# 4

# The Enforceability of Odious Debts in Domestic Law

The vast majority of private lending to foreign sovereigns has since the early 1990s been offered through sovereign bonds. As of 2009, the law governing these sovereign bonds in respect of forty-two emerging market nations is approximately 70 per cent governed by the law of New York, 22 per cent by that of England, and 8 per cent by the laws of Germany and Japan in equal shares, respectively.[1] Therefore debts that might be regarded as 'odious' in international law are nevertheless subject to enforcement (or at any rate litigation) in national courts applying domestic private law. There is however a gap in thinking on this matter – creditors have enjoyed the tools of private law without much reflection on the applicability of public law norms, or even of public policy in private law, to the kind of sovereign lending discussed in chapter 3. Even the outstanding discussions of how private law concepts might handle at least some odious debts (notably corruption debts in the typology offered in this book) tend to treat international law as irrelevant. The present chapter demonstrates how international norms, and how international public law in particular, relates to the enforcement of such debts in the domestic law of the two most important jurisdictions whose law and courts are often regarded as hospitable for creditors – New York and England.[2]

The authorities considered in this part suggest that these two jurisdictions recognise an established legal framework for finding that at least an important part of such debts would be unenforceable. In both jurisdictions, and in most mature legal systems, it is a general principle of law that a contract that aims to further an illegal purpose (one contrary to

[1] US Das, MG Papaiaonnou and C Trebesch, 'Restructuring Sovereign Debt: Lessons from Recent History', IMF Research Department Conference Paper, 14 September 2012 <www.imf.org/external/np/seminars/eng/2012/fincrises/pdf/ch19.pdf>, accessed 22 July 2015, 41 (of a total of 641 outstanding bond issues in 42 emerging market and developing states, based on IMF estimates).

[2] The law of Germany is also considered briefly below.

public policy) is not enforceable at the behest of a party who was aware of that fact. Just as bribery can taint an otherwise unobjectionable contract with illegality, an otherwise unobjectionable loan can be tainted by the unlawful purpose it is knowingly provided to further. This principle has important implications for war debts and subjugation debts.

## I. 'Public Policy' and International Law

It is necessary to answer two important preliminary questions prior to inquiring more deeply into which private law principles might render an odious loan unenforceable. The first is about the relationship between international law and domestic public policy, and the second is about the permissibility of national courts scrutinising foreign sovereign conduct in the way that a claim relating to a subjugation debt might require.

### A. *Three Types of 'Public Policy'*

One finds in domestic and international commercial law (including the law of arbitration) that there are three distinct legal concepts that contain the idea or rules of public policy.[3] First, there is public policy of the law of the forum state, what in French law is called *ordre public interne*, and what I shall for ease refer to as *domestic public policy*. This law is the public policy that, for example, an English court applies to transactions within England and Wales. It would also apply to any transaction that chooses English law as the law applicable to the transaction. The content of public policy will vary according to the respective state's laws, whether French, New York, English and so on.

Second, there is the private international law concept of *international public policy* (in French, *ordre public international*).[4] This public policy is not 'international' in the sense of having one substantive content that is universally applicable. Rather, it is 'international' in the sense of being one particular state's public policy towards foreign judgments and laws when these are sought to be enforced in its own courts. So the 'international public policy' of France and the United Kingdom may differ,

[3] M Gebauer, 'Ordre Public (Public Policy)' in R Wolfrum (ed.), *The Max Planck Encyclopedia of Public International Law* (Oxford: Oxford University Press, 2013) <www.mpepil.com>, accessed 22 July 2015.

[4] Ibid. See the related though distinct notion of 'mandatory rules' in GA Bermann, 'Introduction: Mandatory Rules in International Arbitration' (2007) 18 *Am Rev Int'l Arb* 1. I would thank Alex Mills for explaining the difference.

depending on how their courts respectively treat foreign judgments, arbitral awards and laws. This type of international public policy is construed much more narrowly than the domestic public policy.[5] It is typically narrower due to the need to show comity towards foreign courts and laws, and to discourage 'forum shopping' by defendants seeking to evade legal responsibility. While a state can be cavalier about the content of its own domestic public policy, its international public policy is determined by considerations of reciprocity and comity in its international relations.[6]

A third type of public policy is *transnational public policy*. It is that set of rules that 'involve the identification of principles that are commonly recognized by political and legal systems around the world'[7] or 'an international consensus as to universal standards and accepted norms of conduct that must be applied in all fora'.[8] It was developed mostly by international arbitration tribunals that have been required to apply applicable international law to commercial disputes.[9] It is effectively the international law counterpart of the domestic public policy of any given state. Although this concept of public policy plays an important role in international arbitration, borrowing universally recognised principles of public policy, it is *ex hypothesi* true that flagrant breaches of public international law and of *jus cogens* norms are contrary to transnational public policy. The link has been drawn effectively by a number of writers,[10] and needs no further elaboration in this book.

[5] Gebauer, 'Ordre Public', [6] and [22]; *World Duty Free Company Ltd v The Republic of Kenya* (ICSID Case No ARB/00/7) Award, 4 October 2006 [138].

[6] This much is evident upon a perusal of any work on private international law, but one can start with the collection of essays in (2007) 18 *Am Rev Int'l Arb* 1.

[7] M Hunter and GCE Silva, 'Transnational Public Policy and Its Application in Investment Arbitrations' (2003) 4 *Journal of World Investment* 367, 367.

[8] *World Duty Free*, [139].

[9] See Bermann, (2007) 18 *Am Rev Int'l Arb* 1, 4–5, 15–16.

[10] See especially A Orakhelashvili, *Peremptory Norms in International Law* (Oxford: Oxford University Press, 2008), pp. 10–11. '[P]eremptory norms operate as a public order protecting the legal system from incompatible laws, acts and transactions. As with every legal system, international law can be vulnerable to infiltration of the effect of certain norms and transactions which are fundamentally repugnant to it. It seems that the general concept of public order most suitably reflects the basic characteristics of international *jus cogens*. This concept not only reflects the domestic law analogy, but it is the most suitable, if not the only, analogy that can be adapted, without the disruption of the inherent character of the concept itself, to the decentralized character of the international legal system.' See also J Crawford, *Brownlie's Principles of Public International Law*, 8th edition (Oxford: Oxford University Press, 2012), ch. 27; S Michalowski, *Unconstitutional Regimes and the Validity of Sovereign Debt: A Legal Perspective* (Hampshire: Ashgate, 2007), p. 72 (and references at n 20).

The remainder of this part will focus chiefly on the other two forms of public policy. A transaction that may be challenged as an odious debt will normally have the law of a forum state applied to it, and it will be the public policy of that forum state that will provide the entrée for considerations relating to the loan's purpose, foreign sovereign's conduct, and applicable norms of international law. Nevertheless, the second form (international public policy), despite having the narrowest substantive content, is strikingly instructive for it is there that the most relevant case law is to be found.

## *B. Domestic Public Policy*

### 1. Illegal contracts in English and American law

In English law, a contract to commit a crime or a tort is a violation of public policy and is therefore unenforceable.[11] Crimes may include things such as violating exchange control legislation, or perpetrating fraud; and torts might include libel and possibly a contract to break another contract.[12] As I show in greater detail below, it is also contrary to public policy to enforce a contract whose aim was to further an illegal purpose when that illegal purpose is known to the party seeking enforcement. The difference between these two types of illegal contracts can be illustrated with the following example. A contract to bribe or kill someone is a contract whose very consideration is the performance of an illegal act. A contract to provide funds or weapons that will be subsequently and knowingly used to bribe or kill someone is a contract with an illegal

[11] See H Beale, *Chitty on Contracts*, 31st edition, 2 vols (London: Sweet & Maxwell, 2012), vol. I, ch. 16, esp. [16–003]. A Buckley, *Illegality and Public Policy*, 3rd edition (London: Sweet & Maxwell, 2013). It is notable that in the case of *Les Laboratoires Servier and Another v Apotex Inc and Others* [2014] UKSC 55; [2015] AC 430, Lord Sumption held (for the majority on this point) that the illegality defence is available in respect of acts of 'turpitude' which are either 'criminal' or 'quasi-criminal' and not for torts and breaches of contract, as well as statutory or civil wrongs, concerned with interests that are 'essentially private and not public'. However, his holding contradicted without explanation a recent previous decision of the Supreme Court in *Hounga v Allen (Anti-Slavery International intervening)* [2014] UKSC 47; [2014] 1 WLR 2889, despite it being the subject of a strong dissent in *Apotex*. The holding in the case and its significance for private law have been left open, as confirmed in the case of *Bilta (UK) Ltd (in liquidation) and Others v Nazir and Others* (No 2) [2015] UKSC 23, [2015] 2 W.L.R. 1168 at [15] (Lord Neuberger), [34] (Lord Mance). It is clear that the United Kingdom would part ways with the United States and other European nations were its Supreme Court ultimately to accept the entireity of Lord Sumption's reasoning.

[12] Examples are given in Beale, *Chitty on Contracts*, vol. I, [16–003].

purpose, but whose direct performance does not involve the performance of an illegal act.

The legal effect of illegal transactions was stated in 1775 in the case of *Holman v Johnson* by Lord Mansfield:

> The principle of public policy is this: *ex dolo malo non oritur actio*. No court will lend its aid to a man who founds his cause of action upon an immoral or illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the court says he has no right to be assisted. It is upon that ground the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and the defendant were to change sides, and the defendant were to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally at fault, *potior est conditio defendentis*.[13]

These Latin maxims are still used on occasion in the description of what is the now very settled legal position that illegal or immoral transactions are unenforceable in English law. 'Illegality' in this context embraces both statutory and criminal forms of illegality as well as those acts regarded as contrary to public policy. The learned English treatise *Chitty on Contracts* provides a basic illustrative list of the types of contracts that are contrary to public policy: those which are illegal by common law or legislation; those injurious to good government in the field of domestic or international affairs; those which interfere with the proper working of the machinery of justice; and those objects economically against the public interest.[14] These are illustrative only, and despite the notorious description of the legal concept of public policy as being 'an unruly horse', *Chitty* explains that '[t]here is a general agreement that the courts may extend existing public policy to new situations.'[15] It is established, for instance, that a contract is illegal and unenforceable if its performance would involve the doing of an act that violates the law of a foreign country which is friendly with the United Kingdom.[16]

The basic position is the same in most American states. An agreement to commit a crime, violate legislation (including constitutions and ordinances), or induce the commission of a tort, is against public policy and thus unenforceable.[17] Ordinarily, the contract that is found to be illegal is

[13] *Holman v Johnson* (1775) 1 Cowp 341, 343.
[14] Beale, *Chitty on Contracts*, vol. I, [16–005].
[15] Ibid., [16–003], [16–004].
[16] *Regazzoni v KC Sethia (1944) Ltd* [1958] AC 301 (HL).
[17] *Restatement (2nd) on the Law of Contract* (St. Paul, MN: American Law Institute, 1981), §§178, 192 (torts).

itself a contract to commit a crime or tort. In the United States too, it is recognised that a contract whose performance or object is the violation of the law of a foreign country, but not of American law, is nonetheless contrary to the US or state public policy.[18]

In both jurisdictions, the content of public policy is largely determined by local laws, regulatory, criminal and civil, as well as constitutional law where relevant. However, in a transaction applying the law of these jurisdictions to the foreign behaviour, the role for local norms is less clear. It is thus helpful to consider the attitude of these two fora when foreign official behaviour is brought into question in local courts.

## 2. Odious debts, international law and domestic public policy

Can odious debts be considered to be violations of the public policy of the contract law of England or the United States? Upon closer inspection, and using different terminology, the claim is more compelling than it initially appears. First, it has been clearly established that trading with the enemy[19] (analogous to war debts) and procuring contracts through bribing public officials[20] (corruption debts) are both contrary to public policy in both countries. Illegal occupation debts are unlikely to be the subject of litigation in national courts, and would anyway be dealt with by the rules relating to state succession (which tend to deny relief). The quite trying question is whether subjugation debts could plausibly be considered to be against public policy. It will help to recall the high threshold for such debts that was set out above: violations of *jus cogens* norms, and serious or flagrant breaches of human rights, humanitarian law, or other fundamental international law principles in respect of the population of the debtor state. There are strong doctrinal reasons for the conclusion

[18] *International Aircraft Sales, Inc v Betancourt*, 582 SW2d 632, 635 (Tex Civ App Corpus Christi 1979) (citing Williston on Contracts, Restatement of Contracts).

[19] Beale, *Chitty on Contracts*, vol. I, 16–026; and *Montgomery v United States*, 82 US 395 (1871). Notably, it is common for trading with the enemy legislation to proscribe such matters in the United Kingdom. However, the common law furnished the rule well before such legislation: *Esposito v Bowden* (1857) 7 E. & B. 763, 792 (per Willes J), ('It is now fully established that, the presumed object of war being as much to cripple the enemy's commerce as to capture his property, a declaration of war imports a prohibition of commercial intercourse and correspondence with the inhabitants of the enemy's country, and that such intercourse, except with the licence of the Crown, is illegal.'). In *Horlock v Beal* [1916] 1 AC 486, 507 Lord Shaw held that this proposition 'has never since been doubted'.

[20] See *World Duty Free*. For a helpful discussion of the American authorities, see LC Buchheit, GM Gulati and RB Thompson, 'The Dilemma of Odious Debts' (2007) 56 *Duke LJ* 1202, 1232–1235.

that such contracts are not enforceable in New York or English law. First, as shown in chapter 2, section I, customary international law is appropriately applied as part of the common law of both England and the United States. Cases involving the conduct of foreign sovereigns or their agents or nationals are particularly apt occasions for doing so. Second, it is a mild claim that international law can at the very least provide interpretive guidance to the domestic notion of public policy, particularly where domestic law is applied to foreign transactions or implicates foreign sovereign behaviour. While the logic of this position is clear, we can press on to explore case law, typically within private international law or the law of conflicts, which makes it more compelling still.

### C. *International Public Policy*

#### 1. English law[21]

The act of state doctrine ordinarily forbids English judges from inquiring into the sovereign acts of foreign states pertaining to matters within their own jurisdiction.[22] Yet English law generally recognises two exceptions to the doctrine. The first was found in the English House of Lords case of *Oppenheimer v Cattermole (Inspector of Taxes)*.[23] It concerned a Jewish refugee who emigrated to the United Kingdom in 1939 and was later denied special tax relief by the English revenue authorities. He would have been entitled to that relief had he kept his German citizenship, but he lost it under a Nazi decree of 1941 that stripped Jewish Germans who left the country of their citizenship. The House of Lords found that it 'was it is part of the public policy of this country that our courts should give effect to clearly established rules of international law'.[24] It held that the German law represented 'so grave an infringement of human rights that the courts of this country ought to refuse to recognize it as a law at all'.[25] This rule was viewed as an element of English public policy.[26] The human rights exception

[21] For an excellent discussion of the English cases, see A Mills, 'The Dimensions of Public Policy in Private International Law' (2008) 2 *Journal of Private International Law* 201, and for a comparative perspective, see his *The Confluence of Public and Private International Law: Justice, Pluralism and Subsidiarity in the International Constitutional Ordering of Private Law* (Cambridge: Cambridge University Press, 2009).

[22] See section D below for a discussion. [23] [1976] AC 249 (HL).

[24] Ibid., p. 278 (Lord Cross). [25] Ibid.

