens served.<sup>137</sup>

The Universal Declaration of Human Rights requires that human rights-related public services are provided, and these Declaration provisions are "incorporated into customary international law, which is binding on all states."<sup>138</sup> Thus, a sovereign servicing its debt in lieu of providing public services could be a violation of international customary law. In order to remedy this violation, creditors and sovereign debtors should agree to a fresh start policy that works to discharge specific debts, lower service payments, and increase human rights-related public services.

In addition, letting sovereigns languish under excessive debt burdens without offering them a fresh start is likely a violation of international treaties. The International Covenant on Economic, Social and Cultural Rights requires that each State take steps to internationally coordinate so as to realize all citizens' inherent human rights.<sup>139</sup> This requirement extends to human rights violations related to debt crises and attempts at debt relief.<sup>140</sup> If debt crises are consistently inhibiting sovereigns from providing human rights-related services, the lack of international community coordination is likely a violation of this treaty. This is not to say that the international community is not working to solve the humanitarian toll of debt crises,<sup>141</sup>

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<sup>137</sup> For example, Natasha Lycia Ora Bannan argues that actions like austerity measures "amount to economic violence and have resulted in the forced migration of hundreds of thousands of people, cuts to critical public services . . . reduced employment, and threats to remove federal labor protections." Bannan, *supra* note 113, at 307. It is this "erosion of economic and social rights" that arguably violate customary international law. *See id.*

<sup>138</sup> Hurst Hannum, *The UDHR in National and International Law*, 3 HEALTH & HUM. RTS. 144, 145 (1998).

<sup>139</sup> *See Human Rights Report*, *supra* note 131, ¶ 53.

<sup>140</sup> *Id.* ¶¶ 33 ("The various human rights treaty bodies have also noted . . . that excessive debt burdens pose a significant challenge to the realization of human rights by undermining the human rights obligations of States . . . ."), 56 ("[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.").

<sup>141</sup> *See, e.g., Heavily Indebted Poor Country (HIPC) Initiative*, WORLD BANK (Jan. 9, 2018), <http://www.worldbank.org/en/topic/debt/brief/hipc> [<https://perma.cc/3SDU-9FRQ>] (discussing the HIPC international debt relief Initiative, which was "designed to ensure that the poorest countries are not overwhelmed by unmanageable or unsustainable debt burdens"); *cf. Human Rights Report*, *supra* note 131, ¶¶ 18–19 (arguing that the international community's responses to debt crises, including the HIPC Initiative response, have been inadequate).

but adopting a fresh start policy for sovereigns faced with odious debt is another step in that right direction.

#### IV

#### THE ODIUS DEBT DOCTRINE

Unlike private debtors, sovereigns are capable of incurring and being liable for “odious” debts. Odious debts are debts “contracted and spent against the interests of the population of a State, without its consent, and with full awareness of the creditor.”<sup>142</sup> Private debtors are unlikely to have odious debts because an individual does “not have to repay money that others fraudulently borrow in their name. Similarly, a corporation is not liable for[, for example,] contracts that the chief executive officer enters without the authority to bind the firm.”<sup>143</sup> This is not the case with sovereigns, where citizens, especially taxpayers, remain on the hook for odious debts incurred by prior regimes.<sup>144</sup>

As this odious debt definition suggests, odious debts usually arise when (i) a sovereign is run by an exploitative regime that uses debt to fulfill the idiosyncratic pursuits of the ruling elite; and (ii) the debt is not used to further the interests of the sovereign’s citizenry.<sup>145</sup> But this definition gets muddied because some (usually creditors) argue that for odious debt to exist, the “creditors must have been aware of these conditions

