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Sarah Ludington
Campbell University School of Law

Mitu Gulati
Duke University School of Law

Alfred L. Brophy
University of North Carolina at Chapel Hill

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Applied Legal History: Demystifying the Doctrine of Odious Debts

Sarah Ludington,
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Abstract

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

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Introduction

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

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

If a case involving odious debts repudiation ever does find its way into a court of law, the tribunal will most likely look to customary international law to adjudicate the repudiation. Customary international law is basically the law that can be drawn out of the

² ALEXANDER N. SACK, LES EFFETS DES TRANSFORMATIONS DES ÉTATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÈRES 157-63 (1927).
repeated historical practice of nations and opinio iuris et necessitas—a sense of obligation that drives that practice.\(^3\) Given that most sovereign borrowing takes place under contracts governed by the laws of either New York or the United Kingdom, the historical practices of these two countries regarding sovereign debt repudiation are likely to be of central importance to a modern tribunal trying to determine whether to incorporate some—or all—of the Sackian definition of odious debts into its analysis. Among the pieces of evidence that are used to determine historical practice and opinio iuris are the writings of prominent jurists, who synthesize and analyze prior precedent.

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

The project of this Article is to test the strength of these pillars. A prior article asserted that one of the three pillars was shaky.\(^4\) Odious debts proponents touted Alexander Sack as a former Tsarist minister and the foremost scholar of sovereign debt in his day. Research into Sack’s biography revealed that he was neither a Tsarist minister, nor a prominent legal academic.\(^5\) Given that Sack’s biography bore little resemblance to his modern reputation, it raised the question whether the other historical pillars might be similarly shaky—either in providing support for the Sackian odious debts doctrine, or in differing in important respects from the story that the contemporary odious debts literature has accepted.

This Article also makes a preliminary inquiry into other instances of state repudiation of debts in U.S. history—in particular, to see whether there are examples that support the

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\(^5\) *Id.*
first prong of Sack’s test. A brief tour of debt repudiation in the nineteenth century shows multiple incidents of the United States engaging in and ratifying repudiations of debts contracted by previous regimes. Rather than acting according to the doctrine of odious debts as described by Sack, the United States appears to have followed a different pattern of practice—one that is potentially broader and more flexible than the one written by Sack. This historical inquiry expands the examples of state practice that support an odious debts doctrine, albeit a doctrine that probably is different than the one codified by Sack. This article, therefore, returns to history with a very specific purpose: to understand the long-standing state practices that have been cited, not cited, or incorrectly cited, to support the repudiation of sovereign debts. This seeks to provide a rigorous excavation of historical practices while addressing the contemporary implications of that history. It is, thus, an attempt to provide a correct and useful historical account—in essence, applied legal history.

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

This Article’s suggestion that there is little support in U.S. state practice for the ex ante labeling of a regime as odious is relevant to the contemporary debate over the optimal regime for policing odious debts—whether to use ex ante labeling of regimes as odious, or ex post evaluations of debts as odious. Arguments based on ex ante labeling have been attempted, but as we see in the Tinoco arbitration, they can be intractable. On the other hand, ex post consideration of the uses to which those debts were put, and the

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misbehavior of creditors, are of considerable importance in determining whether a debt can be repudiated.

I. 1898 U.S.-Spain Treaty Negotiations

The odious debts discourse points to the U.S. repudiation of the Cuban debt following the war with Spain as historical precedent for the repudiation of odious debts. The standard narrative promoted by advocacy groups closely tracks the first two requirements of the Sackian definition of odious debts (in some versions, it also has the third step of creditor awareness or collusion):

At the end of the 19th century, the United States government repudiated the external debt owed by Cuba after seizing the island in the Spanish-American war. The U.S. authorities did so on the grounds that Cuba’s debt had not been incurred for the benefit of the Cuban people, that it had been contracted without their consent, and that the loans had helped to finance their oppression by the Spanish colonial government.

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

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7 See Lee C. Buchheit, The Dilemma of Odious Debts, 56 DUKE L. J. 1201, 1216 (“[The creditors] ‘took the obvious chances of their investment on so precarious a security.’”) (quoting ERNST H. FEILCHENFELD, PUBLIC DEBTS AND STATE SUCCESSION 341 (1931)); see also M.H. Hoeflich, Through a Glass Darkly: Reflections Upon the History of the International Law of Public Debt in Connection with State Succession, 1982 U. ILL. L. REV. 39, 55 (describing the hard line taken by the American Commissioners, who argued, with respect to the risks assumed by the creditors, that the “very pledge of the national credit, while it demonstrates on the one hand the national character of the debt, on the other hand proclaims the noxious risk that attended the debt in its origin, and has attended it ever since”) (quoting Feilchenfeld, id. at 312).

practice of odious debts repudiation as sometimes suggested; nevertheless, the
negotiations reveal the extent to which the United States and Spain were familiar with the
moral arguments underlying the doctrine of odious debts. Further historical inquiry into
the Cuban debts might also yield more clear-cut examples of repudiation.

By the time the United States intervened in the Cuban rebellion, Cuba was deeply in debt.
The Cuban government was estimated to be $325 million in debt in 1896, mostly from
notes issued by Cuban banks that were used to finance Spain’s ten-year battle against
Cuban insurgents (from 1868-78) and other military forays in the Caribbean and
Mexico. Beginning in 1876, Spain had floated treasury and mortgage bonds in the
European markets that were theoretically intended to consolidate and pay down the
Cuban debt. These bonds were secured by property in Cuba and guaranteed by the nation
of Spain and various Cuban revenue streams (customs, post-office, and stamp revenues,
indirect and direct taxes). It appears, however, that none of the proceeds from the
various bond issues had actually been used to pay off the Cuban debt, or even to benefit
the island, such as through investments in island industry. Instead, the proceeds stayed in
and enriched Spain. Indeed, there is one example of a nervous European bond
purchaser, no longer willing to rely on the word of the Spanish, traveling to Cuba to
determine exactly how the money from a proposed loan would be spent and repaid.
The island’s indebtedness had been reported in financial journals and the United States
was presumably aware of the debt before entering into the war and the peace
negotiations.