[26] Ibid., p. 278 (Lord Cross) and 282 (Lord Salmon).

announced in *Oppenheimer* is fact an elaboration of principles also found in earlier important cases in private international law.[27]

For a considerable time, this exception to non-justiciability and the act of state doctrine was limited. Only grave infringements of fundamental rights would be considered. However, in *Kuwait Airways Corp v Iraqi Airways Co (No.6)*,[28] the question arose as to whether it would be contrary to public policy to give effect to a law that was a clear breach of fundamental norms of international law. The case was complex, but it essentially concerned whether a decree (Resolution 319) by the government of Iraq would be recognised as transferring legal ownership of aircrafts seized from the state of Kuwait during Iraq's invasion of Kuwait in 1991. Kuwaiti Airways sued in English courts for the tort of conversion to obtain compensation for what it argued was theft. If the decree were found to be good law, it would be a defence against the claim for conversion for it would have rendered the taking lawful.

Counsel for Iraqi Airways argued that the exception found in *Oppenheimer* should not be expanded and, further, that the acts complained of were non-justiciable subject matter for English courts. The House of Lords rejected both arguments and rather found that it would be contrary to English public policy for courts to give effect to a law that constituted a serious or flagrant breach of international law. Lord Nicholls found authority for the claim that 'conceptions of public policy should move with the times' and that '[a]s nations become ever more interdependent, the need to recognise and adhere to standards of conduct set by international law becomes ever more important'.[29] Lord Steyn found that his conclusions on the content of English public policy:

> [did] not reflect an insular approach. [. . .] In recent years, particularly as a result of French scholarship, principles of international public policy (*l'ordre public véritablement international*) have been developed in relation to subjects such as traffic in drugs, traffic in weapons, terrorism, and so forth [. . .] The public policy condemning Iraq's flagrant breaches of

[27] *Somerset v Stewart* (1772) 20 State Trials 1 (contrary to the public policy of England to enforce a Virginia slaveholder's title under Virginia law to a slave who had escaped in England); *Saxby v Fulton* [1909] 2 KB 208, 232 (gambling debt concluded in and relating to Monte Carlo enforceable in English courts, and distinct from 'cases in which an element is present which may be summarized as something contrary to the morality of civilized nations, as we understand it'). I am indebted to Mills, 'Dimensions of Public Policy', 220, 228, for these examples and his analysis of them.

[28] [2002] UKHL 19; [2002] 2 AC 883; [2002] 2 WLR 1353. [29] Ibid. [28].

> public international law is yet another illustration of such a truly international public policy in action.[30]

Lord Hope stated the rule and its continuity with *Oppenheimer*, succinctly:

> If the court may have regard to grave infringements of human rights law on grounds of public policy, it ought not to decline to take account of the principles of international law when the act amounts – as I would hold that it clearly does in this case – to a flagrant breach of these principles.[31]

Lord Hope also made clear the relevance of international law to domestic public policy: '[i]t is not disputed that our courts are entitled on grounds of public policy to decline to give effect to clearly established breaches of international law when considering rights in or to property which is located in England.'[32] This finding supports the view that a contract that chooses English law will have an international law-coloured public policy applied to it when it is appropriate to do so. Indeed, the judgment of the Court of Appeal, affirmed and praised by the House of Lords, held just that: '[b]ut there is, at any rate in the abstract, every reason to think that in most cases English public policy will be at one with, *and will be illuminated by*, clearly established principles of international law'.[33] This echoes a finding made by the House of Lords in the 1958 case of *Regazzoni v K.C. Sethia* 1944 *(Ltd)*.[34], where the court held that a contract that could not be performed without violating the laws of a friendly nation would violate English public policy. Lord Keith found that the issue was not about applying international law to the contract. Rather, '[t]he real question is one of public policy in English law: but in considering this question we must have in mind the background of international law and international relationships often referred to as the comity of nations.'[35] That dictum could hardly have lost any authority since 1958.

### 2. American law

The American authorities are nowhere near as clear on this point, though at various points in the *Kuwait Airways* case the House of Lords claimed

[30] Ibid. [115]. See also the comments of Lord Hope at [145].
[31] Ibid. [149]. See also his comments at [139]: 'But Lord Cross based that conclusion on a wider point of principle. This too is founded upon the public policy of this country. It is that our courts should give effect to clearly established principles of international law.'
[32] Ibid. [144].
[33] Ibid. [323] [emphasis added] of the Court of Appeal decision, reproduced in the same law report.
[34] (1958) AC 301. [35] Ibid., at 323.

to find some harmony with if not inspiration from the American approach. Lord Steyn cited the Restatement (3rd) on the Law of Foreign Relations as authority for the view that violations of fundamental human rights were contrary to international public policy.[36] And Lord Nicholls invoked Judge Cardozo's oft-quoted statement that a court would exclude a foreign law or judgment only when it 'would violate some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal'.[37] The Court of Appeal in the *Iraqi Airways* case found that the American authorities were consistent with *Oppenheimer v Cattermole* in recognising limitations to the act of state doctrine.[38]

The US Supreme Court does clearly recognise certain limits on the recognition of foreign judgments and laws. It has held that courts may not recognise the judgment of a foreign nation (as opposed to another US state) unless:

> there has been opportunity for a full and fair trial abroad before a court of competent jurisdiction, conducting the trial upon regular proceedings, after due citation or voluntary appearance of the defendant, and under a system of jurisprudence likely to secure an impartial administration of justice between the citizens of its own country and those of other countries, and there is nothing to show either prejudice in the court, or in the system of laws under which it is sitting, or fraud in procuring the judgment.[39]

Also important, though legislative in nature, is the Second Hickenlooper Amendment (1964), Congress's response to the *Sabbatinno* case (discussed below) which upheld the act of state doctrine against American citizens seeking compensation for expropriation in Cuba and Argentina. The amendment among other things directs US courts not to apply the act of state doctrine to cases of 'any party' concerning expropriation of their property by foreign states, unless explicitly asked to do so by the executive branch of government.[40] The provision requires the court, when asked, to make a determination of the lawfulness of the foreign state's expropriation under international law.

[36] Note 28 above [115] (citing *Restatement (3rd) Foreign Relations Law* (St. Paul, MN: American Law Institute, 1987) §701).
[37] *Loucks v Standard Oil Co of New York* (1918) 120 NE 198, 202 (cited by Lord Nicholls, *Kuwait Airways*, [17]).
[38] *Kuwait Airways*, [307].
[39] *Hilton v Guyot*, 150 US 113, 202 (1895).
[40] 22 U.S.C. § 2370(e)(2)

Thus, American courts are prepared both to judge the adequacy of proceedings in foreign courts, and to make findings in highly contested cases of expropriation and compensation under international law. Further, American courts, like their British counterparts, are not generally required to enforce foreign tax and penal judgments.[41] There is, however, no analogue to the *Kuwait Airways* case. In the abstract, then, the question may be asked: would an American court apply a law or judgment that was enacted or handed down in clear breach of *jus cogens* or cognate norms? It is hard to see that it would, given the much greater willingness of American courts to question foreign sovereign acts under the Alien Tort Statute litigation.[42] It is more likely that the issue has not arisen squarely for consideration. The Reporter's Note in the Restatement (3rd) on the Law of Foreign Relations claims, for example, without any authority cited, that '[a] judgment in implementation of racial laws would be denied recognition or enforcement in the United States and would probably be denied recognition for any purpose.'[43] Perhaps the strength of the argument is clear enough to the author to not require authority. At any rate, a US court faced with giving effect to a foreign law or executive act that in point of fact carried out clear and grave violations of fundamental human rights or other public international law norms would likely be legally required to consider those same acts, due to their grave moral turpitude, to be contrary to the public policy of the state or federal jurisdiction in which the case is taken. Such conduct would violate a plethora of criminal laws as well as the federal and state constitutions. A contract that seeks to apply New York law, it would seem, must either import New York's criminal or public law, or accept the relevance of public international law and transnational public policy as an appropriate public policy standard.

### 3. Other European jurisdictions

The role for public international law in shaping public policy is evident in the private international law prevailing in European nations more generally. A good weather vane on the issue is found in the policy adopted by the members of the Economic Community towards one another's judgments and laws, formalised in the Brussels Convention on Jurisdiction

[41] *Restatement (2nd) Conflicts of Laws*, 3 vols. (St. Paul, MN: American Law Institute, 1971), vol. I, §89; L Collins and others, *Dicey, Morris, and Collins on the Conflict of Laws*, 15th edition (London: Stevens, 2012), 5–020.

[42] See section II below.

[43] *Restatement (3rd) Foreign Relations Law*, §482, Reporter's Note 1.

and the Enforcement of Judgments in Civil and Commercial Matters 1968. In the *Bamberski v Krombach* decision,[44] the European Court of Justice (ECJ) held that the public policy exception contained in the Brussels Convention ought to be construed so as to give effect to fundamental rights as defined in international law. The case concerned a French citizen who had brought legal proceedings in France against a doctor located in Germany, for both civil and criminally negligent treatment. The court refused to allow the doctor to be represented by counsel unless he was himself present, pursuant to the French Code of Criminal Procedure. The plaintiff obtained civil judgment in his absence and sought to enforce it against the defendant doctor in Germany. An issue in the German courts was whether depriving the doctor of the right to legal representation was a violation of Article 6 of the European Convention on Human Rights, and if so, whether the public policy provision in the Brussels Convention should be interpreted by reference to international human rights law. The German court referred the issue to the ECJ, which held as follows:[45]

> The court has consistently held that fundamental rights form an integral part of the general principles of law whose observance the court ensures: [. . .]. For that purpose, the court draws inspiration from the constitutional traditions common to the member states and from the guidelines supplied by international treaties for the protection of human rights on which the member states have collaborated or of which they are signatories. In that regard, the European Convention for the Protection of Human Rights and Fundamental Freedoms has particular significance.

The same general position holds in the interpretation of international public policy in Germany[46] and in France.[47] Gebauer confirms that this is the general view prevailing in Europe, and of the concept of *ordre public*/international public policy more generally: '[I]f the application of a foreign law [or decision] . . . would violate public international law, a national court will rely on public policy to avoid such a result.'[48]

[44] C-7/98, *Bamberski v Krombach* [2000] ECR I-1935, [2001] QB 709 (ECJ).
[45] Ibid., pp. 728–729 [citations omitted]. See also the court's comments at 730 and the observations of Gebauer, 'Ordre Public', [6]–[7], [20]–[21].
[46] *Spanier-Beschluss* (1971) BVerGE 31, 58 (Federal Constitutional Court).
[47] Judgment 1184, Cass Soc, 10 Mai 2006, Bulletin du droit du travail (2 trimestre 2006) (Court of Cassation) No. 554, 67 (finding, in a case in which a Nigerian contract for employment in the United Kingdom amounted to virtual enslavement, that international conventions are directly related to the defining of French *ordre public international* as well as *transnational public policy*).
[48] Gebauer, 'Ordre Public', [22].

### D. *Foreign Sovereigns in Domestic Courts: Act of State and Cognate Doctrines*

In both English and US law, judges show considerable restraint in scrutinising the conduct of foreign sovereigns taken within their own jurisdictions. The 'act of state doctrine' is a feature of both legal orders.[49] The US Supreme Court expressed this doctrine in *Underhill v Hernandez* (1897) in a statement later adopted by the English courts: 'Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory.'[50] In this original formulation, the doctrine respects international comity and the sovereign equality of states in international law. It often barred claims by disgruntled creditors or property-holders who sought relief against revolutionary governments in US or British courts. As the concept evolved over the twentieth century in both countries, it grew not only to overlap with concerns of justiciability and the separation of powers, but also to recognise certain exceptions.

In English law, 'the normal rule' forbidding the scrutiny of acts of state 'is subject to an exception on grounds of public policy'.[51] As noted above, this exception was recognised in *Oppenheimer v Cattermole* for violations of fundamental human rights, and expanded in *Kuwait Airways* for flagrant breaches of international law. In considering whether either of these exceptions apply in a particular case, however, the court will have regard to whether the claim nonetheless raises a non-justiciable issue. Courts have regard to the guidance provided in the judgment of Lord Wilberforce in *Buttes Gas and Oil Co v Hammer (Nos 2 and 3)*, where he held that the act of state doctrine was an expression of the underlying idea that courts should refrain from adjudicating

[49] M Singer, 'The Act of State Doctrine of the United Kingdom: An Analysis, with Comparisons to United States Practice' (1981) 75 *AJIL* 283; M Alderton, 'The Act of State Doctrine: Questions of Validity and Abstension from Underhill to Habib' (2013) 12 *Melbourne J of Int'l L* 1. The act of state doctrine as applied to foreign sovereigns is principally an Anglo-American doctrine: see F de Quadros and JH Dingfelder Stone 'Act of State Doctrine' in R Wolfrum (ed.), *The Max Planck Encyclopedia of Public International Law* (Oxford: Oxford University Press, 2013) <www.mpepil.com>, accessed 22 July 2015.

[50] *Underhill v Hernandez*, 168 US 250, 252 (1897); *Banco Nacional de Cuba v Sabbatino*, 376 US 398 (1964); *Kirkpatrick & Co v Evtl Tectonics*, 493 US 400 (1990). The ruling in *Underhill* was quoted with approval by the English Court of Appeal in *Luther v Sagor* [1921] 3 KB 532, 548.

[51] *Kuwait Airways*, [137].

non-justiciable issues, in particular those where there were 'no judicial or manageable standards by which to judge the issues'.[52] However, the extraordinary nature of the litigation was clearly pertinent to the Lord Wilberforce's finding. He recognised that to adjudicate the claims in *Buttes Gas*, the court would be asked to review transactions in which four sovereign states were involved, which they had brought to a precarious settlement, after diplomacy and the use of force, and to say that at least part of these were 'unlawful' under international law.[53] Indeed, as the leading English treatise on the conflict of laws notes, although the justiciability principle as announced by Lord Wilberforce is 'very wide in potential scope', it has 'only very rarely been applied' to exclude a claim.[54] Rather, the dictum of Lord Hope in *Kuwait Airways* best summarises the judicial attitude towards such claims: '[r]estraint is what is needed, not abstention.'[55]

English judges look to a range of considerations when deciding whether to show such restraint in a particular case.[56] They will chiefly take account of whether they are asked to apply 'judicial or manageable standards by which to judge the issues',[57] whether the holding would 'embarrass' the Crown or the foreign nation,[58] whether the legal issue has a clear connection with domestic law (a 'domestic foothold')[59] and whether the breach of law is particularly clear, or 'not in doubt' or 'plain beyond dispute'.[60] The last criterion requires particular consideration. In *Kuwait Airways*, there was 'universal consensus' on the illegality and UN Security Council resolutions had not only declared the Iraqi invasion and occupation of Kuwait and expropriation of its assets illegal, but

[52] [1982] AC 888 (HL) 938. [53] Ibid.

[54] Collins and others, *Dicey, Morris and Collins*, 5–052. [55] *Kuwait Airways*, [140].

[56] Collins and others, *Dicey, Morris and Collins*, 5–043-5–053; H Fox and P Webb, *The Law of State Immunity*, 3rd edition (Oxford: Oxford University Press, 2013), ch. 3. See especially D McGoldrick, 'The Boundaries of Justiciability' (2010) 59 *Int'l & Comp L Q* 981, esp. 992ff.

[57] *Buttes Gas*, 938; *Kuwait Airways*, [25]–[26] (Lord Nicholls).