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<sup>142</sup> Robert Howse, *The Concept of Odious Debt in Public International Law*, U.N. Doc. UNCTAD/OSG/DP/2007/4, at 2 (July 2007), [https://unctad.org/en/docs/osgdp20074\\_en.pdf](https://unctad.org/en/docs/osgdp20074_en.pdf) [<https://perma.cc/QXR8-RA5A>]; see also NEW ECONOMICS FOUNDATION, ODIUS LENDING: DEBT RELIEF AS IF MORALS MATTERED 10 (2005), [https://neweconomics.org/uploads/files/fff4a8929678dfec38\\_e5m6bdjp4.pdf](https://neweconomics.org/uploads/files/fff4a8929678dfec38_e5m6bdjp4.pdf) [<https://perma.cc/7FJC-VFYV>] (elaborating on Sack’s odious debt definition and noting, for example, that a “lack of consent exists whenever there is no real democracy (either because power has been taken by force or because of serious electoral fraud but not necessarily because of a one-party state if the constitution was openly approved in a democratic manner)”; Lee C. Buchheit, G. Mitu Gulati, & Robert B. Thomson, *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201, 1203 (2007) (highlighting that the concept of odiousness has changed from a particular debt being labeled odious to a regime being labeled odious, by which all of the regime’s debts are in turn odious).

<sup>143</sup> Michael Kremer & Seema Jayachandran, *Odious Debt: When Dictators Borrow, Who Repays the Loan?*, BROOKINGS (Mar. 1, 2003), <https://www.brookings.edu/articles/odious-debt-when-dictators-borrow-who-repays-the-loan/> [<https://perma.cc/NF7F-Y953>].

<sup>144</sup> See *id.* (noting that “international law does not exempt citizens of a dictatorship from repaying a debt incurred by a dictator for personal and nefarious purposes”).

<sup>145</sup> See NEW ECONOMICS FOUNDATION, *supra* note 142, at 10 (taking Sack’s definition and making it more specific); see also Buchheit et al., *supra* note 142, at 1203 (defining odious debts as “debts incurred by a despotic regime that do not benefit the people bound to repay the loans”).

when they issued the loans.”<sup>146</sup> Otherwise, the creditors would not have either (a) *ex ante* notice about which debts are dischargeable, or (b) *ex post* notice that debts may be discharged.<sup>147</sup> Therefore, creditors argue that it is unfair for odious debts to be discharged since creditors do not have either type of notice.

Scholars, practitioners, and religious figures argue that a sovereign’s odious debt should not always have to be repaid.<sup>148</sup> In other words, sovereigns should be able to discharge odious debt. This would augment current creditor-sovereign-debtor relations since successive governments are currently required to pay the legacy debts of previous regimes, odious or not.<sup>149</sup> However, as will become evident below, the already existing odious debt doctrine supports, on moral, economic, and legal grounds, the notion that successive governments should *not* have to repay odious debts.

#### A. The Odious Debt Doctrine as a Moral Obligation

Section III spotlighted the reasons why a sovereign debtor should be provided with a fresh start. First, the section focused on the shared economic and moral justifications for having a fresh start policy. Then, the section expanded these rationales to include justifications specific to sovereign debtors. The moral, economic, and legal justifications apply to any sovereign facing insolvency. However, when the sovereign faces insolvency because of the fiscally irresponsible actions of a prior illegitimate regime, these moral, economic, and legal arguments are even more persuasive.

The notion of odious debts received significant attention beginning in the late 1990s, with the rise of the Jubilee Movement.<sup>150</sup> The movement focused on forgiving developing country debt that was used in wasteful ways and without citizens’ consent.<sup>151</sup> Leaders of the Jubilee Movement argued that absent citizens consenting or citizens benefiting from the debt, it

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<sup>146</sup> See Kremer & Jayachandran, *supra* note 143.

<sup>147</sup> See *supra* section II.B.1 (explaining how the U.S. bankruptcy code and courts provide creditors with this type of notice).

<sup>148</sup> See Martha Minow, *Forgiveness, Law, and Justice*, 103 CALIF. L. REV. 1615, 1641 (2015).

<sup>149</sup> See *id.* (“[T]he usual rule [is] that agreements must be kept even when the government incurring a debt has been overturned and replaced . . .”); see also Howse, *supra* note 142, at 4 (highlighting the existence of an “international legal obligation to repay state-to-state debts”).

<sup>150</sup> See Kremer & Jayachandran, *supra* note 143.