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Estimates of the Cuban debt at the end of the war range from $406 million to $520 million. ROBERT P.
PORTER, INDUSTRIAL CUBA: BEING A STUDY OF PRESENT COMMERCIAL AND INDUSTRIAL CONDITIONS,
WITH SUGGESTIONS AS TO THE OPPORTUNITIES PRESENTED IN THE ISLAND FOR AMERICAN CAPITAL,
ENTERPRISE, AND LABOUR, 261 (1899).
10 Fernández, supra note 9, at 88-89; Porter, supra note 9, at 257.
12 Porter, supra note 9, at 257-59.
13 Fernández, supra note 9, at 137.
14 Fernández, supra note 9, 135 n. 49 (citing BANKER’S MAG., November 1887, at 367); id. at 137 n.52
(citing BANKER’S MAG., April 1892, at 771).
The United States and Spain devoted the first two weeks of treaty negotiations to resolving the Cuban debt. The United States entered the negotiations resolved not to accept responsibility for any of the Cuban debt; its preliminary peace protocol with Spain required Spain to “relinquish” control of Cuba and evacuate the island immediately, thereby granting Cuba her independence without transferring sovereignty, even temporarily, to the United States.15 The Spanish, however, had every intention of shifting at least a portion of the Cuban debt to the United States. On the third day of talks, Spain proposed a change to the wording of the protocol so that Spain would “transfer” sovereignty over Cuba to the United States, including the transfer of “[a]ll charges and obligations of every kind . . . which the Crown of Spain and her authorities in the Island of Cuba may have contracted lawfully in the exercise of sovereignty.”16

Spain stipulated that the transferred charges and obligations “must have been levied and imposed in constitutional form and in the exercise of its legitimate powers by the Crown of Spain, as the sovereign of the Island of Cuba . . . [and] must have been for the service of the Island of Cuba, or chargeable to its individual treasury.”17 In other words, Spain advanced a theory of debt repayment that sounds like an argument for odious debts repudiation; the United States would only become responsible for debts that were lawfully contracted by Spain as the legitimate sovereign of Cuba, and only for those debts that either benefited Cuba or were “chargeable” to the Cuban treasury (i.e., local).

In response to Spain’s opening volley, the United States developed two arguments for refusing to accept responsibility for the debt. First, it argued that the debts were not chargeable to Cuba because Cuba had not contracted them. The finances of the island

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15PROTOCOL OF AGREEMENT BETWEEN THE UNITED STATES AND SPAIN, EMBODYING THE TERMS OF A BASIS FOR THE ESTABLISHMENT OF PEACE BETWEEN THE TWO COUNTRIES, PAPERS RELATING TO THE FOREIGN RELATIONS OF THE UNITED STATES WITH THE ANNUAL MESSAGE OF THE PRESIDENT, H.R. DOC. NO. 1, at 828 (Dec. 5, 1898) (hereinafter FOREIGN RELATIONS). Further, President McKinley instructed his peace commission to reject any claim that Spain might make for compensation for public property: “the relinquishment of sovereignty over and title to [territory] is universally understood to carry with it the public property of the Government . . . .” William McKinley, INSTRUCTIONS TO PEACE COMMISSIONERS, Sept. 16, 1868, reprinted in FOREIGN RELATIONS, id., at 904-08.


were “exclusively controlled by the Spanish Government”; Cuba was not legally authorized to contract its own debts or float its own loans.\(^\text{18}\)

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

The United States thus challenged the connection between Cuba and the debt in question, not whether Spain, as a despotic ruler, had the moral right to contract debt on behalf of Cuba and its people for various purposes. To use an anachronistic analogy, the United States “pierced the veil” of the Spanish treasury.\(^\text{21}\) In conventional veil piercing doctrine, a defendant is stripped of the legal fiction that its corporate subsidiaries are different from the parent company if it appears the fiction is being used to perpetuate a fraud on the creditors.\(^\text{22}\) Here, the United States argued that the Spanish national treasury

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\(^{18}\) **TREATY OF PEACE**, supra note 16, at 49 (Annex to Protocol No. 5). See also J.B. Moore, **INTERNATIONAL LAW DIGEST VOLUME I**, at 357 (1906); **TREATY OF PEACE**, supra note 16, at 101 (Annex to Protocol No. 10) (reciting evidence from the Diario de las Sesiones de Cortes, showing that Cuban representatives to the Cortes had objected to the proposed Cuban budgets because the debt in the budget was national, not local).

\(^{19}\) **TREATY OF PEACE**, supra note 16, at 49 (Annex to Protocol No. 5).

\(^{20}\) Id.

\(^{21}\) About three-quarters of a century later, in an altogether unrelated dispute over debt, ironically also involving Cuba, the United States Supreme Court applied the veil piercing idea to the sovereign context. See, e.g., First Nat. City Bank v. Banco Para El Comercio Exterior De Cuba, 462 U.S. 611, 629-33 (1983).

\(^{22}\) “[A] corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.” United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (E.D. Wis. 1905).
was absorbing the surplus of the island and charging national obligations to the island, much as a parent company might abuse a subsidiary to make itself look more profitable. The indicia of such misbehavior also includes whether money is being shuttled back and forth across the accounts of the parent and the subsidiary, without clear indications of the purposes of the transfers, hence making a separation of assets difficult for creditors.23 The United States appears to have been accusing Spain of financial misbehavior along these lines.

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

> From the moral point of view, the proposal to impose [the debt] upon Cuba is equally untenable. If, as is sometimes asserted, the struggles for Cuban independence have been carried on and supported by a minority of the island, to impose upon the inhabitants as a whole the cost of suppressing the insurrections would be to punish the many for the deeds of the few. If, on the other hand, those struggles have, as the American Commissioners maintain, represented the hopes and aspirations of the body of the Cuban people, to crush the inhabitants by a burden created by Spain in the effort to oppose their independence, would be even more unjust.24

Significantly, the United States did not question whether Spain had the right, as the sovereign of Cuba, to incur debts on behalf of the Cuban people. Similarly, the United States did not question whether Spain ruled Cuba with the consent of the Cuban people.25 Rather, the United States objected to the fairness of taxing the many with costs imposed by the few, and in the alternative, to the fairness of asking the Cuban people to pay for the rifles that killed their voluntarios. In this last regard, the United States advanced an argument that sounds in the Sackian notion of odiousness.26

23 For the basics on corporate veil piercing, see, e.g., Stephen M. Bainbridge, Abolishing Veil Piercing, 26 J. CORP. L. 479 (2003).
24 TREATY OF PEACE, supra note 16, at 50 (Annex to Protocol No. 5).
25 See also TREATY OF PEACE, supra note 16, at 100 (Annex to Protocol No. 10) (reiterating that the United States has never questioned the legitimacy of the debt “as a national debt of Spain,” or questioned whether the debts of an autocratic nation are legitimate).
26 See also TREATY OF PEACE, supra note 16, at 107 (Annex to Protocol No. 10) (concluding that “the American commissioners therefore feel that they are fully justified both in law and in morals in refusing to take upon themselves . . . the obligation of discharging the so-called colonial debts of Spain—debts, as heretofore shown, chiefly incurred in opposing the object for the attainment of which the resolution of intervention was adopted”).

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Spain’s next tactic was to offer to submit the Cuban debts to arbitration for apportionment. While Spain probably thought that it would get more from an international arbitrator than the American peace commission, its suggestion that the debt be apportioned, and that the United States could only be held accountable for debts that were used for Cuban improvements, is an argument against interest and thus of significance in establishing *opinio juris et necessitas* for the odious debts doctrine.

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

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

On a final note, inquiry into the U.S.-Spain treaty negotiations reveals a stunning (but not surprising) absence in the written record of the negotiations of the viewpoints of Cubans, on whose behalf (putatively) the United States intervened in the war, and on whose behalf the United States negotiated with Spain. The United States did not invite a Cuban delegation or representative to Paris, and in fact, did not consult with any Cubans in advance of or during the negotiations. It is almost certain that Cuban representatives—had they been asked—would have rejected responsibility for the Spanish debt. Based on speeches made in the Cortes, Spain’s misuse of the Cuban budget was notorious. Thus it was apparent to the islanders that the debt was not local to the island; it is more difficult to know whether they also would have advanced a Sackian moral objection to the debt—one based on the despotic nature of Spanish control, on the use of the loans to suppress Cuban rebellion, or on creditor collusion.

