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WHEN BAD THINGS HAPPEN TO GOOD SOVEREIGN DEBT CONTRACTS: THE CASE OF ECUADOR

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I
INTRODUCTION

Multinational corporations were meant to be reassured by the protections incorporated into bilateral and regional investment agreements. However, judging from the growing number of claims filed with the International Centre for Settlement of Investment Disputes (ICSID) and other arbitration vehicles—more than three hundred and fifty treaty-based, investor–state disputes as of the end of 2009—it is evident that many corporations have found out the hard way that sovereign states are not always suitably restrained by the international treaties they have signed and ratified.[1]

Likewise, private-sector commercial-bank creditors, bondholders, and suppliers—even official bilateral and multilateral lenders—have come to learn by repeat experience that financial contracts entered into by sovereign borrowers, no matter how airtight and well-intentioned at the time they were crafted and signed, can be perverted or ignored by governments lacking in ability or willingness to pay.

This article illustrates this point by focusing on the case of Ecuador, a country whose governments have defaulted nine times on foreign-currency bonds and numerous times to foreign commercial-bank creditors and others, such that the sovereign has been in default for at least 109 out of the last 184 years—sixty percent of the time from 1826 through 2010.[2] By its own reckoning, the government has

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[1] See United Nations Conference on Trade and Development [UNCTAD], Geneva, Switz., 2010, *World Investment Report*, at 83.
[2] Ecuador's first default took place when it was part of the Republic of Gran Colombia, which became the nations of Ecuador, Colombia, and Venezuela in 1830. See generally David T. Beers,

been in arrears on interest payments to some foreign creditor or another in each and every year starting in 1987.[3]

The lesson from abundant history is that, despite decades of innovations in international-loan and bond contracts involving sovereign financial obligations—courtesy of some of the best minds in New York, London, and beyond—lawyers, bankers, analysts, and investors are best advised to operate under no illusions: sovereigns are indeed sovereign, independent of the laws of other nations. Those who harbored the hope that Argentina's bad behavior as a sovereign debtor was a major exception that would not soon be repeated should be persuaded by the case of Ecuador that, although the absence of sovereign willingness to pay remains rare, it is not rare enough. Notwithstanding the best of legal contracts and the surrender of sovereign immunities under New York, English, or other foreign law, in actual practice, rogue sovereign debtors can be held accountable or effectively restrained only by the forceful actions of other sovereigns.[4] During the nineteenth century, this was sometimes accomplished by the successful exercise of military force and, during the twentieth century, through the application of diplomatic, trade, and financial sanctions or incentives, both unilaterally and through multilateral organizations.

II

THE GOOD INTENTIONS

After repeated refinancings and deferrals of debt-service obligations to foreign commercial banks, and the accumulation of sizeable interest arrears (particularly from 1987 through 1994), the government of Ecuador finally reached a comprehensive debt-forgiveness and restructuring deal in 1995, under the aegis of the Brady Plan. The terms agreed to reflected creditor concessions that were more generous than those granted to any other Latin American government up to that moment; in particular, the discount bond—accepted by creditors willing to give up claims on principal owed—involved a forty-five percent "haircut" rather than the usual thirty-five percent.[5] As in other Brady Plan applications, the various securities issued in exchange for old defaulted loans (in this instance the par, discount, past-due-interest, and interest-equalization bonds) incorporated a number of legal

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Commentary, *Sovereign Defaults At 26-Year Low, To Show Little Change in 2007*, STANDARD & POOR'S, Sept. 18, 2006, at 18.

[3] BANCO CENTRAL DEL ECUADOR, 80 AÑOS DE INFORMACIÓN ESTADÍSTICA ch. 2 tbl.2.12 (2007), *available at* https://www.bce.fin.ec/documentos/PublicacionesNotas/Catalogo/Anuario/80anios/indice.htm; Banco Central del Ecuador, Movimiento de la Deuda Externa Pública, INFORMACIÓN ESTADÍSTICA MENSUAL, Sept. 2010, at tbl.3.3.1, *available at* http://www.bce.fin.ec/home1/estadisticas/bolmensual/IEMensual.jsp.

[4] See Arturo C. Porzecanski, *From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default*, 6 CHI. J. INT'L L. 311, 331 (2005) (asserting that rogue debtors are a threat to the international financial architecture).