<sup>151</sup> See *id.*

is morally bankrupt to hold them liable for it as taxpayers of the sovereign. Further, it is pointless to repay odious debts because it punishes citizens for bad leadership while creditors are not dissuaded from continuing to offer odious debt.<sup>152</sup>

In particular, odious debt should not be repaid because it is morally repugnant to require citizens to repay debts incurred without their consent and only for the benefit of an illegitimate regime.<sup>153</sup> Additionally, creditors should take a haircut on such debt because the illegitimate actions of the prior regime were “presumably visible to [the] lender” when it lent money; therefore, the lender is also morally culpable and deserves not to be repaid by the incoming administration.<sup>154</sup> When “the evil [regime] is vanquished,” the morally right outcome is “all of the baneful effects of that evil should automatically dissipate.”<sup>155</sup> But for it to actually dissipate, odious debt must be discharged.

### 1. *The U.S. Bankruptcy Code and Odious Debt*

The Code evidences, albeit implicitly, discrete choices about whether to discharge certain types of repugnant debts to the benefit of debtors or creditors. If it would be repugnant for the debtor to wallow under the weight of excessive debt, then the debt is dischargeable.<sup>156</sup> Or, if it would be repugnant for the debtor to have to liquidate certain assets to repay creditors, then the asset is exempt from liquidation.<sup>157</sup> And, if it would be

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<sup>152</sup> See Minow, *supra* note 148, at 1641.

<sup>153</sup> See Lee C. Buchheit & G. Mitu Gulati, *Odious Debts and Nation-Building: When the Incubus Departs*, 60 ME. L. REV. 477, 479–80 (2008) (highlighting that “[t]his is a situation in which a strict requirement of the law (that governments automatically succeed to, and must honor, the debt obligations of their predecessors) is incongruent with most people’s sense of the morally right outcome”).

<sup>154</sup> *Id.* at 480.

<sup>155</sup> *Id.* at 481.

<sup>156</sup> An example of this balancing is the Code’s “Means Test,” which is used to determine the point at which a debtor is too overburdened by debt and deserves a discharge in liquidation. This is to say that U.S. policymakers have devised a test for the courts to use to determine whether it is better to have the debtor or the creditor carry the debt burden (either debtor repayment or creditor write-off) post-bankruptcy. If the debtor makes too much money and it seems that they are using the bankruptcy laws to unjustly eliminate their debt, then the Means Test does not allow the debtor to discharge their debts in Chapter 7 because doing so would be unjust (morally repugnant) to the creditor. Such is but one example of how the Code implicitly makes equitable judgments about who should ultimately be responsible for the debt. To see how the Means Test operates, see generally 11 U.S.C. § 707(b) (2012).

<sup>157</sup> See *In re Victoria and Marcos Medina*, No. 17 B 18090, *Memorandum Opinion on Trustee’s Objection to Debtor’s Claim of Exemptions* at 8 (Bankr. N.D. Ill. Nov. 20, 2017), <https://www.ilnb.uscourts.gov/sites/default/files/opinions/MedinaVictoriaMarcos.pdf> [<https://perma.cc/W8WS-4R4Z>] (holding that a wedding ring was exempt property under Illinois law and thus that the debtor did not

abhorrent to discharge a debt assumed via repugnant actions, then the debt is not dischargeable.<sup>158</sup> In each of these situations, the Code makes the decision to award a discharge or not using an implicit balancing test.

The same analysis, applied to the odious debt context, similarly supports a finding that certain types of debts are more deserving of discharge than others. Whether an odious debt should be dischargeable thus comes down to where the repugnancy threshold is exceeded. For example, if the sovereign debtor is languishing under excessive debt, especially odious debt, then it is repugnant to let the sovereign languish under debt loads to which it did not consent and from which it does not benefit. When the sovereign would have to cease providing human rights-related services or liquidate important state assets to repay creditors for odious debt, then the odious debt should be discharged instead. And creditors should bear the cost of this discharge because they either should have known about the odious nature of the debt or they did know about the odious nature of the debt when they lent money.

It is true that the above argument could apply to all sovereign debt. However, given that odious debt is inherently repugnant (i.e., it was not consented to by the sovereign's citizens nor used for their benefit) in a way that other sovereign debt is not, any such balancing test is much easier to perform. Since this is the case, odious debt should have at least a presumption of dischargeability in sovereign debt restructurings.