[58] McGoldrick, 'The Boundaries of Justiciability', 1006 (also explaining the limited force of this consideration).

[59] *R v Prime Minister of the United Kingdom, ex parte Campaign for Nuclear Disarmament* [2002] EWHC 2777 [35] (Simon-Brown LJ); *Republic of Ecuador v Occidental Exploration and Production Co* [2005] EWCA Civ 1116, [2006] QB 432. McGoldrick, 'The Boundaries of Justiciability', 997–1000; Fox and Webb, *State Immunity*, pp. 65–68.

[60] *Kuwait Airways*, [25] (Lord Nicholls), [140] (Lord Hope). Cf *R (Al Haq) v Secretary of State for Foreign & Commonwealth Affairs* [2009] EWHC 1910 (Admin) (finding the question of whether Israel's actions in the Palestinian Occupied Territories in Operation Cast Lead (2008/2009) violated international law to be non-justiciable); McGoldrick, 'The Boundaries of Justiciability', 995–996.

called upon all states not to recognise its consequences.[61] This is presumably what prompted Dominic McGoldrick's observation that the 'exceptional nature' of *Kuwait Airways* 'cannot be over-stressed'.[62] However, it would be wrong to infer from the case that any finding concerning a foreign state's compliance with public international law must cross so high a threshold. In *Ecuador v Occidental Exploration and Production Co*., Lord Mance observed for the Court of Appeal that the issues of international law in that case were 'not likely to be as clear-cut' as they were in *Kuwait Airways*, but were not 'remotely comparable' to the justiciability concerns present in *Buttes Gas*.[63] There are a number of examples where the courts have made findings about public international law when determining private law rights.[64] In *The Republic of Serbia v Images at International NV*, Beatson J even found that whether Serbia was the successor or continuator state of the former State Union of Serbia and Montenegro was a justiciable question for English courts.[65]

The courts will in particular be prepared to consider foreign sovereign action where human rights are in play. In *Abassi*, the Court of Appeal addressed a claim seeking a declaration that the UK Foreign Secretary was under a duty to take positive steps to redress the fact that the British claimant was held by US armed forces in Guantanamo Bay without trial or legal process, 'or at least give a reasoned response to his request for assistance'.[66] Lord Phillips MR, who later became the President of the UK Supreme Court, found for the unanimous court that not only did *Oppenheimer v Cattermole* support the proposition that 'the legitimacy of the action taken by the executive of a foreign state' is justiciable, but so too did the routine practice of asylum law. And to pre-empt any rejoinder emphasising the statutory nature of asylum law, he added: 'this court does not need the statutory context in order to be free to express a view in relation to what it conceives to be a clear breach of international law, particularly in the context of human rights.' He ultimately found the Guantanamo Bay detention without trial to have clearly breached international law as well as the common law of

[61] *Kuwait Airways*, [20]–[23]. [62] McGoldrick, 'The Boundaries of Justiciability', 994.
[63] [2006] QB 432 (CA) [42].
[64] Ibid.; see also *In re AY Bank Ltd* [2006] EWHC 830 (Ch).
[65] [2009] EWHC 2853 (Comm).
[66] *R (Abbasi) v Secretary of State for Foreign and Commonwealth Affairs* [2002] EWCA Civ 1598 [25]. The court reformulated counsel's claim as such.

England and Wales (and by implication that which is recognised by the United States).[67]

How would these considerations apply to a claim that meets the criteria for a subjugation debt as defined in chapter 3 of this book, governed by English law? The question of whether the court applies 'clear and manageable standards' is not in principle a significant issue for either corruption or subjugation debts as defined above. Breaches of *jus cogens* norms, human rights, international crimes and the laws of war are commonly assessed by domestic and international courts and tribunals, and are frequent fare under the Alien Tort Statute in US law. Regarding the embarrassment of the Crown, the fact that the debtor state itself asks the court to recognise the illegal acts of its former government is highly relevant. It is not determinative, since justiciability and the act of state are doctrines of judicial self-restraint, rather than jurisdictional immunities over which a state enjoys the right to waive. However, it may be part of the context that Mance LJ found relevant in the *Ecuador v Occidental Exploration Production and Co* case, where he found it 'not without irony' that Occidental raised the (unsuccessful) non-justiciability claim rather than Ecuador.[68] At the same time, other diplomatic or multilateral efforts to address the state's debt problems (e.g. Paris Club), perhaps with a previous government, may be equally relevant and render the claim non-justiciable if the UK government participated in the negotiations. The 'foothold' or connection to domestic law is patent: it is the application of English law (including English public policy) that is at issue in the transaction. The final question is whether the violations of international law were clear. The law has been outlined above. This is a case-by-case determination, but it is noteworthy at a general level that it is both possible and at the same time rather difficult to prove.

In the United States, the courts have had an active jurisprudence of scrutinising foreign sovereign acts for compliance with international human rights and public international law norms through the Alien Tort Claims Act (also called the Alien Tort Statute, or ATS).[69]

[67] Ibid. [58]–[67]. At [102], however, the court does reject the claim for reasons arguably subsumed under the US political questions doctrine.

[68] *Ecuador v Occidental Exploration and Production Co*, [39]. It was noted at [57] that '[w]e accept that the English principle of non-justiciability cannot, if it applies, be ousted by consent. We are however concerned with issues regarding its proper scope and interpretation in a novel context.'

[69] *Filártiga v Peña-Irala*, 630 F2d 876 (2d Cir. 1980). See B Stephens, 'Translating Filártiga: A Comparative and International Law Analysis of Domestic Remedies for International Human Rights Violations' (2002) 27 *Yale J Int'l L* 1.

Although for various reasons foreign states are rarely if ever defendants, the courts do routinely review official conduct in a matter incompatible with the traditional act of state doctrine.[70] And so defendants in such actions often raise the overlapping defences of the act of state, political questions and international comity doctrines. The leading case for the act of state doctrine remains *Banco Nacional de Cuba v Sabbatino*, reaffirmed in *Kirkpatrick*.[71] Yet certain considerations were identified in *Sabbatino* as policy concerns underlying the doctrine which might counsel against its application in a particular case. These '*Sabbatino* factors' (as they are commonly called) include the following:

> [T]he greater the degree of codification or consensus concerning a particular area of international law, the more appropriate it is for the judiciary to render decisions regarding it. . .. [T]he less important the implications of an issue are for our foreign relations, the weaker the justification for exclusivity in the political branches. The balance of relevant considerations may also be shifted if the government which perpetrated the challenged act of state is no longer in existence.[72]

In many cases under the ATS, both the foreign sovereign and US government are hostile to the claim. There is a stark difference between how these factors militate in such cases and how they might be in the scenario contemplated in this chapter. The first and third of the *Sabbatino* factors, in the subjugation or corruption debt scenario, both counsel against applying the act of state doctrine.[73] Whether the second factor (the importance to US foreign relations) is determinative may

[70] S Michalowski, 'No Complicity Liability for Funding Gross Violations of Human Rights?' (2012) 30 *Berkeley J Int'l L* 451; cf JG Ku, 'The Curious Case of Corporate Liability under the Alien Tort Statute: A Flawed System of Judicial Law Making' (2010) 51 *Va J Int'l L* 353.

[71] *Kirkpatrick & Co v Evtl Tectonics*, 493 US 400 (1990). See generally, *Restatement (3rd) Foreign Relations Law*, §§443, 444.

[72] *Sabbatino*, 376 US at 428. For applications, see *John Doe I v Unocal Corp* 395 F 3d 932 (9th Cir 2002); *Mujica v Occidental Petroleum Corp*, 381 F Supp 2d 1164 (CD Cal 2005); *Sarei v Rio Tinto, PLC*, 221 F Supp 2d 1116 (CD Cal 2002) ("*Sarei I*"); *Sarei v Rio Tinto*, 499 F3d 923 (9th Cir 2007) (vacated, *Sarei v Rio Tinto, PLC*, 671 F3d 736, 748 (9th Cir, 2011) (en banc). The *Sarei* litigation was long and complex. Ultimately, the 2002 judgment of the District Court was affirmed by the Court of Appeals following the US Supreme Court's remanding of the case for decision in accordance with its decision in *Kiobel v Royal Dutch Petroleum*, 549 US 12, 133 S Ct 1659 (2013): see *Sarei v Rio Tinto, PLC*, 722 F3d 1109 (9th Cir. 2013). Several lengthy portions of various decisions were not explicitly reversed, and time will tell whether they will have persuasive force in future case law.

[73] See also the *Restatement (3rd) Foreign Relations Law*, §443 (comment e) (offering an example of where the consent to adjudication of a loan agreement in New York should imply that the act of state doctrine does not apply).

depend on how the judge characterises the foreign relations issue. She may on the one hand focus on whether refusal to enforce the particular debt claim at issue disrupts US foreign relations. It might or might not. And as the Supreme Court held in *Kilpatrick*, the starting presumption is that '[c]ourts in the United States have the power, and ordinarily the obligation, to decide cases and controversies properly presented to them.'[74] Presumably, actions to obtain judgment on contracts choosing New York law so qualify. However, the judge may on the other hand view the issue more generally as being about the judicial power to invalidate loan agreements in such contexts. Here, many have argued that at least the vaguer, older doctrine discussed in much previous literature could destabilise lending and thus be against US foreign relations interests in smooth financial markets,[75] a claim explored and rebutted at length by Odette Lienau.[76] In practice, the courts give great, if not decisive, weight to views of the executive branch on the question of US foreign relations, expressed through 'Bernstein letters' or statements of interest submitted to the court.[77] The potential unfairness of this becoming an executive veto on a legal claim is patent. However, an advantage is that it can allow judges to proceed with hearing such claims confident in the knowledge that the executive retains the authority to take a different view of its foreign relations interests in a future case, and thus keep the floodgates shut. At any rate, quite apart from the *Sabbatino* factors, there is also jurisprudence finding the act of state doctrine to be inapplicable to grave violations of human rights and the laws of war.[78] The Second Circuit Court of Appeals, for example, has found that 'it would be a rare case in

[74] *Kirkpatrick & Co v Evtl Tectonics*, 409.

[75] For recent such statements, see E D'Angelo, 'Greece and the Odious Debt Doctrine' (2013) 78 *Brook L Rev* 1619 (Greece should not apply the doctrine for fear of upheaval); R Olivares-Caminal, 'Odious Debt: Odious Concept?' (2008) 8 *J of Int'l Banking & Finance L* 418. Various works by Mitu Gulati, Lee Buchheit, Anna Gelpern and Adam Feibelman draw careful attention to this concern, but are more nuanced in their conclusions.

[76] O Lienau, *Rethinking Sovereign Debt: Politics, Reputation and Legitimacy in Modern Finance* (Cambridge, MA: Harvard University Press, 2014).

[77] *Restatement (3rd) of the Foreign Relations Law*, § 443, Reporter Note 8 ('highly persuasive if not binding.'). See also the extensive discussion in *Sarei I*, 221 F Supp 2d at 1178–1183; and in the Court of Appeals panel judgment, 499 F 3d at 1204–1208.

[78] *Sarei I*, 221 F Supp 2d at 207–208: 'So considered, neither [genocide] nor the purported acts of torture, rape and pillage can be deemed official acts of state. See, e.g., *Flatow v. Islamic Republic of Iran*, 999 F Supp 1, 24 (DDC, 1998) [. . .]; *Sharon v Time, Inc.*, 599 F Supp. 538, 552 (SDNY 1984) ([. . .] citing *Sabbatino,* . . . 376 US at 430, n. 34 [. . .]. See also *[Doe I v Unocal Corp.]* 963 F Supp 880, 894–895 (CD Cal 1997).'

which the act of state doctrine precluded suit under [the Alien Tort Claims Act].'[79] The Supreme Court similarly found in *Kirkpatrick* that the judicial finding that a foreign public official received a bribe that is illegal under the local law could not be treated as impugning any act of state.

The political questions doctrine, rightly or wrongly, is applied separately by a number of courts. So a claim may survive an act of state defence but be dismissed as a political question.[80] The determination of whether it is a political question involves the application of the well-known factors announced in the *Baker v Carr* case of the US Supreme Court.[81] Most of these factors overlap with what has been discussed above. A prominent consideration under the political questions doctrine, however, is whether the executive has actively pursued resolution of the particular issue diplomatically, and whether the court's judgment may conflict with or embarrass such efforts.[82] This could have serious implications for taking claims relating to debts restructured through the active participation of the United States, such as through the Paris Club or (and especially) those claims of creditors who participated in the Brady bonds restructuring in the 1980s.

The ATS cases have been numerous, though the number of claims resulting in judgment and enforcement are fairly meagre.[83] The jurisprudence on many relevant points of law is rapidly evolving, though the evolution may be slowed down considerably by the Supreme Court's judgment limiting the extraterritorial application of the ATS in *Kiobel*.[84] What is nevertheless clear at this point is that the various justiciability doctrines will not necessarily prevent US courts from having regard to violations of certain apposite public international law norms by foreign governments 'when deciding cases and controversies properly presented to

[79] *Kadic v Karadzic*, 70 F 3d 232, 250 (2d Cir. 1995); affirmed in *Presbyterian Church of Sudan v Talisman Energy, Inc*. 244 F Supp 2d 289, 344 (SDNY 2003). If so, it is certainly less rare for them to be excluded as political questions: see e.g. *Corrie v Caterpillar*, 503 F 3d 974 (9th Cir. 2007), and *Sarei I*, above.

[80] As occurred in *Sarei I*.

[81] *Baker v Carr*, 369 US 186, 217.

[82] This would be factor 6 in *Baker v Carr:* 'the potentiality of embarrassment from multifarious pronouncements by various departments on one question'. See the discussion of *Sarei I*, 221 F Supp 2d at 1193–1199 for a good example.

[83] Ku, 'Curious Case'.

[84] *Kiobel v Royal Dutch Petroleum*. For a discussion about its impact upon ATS litigation, see RG Steinhardt, 'Kiobel and the Weakening of Precedent' (2013) 107 *AJIL* 4 2013; CI Keitner 'Kiobel v. Royal Dutch Petroleum Co. (U.S. Sup. Ct.), Introductory Note' (2013) 52 ILM 966; MM Winkler, 'What Remains of the ATS after Kiobel' (2013) 39 *North Carolina J of Int'l L and Comm Reg* 171.

them'.[85] Whether they will do so depends upon the laws allegedly breached, the stated position of the executive branch and whether the claim is congenial or hostile to the foreign policy objectives of the US government.

## II. Lending for an Unlawful Purpose in the Law of Contract

Anglo-American contract law recognises that a contract valid on its face can be tainted by the unlawful purpose that it furthers.[86] This is a type of illegality that is one step removed from the face of the contract. Compare the difference between a contract to engage someone directly to bribe a public official in a foreign country[87] and a contract to pay a consultant for local advice and assistance with the knowledge that the person will use the part of the payment to bribe a public official. The former case makes the illegality part of the consideration of the underlying contract, while the second is an example of a transaction in which the contract is not unlawful on its face, but which knowingly furthers an unlawful scheme. Such cases arise in the law of lending. In English law, it is a principle of long standing, as confirmed in the early gambling case of *M'Kinnell v Robinson*, that 'the repayment of money, lent for the express purpose of accomplishing an illegal object, cannot be enforced.'[88] (This principle was adopted verbatim by the New York Court of Appeals, as discussed further below.) This old principle still bears relevance today, as leading practitioners' manuals further attest: '[m]oney knowingly lent for an illegal or immoral purpose cannot be recovered after the purpose has been even partially carried out.'[89] This area of law is more complicated than these statements at first suggest. The remainder of this chapter explores the nuances.