The absence of a Cuban voice in the treaty negotiations suggests two directions for further inquiry. First, it suggests a question about the identity of the party raising the

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35 The absence of a Cuban voice also casts further doubt on the moral bona fides of the United States in making its moral argument against the Cuban debt. The United States asserts that it was an “agent of the Cuban people” in the negotiations, giving it the “duty” to object to the imposition of the debt. Annex to Protocol No. 10 at 107. But Pérez & Weissman argue that the United States’ arguments about the Cuban debt were an “ex post facto moral[r] rationale to explain a political decision.” Perez & Weissman, supra note 31, at 719; see also Hoeflich, supra note 7 at 55 (describing the behavior of the United States as a “maximization of national self-interest” and the negotiation as a “clear instance of power politics”).
odious debts defense, and whether a claim for odious debts repudiation must be asserted by—or at least affirmed by—the population newly liberated from the bonds of the despot. Second, it suggests an avenue for further historical inquiry into Cuban attitudes toward the Spanish debt—specifically, whether in 1909 Cuba rejected Spain’s advances to pay some of the debt strictly on the basis of the Treaty of Paris, or whether Cuba viewed the Spanish overture as an opportunity to repudiate odious debts, invoking explicitly moral justifications. If so, Spain’s acquiescence to Cuba’s position could be viewed as state practice accepting the repudiation of debts based on the doctrine of odious debts, and perhaps on terms similar to Sack’s.

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

II. The Tinoco Arbitration, Reconstructed

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

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

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

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

The Royal Bank, Justice Taft ruled, cannot simply base its case for repayment on "the mere form of the transaction" but must prove its good faith in lending the money "for the real use of the Costa Rican Government under the Tinoco régime . . . for its legitimate use."

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

In conclusion, Justice Taft ruled, "The Royal Bank of Canada cannot be deemed to have proved that the payments were made for legitimate governmental use. Its claim must fail." 36

In this recitation, Tinoco’s debts fit Sack’s three-part definition of odious debts: (1) Tinoco was a despotic ruler who ruled without the consent of the populace; (2) Tinoco borrowed in the name of the state and used the funds for purely personal purposes, contrary to the interests of the state; and (3), the creditors knew or should have known of the despot’s financial misbehavior because of the patent irregularities in the contracting of the debt.

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

Taft, however, did not force Costa Rica to repay the Tinoco loans. In much quoted language, Taft found that that these were not transactions "in regular course of business" but were "full of irregularities." Taft ruled that the bank had the burden of showing that it had furnished money to the government for its legitimate use, but had not done so. The bank knew that the money was to be used by Tinoco for his personal purposes, after the government was overthrown, and Costa Rica was not liable for such loans. The legitimacy of Costa Rica's repudiation of the loans, therefore, had nothing to do with the questionable legal status of the Tinoco government. Taft rejected this line of argument as inconsistent with the doctrine of state succession. In effect, Costa Rica could avoid responsibility for repaying the debts because the Royal Bank of Canada was at fault for not recognizing that the loans were not actually intended for the benefit of the people of Costa Rica, despite being incurred in their name.

\textsuperscript{37} The arbitration is described in \textit{Tinoco} (Gr. Brit. v. Costa Rica), 1 R.I.A.A. 371, 376 (1923); see also Lee C. Buchheit et al., \textit{The Dilemma of Odious Debts}, 56 DUKE L. J. 1201 (2006).  
\textsuperscript{38} 18 AM. J. INT’L L. at 168.  
\textsuperscript{39} \textit{Id.}
A second transaction, known as the “Amory concession,” was also at issue in the arbitration. Prior to Tinoco’s ascension, British companies had found it difficult to gain a foothold in Costa Rican oil exploration. Although the British government, under pressure from the United States, had not recognized the Tinoco administration, a British company took advantage of the regime change to purchase a concession for oil exploration during Tinoco’s regime. Costa Rica argued that it should not have to recognize the Amory concession rights. Taft ruled for Costa Rica here as well, on the rationale that the concession was not properly approved under Costa Rica’s own requirements for legislative approval of such concessions. Again, Taft made it clear that his ruling had nothing to do with the illegitimacy of the Tinoco regime.

A closer look at the history of the arbitration shows that it does not support all three parts of Sack’s definition, and most particularly, the first requirement that the debt be contracted by a despotic ruler. There are three aspects of the Tinoco arbitration that complicate or nuance its support for Sack’s odious debts doctrine: first, Tinoco was not clearly a despot; second, Taft was an arch conservative and an unlikely champion of debt-burdened fledgling democracies; third, Taft employed a substance-over-form analysis to the Tinoco loans that is reminiscent of the arguments made by the American delegation in repudiating the Cuban debt.

a. Tinoco, the Despot?

The odious debts narrative relies on the fact that Frederico Tinoco was a despot who ruled without the consent of the people. But Tinoco’s dictatorial status is complicated, and irregularities surrounding the elections of the regimes that preceded and succeeded Tinoco cast doubt on the popular legitimacy of these governments as well. The history of Costa Rica in that period was one of domination by western interests, with the United

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40 The Amory concession is rarely discussed in the odious debts literature. For a discussion, see Lineau, supra note 36 at 71-72 & n.29
41 18 AM. J. INT’L L. at 173-74; Lineau, supra note 36 at 79.
42 Notably, Sack himself did not cite Tinoco as supporting his doctrine of odious debts. He cites the Tinoco arbitration elsewhere in Les Effets, but not as an example of odious debts. See Ludington & Gulati, supra note 4.
States and Great Britain being the two primary competitors for influence. Even with the benefit of hindsight, it is difficult to determine whether Tinoco’s rise and fall is the story of a foreign colonial power overthrowing a local despot.

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

Tinoco’s government was never recognized by either the United States, then under the presidency of Woodrow Wilson, or Great Britain, which succumbed to U.S. pressure to withhold recognition. The U.S. hostility to the Tinoco government stemmed partly from Wilson’s goal to support only constitutional governments in Latin America. At one point, the U.S. consul in Costa Rica asked for troops to protect U.S. property and citizens there. Officially, the request was denied. But in June 1919, ostensibly acting

