Preventing Odious Obligations
Frequently Asked Questions

Too often, poor countries get saddled with the odious obligations made under repressive dictators. The Center for Global Development Prevention of Odious Obligations Working Group proposes a new tool that would strengthen existing measures against illegitimate regimes and could alleviate successor governments and citizens from the burden of unjust transactions: preemptive contract sanctions.

What is a preemptive contract sanction?

A declaration that any new contracts with, or loans to, a designated illegitimate regime need not be honored by a legitimate successor government.

What value does this add to normal sanctions?

Currently, a country can only directly enforce sanctions against people and companies within its legal jurisdiction; with the result that illegitimate regimes can still trade with people and companies based in third countries. Paradoxically, the courts of the UK and United States can, under some circumstances, be used to uphold and enforce these third-party contracts, even though the same contracts would be illegal and unenforceable for their own citizens. A declaration that such contracts are odious would extend the effect of sanctions by making it harder or more expensive for the targeted regime to bypass traditional sanctions by entering into contracts with third parties.

Furthermore, this tool can help alleviate the burden that unjust transactions impose on legitimate successor governments and their citizens by providing the option for those governments to repudiate odious contracts covered by the declaration without endangering access to international credit markets.

Which contracts would be covered?

Like normal sanctions, preemptive contract sanctions will vary from situation to situation depending on the circumstance. Largely, they will be targeted narrowly at particular types of transaction (e.g. arms, oil), organizations (e.g. federal government, or institution) or individuals (e.g. members of the government and their families). They can also be applied more broadly to whole regimes, but unlike other sanctions, they are still focused exclusively on public rather than private transactions (unlike the comprehensive U.S. sanctions against Sudan, which prohibit most private activity as well).

Who makes the declaration?

In theory, preemptive contract sanctions could work even if the declaration were made only by the governments of the United States and the United Kingdom, since they are home to the world's leading financial centers and the courts that are the most common venue for adjudicating international contracts. In practice, such a declaration would be greatly strengthened by an international consensus that includes key developing countries and the endorsement of relevant regional bodies. Unlike many trade sanctions, contract sanctions do not require international unanimity—or a UN Security Council resolution—to be effective.

Is this an exercise of extraterritorial power over third parties?

No. It is a change in the rules for cases being pursued in the courts of the countries making the declaration.

Would this create uncertainty about the independence of the U.S. or UK legal system, or undermine their legal services industries?

No. Trust in these legal systems might be undermined if measures were introduced retrospectively; but this is a declaration in advance that a particular type of contract will not be upheld in future. If anything, this will enhance the

predictability of British and U.S. courts. There are already contracts that cannot be upheld in these courts, for example, contracts involving slavery: this merely extends that category.

Does this undermine contract law, the widespread acceptance of which is a global public good?

No, for two reasons. First, the proposal does not undo existing contracts but declares only those contracts signed *after* a given date to be illegitimate and therefore unenforceable; this is not about rescinding existing contracts. Second, there are already many 'contracts' which cannot be enforced in U.K. and U.S. courts. For instance, a British court will not enforce a contract for slavery, nor a contract with unfair terms (e.g. unreasonably excluding liability). This tool would extend that principle to exclude the enforcement of contracts with regimes which have been declared illegitimate.

Will contracts simply shift so that they are enforced elsewhere?

It would be a time-consuming and costly process to identify alternative jurisdictions to enforce the odious contracts; and those jurisdictions would only be effective and credible in enforcing judgment if both parties to the contract have significant economic assets in or dealings with that jurisdiction.

Does the UK government have sufficient power to do this?

The UK government has the power to declare that contracts would be nontransferable if done so as part of a package of sanctions set out in an EU Directive or Regulation, or a Security Council agreement. In general, these preemptive contract sanctions can be applied under the same powers as conventional sanctions.

The UK government already limits financial services which can be provided to third parties entering into contracts with Iran (for example, a third party cannot normally buy insurance for a ship carrying goods to Iran at Lloyds of London). If it is possible to limit access to UK financial services for third parties engaged in commerce with regimes under sanction, it should also be possible to restrict access to legal services.

Does the U.S. executive branch have sufficient power to do this?

In the United States, a declaration that odious contracts would not be enforceable could be enacted under existing law. The CGD Working Group concluded that the U.S. president has the power to make the declaration under two statutes: the Trading with the Enemy Act of 1960 (TWEA) and the International Emergency Economic Powers Act of 1977 (IEEPA). These statutes have customarily been used as the basis for traditional economic sanctions and are pertinent for the proposed approach given the expansive powers that the acts authorize.

Could rogue investors take legal action to uphold contracts signed in defiance of a declaration?

It is possible that a rogue investor might turn to international dispute settlement institutions to uphold contracts signed in defiance of a declaration and that international law might oblige a U.S. or UK (or other) court to uphold an arbitral panel award enforcing the contract despite the declaration. The CGD Working Group concluded that this is unlikely in practice, for a number of reasons. In many cases appeals for arbitration would be subject to the approval of the successor regime, and thus the resolve of the successor to renounce the contracts would be sufficient to enact the proposed approach. If a rogue investor, nevertheless, prevailed in arbitration, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (known as the New York Convention) provides that third party countries may refuse to recognize or enforce the award if it "would be contrary to the public policy of that country."

For additional information on the theory and practice of preemptive contract sanctions, see *Preventing Odious Obligations: A New Tool for Protecting Citizens from Illegitimate Regimes: A Report of the Working Group on the Prevention of Odious Debt* (2010).