Before doing so, it will help at once to set aside as inapposite the criminal financing cases that arise under the Alien Tort Statute and the Nuremberg trials of people alleged to have committed war crimes or crimes against humanity in World War II.[90] Some of those cases are

[85] *Kilpatrick & Co v Evtl Tectonics*, 409.

[86] Law Commission, *Illegal Transactions: The Effect of Illegality on Contracts and Trusts* (Law Comm CP No 154, 1999) [2.24]–[2.28]; Beale, *Chitty on Contracts*, vol. I, ch.16, esp. 16–010; Buckley, *Illegality and Public Policy*, ch. 4.

[87] See e.g. *Lemenda v African Middle East Petroleum Co* [1988] QB 448 (English law contract to influence public officials in Qatar contrary to English public policy).

[88] *McKinnell v Robinson* (1838) 150 ER 1215. 1218 (Lord Abinger CB).

[89] *Encyclopaedia of Banking Law* (Lexis Nexis, 2014) Division F(2)[1726] ('Loans for an unlawful purpose').

[90] For an excellent exploration of these themes, see Michalowski, 'No Complicity Liability?', 451.

preoccupied with whether a lender's actions constitute the *actus reus* and *mens rea* of criminal offences. In the *Ministries Case*, for instance, the facts amounted to a paradigm case of an odious loan. The defendant provided banking services to the Nazi *Schutzstaffel* (SS), and thus it directly and knowingly financed death camps. At trial, the question the Nuremberg Tribunal put to itself was '*is it a crime to make a loan*, knowing or having good reason to believe that the borrower will use the funds in financing enterprises which are employed in using labour in violation of either national or international law?'[91] Its answer was 'no'. In my view, the tribunal's answer was unsound on its face, but this is not the occasion to explore this argument.[92] The enforceability of a loan agreement is a civil and not criminal matter. There are different standards of proof, underlying policy concerns and sources of precedent.[93]

### A. *English Law*

The English cases can be explored by reference to (1) the nexus between the loan agreement and the illegal activity and (2) whether mere knowledge by one party of the illegal object of the other party is sufficient, or something more such as participation of the creditor is required. As regards the first issue, it is settled[94] that the agreement need not

[91] *United States v Weizsaecker (The Ministries Case)* 14 Trials of War Criminals before the Nuremberg Military Tribunals under Control Council Law No. 10, 478, 620–622 (emphasis added) (Nuremberg Military Tribs. *1950)*.

[92] I agree with the analysis in Michalowski, 'No Complicity Liability?'.

[93] Some of the ATS cases adapt criminal standards such as *mens rea* into civil claims, such as 'aiding and abetting liability'. See *In re South African Apartheid Litigation*, 617 F Supp 2d 228, 257ff (SDNY, 8 April 2009), and see further Michalowski, *Unconstitutional Regimes and Sovereign Debt*, pp. 74–81. This is not the case with the broader law on civil liability for aiding and abetting: see the survey article, RC Mason, 'Civil Liability for Aiding and Abetting' (2006) 61 *The Business Lawyer* 1135. The authorities examined there are consistent with the approaches examined below.

[94] In *Apotex*, Lord Sumption asserts vigorously a principle of 'reliance' as a test for whether the illegality of the transaction should prohibit enforcement of the contract. This principle suggests that the contract shall be unenforceable only where the party must rely on the illegal behaviour when bringing the claim. This principle, if ultimately accepted, would, it seems to me, erase the category of debts for an illegal purpose, a category with a deep body of case law behind it in both England and America. It is not clear that this consequence of the reliance test was adequately understood, or whether the reliance test would operate in such a way as to overturn that body of case law. The operation of the test was criticised in strong terms and rejected by a differently constituted bench of the Supreme Court in *Hounga* v *Allen*, above at [25], [30–31], [35–40]. The issue is not as yet resolved. See above, note 11 for a discussion of the *Bilta* case.

stipulate unlawful conduct. In *Alexander v Rayson*,[95] a landlord concluded two agreements with a tenant. One was for the payment of rent, and the other was for the payment of services to be provided by the landlord. The rent charged was very low, and the charge for services was out of all proportion to the services rendered. In fact the two agreements were used, unbeknownst to the tenant, by the landlord as a way to avoid payment of certain taxes owed on the value of the property (determined chiefly by reference to rent paid), by shifting the bulk of what ought to have been owed as rent to a charge for services that would be subject to a much lower tax rate (or none at all). When the tenant subsequently withheld payment for services due to the landlord's non-performance, the landlord brought an action and the sham unravelled at trial. Neither agreement was, on its face, illegal. The trial judge found the tax fraud to be too remote from the transactions to prevent the claimant from relying on the contract, but the Court of Appeal reversed. It held the agreements to be unenforceable. It summarised the principle applicable to the case as follows:

> It is settled law that an agreement to do an act that is illegal or immoral or contrary to public policy, or to do any act for a consideration that is illegal, immoral or contrary to public policy, is unlawful and therefore void. But it often happens that an agreement which in itself is not unlawful is made with the intention of one or both parties to make use of the subject matter for an unlawful purpose, that is to say a purpose that is illegal, immoral or contrary to public policy. The most common instance of this is an agreement for the sale or letting of an object, where the agreement is unobjectionable on the face of it, but where the intention of both or one of the parties is that the object shall be used by the purchaser or hirer for an unlawful purpose. In such a case any party to the agreement who had the unlawful intention is precluded from suing upon it. *Ex turpi causa non oritur actio*. The action does not lie because the Court will not lend its help to such a plaintiff. Many instances of this are to be found in the books.[96]

A number of such instances involve contracts relating to so-called bad morals. So in *Pearce v Brooks*,[97] a contract for the hire of a brougham (an enclosed carriage) that was known to the lender to be for the uses of

[95] [1936] 1 KB 169 (CA). Approved in *Tinsley v Milligan* [1994] 1 AC 340 (HL) 370 (Lord Browne-Wilkinson). Affirmed in *Stone & Rolls Ltd v Moore Stephens* [2009] UKHL 39; [2009] 1 AC 1391 [21] (Lord Phillips).

[96] Ibid., p. 182. See also M P Furmston, 'The Analysis of Illegal Contracts' (1966) 16 *U of Toronto LJ* 267, 287 (arguing that *Alexander v Rayson* shows the outer limits of how remote the illegality ought to be from the contracts itself).

[97] (1866) LR 1 Exch 213.

prostitution was held unenforceable. In *Upfill v Wright*,[98] rent due in respect of a flat let to a woman who was known to the landlord to be the mistress of a man, the flat being used for the 'immoral' acts, was unrecoverable. Although these cases remain good law, the impression given by modern contract scholars is that their authority has eroded over time, particularly concerning sexual morality. However, the early lending cases extended beyond the so-called immoral acts like prostitution, gambling and adultery. And these further cases also show that it is not necessary that the contract itself specify the illegal purpose. This was the central finding in the old case of *Gas Light and Coke Co. v Turner*,[99] where a property was let to a person for the purpose of extracting oil from tar in contravention of a statute. The plaintiffs (seeking payment) argued that the defendants were not obliged under the written contract to extract the oil. Abinger CB rather held that '[i]t is true that you cannot add to a contract under seal any thing to vary the contract; but you may shew *dehors* the instrument that such contract was entered into for an illegal purpose: such proof does not vary the terms of the contract, but merely shews the illegal object.'[100] Similarly, in *Scott v Brown, Doering, McNab & Co*,[101] a purchase of shares on the open market was, though itself legal on its face, held illegal because it was in fact an integral part of a sham that would deceive the public over the true market value of the company.

A more recent leading case on illegal loans is *Spector v Ageda*.[102] The case concerned two loans. The first was manifestly illegal because though disguised as legitimate, it in fact carried compound interest, which was illegal under the Moneylenders Act 1927. The transaction at the heart of the case was a second loan, which was made to the defendant by yet another person but for the express purpose of repaying the first loan. Megarry J found that the illegality of the first tainted the second loan, and so the court would not lend its assistance to recovery upon it. The judge addressed at some length the argument that the one contract does not require the illegal activity and is thus too remote from it to be considered contrary to public policy. It is worth quoting at length the way in which the judge addressed it:

> If a transaction is illegal, no proceedings can be brought to enforce any payment under it: but it was contended that unless, as in *Cannan v Bryce*,

[98] [1911] 1 KB 506 (KB).
[99] *Gas Light & Coke Co. v Turner* (1840) 6 Bing. N C 324; 133 ER 127.
[100] 133 ER 127, 129. [101] [1892] 2 QB 724 (CA).
[102] *Spector v Ageda* [1973] Ch 30 (QB).

> 3 B. & Ald. 179, statute provides that it shall be illegal to make or receive any payment under the contract, there is nothing to stop one of the parties from voluntarily choosing to make a payment under it, or binding himself to do so. He who wishes may give, or oblige himself to give. If that is so, what is there to affect with illegality any loan made for the purpose of making a voluntary payment of this kind? Thus ran the argument.
>
> If one goes back to the decision of the Court of Queen's Bench in *Fisher v Bridges* (1853) 2 E. & B. 118, one can see the court accepting there just the sort of argument that has been put forward in this case. In that case, there was a purchase by way of an illegal lottery, and subsequently the defendant entered into a covenant with the plaintiff to pay him some money remaining due. This was treated as being a mere voluntary agreement to pay a sum of money after the illegal purposes had come to an end, and so as enforceable. The Court of Exchequer Chamber, however, reversed this decision in a judgment delivered by Jervis C.J., [(1854)] 3 E. & B. 642, 647. The essence of the decision appears, I think, in this passage, at p. 649:
>
> It is clear that the covenant was given for payment of the purchase money. It springs from, and is a creature of, the illegal agreement; and, as the law would not enforce the original illegal contract, so neither will it allow the parties to enforce a security for the purchase money, which by the original bargain was tainted with illegality.
>
> In that case, the subsequent transaction was between the original parties: but a third party who takes part in the subsequent transaction with knowledge of the prior illegality can, in general, be in no better position. [. . .]. In relation to the case before me, if Mrs. Spector lent money to the borrowers knowing that it was to be used for the discharge of an illegal loan, Mrs. Spector's loan is also tainted with illegality, and she cannot enforce repayment of her loan.[103]

(The essence of this holding is that a loan which is legal on its face may be tainted with illegality if the proceeds of the loan are intended, to the knowledge of the lender, to be used for an unlawful purpose.)

*Spector v Ageda* remains a leading case in bank lending practice. One practitioners' manual gives the following examples of other potentially illegal purposes in international lending: 'loans contrary to prohibited financial assistance by the company for the purpose of acquiring its own shares; loans to pay dividends which are unlawful because the borrower is insolvent; loans to defraud foreign revenue authorities; loans in breach of

[103] Ibid., pp. 43–44.

an embargo or trading with the enemy legislation or orders; and loans to pay a bribe to an official to procure a government contract'.[104] These forms of illegality are important, though certainly no more so than violations of international criminal law, fundamental human rights and other *jus cogens* norms of international law.

The analysis in *Spector v Ageda* also raises the second sub-issue referred to above, which is whether mere knowledge of the unlawful purpose will suffice or whether actual participation in the illegal conduct is required. The distinction and (relatively sparse) case law in England is discussed in Richard Buckley's treatise on illegality and public policy.[105] In short, there are lines of authority supporting both positions and the issue is not resolved. This area of law is much more developed in the United States, as discussed below. It is conceivable that in cases involving loans, rather than sale of goods, participation may be more easily found, hence the rather broad statements from the cases and manuals cited above. A loan that wholly and knowingly enables the illegal conduct is plausibly considered participation. Yet others might amount to mere knowledge alone, and the trend in US cases, if found instructive, tends to favour a quite narrow notion of participation. Yet if we look to the US authorities, one may also be inclined to agree with Buckley, who opines that in English law there must be circumstances in which mere knowledge alone is sufficient, namely, those situations 'where the illegal scheme is especially grave'.[106] Buckley draws on the US position, but also the Law Commission of England and Wales. Now the English courts also support the position that the seriousness of the illegality should militate in favour of the application of the defence of illegality. Admittedly, Lord Goff in the House of Lords case of *Tinsley v Milligan* – a much criticised case – found that he would not inquire, in the trusts context at any rate, into 'degrees of iniquity'.[107] Yet in recent years, judges, commentators, and the Law Commission have supported an approach under which judges would inquire into a variety of factors in deciding whether to apply the illegality defence in every case, one of which

[104] *Encyclopaedia of Banking Law*, [1726].
[105] Buckley, *Illegality and Public Policy*, ch. 4. See also Law Commission, 'Illegality' (Consultation Paper No 154), [2.25]; N Enonchong, *Illegal Transactions* (London: Lloyd's, 1998) pp. 284–291; RA Buckley, 'Participation and Performance in Illegal Contracts' (1974) 25 *NILQ* 421.
[106] Buckley, *Illegality and Public Policy*, 4.21–4.25.
[107] [1993] 1 AC 340, 362 (Lord Goff).

being the 'seriousness of the illegality'.[108] However, the decision of Lord Sumption for the majority of the Supreme Court in the case of *Apotex* claimed to affirm the approach of Lord Goff in *Tinsley v Milligan* and thus rejected the idea of weighing iniquities. *Apotex* was itself a flat departure from a Supreme Court case that held the opposite handed down only a few months earlier.[109] Leading commentators on public policy have criticised the judgment in strong terms,[110] for it departs from the thrust of extensive Law Commission consultations and reports. The issue of whether Lord Sumption's position will govern was explicitly left open by the Supreme Court at the time this book goes to press.[111] At any rate, it is doubtful that Lord Sumption's approach would have the effect of rendering contracts that knowingly facilitate the commission of grave crimes to be enforced in English courts. How his principle might be adapted to account for the non-enforcement of such contracts (consistently also with the American authorities) is an issue that defenders of so narrow a view of illegality must resolve.[112]

On the whole, then, the English cases suggest that knowledge of the illegal purpose either may, depending on the facts, be sufficient on its own to render an agreement unenforceable, or may, depending on extenuating circumstances, be part of a larger design that constitutes participation

[108] As Paul S Davies puts it in 'The Illegality Defence: Turning Back the Clock' (2010) 4 Conv 282 (citing *Gray v Thames Trains Ltd* [2009] UKHL 33 [83]); the point was noted too by the Law Commission in *The Illegality Defence* (Law Comm No. 320, 2010) [3.26], [3.36]. See also the decision of Hamblen J in *Nayyar v Denton Wilde Sapte* [2009] EWHC 3218 [92] (an act of bribery involved 'serious moral turpitude' sufficient to bring the illegality defence into play); *K/S Lincoln v CB Richard Ellis Hotels Ltd* [2009] EWHC 2344; and *Hounga v Allen*.

[109] See above, notes 11 and 94 for citations and context for this case.

[110] R Buckley, 'Illegality in the Supreme Court' (2015) 131 *LQR* 341.

[111] See comments in note 11 above, relating to the *Bilta (UK)* case. For instance, in *R (on the application of Best) v Chief Land Registrar* [2015] EWCA Civ 17, the majority of the Court of Appeal applied *Hounga* and used an approach under which it balanced policy considerations to decide how and whether the defence of illegality ought to be applied. Lady Justice Arden expressed doubts about doing so at [111], but failed to persuade the majority of the Court.