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45 Id.
46 Busey, supra note 44 at 68 Although this was the constitutional way to resolve an undecided vote, the suggestions of electoral fraud comprised Gonzales’ claims of legitimacy. Baker, supra note 41 at 5.
47 Baker, supra note 44 at 8 & 13. Tinoco had the support of all the political factions as well as several ex-presidents of Costa Rica.
48 Id. at 10 & 12. Wilson had even gone so far as to declare that the US would not honor and contracts or concessions granted by the Tinoco regime to a US citizen. See also Thomas M. Leonard, Central America and the United States: Overlooked Foreign Policy Objectives, 50 THE AMERICAS 1, 12 (1993).
49 See Lineau, supra note 36 at 71 (citing Richard V. Salisbury, Revolution and Recognition: A British Perspective on Isthmian Affairs During the 1920s, 48 THE AMERICAS 331, 335 (1992)).
50 See id. at 71; see also DANA MUNRO, INTERVENTION AND DOLLAR DIPLOMACY IN THE CARIBBEAN 1900-1921, 271 (1964).
51 The United Fruit Company was one of the biggest landowners in Costa Rica at the time; ironically, it may have had a hand in enabling Tinoco to take power. See Lineau, supra note 36 at n. 20 (pointing to evidence suggesting the involvement of United Fruit’s founder, Minor Keith, in the coup that put the Tinocos in power); Cf. Marcelo Bucheli, Good Dictator, Bad Dictator, United Fruit Company and
independently, a U.S. Naval Commander landed forces at the coastal city of Limon, leading to speculation that the U.S. government supported a regime change. In addition, Tinoco faced opposition from a counter-revolutionary group led by Julio Acosta, who in May of 1919 had led an attack into Costa Rica to wrest control from Tinoco. Soon thereafter, in August 1919, Tinoco abdicated—with the funds from Royal Bank of Canada—and his government fell a few months later.

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

The foregoing history complicates the use of the Tinoco arbitration as support for the consent prong of Sack’s odious debts test in several ways. First, the fact that Tinoco initially enjoyed popular support suggests that the first prong of Sack’s odious debts test—that the debts be incurred by someone lacking the consent of the populace—was not satisfied, and it also shows how difficult it can be to determine whether a regime is actually despotic.

Second, the dubious legitimacy of the Acosta regime raises the question whether the odious debts defense can be raised by a successor regime that is as unrepresentative or despotic as its predecessor—as Acosta may have been when his government enacted the

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52 Lineau, supra note 36 at 71 (citing Leonard, supra note 46 at 12).
53 See Baker, supra note 44 at 20.
54 Id.
55 Id. at pp. 68-69
56 Baker, supra note 44 at pp. 20-21. The history after the Tinoco Arbitration shows that Acosta did in fact restore the old constitution, but until he had actually allowed free elections the United States was unsure what diplomatic posture to take towards the Acosta government. Id. at pp. 20-21.
Law of Nullities. From a policy perspective, successor despots should not be able to assert an odious debts defense. After all, the one of the underlying economic justifications for having an odious debts doctrine is that it will deter future despots: i.e., if prospective despots know they will have less access to foreign funds, they will be less motivated to become despotic leaders.58

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

The second set of complicating facts has to do with the arbitrator, Chief Justice Taft. Taft was a larger than life figure, to say the least.59 A somewhat caricatured view of Taft is as “a stubborn defender of the status quo, champion of property rights, apologist for privilege, and inveterate critic of social democracy.”60 For him, the preservation of strong property rights, including the rights of creditors investing in foreign debt, was crucial to economic stability and growth. Taft was also a proponent of “dollar diplomacy,” a modification of the Monroe doctrine proposing that money rather than military power should be used to solidify U.S. influence in Latin American and elsewhere.61 Taft, in contrast to most of those sympathetic to the modern doctrine of odious debts, was likely focused on maximizing U.S. interests abroad rather than enabling an exception to the strict rule of governmental succession to debts. It is unlikely he would have had much sympathy for the notions of universal human rights underpinning many contemporary claims regarding international law, including some of those being made within the odious debts movement.62

Taft’s conservatism is apparent in the first part of the Tinoco decision, where Taft sidesteps the question of whether Tinoco was the legitimate representative of the

58 See Michael Kremer & Seema Jayachandran, supra note 6.
60 Lineau, supra note 59 at 92; ALPHEUS THOMAS MASON, WILLIAM HOWARD TAFT: CHIEF JUSTICE 13 (1965).
61 See WALTER V. SCHOLES & MARIE V. SCHOLES, THE FOREIGN POLICIES OF THE TAFT ADMINISTRATION 35 (1970); Lineau, supra note 59 at 105-06.
The litigating parties likely expected this to be a crucial issue in the case, given Tinoco’s reputation as a despot, the fact that neither the United States nor Great Britain had recognized his government, and that the United States had explicitly withheld recognition because the Tinoco government was not adequately constitutional. In a 180 degree turn away from both Sack’s first element of the odious debts doctrine and Wilsonian policy, Taft ruled that the Tinoco government was legitimate simply by having de facto control of the state, regardless of whether Tinoco enjoyed popular support or foreign state recognition. For this reason, conventional international law treatises and articles cite the Tinoco arbitration as a conservative, if not reactionary, decision. For our purposes, what is clear is that Taft and the Tinoco decision reject the first element of the Sackian test—the consent of the populace, or whether the leader is despotic or dictatorial. That element was irrelevant to Taft in deciding the ultimate question of whether the debt needed to be paid.

In terms of the modern debate about whether the optimal solution to the odious debt problem is to have a mechanism for the ex ante labeling of regimes as odious, we see that Taft rejected this approach. In theory, because of the 1907 treaty of Peace and Amity, where the U.S. had committed to the non recognition of extra-constitutional governments, Taft could have ruled against the creditors on the basis that the treaty specified that such illegitimately arising governments would not be recognized. But Taft did not take that path, choosing instead to focus on the question of whether the debt was contracted for legitimate purposes and whether the creditors should have known about this.

Examining the Tinoco decision through the lens of Taft’s promotion of dollar diplomacy sheds further light on its significance. Taft believed that using finance, in the form of loans by private bankers who were then backed by the U.S. government, was the best

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63 Not surprisingly, odious debt advocates have ignored this part of Taft’s decision. Lineau, supra note 59, is an important exception and we draw from her work.
method of extending U.S. influence internationally, and certainly a superior alternative to diplomacy through military force.\textsuperscript{66} During his presidency, Taft encouraged and facilitated U.S. financing in countries like Nicaragua, Honduras, and China. In Honduras, to encourage U.S. bankers to lend, the Taft government proposed sending a U.S. official to help oversee the Honduran customs houses, so that the bankers could be assured repayment.\textsuperscript{67} In Nicaragua, where banks were willing to lend on a private basis, the Taft administration insisted that the loans be secured by customs revenues to ensure stability.\textsuperscript{68} Taft also believed that the key to maintaining U.S. influence in China was for the United States to participate in funding the Hukuang Railway.\textsuperscript{69}

Given the foregoing, it is unlikely that Taft, in the \textit{Tinoco} ruling, was trying to establish a rule of odious debts that cut deep into the contractual rights of bondholders, as such a rule would have undermined the policy goals of dollar diplomacy. The success of dollar diplomacy relied on creditors feeling confident about making foreign loans, particularly in Central America. Consistent with this goal, Taft would have established and enforced legal rules that would make lending (and the returns from lending) more—not less—predictable.

For this reason, it is unlikely that Taft would have enforced a rule that predicated creditor liability on an ex post determination of the “legitimacy” of a regime.\textsuperscript{70} Further, assuming that Taft wanted to make it easy for creditors to lend, he probably would not have put the burden on them to investigate ex ante whether a government was adequately democratic.