[5] Lee C. Buchheit, *How Ecuador Escaped the Brady Bond Trap*, INT'L FIN. L. REV., Dec. 2000, at 17, 17.

innovations designed to make them virtually inviolable in any future economic emergency. First, they were freely transferrable bonds listed on the Luxembourg Stock Exchange, precisely so their ownership could change over time and so they would not be easily traceable for the purpose of getting them restructured again. Second, the bonds that involved debt forgiveness or concessional interest rates and that had very long grace periods and maturities (the pars and discounts) were backed in part with good collateral (U.S. government zero-coupon bonds), so future governments would not be tempted to default merely to avoid servicing them. And, third, the new bonds contained "exit covenants" by which the obligor pledged neither to ask for a future restructuring of the securities nor to request additional funding from the holders of the bonds.[6]

In addition, the Ecuador and other loan-for-Brady-bond exchanges were accompanied by concrete steps and pledges of improved macroeconomic policies and market-friendly structural reforms that would enhance the ability of governments and their successors to service the new financial obligations until their eventual maturity. In Ecuador's case, good progress in terms of economic stabilization and structural reforms was made ahead of the Brady Plan's implementation, with the support of the Washington-based multilateral agencies, moving the International Monetary Fund (IMF) twice (in 1992 and 1994) to endorse a rescheduling of debts owed by the government of Ecuador to the official foreign-aid and export-financing agencies represented at the Paris Club. However, in 1995, the debt relief obtained in these reschedulings was squandered via increased military spending following a brief border war with Peru; and what had been a duly balanced government budget from 1993 through 1994 became a string of deepening fiscal deficits—and renewed foreign indebtedness, including for armaments. Battered also by drought-related power shortages and the adverse repercussions of the financial crisis in Mexico, the economy stagnated that year, and the country's vice president, who had been the driver of market-friendly economic reforms, fled Ecuador to evade arrest on charges of corruption.[7]

Notwithstanding the good intentions incorporated into the 1995 debt-relief operation, by 1999, Ecuador was in very serious—indeed far more serious—financial trouble. A decline in world oil prices, damaging floods occasioned by the El Niño weather phenomenon, a drop in capital inflows in the wake of the Asian and Russian financial woes, a major domestic banking crisis, and loose fiscal and monetary policies all combined to push the economy to the brink of ruin. During the second half of that year, Ecuador became the world's first government to default on its Brady bonds. Ecuador defaulted as well on two Eurobonds that had been issued in better days (1997) and on dollar-denominated domestic obligations maturing in the short run. In a desperate move, the government officially dollarized the economy in January 2000, but soon after, the president was

[6] Lee C. Buchheit, *The Evolution of Debt Restructuring Techniques*, INT'L FIN. L. REV., Aug. 1992, at 10, 12.

[7] Stanley Fisher, First Deputy Managing Dir., Int'l Monetary Fund, Remarks at the Hoover Institution Conference on Currency Unions: Ecuador and the IMF (May 19, 2000), *available at* http://www.imf.org/external/np/speeches/2000/051900.htm.

deposed and was replaced by his vice president. As financial stability and improved macroeconomic policies took hold, the IMF offered its financial support in April of that year—provided that substantial debt relief was obtained from foreign private creditors.[8]

In July of 2000, with the IMF's backing, the government sought and obtained a second round of principal forgiveness from its creditors, estimated at around forty percent of face value. Bondholders were presented with a take-it-or-leave-it exchange offer whereby they would get new, uncollateralized obligations due in 2030 that paid very little interest, at least in the initial years, in exchange for their long-dated Brady bonds, to which a heavy discount was applied, and for their short-dated Eurobonds, to which no discount was applied. If creditors had opted instead for a bond paying a high interest rate and maturing in 2012, they would have had to concede an additional thirty-five percent "haircut" on the principal owed by Ecuador. Some ninety-seven percent of all bondholders accepted the exchange offer, which gave Ecuador substantial debt reduction as well as significant cash-flow relief in the initial years.[9]

The new bonds incorporated contractual innovations meant to reassure investors that the risk of future losses would be minimized and that the new securities had upside potential. As the venerable Lee Buchheit, New York counsel to the Republic of Ecuador, recounted, "A deliberate effort was . . . made to include structural features in the new bonds that would reduce the likelihood that the debt stock would become the subject of a third round of debt relief in the future."[10] The first legal innovation was to incorporate a pledge that, if there should be a default that was not cured within one year on the 2030 bonds during the first decade after issuance, Ecuador would compensate bondholders: it would grant them additional 2030 bonds under a sliding scale, starting with an extra thirty percent of bonds if the default took place in the first four years after their original issuance. This principal-reinstatement provision sought not only to reassure those investors who had granted debt forgiveness that a meaningful portion of their original claims against Ecuador would be restored in case of a default, but also to discourage future Ecuadorian governments from defaulting by making it expensive for them to do so.