## B. The Odious Debt Doctrine as an Economic and Legal Obligation

The legal and economic arguments for discharging odious sovereign debts go hand-in-hand. First, if providing credit to repressive regimes elongates their tenures and if repressive regimes stymie productivity and economic growth, then we are supporting an international system where productivity and economic growth is not maximized. This is obviously a negative outcome. Instead, the “[l]egal embrace of the odious debt doc-

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have to sell it to pay creditors). This case is another example of how the court and the code balances equity considerations to determine whether it is less morally repugnant if the debtor or the creditor ultimately bears the debt burden, since whichever is less subsequently bears the burden.

<sup>158</sup> See *supra* subsection I.B.1 (highlighting that certain debts are exempt from discharge because the debtor's actions in acquiring certain debt evidenced morally repugnant actions (e.g., debt acquired through fraud)).

trine could redirect international capital to better uses” and growth could be maximized, or at least increased.<sup>159</sup>

Further, the legal concept of unjust enrichment helps clarify the illegitimacy of odious debt.<sup>160</sup> When an illegitimate head of state confers a benefit to creditors without its citizens receiving a benefit, the creditors have arguably been unjustly enriched.<sup>161</sup> Therefore, the creditor should have to absorb the losses or repay the sovereign’s losses. This legal concept does not have to be rigidly applied. Instead, it could be wielded creatively to partition odious debts from non-odious debts, validating parts of the debt that were used to benefit citizens and invalidating those that were not.<sup>162</sup>

Beyond the legal concept of unjust enrichment, agency law also explicates the illegitimacy of odious debt. Implicit in the odious debt definition is the lack of an agency relationship between the principal (the citizens) and the agent (the government).<sup>163</sup> Per agency law, unless the principal consents to the agent’s representation, the agent cannot bind the principal.<sup>164</sup> Thus, a dictator or other regime that comes to power without citizens’ consent cannot rightfully make decisions that bind those citizens.<sup>165</sup> Like individuals and corporations who are not liable for actions of unauthorized agents, sovereigns similarly should not be liable for actions, including entering into debt contracts, by an unauthorized agent (the illegitimate regime).

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<sup>159</sup> Minow, *supra* note 148, at 1641 (citing LIENAU, *supra* note 94, at 98).

<sup>160</sup> *See id.* at 1642.

<sup>161</sup> *See* LEGAL INFO. INST., *Unjust Enrichment*, [https://www.law.cornell.edu/wex/unjust\\_enrichment](https://www.law.cornell.edu/wex/unjust_enrichment) [<https://perma.cc/4XRH-TEVG>] (defining unjust enrichment). Obviously, this hypothetical head of state has also been unjustly enriched, but for present purposes we can assume that citizens will be unable to recover from this head of state and will, instead, focus on trying to recover from the creditor.

<sup>162</sup> Buchheit et al., *supra* note 142, at 1235. Of course, this still leaves open the major question about which courts would have the necessary jurisdiction to make this determination.

<sup>163</sup> *See, e.g., id.* at 1237–38 (discussing the relationship between citizens and the government as an agent/principal relationship and supporting this characterization with reference to foundational texts in American political philosophy and legal theory).

<sup>164</sup> *See* Deborah A. DeMott, *Agency by Analogy: A Comment on Odious Debt*, 70 LAW & CONTEMP. PROBS. 157, 163–64 (2007). Professor DeMott also points out the difficulty in determining who exactly the principal is (e.g., the citizens, the government, or the state itself), *see id.* at 160–61, but for this Note’s purposes, it is assumed that the citizens are the principal.

<sup>165</sup> *See generally* Buchheit et al., *supra* note 142, at 1237–45 (exploring in-depth how agency law leads to the conclusion that despotic governments (as purported “agents”) lack the citizens’ authorization (as “principals”) to enter into odious debt contracts).