\textsuperscript{66} See \textit{EMILY S. ROSENBERG, FINANCIAL MISSIONARIES TO THE WORLD: THE POLITICS AND CULTURE OF DOLLAR DIPLOMACY} (1999); Scholes & Scholes, supra note 61 at 35.
\textsuperscript{68} Id. at 219.
\textsuperscript{69} The group of investors also included France, Great Britain, and Germany, and later Japan and Russia. \textit{The Chinese Railway and Currency Loans}, 5 \textit{AM. J. INT’L L.} 706 (Jul., 1911); \textit{The Passing of Dollar Diplomacy}, 7 \textit{AM. J. INT’L L.} 340 (Apr., 1913).
\textsuperscript{70} Probably for similar reasons, Taft did not place much weight on the fact that the loans did not benefit the populace of Costa Rica, as this also burdens creditors with the risk of opportunistic defaults—a new government could come in and decide, ex post, to argue that certain projects had not resulted in good outcomes and were therefore odious. Creditors exposed to this type of risk would likely exit the market. By contrast, if a creditor knows that it is lending money to a head of state that intends to steal it, then they are in effect betting that he will be in power long enough to pay them back. That is a risk they can calculate.
Thus Taft explicitly rejected Costa Rica’s attempts to argue that Tinoco’s government was “illegitimate” and ignored the fact that the U.S. government itself had refused to recognize the Tinoco regime on account of its irregular and non-democratic origins. Instead, Taft focused on whether Tinoco was in control of the government when he contracted the loans and whether it reasonably appeared so to outsiders such as creditors.  

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

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

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

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72 In Nicaragua, Taft’s government approved of a claims commission to evaluate which of the debts of the prior regime should be honored, including a loan that the prior government had negotiated with the British where the funds were supposed to be used for a war with El Salvador. Dana G. Munro, Dollar Diplomacy in Nicaragua, 1909-1913, 38 HISPANIC AMER. HISTORICAL REV. 219-33 (1958). Significantly, Taft was willing to call into question loans that were made in the interest of destabilizing governments in Central America (at least those not supportive of U.S. interests).
73 Lineau, supra note 36 at 68, 88, 90,
74 Message of the President of the United States on Our Foreign Relations, Communicated to the Two Houses of Congress, December 3, 1912 (Washington, 1912), pp. 7-8, 10-11.
Viewed through the lens of conservatism and dollar diplomacy, Taft’s award in favor of the government of Costa Rica is consistent with his twin goals of advancing U.S. political and financial interests, and promoting stability in the Central American states. Taft placed the risk of creditor misbehavior—a risk well within the control of the creditors—squarely on the creditors themselves. But it is much more difficult to view the Tinoco decision as support for a doctrine that values representative government over creditors’ interests.

**c. Removing the Legal Fiction (Veil Piercing)**

A final aspect of the Tinoco arbitration that adds nuance to the Sackian definition of odious debts is the way that Taft strips the Tinoco loans of the legal fiction of the state. Taft’s analysis is reminiscent of the “veil piercing” argument advanced by the United states in its treaty negotiations with Spain. As discussed in Part I, the United States “pierced the veil” of the financial relationship between Spain and Cuba, effectively stripping Spain of the fiction that its subsidiary, Cuba, had separate finances from its parent country. Once the fictional separation was removed, the subsidiary’s debts (Cuba’s) become the debts of the parent/ruler (Spain).75

In the Tinoco decision, Taft relies on two facts to justify removing the fiction of state responsibility from the loans: first, that Tinoco clearly borrowed the funds from the bank for personal purposes; and second, because the bank was likely aware of the improper purpose of the loans because their personal purpose was facially evident. Once the fiction of state action was removed, the loans in effect become the personal loans of the Tinocos, except to the extent that the state (Costa Rica) received a benefit from the loans. Taft noted that although there was no direct benefit to the state from the loans, the state had confiscated the property of Tinoco’s brother from his widow. For that reason, Taft ruled that the state was at least partially responsible to the Bank, up to the value of the property that it had confiscated.76

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75 [See supra Part I.](#)
76 [18 AM. J. INT’L L. at 169.](#)
Taft relied on an arbitration between Jarvis, a U.S. citizen, and Venezuela, as precedent to support his fiction-stripping logic.\textsuperscript{77} In that case, Jarvis had assisted Paez, a Venezuelan, with arms and ammunition for an aborted coup attempt in 1849. Thirteen years later, Paez ascended to power in Venezuela and issued bonds to Jarvis to repay him for funding the prior coup attempt. The subsequent government in Venezuela challenged the validity of the bonds and won. As Taft explained it, the commissioner held that there had been no lawful consideration provided to the state for these bonds; instead, these debts were personal to Paez.\textsuperscript{78} The Venezuelan state under Paez issued the bonds, as a formal matter. But the fiction of the state was removed, given that Paez was attempting to abuse the fiction of the state so as to repay personal debts.

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

III. Repudiating Debts of States in the United States

Despite not providing perfect support for Sack’s doctrine of odious debts, the U.S.-Spain Treaty and the Tinoco Arbitration are both remarkable in that the United States—generally associated with the strong support of property and contract rights—winds up in favor of repudiating debts. Similarly surprising are the repudiations of debts contracted by state legislatures in the United States that occurred at points across the nineteenth century. While classical liberalism, with its rigorous support of vested rights, is a central motif of American history,\textsuperscript{79} there are a surprising number of examples in American

\textsuperscript{77} Id. at 156.

\textsuperscript{78} Id.

\textsuperscript{79} This image of the United States as the champion of vested rights was famously portrayed by Charles Beard, the Progressive-era historian, in An Economic Interpretation of the Constitution.(1913)
history of attacks on vested rights. Some of those attacks were successful. They illuminate a more robust support for odious debts doctrine in United States history than is typically understood.

We now turn to three episodes of American history that are occasionally mentioned in the literature on odious debts. The odious debts literature has done little to recognize the potential of the precedents to modify our understanding of the doctrine of odious debt.80 These are (1) the repudiation of debts by Mississippi, Arkansas, Florida and Michigan during the economic crisis of the 1830s; (2) the repudiation in the wake of the Civil War of debts incurred during the Civil War by the states of the former Confederate States of America;81 and (3) the repudiation of debts incurred by southern state governments dominated by African-Americans and Yankees during the period of Reconstruction following the Civil War. Those debts were repudiated by the pro-southern legislatures that followed them in the 1870s in the wake of Reconstruction (in the period that was often called “redemption” and is perhaps best characterized by the phrase the period of de-construction). Together those episodes of repudiation, where claims that the debts in question were illegitimate were common, reveal that repudiation claims that sound in odious debts have a more robust history than previously recognized, including in the United States.

A. The Antebellum Repudiations

Beard depicted the Constitution as the product of monied interests in support of their property rights. Many historians on the left have subsequently employed such images of class conflict, indeed domination of the wealthy, to support an interpretation of American history that depicts oppression. See, e.g., MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1790-1860 (1977). Other, more traditional historians have employed such images to support a robust constitutional regime of protection of property. See, e.g., JAMES W. ELY, THE GUARDIAN OF EVERY OTHER RIGHT: A CONSTITUTIONAL HISTORY OF THE RIGHT OF PROPERTY (1992).