The second legal novelty was to include a binding commitment that Ecuador would repurchase a specified percentage of both the outstanding 2012 and 2030 bonds in each year starting six and eleven years after their issuance, respectively. These mandatory buybacks (at secondary-market prices) were intended to set investors' minds at rest that the aggregate amount of Ecuador's bonded debt would

[8] *Id.* ("The country needed both cash flow relief and debt reduction to secure a sustainable external and fiscal position for the medium term.").

[9] Lee C. Buchheit, *supra* note 5, at 18–19. A ceiling was placed on the overall issuance of 2012 bonds and a cash payment was made on past-due interest and principal, funded by the collateral set aside when the Brady bonds had originally been issued. There was also an innovative, aggressive use of "exit consents" to penalize bondholders who might choose to retain their existing bonds; they would be rendered substantially inferior by the consent to various prejudicial amendments granted by bondholders entering into the debt exchange. The application of these exit consents surely helps to explain the high bondholder participation rate. *Id*. at 19–20.

[10] *Id*. at 19.

be gradually reduced to a smaller, more manageable size before the bonds matured and to reassure them that, by its actions, the government of Ecuador would help bolster the price of these securities in the secondary market. Ecuador's failure to meet the debt-reduction targets in any one year would trigger a mandatory partial redemption of the bonds at par. However, this novelty was potentially quite advantageous also for Ecuador because it allowed the government to satisfy its amortization commitments by purchasing the bonds and retiring them whenever they traded at a discount in the secondary market—which they usually did, at prices in the range of fifty to sixty cents on the dollar. If the 2012 or 2030 bonds were ever to trade above par, the government could always make the amortization payments at par.[11]

With the IMF's blessing, the Paris Club subsequently refinanced accumulated arrears and maturities through April 2001. It did not grant any debt forgiveness, however, just as it had not done in the early 1990s. And yet Ecuador's interest and principal arrears to official creditors were more than twice as large as they had been to commercial banks and bondholders before the refinancing.[12] Evidently, while Ecuador was deemed (by the United States and European governments, as well as by the IMF's management) to be insolvent enough to deserve major write-offs from private creditors twice in five years, it was considered solvent enough not to deserve write-offs from official creditors even once—despite being in the midst of the country's arguably worst economic crisis. This was one of several instances in which the Paris Club's principle of "comparable treatment" proved to be a highly discretionary one-way street.[13] It would take less than a decade for investors in vintage-2000 Ecuador bonds to come to regret ever owning the new, and supposedly much-improved, securities.

III

THE BAD OUTCOMES

In late 2008 the current populist government of Ecuador, headed by President Rafael Correa, defaulted on the 2012 and 2030 sovereign bonds, claiming they were

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[11] *Id.* at 19–20. This was one of the motivations for the government to set up a fund known as the Stabilization and Investment Fund for Petroleum Resources (FEIREP), *infra* at p. 8, to provide a pool of cash to repurchase the 2012 and 2030 bonds opportunistically whenever they would trade at a deeper than usual discount. The government could also achieve the promised reduction in the stock of outstanding bonds by other means, such as debt for equity exchanges.

[12] INT'L MONETARY FUND, ECUADOR: SELECTED ISSUES AND STATISTICAL ANNEX 141 tbl.47 (2000), *available at* http://www.imf.org/external/pubs/ft/scr/2000/cr00125.pdf (demonstrating that as of May 2000, Ecuador's arrears to bilateral agencies had reached $742 million, versus $311 million to commercial banks and bondholders).