This Note contends that not adopting something like the odious debt doctrine is an affront to human dignity because creditors are permitted to force people (here, citizens) to pay for something from which they did not benefit and to which they did not consent. This goes against prevailing laws and principles including, *inter alia*, agency and unjust enrichment principles that are found within many domestic and international laws.<sup>166</sup> Therefore, the international community should adopt the odious debt doctrine because (1) it would help resolve the conflict between odious debt repayment and prevailing international laws and principles; and (2) it would remedy the negative economic effects of odious debt repayment, which in practice limits human rights-related services and in turn harms citizens.<sup>167</sup>

Furthermore, while the justifications for a fresh policy examined above apply to sovereign debt generally, the argument here is admittedly only advocating for discharging odious debt. This is a conscious position and is chosen for pragmatic reasons. First, pursuing a fresh start policy for sovereign-debtors generally has been stalled for years. Second, there are even more reasons for discharging odious debt. And third, it is a conservative recommendation, as only a very small amount of sovereign debt would be labelled odious.<sup>168</sup>

### C. A Possible Solution Supported by a Fresh Start Policy

The odious debt doctrine has been actively debated among scholars and practitioners “in recent years,” with interest renewed after the fall of Saddam Hussein’s regime in Iraq.<sup>169</sup> Its usefulness wanes when questions about how to practically solve the odious debt problem arise. Even still, discharging

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<sup>166</sup> See Christina Binder & Christoph Schreuer, *Unjust Enrichment*, OXFORD PUB. INT’L L., <http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e1002> [https://perma.cc/D9F7-MZRQ] (last visited Feb. 24, 2019) (revealing how unjust enrichment is both a general principle of law within domestic laws and international law); Dieter Martiny, *Hague Conventions on Private International Law and on International Civil Procedure*, OXFORD PUB. INT’L L., <http://opil.ouplaw.com/view/10.1093/law:epil/9780199231690/law-9780199231690-e942?rskey=hCi0m9&result=1&prd=OPIL> [https://perma.cc/P5B7-TSEK] (last visited Feb. 24, 2019) (spotlighting that agency law was internationalized, in part, by The 1978 Convention on the Law Applicable to Agency).

<sup>167</sup> See Mancina, *supra* note 117, at 1240.

<sup>168</sup> See LIENAU, *supra* note 94, at 9 (observing that “[w]ere the doctrine [of odious debt] to be adopted more broadly, it is likely that most sovereign debt incurred in the contemporary era would still be binding most of the time”).

<sup>169</sup> See Christiana Ochoa, *From Odious Debt to Odious Finance: Avoiding the Externalities of a Functional Odious Debt Doctrine*, 49 HARV. INT’L L.J. 109, 111 (2008).

odious debt is an attainable outcome because odious debt is narrowly defined. It is only debt lent by creditors, who had notice of a regime's odiousness, and used by the sovereign outside of the citizens' benefit. This Note argues that the solution proposed by Kramer and Jayachandran (the Authors) comports with the existing odious debt doctrine and can be supported and refined by the fresh start policy and the Code.

The Authors argue for "establishing an independent institution" with a mandate to assess regime legitimacy.<sup>170</sup> Any debt incurred subsequent to a regime being deemed illegitimate would be odious.<sup>171</sup> If a debt is deemed odious, then succeeding governments are not obligated to repay the debt.<sup>172</sup> Regimes labelled odious are therefore unlikely to receive additional creditor funds "since [creditors] would know that successor governments would have little incentive to repay them."<sup>173</sup> This would lead to a new sovereign-debt-market equilibrium wherein a sovereign's reputation as a debtor will not suffer due to nonrepayment of odious debts.<sup>174</sup>

Additionally, in order to ensure parties (all major creditor nations and debtors) coordinate, the Authors suggest establishing two enforcement mechanisms.<sup>175</sup> First, countries shall change their laws to "disallow seizure of a country's assets for non-repayment of odious debt."<sup>176</sup> Second, countries shall make "foreign aid to successor regimes . . . contingent on non-repayment of odious debt."<sup>177</sup>

The Authors' proposal shares many similarities with the U.S. bankruptcy court and laws. As noted above, the Code is concerned about creditor notice. In particular, three concerns are central: the creditor should have (i) *ex ante* notice about which debts are dischargeable; (ii) *ex post* notice that debts may be discharged; and (iii) a fairness assessment. The Authors' proposals would solve these tripartite concerns.