[112] Lord Sumption's view would require abandoning the case law on contracts for an unlawful purpose as well as those relating to contracts to commit a tort or breach of contract being unenforceable as a matter of public policy; it rejects without much consideration the extensive work conducted by the Law Commission on this topic; and it would depart strongly from American law as well as the drafting of general principles of European contract law (which was heavily influenced by the Law Commission's work on illegal transactions: see note 149 below and accompanying text).

by the creditor in the illegal scheme. At the same time, the trend in modern case law has been to be cautious in extending public policy and to row back from earlier unflinching acceptance of knowledge alone. It is likely, therefore, that the circumstances in any particular case must show quite strongly that the purpose of the loan was known clearly to the lender to be in support of such violations. Where, on the other hand, the purpose of the loan is in part to support the personal enrichment of a government official, which is in many cases likely to be contrary to the laws of the foreign nation as well as those of New York or England, that alone will be sufficient to render the agreement unenforceable as against public policy. Nevertheless, there is nothing revealed in this analysis to suggest that *merely doing business* with a known offender renders a contract illegal.

### B. *American Law*

The American cases, while accepting and applying the central rules given in the English authorities, nonetheless have resolved more strongly that mere knowledge is insufficient and actual participation is ordinarily required. An early leading case on the subject is the decision of the New York Court of Appeals in *Tracy v Talmage*.[113] The key rulings in this case are that (a) '[t]he repayment of money lent for the express purpose of accomplishing an illegal object, cannot be enforced'[114] and (b) 'that it is no defence to an action brought to recover the price of goods sold, that the vendor knew that they were bought for an illegal purpose, provided it is not made a part of the contract that they shall be used for that purpose; and, provided also, that the vendor has done nothing in aid or furtherance of the unlawful design'.[115] The case is most often cited by various courts around America for the second holding. The reference to 'express purpose' in the first holding, when combined with the second, suggests a very high standard of proof that requires that the contract all but specify overtly that the goods or money be dedicated to an illegal purpose. This is a clear break with the English authorities. Precisely this point was made by the plaintiff in *Tracy v Talmage*, who sought and obtained reargument on the point. After considering the point anew, the Court of Appeals refused to reverse its initial holding, but in light of the subsequent arguments also added a caveat:

[113] (1856) 14 NY 162. [114] Ibid. [115] Ibid., p. 177.

> The principle should, perhaps, be stated, with some qualifications not suggested in the former opinion of the court. The case may be put of poison, or a deadly weapon purchased for the purpose of murder. The offence intended may be of such enormity, that no man having a knowledge of the design can remain neutral without being in a just sense a criminal himself. Where the design is to violate the fundamental laws of society, a positive duty of intervention may arise to prevent the perpetration of the crime. To such cases, the rule which we laid down ought not to be applied.[116]

The Court of Appeals continued its discussion to rely on the distinction between an act that is *malum in se* (wrong in itself), and *malum prohibitum* (wrong because prohibited by some law). This exception has been affirmed in other cases, sometimes in *obiter*, and elsewhere as the *ratio decidendi*.[117]

It would be wrong to read the exception in *Tracy v Talmage* as just applying to heinous crimes. In *Musco v Torello*,[118] the plaintiff sought payment on a lease for a saloon that he knew would be used for the sale of liquor during the prohibition era in the United States, what is for most cultures a good example of *malum prohibitum*. In that case, mere knowledge of the illegal purpose, without more, was held to be enough because the contract contemplated the violation of the Eighteenth Amendment of the United States Constitution (which outlawed the sale or trade of liquor). That brought it within the exception announced in *Tracy v Tamalge*. The Court held that '[p]ublic policy of the highest concern forbids the enforcement of such a contract, a rule adopted [. . .] solely in the interest of the public welfare and of the preservation of the Federal Constitution upon which our entire social fabric rests'.[119] In an earlier case, the Court of Appeals of Kentucky stated, in *obiter*, after reviewing *Talmage* and other conflicting authorities, that no one can sell a commodity knowing that the buyer intends to use it for a purpose such as 'murder or treason, or other flagrant violation of the fundamental rights of man or of society' for it would betray such 'turpitude and recklessness as to implicate him, as a voluntary and active participant in the unlawful design'.[120]

The highest authority for the claim that mere knowledge may be sufficient, particularly in cases of grave or fundamental crimes or acts

[116] Ibid.
[117] *California Raisin Growers Ass v Andrew Abott* (1911) 160 Cal 2d 601, 609; *Austin B Webber v John C Donnelly*, 33 Mich 469 (1876) 472–473 (affirmed as 'unquestionably correct'); *Hanauer v Doane*, 79 US 342 (1871).
[118] 102 Conn 346 (1925). [119] Ibid., p. 352. [120] *Steele v Curle*, 34 Ky 381, 387 (1836).

of moral turpitude, is found in the US Supreme Court case of *Hanauer v Doane*.[121] The case concerned the enforceability of due bills, a form of promissory note, which were used to finance the provision of goods and supplies to the rebellious Confederate Army during the US Civil War. It was established by the US Supreme Court in *Texas v White* that any contract in aid of the rebellion against the United States was void as against public policy.[122] In the *Hanauer* case, an Arkansas Circuit Court judge had found that mere knowledge that the goods would be supplied to the Confederate Army, without more, was insufficient to taint the contract with illegality. The judge essentially followed the reasoning found in the *Tracy v Talmage* case discussed above. Yet the Supreme Court rejected the judge's finding in favour of the wider rule set down in some of the English cases. It found as follows:

> [The plaintiff] cannot be permitted to stand on the nice metaphysical distinction that, although he knows that the purchaser buys the goods for the purpose of aiding the rebellion, he does not sell them for that purpose. The consequences of his acts are too serious and enormous to admit of such a plea. He must be taken to intend the consequences of his own voluntary act. [. . .] There are cases to the contrary; but they are either cases where the unlawful act contemplated to be done was merely *malum prohibitum*, or of inferior criminality . . . In our judgment [the trial judge's opinion] is altogether too narrow a view of the responsibility of a vendor in such a case as the present. Where to draw the precise line between the cases in which the vendor's knowledge of the purchaser's intent to make an unlawful use of the goods, will vitiate the contract, and those in which it will not, may be difficult. Perhaps it cannot be done by exact definitions. The whole doctrine of avoiding contracts for illegality and immorality is founded on public policy. It is certainly contrary to public policy to give the aid of the courts to a vendor who knew that his goods were purchased, or to a lender who knew that his money was borrowed, for the purpose of being employed in the commission of a criminal act, injurious to society or to any of its members.[123]

So the exception to the rule announced in *Tracy v Talmage* must be one read as one having serious bite where the illegal conduct is of great moral turpitude, such as a felony or serious crime, a breach of the

[121] 79 US 342 (1871).

[122] 74 US 700 (1868). For an illuminating discussion of this case and several others concerning the repudiation of Confederate debts, see S Ludington, M Gulati and AL Brophy, 'Applied Legal History: Demystifying the Doctrine of Odious Debts', (2010) 11 *Theoretical Inquiries in Law* 247.

[123] *Hanauer v Doane*, pp. 347–349.

Constitution or the crime of treason. Merely knowledge alone in such cases will suffice, and claimants will not be permitted to 'stand on [a] nice metaphysical distinction'[124] between knowing but not participating in the enterprise.

It must also be acknowledged that the clear trend of modern American jurisprudence has been to sharply contrast knowledge and participation, and there are many more judgments finding that the facts make out knowledge alone and thus defeat the illegality defence.[125] More strongly than the English cases, the courts have not only insisted on this important distinction but have also set a high bar for what constitutes participation.[126] And as a New Jersey court was quick to put it in 1942, 'the mere lending of money in the ordinary course of business is not a participation in the illegal transactions of the borrower.'[127] Nonetheless, the leading treatises and cases continue to recognise the important stipulation announced in *Tracy v Talmage* and applied in *Hanauer v Doane*. For instance, Corbin restates the position thus:

> A seller who, with knowledge of the buyer's illegal purpose, makes the sale and delivers the subject matter, thereby increases the probability that the illegal purpose will be carried out, even though he does not participate in the purpose, urges its abandonment, and hopes for the best. This fact makes the bargain unenforceable by the seller also, if the illegal purpose of which he has knowledge involves the commission of a serious crime or an act of great moral turpitude. In cases other than these, the seller's knowledge of the purpose does not prevent his enforcement of the bargain, if he in no way participates in the purpose and does not act in furtherance of it aside from making the sale.[128]

[124] Ibid.

[125] Such is evident upon perusal of the leading treatises and case law cited therein. For (in my view weak) policy arguments supporting the narrow position, see JP Kostritsky, 'Illegal Contracts and Efficient Deterrence: A Study in Modern Contract Theory' (1988) 74 *Iowa L Rev* 115, pp. 147–150.

[126] Examples of 'participation' include *International Aircraft Sales, Inc v Betancourt*, 582 SW2d 632 (Tex Civ App Corpus Christi 1979) (putting fraudulent labels on boxes to facilitate smuggling by another party, in breach of foreign law); *MPH Co v Imagineering, Inc*, 243 Mont 342, 792 P2d 1081 (1990) (supply of lawfully useable gambling machines may create enforceable debt, but supplying guidance and oversight to enable them for unlawful cash use amounts to participation).

[127] *Schaffer v Federal Trust Co*, 31 Backes 235, 28 A2d 75 (NJ Ch 1942).

[128] AL Corbin, *Corbin on Contracts*, 12 vols. (St Paul, MN: West Publishing, 1963), § 1519. (1962) (cited with approval in *Potomac Leasing Co v Vitality Centers, Inc* 290 Ark 265, 718 SW2d 928 [Ark, 1986]).

The Restatement (2nd) of the Law of Contracts is yet more succinct:

> If the promisee has substantially performed, enforcement of a promise is not precluded on grounds of public policy because of some improper use that the promisor intends to make of what he obtains unless the promisee (a) acted for the purpose of furthering the improper use, or (b) knew of the use and the use involves grave social harm.

This rule has the effect of making knowledge sufficient where the matter relates to grave social harm. And all the ample authorities finding that knowledge alone is insufficient also demonstrate how judicially manageable a 'knowledge' standard is in such a context.

Given these authorities, the question relevant to the enforceability of subjugation debts must be, whether the acts knowingly supported and enabled by the loan were acts 'of great moral turpitude', *mala in se*, involving 'grave social harm' or a breach of the 'fundamental laws of society'? The answer seems obvious. Such debts are defined by reference to breaches of law far more serious than murder or treason, or procedural irregularities in a foreign trial. They speak to acts so heinous that many were deemed crimes under international law at the Nuremberg Trials before any convention announced them as such, while many others are so fundamental that they are regarded as non-derogable even by treaty under international law.

### C. *A Note on German Private Law*[129]

While the attention above has been on Anglo-American law, it is worthwhile to consider briefly the position in a civilian jurisdiction, and in particular in Germany, whose law (as noted above) governs about 4 per cent of outstanding bonds as of 2009 and whose importance in sovereign lending is clear. Such a treatment can be relatively brief, for a similar result to what has been detailed above can be reached in a less tortuous manner.

Article 25 of the German Basic Law provides that generally accepted rules of public international law (*jus cogens*, customary international law and general principles) have the status of federal law in Germany.[130] All

[129] Stefan Theil and Sarah Luise Menninghaus provided exceptionally helpful research assistance in the preparation of this section.

[130] BVerfGE 46, 324 (363, 403 et seq.) BVerfGE 112, 1 (27 ff) (Federal Constitutional Court) (for *jus cogens*); BVerfGE 117, 141 (149) (Federal Constitutional Court) (for customary international law); BVerfGE 118, 124 (134) (for general principles) (Federal Constitutional Court).

branches of the German state are required to abide by these laws.[131] For instance, a German soldier is not obligated to follow an order that would violate general rules of international law.[132] A German court would thus have to consider whether a violation of such rules has occurred, and take this into account when applying German domestic law, [133] for instance, the German Civil Code in a private law case. Any provision of the German Civil Code that would violate such norms would itself be of no effect (*unwirksam*).[134]

The position in German private law relating to the prohibition on contracts violating public morals (*Sittenwidrigkeit*) is found in article 134 of the German Civil Code.[135] This provision is a so-called general clause, and under the doctrine of horizontal effect, all German courts are required to interpret such clauses to give effect to the Basic Rights provisions of the Basic Law.[136] It would appear consistent with the reasoning in the *Lüth* decision[137] and subsequent commentary, and in light of the jurisprudence reviewed above, that they are also obliged to interpret article 138 in light of the constitutionally mandated application of international law. This suggests, essentially, that public policy in German contract law as applied under article 138 of the Civil Code will be illuminated and guided by the application of public international law norms if they are relevant to the underlying legal dispute.[138] A loan agreement governing a foreign sovereign will be just such a rare case.

The doctrinal development of public policy in the courts and in learned commentaries has recognised a range of abstract criteria which may contribute to a contract being regarded as contrary to public morals under article 138 of the Civil Code.[139] Such criteria are numerous, and none is essential to such a finding. One such criteria is harm to third

[131] BVerfGE 112, 1 (26, 27) (on all three branches, and in particular the executive and judiciary); BVerfGE 63, 343 (373); BVerfGE 75, 1 (19) (regarding the judiciary and executive); BVerfGE 23, 288 (300) (on the legislature).
[132] BVerwGE 127, 302 (316) (Federal Administrative Court).
[133] BVerfGE 75, 1 (18ff) (Federal Constitutional Court).
[134] BVerfGE 6, 309 (363); BVerfGE 23, 288 (316) (Federal Constitutional Court).
[135] C Armbrüster, '§ 138 BGB', in: *Münchener Kommentar zum Bürgerlichen Gesetzbuch*, 7th edition, 11 vols. (München: CH Beck, 2015), vol. I (*Sittenwidriges Rechtsgeschäft, Wucher*).
[136] BVerfGE 7, 198 (Federal Constitutional Court); CW Canaris, *Grundrecht und Privatrecht – eine Zwischenbilanz* (Berlin, New York: Walter de Gruyter, 1999).
[137] BVerfGE 7, 198 (Federal Constitutional Court).
[138] W Fikentscher, *Recht und wirtschaftliche Freiheit*, 2 vols. (Tübingen: Mohr Siebeck, 1993), vol. II (Transnationales Marktrecht), p. 251.
[139] Armbrüster, '§ 138 BGB', [27]–[32].

parties.[140] Another recognises the situation where there is stark imbalance of bargaining power and one of the parties is liable to abuse thereby,[141] as well as an abuse of a position of power (*Machtposition*) against a weaker contracting party.[142]

There are different trends in the jurisprudence of the Federal Court of Justice (*Bundesgerichtshof*) about whether a finding that a contract violates public policy must also import a requirement of 'reprehensible conviction' (*verwerfliche Gesinnung*) within the party against whom the defence is raised.[143] This would be to require something more than mere subjective awareness of the facts constituting the illegality. The commentator in the leading treatise advocates mere knowledge or recklessness as to the truth (*grob fahrlässige Unkentniss*) for the establishment of the defence, citing a case of the Federal Court of Justice applying such a standard to find a contract providing a payment for a bribe of a foreign dignitary to be contrary to public policy.[144]