80 See, e.g., BENJAMIN U. RATCHFORD, AMERICAN STATE DEBTS 104-34 (1941); JEFF A. KING, THE DOCTRINE OF ODIOUS DEBT IN INTERNATIONAL LAW: A RESTATEMENT 57-59 (January 21, 2007 draft) (discussing in one section the southern states’ repudiation from 1836 to 1880, which includes repudiation of states’ pre-war debts, war debts, and post-war debts).

81 Section four of that Amendment bars payment of debts of those states that rebelled against the United States; King, supra note 75, at 57; Ratchford, supra note 75, at 141-56 (discussing repudiation of southern states’ war debts and distinguishing states’ debts according to whether they involved war purposes or not).
Prior to the Civil War, and following the financial panic of 1837, four states—Mississippi, Arkansas, Florida, and Michigan—repudiated state debts owned largely by foreign investors. Arkansas repudiated one-half million dollars in debt; Florida four million; Michigan approximately 2.27 million; and Mississippi seven million. When challenged in court, the defaults were largely upheld either because a court determined that the loans had been contracted without the proper authority of the state, or because the Eleventh Amendment protected states from lawsuits brought in federal court.

The antebellum repudiations occurred during the era of Jacksonian Democracy, when many questioned the protection of vested rights at the expense of the community of taxpayers. On the other side of the political spectrum, Whigs (the forerunner of the Republican Party) viewed the Jacksonians’ actions with suspicion, believing that they left property insecure and led to instability in the economy. In 1840, one writer in the *North American Review* (a well-known Whig periodical) warned states about contracting more debts and warned creditors about the wisdom of extending further credit: “The more usurious a contract is, the more oppressive it will be felt by the borrower; and if, ultimately there should be found an unwillingness to comply with its conditions . . . the
greater will be the disposition to seek in the severity of those conditions an excuse for non-performance.”

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

It is difficult to draw doctrinal inferences from the state repudiations of the 1830s because the repudiations were made by various state legislatures acting on a diverse set of motives and justifications. Nevertheless, there appear to be several core elements common to the repudiations, including a concern that the taxpayers of the repudiating states would be burdened with crushing debt while having received little if any benefit from the loans.

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87 Benjamin R. Curtis, *Debts of the States*, 58 N. Am. Rev. 109-54 (January 1844). Curtis’ solution to the problem of sovereign default was for creditors to transfer bonds to sovereigns, like Great Britain, and have them proceed directly against the states in the United States Supreme Court. *Id.* For extensive discussion of the Eleventh Amendment’s bar on suits at this time, see Christopher Shortell, *Rights, Remedies, and the Impact of State Sovereign Immunity* chapter 4 (2008) (exploring “Debt Repudiation and Backlash in the 1840s”).

88 Curtis, *supra* note 87, at 115 (acknowledging that it was “rash and improvident” to lend); see also *id.* at 122 (“if it is found that a State has been led astray partly by the insane confidence of its creditors, those creditors must bear some of the blame which always attaches to unsuccessful rashness”).

89 Curtis, *supra* note 87, at 115-16 (discussing argument among proponents of repudiation that the states received little benefit and that creditors were on notice that their loans were at risk). Curtis acknowledged that there had been poor investments on all sides, and that the poor investments were the result of innocent behavior. *Id.* at 117 (“The mere fact of insolvency furnishes no ground for interfering bad faith, or even bad judgment. The circumstances under which the debts were contracted, and especially the inducements which led to them, must be taken into account, before any decisions unfavorable to the debtor can be justly made.”) Curtis, however, thought the states were honor-bound to pay the debt. Curtis recognized that there were legitimate places where there might be repudiation—where a legislature found a debt invalid “in point of law or natural equity.” *Id.* at 142. However, he thought the states were capable of repaying the debt and they were dishonorably refusing to do so. *Id.* at 127, 153-54.
and that the creditors had some sense ex ante that the economy could not support repayment.

B. Repudiation of Confederate State Debts

In the aftermath of the Civil War (1861-65), the U.S. government required the former Confederate states to repudiate the debts they incurred during the war. The United States implemented this repudiation through section four of the Fourteenth Amendment, which repudiated all “debt or obligation incurred in aid of insurrection or rebellion against the United States.” The former Confederate states were required to ratify the Fourteenth Amendment to regain full participation in Congress and in the United States.90 In interpreting the Fourteenth Amendment, however, the Supreme Court did not reject all Civil War-era debts of the Confederate states outright. Rather, it examined the purpose of the debt; debts in aid of rebellion were void, but debts incurred to maintain the peaceful, civil functions of government were valid and enforceable.

The Confederate government and its constituent states largely financed the Civil War by selling Cotton Bonds—bonds backed by guarantees on the cotton crop—to investors in the United Kingdom, the Americas, and even in the northern states. The Confederacy’s strategy, known as “King Cotton Diplomacy,” was to entice foreign countries to intervene on the side of the Confederacy because of their financial investment in the future of the Confederacy.91 Cooler heads prevailed throughout Europe, but in the wake of the war, European creditors still sought payment. That was not to be, for Congress was in no mood to allow the payment of debts incurred to prosecute the war.

There is little legislative history about the fourth section of the Fourteenth Amendment. Some have interpreted the scarcity of discussion to mean that the debt repudiation was a

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

fundamental—and therefore uncontroversial—aspect of re-uniting the United States.\textsuperscript{92} The repudiation ensured that the successor states did not have to (and were not permitted to) pay for the war against the United States. It also ensured that the financiers who supported the Confederacy were not restored to the place they had been before the war. Southern state courts and lower federal courts in the south began hearing cases on the debts—and declaring them invalid—in the 1860s.\textsuperscript{93}

The issue of Confederate debts reached the United States Supreme Court on several occasions, requiring the Court to develop a test to determine which Civil War-era debts had been repudiated by the Fourteenth Amendment. In\textit{ Texas v. White}, Texas sought to reclaim bonds that it had been given by Congress in 1850 as part of the Compromise of 1850. Near the end of the Civil War, the “military board” of the State of Texas sold the bonds; the post-war government of Texas sought to reclaim the bonds, on the theory that the Texas government during the Civil War was not the owner of those bonds. Texas found a receptive ear in the United States Supreme Court in 1873. Chief Justice Waite’s majority opinion sought first to establish the principle that the union was indestructible, so that the acts of the Texas government during the Civil War were considered valid and upheld. In Waite’s oft-quoted words, “The Constitution, in all its provisions, looks to an indestructible Union, composed of indestructible States.”\textsuperscript{94} This position—required by northern interpretations of the Constitution—foreclosed perhaps the most direct route to abrogation of the sale of the bonds: that the acts were\textit{ ultra vires}.

However, the Court went on to distinguish between bonds sold for normal state purposes and those used to support the war effort, suggesting that the former might be valid, while the latter clearly were not:


\textsuperscript{93} See, e.g.,\textit{ Thomas v. Taylor}, 42 Miss. 65, 710 (1869) (repudiating Cotton notes because they were “in aid of the late rebellion, and therefore was not revived and continued in force by the ordinance of the Convention of 1865”); Branch v. Haas, 16 F. 53 (C.C.M.D. Ala. 1883) (repudiating Alabama’s Confederate debt).