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<sup>170</sup> MICHAEL KREMER & SEEMA JAYACHANDRAN, BROOKINGS INST., POLICY BRIEF #103: ODIUS DEBT 3 (2002), <https://www.brookings.edu/wp-content/uploads/2016/06/pb103.pdf> [<https://perma.cc/B2PX-368L>]. For further explanation on how this institution could be implemented, see *id.* at 7–8.

<sup>171</sup> See *id.* at 3–4.

<sup>172</sup> *Id.*

<sup>173</sup> *Id.* at 4.

<sup>174</sup> *Id.* The theory that this would create a new market equilibrium is based on "well-known result[s] in game theory." *Id.*; see *id.* at 2 (describing how South Africa decided to repay odious debt because it was afraid that not doing so would hurt its reputation in international capital markets—something that the new equilibrium would help insure against).

<sup>175</sup> *Id.* at 4.

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

First, the presence of the proposed institution puts creditors on notice that as a general matter odious debt is dischargeable.<sup>178</sup> Second, given that only debt incurred after a regime is labeled illegitimate is odious, creditors have notice at the time of the labelling that the debts they subsequently fund may be discharged. Lastly, the proposed institution will act as a neutral arbiter, only declaring a regime illegitimate according, presumably, to well-defined international norms and laws. That is, a neutral, authorized third-party, like the judge in bankruptcy court, will perform a fairness assessment to determine whether to deem a regime illegitimate and its future debts odious. Therefore, the tripartite concerns noted above are satisfied by the Authors' proposed institution's structure and practices.

While the United States already makes it exceedingly difficult to attach to a sovereign's property abroad, the Authors' solution would make it even harder. Instead of a sovereign nevertheless having to deal with, for example, a hedge fund successfully levying against its assets abroad for the nonpayment of odious debt, the suggested enacting legislation would negate that possibility entirely.<sup>179</sup> In fact, these suggested enforcement mechanisms are similar to the Code's discharge injunction. Like the discharge injunction in bankruptcy, which makes it impermissible for creditors to collect on discharged debt,<sup>180</sup> these enforcement mechanisms are the functional equivalent—they make it impermissible for creditors to collect on odious debt, which would be presumptively discharged.

Although the Authors' proposed solution is novel, there are still some potential blind spots that can be filled in from the Code's existing concepts. The proposed solution provides the illegitimate government's successor with a discharge of odious debts. The idea being that a respectable government should not have to bear the debt burdens of a repugnant government. However, what happens if the successive regime is also repugnant? Does the successive (also repugnant) government re-

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<sup>178</sup> Some creditors would argue that it is unfair that they suffer the consequences of regimes being labeled illegitimate when they do not have the ability to decipher which regimes are or are not legitimate a priori. Even if we accept this as true, this concern about creditor notice is irrelevant because the Authors' proposed solution only qualifies debt as odious if it is provided *after* a regime is labeled illegitimate. Therefore, a creditor does not need to be able to decipher a legitimate regime from an illegitimate regime.

<sup>179</sup> Of course, this is assuming that the hedge-fund is levying on an asset to collect on an odious debt.

<sup>180</sup> See *supra* note 14 (explaining what a discharge injunction is).

ceive the odious debt discharge? Or does the successive government have to be respectable under the eyes of the institution to receive the discharge? Or is just being less repugnant than the last regime sufficient to receive the odious debt discharge?<sup>181</sup>

Moreover, the definition of odious debt, which the Authors' proposed solution is based around, assumes that the debt is not used to benefit citizens. However, if the proposed institution deems a government illegitimate, and that government then receives creditor funds (of say \$1 billion), spends \$700 million on a presidential palace and the other \$300 million on new highways, is this debt dischargeable? It is debt issued after the proposed institution labeled the regime illegitimate, but was used partly for the citizens' benefit. Therefore, can it be odious debt under the prevailing definition?

The Code's posture in deciding which debts are dischargeable and which are exempt from discharge provides a helpful guidepost in answering these dilemmas. Under the Authors' proposed solution, all odious debts are eligible for discharge. This is similar to how all unsecured prepetition debts are dischargeable in bankruptcy, unless they are exempt. Comparably, there should be sets of odious debts that are exempt from discharge.<sup>182</sup> The sets of nondischargeable odious debts can follow a similar categorization as nondischargeable debts under the U.S. bankruptcy laws.