There are cases involving contracts that are lawful on their face but relate to an underlying unlawful purpose. In one case, domain grabbing – buying up internet domains relating to famous persons or entities with the sole purpose of extracting a fee from such persons – was found void under article 138.[145] Similarly, side agreements that do not touch the primary purpose of the contracts can still render the primary contract void.[146] In such cases, furthermore, there is no strong indication of any distinction between knowledge and participation, or that knowledge alone is insufficient. In a recent decision, the Federal Court of Justice found that a contract of sale would be contrary to public morals under Article 138, where the item was a radar detection device that despite not being prohibited for sale in Germany was nevertheless coded for illegal use in Germany. The manufacturer coded the device, and thus the seller did not adjust it to facilitate its illegal use. It was held that mere knowledge of the unlawful purpose by both parties, or reckless disregard of the truth about the underlying

[140] Armbrüster, '§ 138 BGB', [36] (defence against harm to third parties (*Abwehr der Schädigung Dritter*)).
[141] BVerfGE 89, 214 (die *Bürgshaftsentscheidung*/Surety decision) (Federal Constitutional Court); Armbrüster, '§ 138 BGB', [92].
[142] Armbrüster, '§ 138 BGB', [35] *(Abwehr der Ausnutzung von Machtpositionen).*
[143] Armbrüster, '§ 138 BGB', [129].
[144] BGHZ 94, 268 (272 ff) (Federal Court of Justice); Armbrüster, '§ 138 BGB', [129], [131].
[145] LG Frankfurt, NJW-RR 1998, 999 (District Court).
[146] BGH NJW 1997, 3372, 3374 (Federal Court of Justice).

facts making the action contrary to public policy (*grobfahrläsige Unkenntnis)*, sufficed.[147]

This position is similar, indeed, to the general principles of illegal contracting found in the Draft Common Frame of Reference (DCFR) document that serves as a pan-European frame of reference for the further evolution of the Principles of European Contract Law. Hector Macqueen sat on the Lando Commission, which was tasked by the European Parliament with the preparation of the DCFR.[148] He reported to the Commission on the question of regulating illegal contracts. In his account of the negotiations, he explained how the Report of the Law Commission of England and Wales provided helpful guidance to the Lando Commission, notably on recommending a broad discretion to the court to decide whether to apply a defence of illegality, structured by principles to guide the court's discretion. Among the considerations was the 'seriousness of the illegality', but Macqueen also addressed exactly the question raised for consideration in this chapter:

> There is a stronger case for the illegality rendering the contract ineffective if it was known to or intended by the parties than if both were unaware of the problem.[. . .] The most difficult situation is the contract for an illegal purpose. If it is lawful for A to sell a weapon or explosive material to B and these materials may be lawfully used (for example, in self-defence or in construction work), the fact that B intends to use the goods illegally ought not to affect the validity of the contract of supply. If however at the time of contracting, A is aware of or shares B's illicit purpose (e.g. supplies Semtex to a person whom A knows to be an active member of a terrorist organization), then there may be some deterrence from entering the contract (on credit terms at least) if A cannot compel B to pay for material supplied.[149]

While such principles do not have the force of law, they are indicative of emerging pan-European agreement on the fundamentals of private law. It is well known that the concept of public morals and public policy is

[147] BGH VIII ZR 129/04 (Federal Court of Justice), at p. 4 ('*Voraussetzung dafür ist, daß alle an dem Geschäft Beteiligten sittenwidrig handeln, also die Tatsachen, die die Sittenwidrigkeit begründen, kennen oder sich zumindest ihrer Kenntnis grob fahrlässig verschließen*').

[148] MacQueen, 'Illegality and Immorality in Contracts, (referring to the *Principles, Definitions and Model Rules of European Private Law – Draft Common Frame of Reference (DCFR)*, published in 2009 <http://ec.europa.eu/justice/policies/civil/docs/dcfr_outline_edition_en.pdf>, accessed 3 August 2015).

[149] Ibid. at p. 15 [555–70]. MacQueen adds: 'but it may be appropriate to allow A to seek restitution'. However, as MacQueen explains later in the essay, DCFR Model Rules VII.-6:103 operates a limiting principle for this relief which appears to be akin to the non-stultification principle examined in the discussion of unjust enrichment below.

applied more liberally to intervene in contractual relationships in civilian jurisdictions in Europe.[150] The likely approach in German courts must be understood in that context.

## III. Non-Contractual Obligations

The law of contract is but one area of private law that addresses the topic under consideration. Other principles that are connected to but also distinct from the law of contract – ranging from the law of unjust enrichment, good faith, abuse of rights, and obligations in the law of agency – are instructive in various ways.

### *A. Unjust Enrichment*

The principle of unjust enrichment requires that '[a] person who has been unjustly enriched at the expense of another is required to make restitution to the other.'[151] In Anglo-American law, 'unjust enrichment is not an abstract moral principle' but rather 'an organising concept' for identifying cases in which 'the defendant has been enriched by the receipt of a benefit that is gained at the claimant's expense in circumstances that the law deems to be unjust'.'[152] Common grounds include payments made by mistake, those made under duress or undue influence and those made under frustrated contracts, to name some of the categories. It is a frequently mentioned principle of public international law,[153] though O'Connell's usage of the expression, to take one, departs

[150] See J Cartwright, 'Defects of Consent in Contract Law' in AS Hartkamp and C von Bar (eds.), *Towards a European Civil Code*, 4th edition (Alphen aan den Rijn, Frederick, MD: Kluwer, 2011), p. 537.

[151] *Restatement (3rd) of the Law, Restitution and Unjust Enrichment*, 2 vols. (St Paul, MN: American Law Institute Publishers, 2011), vol. I, § 1.

[152] C Mitchell, P Mitchell and S Watterson, *Goff & Jones: The Law of Unjust Enrichment*, 8th edition (London: Sweet & Maxwell, 2011) [1–08]. The authors also explain at [1–01]–[1–05] the relationship between unjust enrichment and the law of restitution, which are related but not interchangeable concepts.

[153] See CH Schreuer, 'Unjustified Enrichment in International Law' (1974) 22 *A J Comp L* 281; see also JF O'Connor, *Good Faith in International Law* (Aldershot: Dartmouth, 1991), p. 40, where he alludes to the significance of unjust enrichment as part of the principle of good faith. DP O'Connell, *State Succession in Municipal and International Law*, 2 vols. (Cambridge: Cambridge University Press, 1967), vol. I, p. 34, writes '[t]he ultimate principles of legal reasoning are formulated in rubrics known as the "general principles of international law" . . . The concept of unjust enrichment is such a principle.' On p. 266, he clarifies that the concept 'lies at the basis of the doctrine of acquired rights'.

substantially from how the idea is understood in Anglo-American private law.[154] The law of restitution for unjust enrichment is important in domestic private law in the scenario in which the creditor's primary avenue (contract) is found to be contrary to public policy and therefore unenforceable. Will the creditor be entitled to restitution?

In both US and English law, the answer is ordinarily no: benefits transferred under an illegal contract are not ordinarily recoverable by way of restitution. The position in English law is somewhat firmer than the US position.[155] Nelson Enonchong states the English rule for loans in particular: '[a] person who advances money to another under a loan agreement which is illegal cannot recover his money either in contract or in an action in restitution for money had and received.'[156] The claimant in *Spector v Ageda*, for instance, was unable to recover. Indeed, the rather inflexible application of the rule precluding recovery in the wake of illegal transactions has been the cause of an intense effort to reform the law in this area, to avoid potential harshness.[157] Peter Birks, in an influential analysis, argued that unjust enrichment should be available in such contexts only when it would not 'stultify' the law: '[t]he question is always whether allowing the claim in unjust enrichment would make nonsense of the law's condemnation of the illegal conduct in question and of its refusal to enforce the illegal contract.'[158] Considering odious debts, if the court could be convinced that the contract were contrary to public policy for the reasons discussed above (corruption and subjugation debts), it is unlikely that it would be comfortable achieving a similar result by means of restitution. It is contrary to English public policy to

[154] A point emphasised to me in discussion with Charles Mitchell.

[155] Law Commission, 'Illegal Transactions', 27–35 ('the general rule is that illegality acts as a defence to a standard restitutionary claim except where the parties are "not equally at fault" [i.e. *non in pari delicto*]'); Mitchell, Mitchell and Waterson, *The Law of Unjust Enrichment*, ch. 35 ('it was settled towards the end of the 18th century that money paid under an illegal contract could not generally be recovered if the parties were equally blameworthy.' The rule in *Spector v Ageda* is also explained at [35–21]). See further, G Dannemann, 'Illegality as Defence against Unjust Enrichment Claims' in R Zimmermann and D Johnston (eds.), *Unjust Enrichment: Key Issues in Comparative Perspective* (Cambridge: Cambridge University Press, 2002), p. 310.

[156] Enonchong, *Illegal Transactions*, pp. 74–78.

[157] A helpful overview is available in Davies, 'The Illegality Defence: Turning Back the Clock'.

[158] P Birks, 'Recovering Value Transferred under an Illegal Contract' (2000) 1 *Theoretical Inquiries in Law* 155, 202. This is endorsed in the leading treatise, Mitchell, Mitchell and Watterson, *The Law of Unjust Enrichment*, [3–35]–[3:36]. I am greatly indebted to Charles Mitchell for guidance on this issue.

bribe a public official in either England or abroad, and monies paid for such purposes are not recoverable.[159] On the other hand, the law of restitution also provides legal recognition of the right to withdraw and obtain recovery where a creditor elects to withdraw early from a contract on account of its illegal character.[160] Such a position does not stultify, but rather encourages obedience to the law.

The basic position in US law is outlined in the Restatement (2nd) of the Law of Contracts: '[e]xcept as stated in §§ 198 and 199, a party has no claim in restitution for performance that he has rendered under or in return for a promise that is unenforceable on grounds of public policy unless denial of restitution would cause disproportionate forfeiture.'[161] Although the rule's title is 'restitution generally unavailable', it is also laden with three exceptions. Restitution may be available where the person is excusably ignorant or not equally in the wrong (§ 198), where the person withdrew or it would be contrary to the public interest to let the loss lie where it fell (§ 199) or that a denial of restitution would lead to 'disproportionate forfeiture'. For reasons made amply clear in the reporters' comments on these various provisions, the first two categories will not assist an odious creditor. And although one might conjure a scenario where forfeiture appears disproportionate (e.g. where the bribery or amount knowingly earmarked for subjugation constitutes a fraction of the overall loan value), the reporters' comments here make clear that the claimant's involvement in a 'grave social harm' would preclude recovery.[162] In brief, the moral turpitude of the lender's behaviour

[159] *Parkinson v College of Ambulance* [1925] 2 KB 1 (money paid to charity in the expectation of it causing the claimant to receive knighthood is not recoverable); see also *Lemenda Trading Co Ltd v African Middle East Petroleum Co Ltd* [1988] QB 448 (contrary to English public policy to enforce agreement abroad involving the purchase of someone's influence over a person in a public position). In *World Duty Free v Kenya*, the tribunal found it unnecessary to deal with the argument that there should be *restitution in integrum* as it was not pleaded.

[160] *Clay v Yates* (1856) 156 ER 1123; *Tribe v Tribe* [1995] EWCA Civ 20 (resulting trusts); see also Birks, 'Recovering Value', pp. 188–191 (discussing the *locus poenitentiae* (space for repentance) rule).

[161] *Restatement (2nd) on the Law of Contracts*, § 197.

[162] *Restatement (2nd) on the Law of Contracts*, § 197 Comment B: 'Whether the forfeiture is "disproportionate" for the purposes of this section will depend on the extent of that denial of compensation as compared with the gravity of the public interest involved and the extent of the contravention. If the claimant has threatened grave social harm, no forfeiture will be disproportionate.'

in our scenario, and the nature of the illegal transaction under consideration, is likely as a matter of law to bar the availability of any remedy in restitution.[163] The Restatement (3rd) of the Law of Restitution and Unjust Enrichment reformulates but confirms these basic principles,[164] including specifically with respect to contracts for an unlawful purpose.[165]

In a quite nuanced discussion, Buchheit, Gulati and Thompson have shown that the equitable maxim that 'he who comes to equity must come with clean hands' would also sometimes serve to deny certain creditor claims.[166] They explain that this equitable maxim is available to deny legal (not just equitable) claims in some though not all US states. The relationship between equity and law, and how it relates to unjust enrichment, varies between countries. An equitable defence is not available in English law to deny legal relief that is otherwise available.[167] Even so, the normative idea of not lending the courts' assistance to help an immoral actor is well recognised, in the principle of *ex turpi causa* as well as in the other principles discussed above.

### *B. Good Faith and the Abuse of Rights*

Some commentators, such as Frankenberg and Kneiper, believe that a sound basis for odious debt is found in the doctrine of abuse of rights:

> Odious debts are excepted from the obligation of fulfillment not because they are considered an excessive burden for the successor, but rather because they are contracted under abuse of rights. The abuse is

[163] The question of whether bondholders, rather than underwriters, would be involved in the grave social harm is a highly complicated question of private law, and its answer lies beyond the scope of this chapter. So too does the question of from whom such bondholders would seek their remedy.

[164] *Restatement (3rd) of the Law, Restitution and Unjust Enrichment*, § 32 (illegality) ('The present section reformulates the applicable rules [of the Restatement, Second, Contracts §§ 197–199] without proposing to alter specific outcomes.' The reformulated rules also put emphasis on examining the policy underlying the prohibition, on using a rule against stultification as the test for applying unjust enrichment, and of denying any recovery where the claimant has shown 'inequitable conduct.' See further § 63 (equitable disqualification).

[165] *Restatement (3rd) of the Law, Restitution and Unjust Enrichment*, § 32(3) (Comment D.); § 63 (Comment B).

[166] Buchheit, Gulati and Thompson, 'The Dilemma of Odious Debts', pp. 1235–1237.

[167] The British view is that since the claimant is not coming to equity, the maxim does not apply. On equitable maxims and their role, see J Edelman 'Maxims of Equity' in McGhee (ed.), *Snell's Equity*, 32nd edition (London: Sweet & Maxwell, 2013), 5–002.

> constituted in a purpose which contradicts the interest of the attributable subject (the population).[168]

The doctrine of abuse of rights is recognised in the Civil Codes of Germany (art. 226), Italy (art. 833), Austria (art. 1295.2), Spain (art. 281), Greece (art. 281) and Luxembourg (art. 6.1), as well as in the case law of France and a variety of international decisions.[169] Examples would include erecting a false chimney for the purpose of blocking a neighbour's light, singing specifically to annoy a person[170] or the eviction of a tenant solely because he gave evidence against the landlord.[171] There is some dispute over whether the doctrine has risen to the status of a general principle of law,[172] though the weight of authority seems to favour its existence.[173] Whether it exists or not, it appears that it may pose a somewhat high threshold. In some legal systems, it has traditionally required showing that the right was exercised with the specific intent of harming the aggrieved party, and for that reason *only*. There is a divergence among various jurisdictions as to whether something less – such as the absence of a legitimate or reasonable ground for the exercise of the right – would suffice.[174] If the stricter view were taken, then it may be difficult to characterise an odious creditor's behaviour as an abuse of rights. Most (though certainly not all) cases of odious lending will involve cases where creditors were indifferent to, rather than actively promoting, harm.

[168] G Frankenberg and R Knieper, 'Legal Problems of the Overindebtedness of Developing Countries: The Current Relevance of the Doctrine of Odious Debts' (1984) 12 *Int'l J of the Sociology of Law*, 415, 428.