[13] Arturo C. Porzecanski, *Debt Relief by Private and Official Creditors: The Record Speaks*, 10 INT'L FIN. 191, 204 (2007) (observing that during the 1990s, the Paris Club never granted debt relief to several governments in Asia and Latin America that did obtain debt relief from private creditors, and then in 2005–2006, the Paris Club benefited from debt prepayments made by Nigeria, Peru, and Russia, but did not insist that private creditors likewise receive prepayments).

immoral and illegitimate obligations.[14] At no point before or after the default—when Ecuador was repurchasing the bonds both indirectly (through the secondary market) and directly (through a buyback for thirty-five cents on the dollar)—did the government assert that servicing these obligations posed a financial hardship. There was no objective basis for doing so: in 2008, the public external debt was the least burdensome it had been in over three decades, relative to government revenues or to the gross domestic product (GDP). Moreover, the country's central bank held more freely disposable international reserves ($6.5 billion) than it had ever accumulated before.[15] The United States and Europe were in a financial crisis and world oil prices had plunged, but the Ecuadorian economy was unusually well positioned to withstand these exogenous shocks, which proved temporary anyway. Therefore, this default was not the consequence of a sovereign's inability to pay.[16] It was also out of character with Ecuador's many prior defaults, which had taken place during major fiscal and economic emergencies.

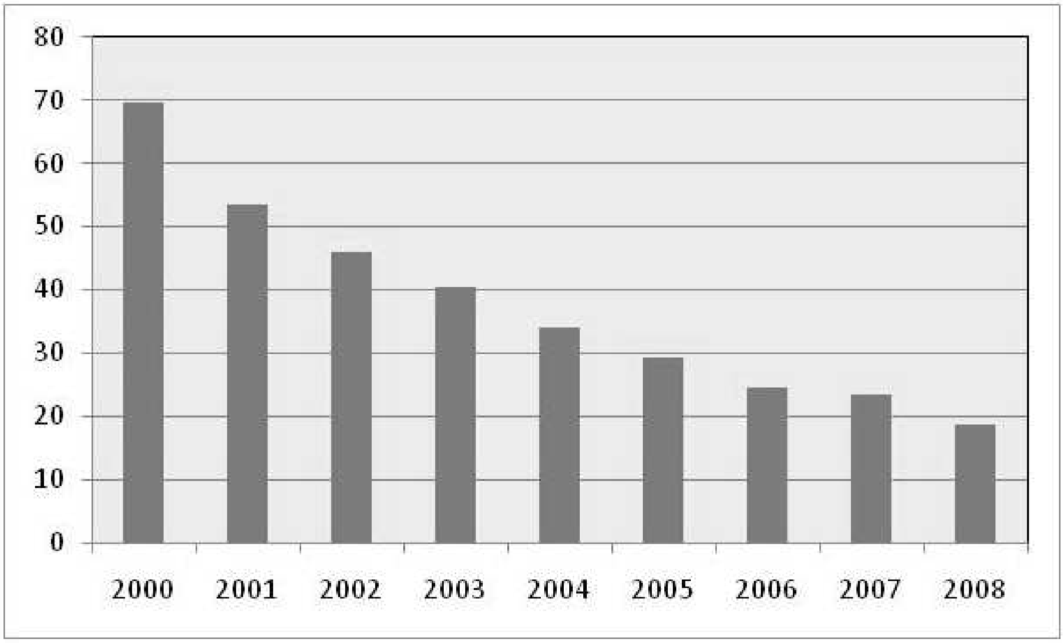
During the period from 2000 through 2005, the government's external public indebtedness remained fairly steady averaging $11.25 billion, then declined to $10.1 billion by the time of the default, as repayments exceeded new disbursements because rising world oil prices provided a fiscal windfall that minimized Ecuador's borrowing needs. The economy expanded steadily and the market value of Ecuador's GDP ballooned from an abnormally depressed $16 billion in 2000 to $54 billion by 2008. Consequently, by the time President Correa announced the default, the ratio of external public debt to GDP had dropped sharply from seventy percent in 2000 to a very manageable proportion of under twenty percent in 2008 (see Figure 1 below).

[14] Simon Romero, *Ecuador: President Orders Debt Default*, N.Y. TIMES, Dec. 13, 2008, *available at* http://www.nytimes.com/2008/12/13/world/americas/13briefs-PRESIDENTORD_BRF.html.

[15] BANCO CENTRAL DEL ECUADOR, *supra* note 3, at tbl.1.2.1.

[16] Fifteen months later, the finance minister would confirm that the December 2008 default was not triggered by any economic difficulties. See Press Release, Ministerio de Finanzas del Ecuador, La Moratoria de los Global 2012 y 2030 Fue por Ilegitimidad y No por Falta de Recursos (Mar. 4, 2010), *available at* http://mef.gov.ec/pls/portal/docs/PAGE/MINISTERIO_ECONOMIA_FINANZAS_ECUADOR/ARCHIVOS_INFORMACION_IMPORTANTE/TAB138898/TAB190900/TAB203179/BOLETIN07_04_03_2010.PDF.