Recall that nondischargeable debts fall largely into three categories: (1) familial obligations; (2) debts owed to governmental entities and entities providing educational loans; and (3) debts resulting from unfair debtor conduct vis-à-vis their creditors. Similarly, a sovereign's odious debts could fall into any one of these categories and therefore be exempt from discharge.

For example, in the hypothetical above where the sovereign is using thirty percent of the odious debts for the citizens' benefit, is it right to allow discharge? Arguably not. The Code exempts debts from discharge that are familial obligations. Citizens are functionally equivalent to family members. Providing for one's family is "beyond question" and a "universalist

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<sup>181</sup> Cf. KREMER & JAYACHANDRAN, *supra* note 170, at 7 (recognizing a variation on this type of problem—legitimate government debt in the hands of an illegitimate government).

<sup>182</sup> Otherwise, this proposed solution could be too debtor-friendly, which is not ideal because an effective fresh start policy seeks to find a middle ground between an overly-friendly creditor framework and an overly-friendly debtor framework. See *supra* section 1.

sentiment"; likewise it is beyond question and a universalist sentiment that a sovereign is required to take care of its citizens—as much is required for by international customary law.<sup>183</sup> Therefore, when a sovereign provides services to the benefit of its family (its citizens), then that portion of the debt should be exempt from discharge.

The second category of nondischargeable debts should not be replicated in the odious debt context. As noted above, debts owed to governmental entities are not eligible for discharge because of the government's power over the Code. This exemption does not fulfill any outright moral objective. Therefore, it would be senseless to replicate this exemption just for the purpose of replicating the exemptions generally.

Lastly, the third category of exemptions exists to ensure that the debtor's repugnant actions are not rewarded with a discharge.<sup>184</sup> For example, assume a government has been labeled illegitimate. Now all future debts are technically odious. However, what if during this time a judgment is rendered against the government for its tortious activity against another; should this debt be similarly discharged? Arguably not. The Code, for example, exempts debts acquired through tortious activity.<sup>185</sup> Likewise, an odious debt that is the result of the sovereign's repugnant behavior should also be exempt from discharge.

In sum, the prevailing definition of odious debt and the Authors' proposed solution, which effectively works to discharge odious debt, fits nicely into the Code's existing framework. And where the proposed solution or the definition of odious debt would lead to confounding outcomes, the Code provides helpful insights for how to resolve these to achieve just outcomes. Parsing the fresh start policies helps explain *why* an odious debt should be dischargeable and the Code and the Authors' proposed solution shows *how* an odious can be discharged.

#### CONCLUSION

This Note started with a simple question: should a sovereign be eligible for a fresh start and is it possible to provide them with one? The concept of the fresh start is well-founded in American jurisprudence. Its adoption was premised on posi-

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183 See *supra* subsection III.B.1.

184 See *supra* subsection I.B.1.

185 See *supra* note 67.

tive (socio)economic and moral arguments, which showed that a discharge of certain debts provides an individual with a fresh start; and incorporating a fresh start makes the individual and society better off. These same policy arguments also apply to why the sovereign should receive a fresh start. Additionally, various legal arguments also support incorporating a fresh start policy into the sovereign-debt restructuring context.

However, in order to provide a sovereign with a fresh start there must be a determination of which debts are dischargeable and which debts are not. While agreeing unanimously about which debts to discharge is politically challenging given the number of international constituents, at least agreeing that odious debts are dischargeable is an attainable outcome.

The economic, moral, and legal arguments in support of discharging odious debts are clearer and more persuasive than the arguments for discharging sovereign debts generally. Therefore, it should be politically easier to adopt the odious debt doctrine. Further, the Authors have proposed a novel solution wherein odious debts can be discharged if certain practices and laws are adopted. Their proposal fits within the odious debt definition, and where it is incomplete, it can be supported by existing bankruptcy policies and rules. The Code's policies around which debts to discharge help to fill in the gaps within the Authors' proposed solution. Consequently, the answer to the above question is positive: the policy rationales support a sovereign receiving a fresh start, and a fresh start can partly be achieved by discharging odious debts.