[169] For an overview of abuse of rights in national and international law, see M Byers, 'Abuse of Rights: An Old Principle, a New Age' (2002) 47 *McGill L J* 389.

[170] These instances are reviewed among others in the important Canadian case *Houle v Canadian National Bank*, [1990] 3 SCR 122. The case applied civil law to a dispute arising in Quebec, but contains an interesting survey of the doctrine's origins and various schools of thought.

[171] *Chapman v Honig* [1963] 2 QB 502 (CA). The English Court of Appeal, Lord Denning MR dissenting on this point, refused to countenance the doctrine in these circumstances.

[172] Those in favour of such a view include O'Connor, *Good Faith in International Law*; E Zoller, *La bonne foi en droit international public* (Paris: Pedone, 1977) pp. 109–122. Crawford, *Brownlie's Public International Law*, p. 563, regards it a valuable principle for developing the law but not part of positive law. For an historical examination of how and why the common law in England largely rejected the idea, see M Taggart, *Private Property and Abuse of Rights in Victorian England: The Story of Edward Pickles and the Bradford Water Supply* (Oxford: Oxford University Press, 2002).

[173] Byers, 'Abuse of Rights', adduces nearly overwhelming evidence in support of this view.

[174] The debate is summarised in Byers, 'Abuse of Rights', pp. 392–395. It was also a live issue in *Houle v Canadian National Bank*, where the Court opted for the wider standard.

Distinguishing commercial interest from predatory intent will be very difficult, certainly in private lending. If by contrast the wider view were taken, then the claim appears more plausible. The broader view was expressed by the Appellate Body of the World Trade Organisation (WTO) in the Shrimp-Turtle case.[175] If this approach were taken, and the high threshold of subjugation were met, then it would be reasonable to characterise the exercise of lending rights as abusive vis-à-vis the debtor state. This would be the case, for example, where a creditor lent to prop up a notoriously despotic regime in its hour of need.

The legal concept of good faith is a general principle of international law[176] and it would play an analogous as well as supportive role to the abuse of rights argument. Although traditionally regarded as a civil law principle, it was recognised by the New York Court of Appeals in the case of *Kirke La Shelle Company v The Paul Armstrong Company et al.*, where the court found that 'there is an implied covenant that neither party shall do anything, which will have the effect of destroying or injuring the right of the other party, to receive the fruits of the contract.'[177] The application of this principle to the scenarios under contemplation in this book is uncertain. However, it would seem, at least at an abstract level, that the furnishing of the economic or other means to carry out 'subjugation' of the population would injure the right of the other party to receive the fruits of the contract, to say the very least. Whether the undeniable logic of this position alone would be capable of prompting judges to shoulder its legal consequences is at best uncertain. It may, however, be yet another ground in a set of overlapping legal arguments relating to why such debts do not bind.

[175] WTO, *United States—Import Prohibition of Certain Shrimp and Shrimp Products – Report of the Appellate Body* (12 October 1998) WT/DS58/AB/R [148]: 'The chapeau of Article XX is, in fact, but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the exercise of rights by states. One application of this general principle, the application widely known as the doctrine of abus de droit, prohibits the abusive exercise of a state's rights and enjoins that whenever the assertion of a right "impinges on the field covered by [a] treaty obligation, it must be exercised bona fide, that is to say, reasonably"'.

[176] O'Connor, *Good Faith in International Law*; Zoller, *La bonne foi*.

[177] 263 NY 79; 188 NE 163 (1933). See also *Restatement (2nd) on the Law of Contracts*, § 205 (Duty of Good Faith and Fair Dealing).

### C. *The Law of Agency and the Fiduciary Obligations of Government*

The law of agency and mandate, and of representation, is recognised principles in both common and civil law traditions,[178] and commonly lead to the same practical result.[179] This area of law regulates relationships in which one person (the agent) is empowered to bind another (the principal) in legal relations with a third party. In such relationships, the law imposes a fiduciary obligation on the agent to act loyally in the interests of the principal. The most common breach of this duty is to receive secret profits from a transaction – or a bribe – in exchange for concluding the contract. The idea is appealing in the odious debt context. In such a context, the head of state acts as the agent of the state; the state is the principal; and the bank or other creditor is the third party transacting business with the state through the agency of the head of state. Part of the allure of the agency analogy is that there is ample domestic law showing that third parties who have knowingly assisted the agent's breach of the fiduciary obligation to the principal have been found liable to the principal in various ways. What is not immediately evident, on the other hand, is where the 'people' of the state enter the picture, and this is relevant here because the odious debt doctrine focuses on harm to the people. There is no conundrum, however. The population is a constituent element of a state,[180] and thus harm to the population, just like destruction of the territory of a state, constitutes harm to the state itself.

In English law, writers in public law and the law of agency alike discuss the power of public officials to bind the state in terms of agency law.[181] The position in international law is similar. Article 50 of the Vienna Convention on the Law of Treaties provides that the corruption of a state

[178] For an historical survey, see W Müller-Freienfells, 'Legal Relations in the Law of Agency: Power of Agency and Commercial Certainty' (1963) 13 *A J Comp L* 193–215 (Part I) and 341–359 (Part II).

[179] Ibid., 202.

[180] *Montevideo Convention on the Rights and Duties of States*, 165 LNTS 19, art. 1.

[181] AW Bradley and KD Ewing, *Constitutional and Administrative Law*, 14th edition (Harlow: Longman, 2006), p. 803; P Craig, *Administrative Law*, 7th edition (London: Sweet and Maxwell, 2012), 22–027. GH L Fridman, *The Law of Agency*, 7th edition (London: Butterworths, 1996), p. 381: '[t]he Crown, which is a corporation sole, and Government departments, which also may be corporations sole, like other corporations, can only act through agents (or servants). Hence the law of agency is relevant to the legal position of the Crown and Government departments, most of all in respect of contract and torts.'

representative is a valid ground for invalidating consent to be bound by a treaty. And the ICSID tribunal in *World Duty Free v Republic of Kenya* found, we may recall, that 'there is no warrant at English or Kenyan law for attributing knowledge to the state (as the otherwise innocent principal) of a state officer engaged as its agent in bribery.'[182] The idea has been examined previously in the context of odious debt.[183] The view presented here is that agency law is unlikely to provide a route through which a state can avoid a subjugation debt (though it may assist to avoid a corruption debt). There is, nevertheless, proper legal scope for recognising the related idea of public fiduciary obligations,[184] and these may ground affirmative duties upon third parties to ensure that loan proceeds are used for public and lawful purposes.

### 1. Obligations of agents to act for the benefit of the principal

In the English common law, agency obligations are generally classed as (1) those arising from agreement and (2) those arising from the fiduciary nature of the agency.[185] Regarding the latter, Fridman writes that '[i]rrespective of any contract, or even agreement, between the parties, once the relationship of principal and agent exists, however it may arise, a complex of duties attaches to the agent'.[186] The US Restatement (3rd) on the Law of Agency states that '[a]n agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship'.[187] Specific modalities of the obligations of agency include the duty not to delegate responsibility, to avoid any conflict of interest, to refuse bribes, to avoid secret benefits, and to account to the

[182] *World Duty Free*, 185.

[183] Previous examinations of this issue have included my treatment in A Khalfan, J King and B Thomas, 'Advancing the Odious Debt Doctrine' (2003) CISDL Working Paper, 11 March 2003 <http://cisdl.org/public/docs/pdf/Odious_Debt_Study.pdf>, accessed 22 July 2015, 36–40; N Hertz, *IOU: The Debt Threat and Why We Must Defuse It* (Fourth Estate, 2004), p. 179. A better analysis can be found in Buchheit, Gulati and Thompson, 'The Dilemma of Odious Debts', 1237–1245. A particularly thorough, critical and to my mind largely faultless analysis is DA DeMott, 'Agency by Analogy: A Comment on Odious Debt' (2007) 70 *Law and Contemporary Problems* 157. I take a less sanguine view of the applicability of agency law principles per se in the present chapter than I did in my earliest working paper.

[184] Although the analysis is cast in terms of fiduciary obligations, which is a concept distinct to the common law tradition, it would be surprising if the civil law did not also recognize duties of a similar character to what I describe here as 'public fiduciary obligations'.

[185] Fridman, *The Law of Agency*, p. 155 ff. (agreement) and p. 174 ff. (fiduciary).

[186] Fridman, *The Law of Agency*, p. 174 (emphasis added).

[187] *Restatement (3rd) on the Law of Agency*, 3 vols. (St. Paul, MN: American Law Institute, 2006), vol. I, §8.01.

principal.[188] It is well settled in both English and American law that bribes paid to agents entitle the principal to recover the amount from the agent as well as to rescind any contract procured thereby.[189] The law of agency also provides a significant jurisprudence demonstrating when third parties should be deemed to be on notice of circumstances that require them to make further inquiries. In *General Overseas Films, Ltd v Robin International, Inc.*,[190] a New York District Court found that a company's vice-president's act of guarantying the debt of another corporation was manifestly not in the interest of the corporation he purported to bind. Thus the third party was on notice of circumstances requiring it to inquire as to his actual authority. There is an important line of American case law regarding civil liability for aiding the breach of a fiduciary obligation.[191] In English law, similarly, there is settled law founding liability for the dishonest assistance of a breach of a fiduciary obligation. The unanimous House of Lords found that a dishonest state of mind was not only limited to actual knowledge of the wrong doing, but also 'it may consist in suspicion combined with a conscious decision not to make inquiries which might result in knowledge'.[192]

The law of agency may assist a state in avoiding a debt or rescinding a contract relating to at least some corruption debts. In such cases, however, the contract procured by a bribe is more likely to be seen as contrary to public policy. Yet it would be more difficult for a state to avoid a subjugation debt under the American and English law of

[188] PG Watts, *Bowstead and Reynolds on Agency*, 20th edition (London: Sweet & Maxwell, 2014) ch. 6, sections 1 and 2; B Markesinis and RJC Munday, *An Outline of the Law of Agency*, 4th edition (London: Butterworths, 1998), p. 93ff. See also Unidroit principles, Art 2.2.7 (conflict of interest).

[189] *Taylor v Walker* [1958] 1 Lloyd's Rep 490; *Mahesan v Malaysia Housing Society* [1979] AC 374, 379–383 (PC); Watts, *Bowstead and Reynolds on Agency Law*, [6–085]; Buchheit, Gulati and Thompson, 'The Dilemma of Odious Debts', 1242–1243.

[190] 542 F Supp 684, 690 (SDNY 1982).

[191] *Kaufman v Cohen*, 760 NYS2d 157, 169 (1st Dept 2003). However, this case finds that constructive knowledge of the illegality will not on its own suffice – there must be actual knowledge of the breach of fiduciary obligation. It thus appears somewhat weaker than the English authorities.

[192] *Barlow Clowes v Eurotrust* [2006] 1 All ER 333, [10] (Lord Hoffmann, for the unanimous court): '[L]iability for dishonest assistance requires a dishonest state of mind on the part of the person who assists in a breach of trust. Such a state of mind may consist in knowledge that the transaction is one in which he cannot honestly participate (for example, a misappropriation of other people's money), or it may consist in suspicion combined with a conscious decision not to make inquiries which might result in knowledge'. See also, S Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 *LQR* 56.

agency. The problem is characterising 'subjugation' as a breach of a general fiduciary obligation. Although the duty to act for the benefit of the principal is often laid down as a wide general principle that the agent must act for the 'benefit' of the principal, and although subjugation appears as clear an instance of harm as one can look for, in practice the courts find the duty breached in the distinct and circumscribed range of instances just noted.[193] There is not only no clear indication of a robust residual judicial discretion to expand the list as needed (however plausible and desirable that may be), but the types of duties noted there depart quite fundamentally from the character of subjugation detailed earlier. Subjugation pertains to public and criminal law norms rather than private gain, and this in a context where the principal (the state, including its population) is a complex body with highly heterogeneous interests which do not reduce easily to the bottom line on a balance sheet. Over and above the justiciability and comity concerns, courts are also wary of introducing novel interpretations of 'benefit', even in corporate law.[194] Were these hurdles cleared, two higher ones still remain: (1) showing that the head of state or state representative did not have 'apparent' or 'actual' authority to conclude the agreement in the name of the state, and (2) showing that the state did not 'ratify' the agreement's obligations afterwards, whether by way of enjoying the benefits of the contract, or by reaffirming its commitments to the debt obligations in subsequent negotiations, restructurings, or unilateral declarations.[195] These obstacles are significant, and in many cases would be insurmountable under a straightforward agency analysis. For example, Silvestre Martha reaffirms what appears implicit in the *Tinoco* case, namely, that the head of state and certain ministers are virtually always deemed to have representative authority for the

[193] Watts, *Bowstead and Reynolds on Agency*, ch. 6, sections 1 and 2.

[194] This scepticism is evident in the deferential 'business judgment rule' employed by US judges considering shareholder suits against corporate directors alleged to have breached their fiduciary duties towards shareholders. See *Cede v Technicolor, Inc*, 634 A 2d 345, 360–61 (1994). For a critique from a public law perspective, see G Frug, 'The Ideology of Bureaucracy in American Law' (1984) 97 *Harv L Rev* 1276, 1305–1307. For a more detailed discussion, see American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (1992) §4.01.

[195] The analysis in Buchheit, Gulati and Thompson, 'The Dilemma of Odious Debts', 1244 in my view understates the difficulties. Cf DeMott, 'Agency by Analogy', 161–162. The problem of restructured debt is yet more profound: see B Thomas, 'The Doctrine of Odious Debt and International Public Policy: Assessing the Options' in Khalfan, King and Thomas, 'Advancing the Odious Debt Doctrine', 95–100.

state.[196] Thus even if a head of state broke national law constraining his or her powers, it would still be very possible for a national court to find that he had 'apparent authority' (presumably this argument would not work if the creditor knew that the head of state was violating relevant domestic law). As for the issue of ratification, it was shown in chapter 1 that much of the developing world debt has at some point been rescheduled and at such point states tend to make statements reaffirming their commitments to honour the debt.

The fact that agency law might deliver less than it seems at first to promise is also not surprising when one takes account of the broader structure of agency law. It is designed chiefly for regulating private persons operating under a representative government that is bound by principles of public and criminal law, and which enacts a regulatory system to provide for and enforce public policies in specific areas. Most importantly, agency law is mostly though not exclusively premised on the ongoing power of the principal to dismiss its agents at almost any time – a consensual relationship. This fact accounts in part for why the rules tend to allocate many risks to the principal. This power of consensual dismissal at times grafts poorly onto even representative government,[197] and not at all onto dictatorships whose authority to bind the state is unfortunately recognised in international law under the principle announced in the *Tinoco* case. The problem is therefore chiefly one of fit.

## 2. The government as fiduciary

It is important to note that agency law is only one branch of the law of contract, and the law of wrongs more broadly recognises fiduciary obligations in a wide range of circumstances. There is a body of authority and reasons of principle for recognising distinct fiduciary obligations that are particular to state agents, which might apply either independently of the

[196] RSJ Martha, *The Financial Obligation in International Law* (Oxford: Oxford University Press, 2015), p. 201.