\textsuperscript{94} 74 U.S. 700, 725 (1868).
It may be said, perhaps with sufficient accuracy, that acts necessary to peace and
good order among citizens, such, for example, as acts sanctioning and protecting
marriage and the domestic relations, governing the course of descents, regulating
the conveyance and transfer of property, personal and real, and providing
remedies for injuries to person and estate, and other similar acts which would be
valid if emanating from a lawful government, must be regarded in general as valid
when proceeding from an actual though unlawful government; and that acts in
furtherance or support of rebellion against the United States, or intended to defeat
the just rights of citizens, and other acts of like nature, must, in general, be
regarded as invalid.95

The Court concluded that the purpose of the military board that sold the bonds was to
levy war against the United States, and thus its sale of the bonds did not divest the state
of Texas of its title in the bonds.96 The reasoning of the case was confirmed by the fact
that the later purchasers of the bonds bought them with notice that they were suspect;
they had traded below what their fair market value would have been, “had the title to
them been unquestioned.”97

In Keith v. Clark, the Supreme Court reiterated the rule it announced in Texas v. White,
that “a contract made in aid of the late rebellion, or in furtherance and support thereof, is
void.”98 Keith v. Clark dealt with a dispute over whether a tax collector for the state of
Tennessee had to accept notes issued by a state-chartered bank during the Civil War. A
state law obligated its tax collectors to accept paper notes from the Bank of Tennessee for
payment of taxes. The tax collector argued that the notes were invalid because they had
been issued while the bank was under Confederate control. The decision in Keith turned
on whether the notes were issued pursuant to the Confederate war effort or merely for the
peaceful and ordinary actions of the state. The former were void; the latter were not. On
the record before the Court, there was “nothing to warrant the conclusion that these notes
were issued for the purpose of aiding the rebellion or in violation of the laws or the
Constitution of the United States”; on the contrary, the Supreme Court of Tennessee had

95 74 U.S. at 734.
96 Id. at 734-35.
97 74 U.S. at 736.
98 97 U.S. 454 (1878); see also Hanauer v. Doane, 79 U.S. 342 (1870).
found that “the bank during this time was engaged in a legitimate banking business.”

Keith put the onus on the tax collector, who sought to reject the notes, to show that the notes had been issued in support of the war effort.

C. Post-Reconstruction Repudiation

The southern states and their creditors nursed the memory of the forced repudiation for decades—well into the twentieth century. That memory of repudiation likely made it easier for southern states to contemplate debt repudiation in the wake of the Civil War. This time the southern states turned to debts that had been incurred by the Reconstruction governments. Following the “compromise of 1877,” when federal troops were removed from the southern states, southern legislatures frequently repudiated public debts contracted during Reconstruction, arguing that the debts were contracted by corrupt carpetbag politicians for their own use. Though they may have been duly elected according to the law of the time, they were not the appropriate representatives of the people. The carpet baggers and scalawags acted for their benefit, so the argument went.

100 The rule is also reiterated in Bruffy v. Williams, 96 U.S. 176, 192 (Oct. Term 1877) (“Order was to be preserved, police regulations maintained, crime prosecuted, property protected, contracts enforced, marriages celebrated, estates settled, and the transfer and descent of property regulated, precisely as in time of peace. No one, … seriously questions the validity of judicial or legislative acts in the insurrectionary States touching these and kindred subjects.”) (quoting Horn v. Lockhart, 84 U.S. (17 Wall.) 570 (1873)).
101 A. B. Moore, One Hundred Years of Reconstruction of the South, 9 J. S. Hist. 153, 157 (1943); James B. Sellers, The Economic Incidence of the Civil War in the South, 14 MISS. VALLEY HIST. REV. 190 (1927). For a recent discussion of the Confederacy’s war financing, see Herschel I. Grossman & Taejoon Han, War Debt, Moral Hazard and the Financing of the Confederacy, 28 J. MONEY, CREDIT & BANKING (1996). These issues became salient again in public memory in the wake of the First World War, when the United States sought repayment of debts incurred during that war. European nations countered that southern states had never paid the obligations owed it. An article in Foreign Affairs suggested that the United States relieve foreign debt up to the amount of the debts owed by southern states from before the Civil War and from the war, too. Charles Howland, Our Repudiated State Debts, FOREIGN AFFAIRS (April 1928); John F. Hume, Responsibility For State Roguery..., 139 NORTH AMERICAN REVIEW 563 (Dec 1884).
102 The term “Reconstruction” refers to the period when southern states were reincorporated into the United States; it runs from 1865 to 1877. Following the “compromise of 1877,” when federal troops were removed from the southern states, southern legislatures frequently repudiated their debts contracted during Reconstruction.
103 That image of Reconstruction as an era of corrupt northern politicians and recently freed slaves defrauding the hard-working white southerners is one of the most important—and most frequently criticized—tropes of American history. That story, popularized by such works as Thomas Dixon’s novel The Clansman, which was made into the movie Birth of A Nation, formed a toxic interpretation of American history, which supported disfranchisement of African Americans. However, that toxic (and incorrect) history should not cause us to forget the precedent for repudiation of what are believed to be
Seven southern states engaged in large-scale repudiation or scaling down of their Reconstruction-era debt:\textsuperscript{104}

<table>
<thead>
<tr>
<th>State</th>
<th>Repudiated</th>
<th>Scaled Down</th>
<th>Accrued Interest On Scaled Debt, Not Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>$3,703,000</td>
<td>$5,185,000</td>
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</tr>
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<td>Arkansas</td>
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<tr>
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<td>$7,746,000</td>
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<td>Louisiana</td>
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<td>$911,000</td>
</tr>
<tr>
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<td>$9,037,000</td>
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<td></td>
</tr>
<tr>
<td>Tennessee</td>
<td>$13,000,000</td>
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In the 1940s, historians sympathetic to Southern interests\textsuperscript{105} assessed the costs and benefits of the Reconstruction era repudiations:

Debt repudiation had both its advantages and disadvantages. It would teach future generations not to attempt another war of disruption and it would free the present generation of a great financial burden—as an instance, Georgia would be relieved of $18,000,000 of her $20,000,000 debt. Yet repudiation set a dangerous example for the future, and it well might weaken a state’s financial credit; and more particularly in this instance it would work a social and economic revolution, by bringing about the destruction of the southern upper classes who held this debt.\textsuperscript{106}

On balance, however, many historians concluded that the repudiations were justified because of the fraud and bribery involved in the authorization of the bonds and the impositions of taxes that were required to discharge such debts.\textsuperscript{107}


\textsuperscript{104} Ratchford, \textit{supra} note 80, at 192 (providing a comprehensive listing of post-war state debts that were repudiated or scaled down, as of 1890).

\textsuperscript{105} Many historians during this era were sympathetic to Southern interests. E. Merton Coulter described the period, for example, as the “Blackout of Honest Government.” E. MERTON COULTER, \textit{The South During Reconstruction}, 1865-1877 139 (1947).

\textsuperscript{106} COULTER, The Confederacy, \textit{supra} note 105, at 34-35.