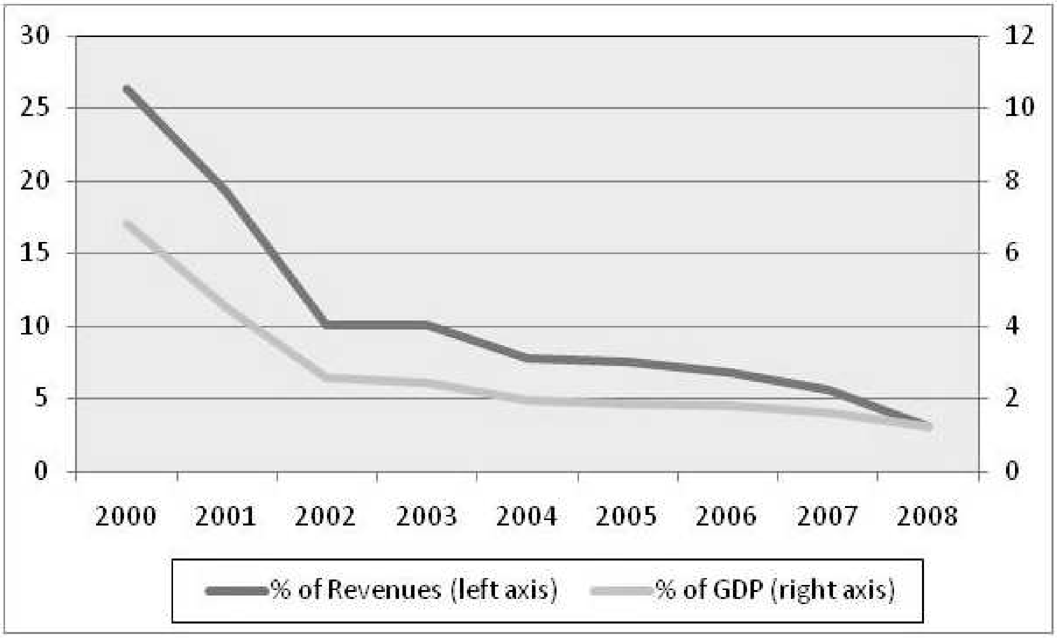
Figure 1: Ecuador's External Public Debt as a Percentage of GDP (including any interest or principal arrears)[17]



Servicing this external indebtedness imposed an increasingly lighter burden on the country and its public finances, especially given the rapid growth of government revenues during the intervening years, from $4.2 billion in 2000 to $21.4 billion in 2008. The interest bill averaged $1 billion in 2000 and 2001, but it started to drop and settled at less than $700 million per annum in 2002 through 2008. As a proportion of government revenues, interest payments dropped from over twenty-six percent in 2000 to under four percent in 2008, and in relation to GDP, they fell from seven percent to nearly one percent (see Figure 2 below).

[17] Author's calculations based on BANCO CENTRAL DEL ECUADOR, *supra* note 3.

Figure 2: Interest Payments on Ecuador's External Public Debt (including any interest arrears)[18]



In particular, the 2012 and 2030 bonds, which accounted for nearly one-third of the external public debt as of the end of 2008, required annual interest payments of $331 million, which is the equivalent of a mere 1.9% of 2008 government revenues and 0.6% of 2008 GDP—a relatively insignificant amount by any standard. Even though revenues and GDP dropped somewhat in 2009 in the aftermath of the global recession, the burden of interest payments on the 2012 and 2030 bonds would not have increased appreciably in the absence of a default.

To understand the genesis of this decision to default out of unwillingness rather than inability to pay, it is necessary to paint a brief profile of President Correa. He was born in 1963 in the coastal city of Guayaquil to a family of modest means. Throughout his formative years—until age twenty-eight, in fact—he attended or was otherwise affiliated with Catholic schools and universities, mostly run by the Salesians, one of the world's largest Catholic missionary orders. This upbringing included spending one year on a mission at a social center run by the Salesians in the Cotopaxi province, where Correa gained empathy for the native population, by seeing their extreme poverty up close. In a speech delivered recently at Oxford entitled *My Experience as a Leftist Christian in a Secular World*, President Correa stated that his "economic principles are based on the Social Doctrine of the Catholic Church and on Liberation Theology."[19] He denounced the very unequal distribution of income in Latin America and said, "As a practicing Catholic, I will always believe in the importance of charity and solidarity," and he pledged to keep ruling "with a

[18] Author's calculations based on BANCO CENTRAL DEL ECUADOR, *supra* note 3.