[197] Buchheit, Gulati and Thompson, 'The Dilemma of Odious Debts', 1238, suggest that the people are the principal, and that a requirement of democratic consent to be governed is a key ingredient of government/state relations that renders applicable the American law of agency. However, neither is true. The state is the legal personality constituting the principal. And consent by the people or even *de jure* recognition is not a necessary element of the power to bind the state internationally: *Tinoco Arbitration*. Even under representative government, consent does not operate as it does in agency law. Recall powers vis-à-vis elected representatives are highly restricted and normally non-existent in representative government. The power/liability model discussed below does not depend on consent and so avoids these problems.

private law of agency, or within a branch of agency law applicable to contracting by public authorities. The basic idea offered here is that due to the fiduciary character of the obligation owed by the representative to the state and its people, the third party is under an obligation to make reasonably searching inquiries into whether proceeds are used for lawful and public purposes. Where there has been a knowing assistance of a breach of any such duty by third parties, there may be a claim that the contract can be rescinded or avoided because the creditor knew of the unlawful purpose, or a claim or counter-claim by the state against the creditor that can be set off against any amount owing under the contract.

There are a few reasons to recognise a fiduciary duty of such character. First, fiduciary obligations have a history in the public law of certain common law nations. The financial powers and duties of public officials in most democratic societies are now highly regulated by statutes, criminal law and constitutional law. But even before many of these statutes, and perhaps due to their paucity, it was common for American courts to recognise and impose fiduciary obligations on local government authorities.[198] Relatedly, obligations to spend public money raised by debt for public purposes have been elaborated and applied extensively at both the federal and state levels in the United States, and such obligations were derived under the common law as well as from constitutional interpretation.[199] Fiduciary duties per se have been firmly established in English public law, particularly in respect of local authorities vis-à-vis their ratepayers (i.e. those who pay tax to local authorities).[200] Borrowing powers in English local government finance are strictly regulated by statute, both in terms of how much may be borrowed and for precisely what types of works such borrowing can take place.[201] But Martin Loughlin shows how, historically, local authorities were entrusted with

[198] DM Lawrence, 'Local Government Officials as Fiduciaries: The Appropriate Standard' (1993–94) 71 *U Detroit Mercy LR* 1.

[199] 64 Am Jur 2d Public Securities and Obligations § 94.

[200] M Loughlin, *Legality and Locality: The Role of Law in Central–Local Government Relations* (Oxford: Oxford University Press, 1996), pp. 203–262 ('The Fiduciary Duty in Public Law'). Though Loughlin is mostly critical, he is critical of the way in which the concept was insidiously evolved from one owed to the general public to one owed specifically to ratepayers.

[201] Local Government Act 2003, s 1; But see s 6 ('A person lending money to a local authority shall not be bound to enquire whether the authority has power to borrow the money and shall not be prejudiced by the absence of any such power.'; see also C Crawford, 'Local Authority Finance', in SH Bailey (ed.), *Cross on Principles of Local Government Law*, 3rd edition (London: Sweet & Maxwell, 2004), ch. 12, esp. 12–44–12–48.

money to be used for specific purposes, and that an equitable doctrine of fiduciary obligation was used as the vehicle for the enforcement of a duty to spend any surplus funds in the public benefit.[202] Local authorities were thus judicially regarded as 'trustees of their corporate property for public purposes[.]'[203] It was found in *Attorney-General v. Compton*, that '[t]he beneficial right to the fund is in the public generally of that district, for whose benefit and in a particular manner it is to be applied by the public officers of that district'.[204] Although some of these authorities are now dated (and infamous),[205] they represent initiatives undertaken at a time when the legal systems had not evolved more elaborate statutory and procedural controls on public finance. The law relating to sovereign defendants in private law proceedings in foreign national courts is similarly embryonic.

The Supreme Court of Canada appears to have gone the furthest in developing the notion of public authority fiduciary obligations, in relation to the Canadian government's dealings with Canada's First Nations (aboriginal nations and peoples), in particular with respect to dealings concerning aboriginal title and land-use rights. These fiduciary duties were initially drawn from the Indian Act in respect of reserve lands, and section 35 of the Canadian Charter of Rights and Freedoms, but were later held to apply more generally to 'the high degree of discretionary control gradually assumed by the Crown over the lives of aboriginal peoples'.[206] The constitutional theorist Evan Fox-Decent has argued persuasively that the general relationship between sovereign authorities and the people of a state must be conceived of in fiduciary terms.[207]

[202] Loughlin, *Legality and Locality*, p. 207.

[203] Loughlin, *Legality and Locality*, p. 208, citing S Brice, *The Law of Corporations and Companies: A Treatise on the Doctrine of Ultra Vires; Being an Investigation of the Principles Which Limit the Capacities, Powers, and Liabilities of Corporations, and More Especially of Joint Stock Companies*, 3rd edition (London: Steven & Haynes, 1893), p. 192.

[204] [1842] 1 Y & CCC 417, 427 (cited in Loughlin, *Legality and Locality*, p. 208).

[205] The infamy was due to judicial obstruction of progressive social policy reforms, as Loughlin shows, but see too HJ Laski, 'Judicial Review of Social Policy in England' (1926) 39 *Harv L Rev* 839 for a contemporaneous analysis by a great political theorist, lifelong correspondent with Oliver Wendell Holmes Jr, and active public intellectual who served as Chairman of the British Labour Party 1945–46.

[206] *Wewaykum Indian Band v. Canada* [2002] 4 SCR 245 [79]. This unanimous judgment contains a helpful overview of the developments in the court's jurisprudence on this subject: [72]–[85].

[207] E Fox-Decent, *Sovereignty's Promise: The State as Fiduciary* (Oxford: Oxford University Press, 2011).

While, Canada's legal doctrine of a public fiduciary obligation is at the moment recognised chiefly in its dealings with Canada's aboriginal communities, the rationale for that position would appear to extend to much sovereign lending, particularly where the sovereign came to power other than by free and fair elections.

A second reason to acknowledge the fiduciary nature of the obligation is that it does not arise on the basis of consent only, but also on the mere existence of a power/liability relationship. The rationale is stated best by Ernest Weinrib:

> The reason that agents, trustees, partners and directors are subjected to the fiduciary obligation is that they have a leeway for the exercise of discretion in dealings with third parties which can affect the legal position of their principals. . . . Accordingly, the hallmark of a fiduciary relation is that the relative legal positions are such that one party is at the mercy of the other's discretion.[208]

This is a view broadly adopted in the English tradition of agency law,[209] and one adopted explicitly by the Supreme Court of Canada.[210] Some agency relationships are not based on consent: agency of necessity, agency of cohabitation, and other agencies by operation of law.[211] The obligation arises either out of the special relationship between the parties, or out of the very nature of the agency relationship. This power/liability model also helps explain common intuitions about why governments ought to be recognised as having special duties to act in the public interest, duties which have a distinctly public policy rather than purely financial character. This is no more exotic than is the common law recognition of fiduciary duties specific to professions such as medicine, law and social care.

A third and final reason for accepting an idea of a distinctly public fiduciary obligation is that, whatever the position of the asserted right to

[208] EJ Weinrib, 'The Fiduciary Obligation' (1975) 25 *U of Toronto LJ* 1, 7.

[209] An early statement of this view is found in FE Dowrick, 'The Relationship between Principal and Agent' (1954) 17 *MLR* 24, esp 36ff., '[The] power-liability relation is the essence of the relationship of principal and agent.'; Fridman, *The Law of Agency*, p. 174; Watts, *Bowstead and Reynolds on Agency*, 20th edition (London: Sweet & Maxwell, 2014); Markenesis and Munday, *An Outline of the Law of Agency*, pp. 8–11. For a critique, see G McMeel, 'Philosophical Foundations of the Law of Agency' [2000] 116 *LQR* 387 (contrasting the 'consensual' and 'power-liability' models).

[210] *Wewaykum Indian Band*, [80].

[211] Markenesis and Munday, *An Outline of the Law of Agency*, pp. 52–65; the Unidroit principles exclude agency created by operation of law from those covered by its provisions, oriented as it is towards international commercial sales contracts: Art. 2.2.1.

democratic governance in international law (the case for which has been made impressively by Gregory Fox),[212] there can be no question that in international law a government is at the very least obliged to rule in the interests of its own population. This is manifested in the UN Charter, in the universally affirmed right of all peoples to self-determination, in the Universal Declaration on Human Rights and the various human rights covenants and conventions, along with numerous UN General Assembly declarations, including the Declaration on the Right to Development and the Millennium Declaration. The collective weight of these legal instruments recognises that all governments, non-democratic as well as democratic, have a duty to rule in the interests of their people and to respect their basic human rights. That international legal obligation, it may be contended, can be recognised in private law by means of a public fiduciary obligation. Indeed, the clearest contribution of the UNCTAD Principles on Responsible Sovereign Lending and Borrowing to the doctrine of odious debt was its clear articulation of the notion of agency obligations between head of state and the population, and the role of fiduciary obligations therein which must be respected by creditors. The first principle states that '[l]enders should recognise that government officials involved in sovereign lending and borrowing transactions are responsible for protecting public interest (to the State and its citizens for which they are acting as agents)'. While the principles are not binding law, as soft law they inform the development of international law and make, in the views of Robert Howse, a substantial contribution to the evolution of the odious debt doctrine.[213]

Given these authorities and principles, the recognition of such public fiduciary obligations under the common law of New York and England would an incremental step rather than radical departure from settled principles. It is, however, reasonable to ask what difference such a finding would make. If the contract is contrary to public policy, what is added by

[212] GH Fox, 'The Right to Political Participation in International Law' in GH Fox and BR Roth (eds.), *Democratic Governance and International Law* (Cambridge: Cambridge University Press, 2000), p. 48.

[213] See United Nations Conference on Trade and Development (UNCTAD), 'Principles on Promoting Responsible Sovereign Lending and Borrowing' (10 January 2012) <www.unctad.info/upload/Debt%20Portal/Principles%20drafts/SLB_Principles_English_Doha_22–04-2012.pdf>, accessed 3 August 2015, no.1; see also the concluding essay by Robert Howse, 'Concluding Remarks in the Light of International Law' in C Espósito, Y Li and JP Bohoslavsky (eds.), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (Oxford University Press, 2013), p. 385.

a further finding that there has been a breach of a public fiduciary obligation? In my view, the recognition of public fiduciary obligations and violations thereof adds something in that the behaviour is condemned as wrong by more than one branch of private law. It confirms how roundly the fabric of the law disdains the conduct at issue. More importantly, it offers another distinct contribution – it explicitly imposes more searching obligations on third parties who knowingly assist a person who breaches a fiduciary obligation. Whereas in the law of contract it seemed actual knowledge (if not participation) was required, under the law for dishonest assistance of a breach of trust the standard consists of 'suspicion combined with a conscious decision not to make inquiries which might result in knowledge'.[214] Such a standard also makes good sense. While the law of contracts presupposes transactions between free and equal persons, the law of fiduciary relationships recognises imbalances of power and special duties arising therefrom. And even in the special field of fiduciary relationships, it must be the case that no relationship can rank higher or even equal in importance to that between state representative and the tens or hundreds of millions making up the general public. It must be sound legal policy that in any fiduciary relationship, where the scale for potential harm is greater, so too is the third party's duty to take diligent steps to establish the bona fides and legality of the transaction.

## IV. Summary and Conclusion on Odious Debts in Domestic Law

In a rather recent development, domestic (or municipal) law has overtaken international law as the key framework for determining the enforceability of sovereign debts between private creditors and foreign states, and two key jurisdictions play the most prominent role in governing the matter. The question in this chapter has been whether what were described as odious debts in chapter 3 would be enforceable in such jurisdictions. The conclusions can be restated as follows.

First, there is no settled rule recognised by either New York law or English law that a successor state is liable for the debts of a predecessor state. Thus debt claims against successor states will ordinarily not succeed in English or New York courts, absent special circumstances. This would mean that any war debt, subjugation debt or illegal

[214] *Barlow Clowes*, above at note 192.

occupation debt against a successor state will not ordinarily be enforceable. However, the position may be different in other nations. Second, the classical definition of a war debt has been debts arising out of transactions which helped or are presumed to have helped the defeated country in waging or preparing war against the successor state or its allies. Since this pertains to state succession the answer has already been given. However, it can also be observed that the common law recognises a doctrine of 'trading with the enemy' that would also arguably deny relief of any kind, particularly where the lender supported an insurrectionary movement that failed, whether there has been state succession or not. As for illegal war debts, the position is not settled. However, in my view it follows inexorably from the discussion of illegal lending that a debt funding the prosecution of an illegal war must be found unenforceable as being contrary to a *jus cogens* norm and thus the public policy of England and New York. Third, as for corruption debts, under the law of New York and England, ultra vires debts will not ordinarily bind. Debts of personal enrichment are effectively a form of indirect bribery, or self-dealing, and knowledge of any such result must be dealt with as a species of bribery. In the case of bribery, it is settled that debts procured through bribery are contrary to public policy and thus unenforceable in both jurisdictions.

The fourth, and most difficult, case concerns subjugation debts, for in adjudicating them a court is asked to pass judgment on foreign public acts that are not principally of a financial character. Subjugation debts are those debts that are made for the purpose of facilitating the violation of *jus cogens* norms, commission of serious or flagrant violations of human rights, humanitarian law, or other fundamental international law principles in respect of the population of the debtor state. I concluded that such debts would be contrary to the public policy of New York and of England. Provided the facts pleaded to establish such subjugation were justiciable in those courts and the violations of public international law were clear, a New York or British court should not enforce any such contract. Principles relating to illegal loans conduce to such a conclusion. Such principles show, however, that it is not contrary to public policy merely to do business with a known violator of such norms. There must ordinarily be a tight causal nexus, or clear relationship of support, between the loan and unlawful activity, though it need not be stated in the contract itself nor stipulated as a condition of the loan. In both jurisdictions, whether knowledge of the unlawful purposes alone (rather than active participation) will suffice is a matter of some dispute, but

authority suggests that in the case of grave crimes or violations of fundamental norms knowledge alone would indeed be sufficient.

Fifth, extra-contractual principles that are sometimes referred to as 'equitable' play an uncertain role. The law of restitution, or unjust enrichment, is not ordinarily available in either New York or English law to assist a creditor recover property transferred under a contract deemed to be contrary to public policy. This may at times be seen as leading to unfair results, and there has been an effort in both jurisdictions to modernise the law to account for this. Yet in my view it would be a clear break with such principles to allow recovery on a subjugation debt. Such recovery would stultify the underlying public policy. The principles of abuse of rights and good faith play an uncertain and at best subsidiary role. While the more elaborate rules found in the law of agency are on their own of limited assistance to a state seeking to avoid a subjugation debt, the core idea in the law of agency – that the agent owes the principal a fiduciary duty and the third party may assist in the breach thereof – is an important one that can be recognised independently from the rest of agency law. The rather mild claim advanced above was that due account taken of the history of fiduciary obligations in the public law of the United States and Britain, of the central role of the power/liability model as the rationale for the imposition of fiduciary obligations, and of the undeniable force of the legal proposition that international law compels all state representatives everywhere to act in the interests of their populations, it is appropriate for New York and English courts applying private law to foreign sovereigns to recognise the existence of a distinctly public fiduciary obligation. Such an obligation would not ground a wide-ranging 'public benefit' principle that can undo any project vaguely considered unhelpful to a country. But it would support the idea that creditors engaging with such fiduciaries have an affirmative obligation to ensure that the proceeds from the loan are applied to public purposes and are consonant with international public policy.