\textsuperscript{107} COULTER, \textit{supra} note 105, at 379 (citing McGrane, 290-91, 296, 303-22, 344-81); Ratchford, \textit{supra} note 80, at 193-95.
officials were of the same caliber. Those in control were out to loot and plunder. The credit of the states was the vehicle whereby much of the stealing was accomplished. As soon as Congress readmitted the states the military authorities relinquished their powers, and these bands of thieves were free to plunder.108

* * *

When the Democrats had succeeded, slowly and painfully, in wresting control from the carpetbaggers, they proceeded to make good their warnings that the Reconstruction debts would not be paid. In several instances they went farther and scaled down the debt incurred before Reconstruction.109

Viewed through the lens of the times, the post-Reconstruction repudiations by Southern states were paradigmatic odious debt cases. According to the governments that urged repudiation, these were the debts of prior illegitimate governments. Once these usurpers were overthrown, the successor governments refused to repay the debts that the despots had incurred in the name of the state.

It is more than obvious that the claims of the post-Reconstruction governments sound laughable today—particularly, the claims that the Reconstruction governments were illegitimate because they were run by “negroes and carpetbaggers.” At the time though, these views represented a majority view of the white people in control in the states that repudiated their debts. This further illustrates the difficulty in making moral judgments about the despotic nature of a prior government. Such judgments are also fluid; what appears to one set of voters and judges as a legitimate government is in a short period seen as despotic. Years later history may, again, reverse its judgment.

As a consequence of state debt repudiations, the Supreme Court heard several cases arising from mandamus actions to compel municipalities to abide by their contracts. In 1881, for example, the United States Supreme Court compelled the city of New Orleans to levy $650,000 in annual taxes to pay bonds issued under an 1873 act.110 Justice Field, writing for the court, warned of the “leprosy of repudiation.” That case, *Louisiana v. Pillsbury* reaffirmed the usual doctrine that local governments must abide their

109 RATCHFORD, *supra* note 80, at 183.

obligations, even though there was Louisiana legislation that prohibited New Orleans from levying a tax to pay those obligations.

The Supreme Court also heard three cases arising from North Carolina’s repudiation of debts. In *South Dakota v. North Carolina*, the state of South Dakota successfully sued North Carolina for repayment of some of its Reconstruction era bonds. South Dakota’s success in court prompted North Carolina to settle with individuals for a fraction of the value of the bonds. As with *Pillsbury*, the North Carolina suits illustrate the continuing attempts to collect on repudiated debts and the ways that states tried to avoid those debts, with significant, but not complete, success. None of those cases robustly test Sacks’ formulation—or that of other odious debt doctrines—because they deal with the legal defenses available to states and municipalities that sought to repudiate their debts. However, the cases draw boundaries around the limits of the repudiations permitted under the United States Constitution. In all of these cases, the Court was reluctant to rule that the Reconstruction debts are legally problematic or odious on the basis of moral judgments about the despotic nature of the governments that had issued those loans.

Conclusion

The goal of this Article was to explore in more depth the two examples of state practice that are most frequently cited as support for the odious debts doctrine, and to suggest additional historical events that might yield support for the doctrine.

Our basic findings are straightforward. First, there is little or no support in U.S. history for the first step in Sack’s three-part doctrine—the requirement that the debt-contracting regime be despotic. Neither the U.S-Spain treaty negotiations, nor the *Tinoco* arbitration support this element. Further, the Supreme Court cases construing the Fourteenth Amendment show that even the rebelling states were capable of incurring legitimate debt. Viewed in the modern context, these states would surely be branded despotic or

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illegitimate because of their proslavery stance; still, the debts they incurred for basic governance were valid, despite the terms of the Fourteenth Amendment. Put simply, U.S. state practice shows that bad regimes can incur good debts.

Second, there is support for the second step in Sack’s doctrine—a hindsight-based substantive analysis of whether the debts in question have been used to benefit the populace.\footnote{Whether this requirement is normatively sensible is outside the scope of this article.} In its negotiations with Spain, the U.S. argued that the so-called Cuban debt had evidently not been used for the benefit of Cuba. Similarly, the Supreme Court in \textit{Texas v. White} and \textit{Keith v. Clark} suggested that an ex post analysis of the purpose and use of state debts would determine whether they were repudiated by the Fourteenth Amendment.\footnote{In 1938, we find another instance of the U.S. arguing that the uses to which a loan is being put are what is relevant in determining whether successor regimes have to repay. Where the uses of the loan are those that benefit the populace, they have to be repaid. In the aftermath of the German invasion of Austria, and the German refusal to pay U.S. held loans that had been made to Austria, the U.S. argued that these loans should be paid because “[t]he loan[s] . . . w[as] made in time of peace, for constructive works and the relief of human suffering.” Hoeflich, \textit{supra} note 7 at 63 (quoting Hacksworth, \textit{Effects of Change of Sovereignty} 1 DIG INT’L 1, 545 (1940)).}

Third, there is support for the third part of Sack’s test—the requirement of creditor awareness or collusion. For Taft in the \textit{Tinoco Arbitration}, the key question regarding the money owed the Royal Bank of Canada was whether the creditor knew or should have known that Tinoco was borrowing the funds for personal purposes, and if so, the debts were personal to Tinoco and not the obligations of Costa Rica. Similarly, the United States rejected Spain’s formalist argument that the Cuban bonds were Cuban because secured by Cuban revenue streams; instead, the United States argued that the proceeds of the loans had actually been absorbed into Spain’s budget and were properly considered Spanish debt. In a fashion similar to the corporate law doctrine of veil piercing, the United States has been willing to strip away the fiction of state borrowing when it appears that the fiction has been abused by either the ruler or the creditors.
By the standards of historians, this Article represents a minimal inquiry: it relied almost entirely on secondary sources, which were assembled to address questions different from the ones asked here. This inquiry has yielded indications of a doctrine different than Sack’s that, as a legal matter, would be easier to prove than the version being pushed by many contemporary advocates of the doctrine (easier to prove because it does not require a declaration that a regime is despotic). Given the foregoing, it is curious why those in the modern odious debts movement continue to push for the first element in Sack’s doctrine—especially since this particular element is extremely difficult to prove (as shown in the Tinoco example).

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

If advocates hope to win in a court of law, however, they are well advised to consider some of the alternative paths to the rejection of sovereign debt. This cursory exploration of U.S. domestic debt repudiation suggests that history is rich with examples that could be mined to develop a new doctrine, one that is potentially broader and more flexible than the one written by Sack. It is worthwhile for advocates to explore this history, not only to expand the doctrine and potentially expand its applications and usefulness, but also to show that its application has not been rare in history. In a world where what was done yesterday implicates what a court will do today, the multiple episodes of repudiation of sovereign debt in U.S. history offer some counsel for the future.\(^{115}\)

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\(^{115}\) A similar point about the numerous instances of state repudiations of debt in U.S. and U.K. history has been made by Hoeflich, supra note 7. However, Hoeflich’s interpretation of these instances of repudiation is more cynical than ours. He suggests that there may be no real doctrine there, just countries acting in their self interest. \textit{Id.} at 69-70.