[19] Rafael Correa, President of Ecuador, Address Before the Oxford Union Society: My Experience as a Leftist Christian in a Secular World 6 (Oct. 26, 2009), *available at* http://www.presidencia.gov.ec/pdf/Discurso%20ingles.pdf.

clear preferential option for [helping] the poorest and the forgotten; and [for] prioritizing human beings over [the owners of] capital."[20]

Vice President Alfredo Palacio, a cardiologist with no business experience, "discovered" Correa in 2003, when Correa was an economics professor and consultant. Palacio retained Correa as his economic advisor on the issue of how to set up and pay for a universal health-care system, which had been one of Palacio's campaign promises.[21] At the time, funding for social programs was limited, and resources that might otherwise be available were not within reach because a portion of oil-related revenues was being deposited into a government fund known as the Stabilization and Investment Fund for Petroleum Resources (FEIREP).[22] The fund was set up in 2002 largely to generate the fiscal savings necessary to pay for the buybacks required by the debt restructuring of 2000. Palacio and Correa tried to tap into the FEIREP to help fund a universal health-care system, but were unsuccessful.

In March 2005, Correa presented a foreboding paper at a meeting sponsored by a regional council of Christian churches held to discuss Latin America's foreign-debt problems. It was entitled *Debt Exchange: It's All About the Creditors*, and in it, Correa denounced the 2000 restructuring as having delivered insufficient relief. To begin with, he wrote, Ecuador's obligations should have been written down to then-prevailing prices in the secondary market—precisely the kind of massive forgiveness that Argentina was rightly demanding, he felt, from its creditors. Correa went on to denounce the FEIREP for starving the country of funds for social programs and for enriching bondholders by boosting the market price of Ecuador's debt.[23]

A few weeks later, on April 20, 2005, Palacio was appointed to the presidency when the legislature removed the incumbent, Lucio Gutiérrez. This followed a week of growing popular unrest and was done as political retribution against what was perceived as dictatorial decisions made by President Gutiérrez in prior months.[24] Palacio, in turn, appointed Rafael Correa as his finance minister. Correa wasted no time in proposing to the legislature the abolition of the FEIREP, which it did in June while setting up an alternate fund (CEREPS), largely to underwrite social spending.[25] This was done even though the FEIREP, which had accumulated $1.1 billion during its nineteen months of existence, had not spent a single dollar to buy back any foreign debt. According to the World Bank, the fund had been turned into "the piggy bank to

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20 *Id*. at 4, 11.

21 See *Vida Política*, DR. ALFREDO PALACIO, http://www.dralfredopalacio.org/actividades.htm (last visited Nov. 9, 2010).

22 *Id.*

23 Rafael Correa, *Canje de Deuda: Todo en Función de los Acreedores*, LA INSIGNIA, June 20, 2005, *available at* http://www.lainsignia.org/2005/junio/econ_008.htm . The sponsoring regional council was Consejo Latinoamericano de Iglesias.

24 Monte Reel, *Ecuadoran Congress Ousts President*, WASH. POST, Apr. 21, 2005, *available at* http://www.washingtonpost.com/wp-dyn/articles/A5002-2005Apr20.html.

25 WORLD BANK, REPORT NO. 00000-EC, ECUADOR COUNTRY ECONOMIC MEMORANDUM: PROMOTING STABLE AND ROBUST ECONOMIC GROWTH 33 (2005), *available at* http://siteresources.worldbank.org/EXTEXPCOMNET/Resources/2463593-1213987636514/02_Ecuador.pdf.

finance the liquidity needs of the central government."[26] Correa also denounced the prior administration's supposedly secret consent to various policy conditions imposed by the IMF and the World Bank, threatened to withhold debt-service payments to the multilateral agencies if they did not fulfill their loan commitments, and raised the possibility of bypassing the multilateral agencies altogether and selling bonds to Venezuela instead.[27]

In late July, the World Bank made it known to Minister Correa that it would not authorize the disbursement of a $100-million loan he was counting on. Correa fired off an angry letter to World Bank President Paul Wolfowitz, telling him the Bank had offended Ecuador by reneging on the loan and demanding to know precisely why the disbursement had been cancelled.[28] A couple of days later, having set himself proverbially ablaze, Minister Correa tendered his resignation at the request of President Palacio, whose office let it be known that the minister had failed to keep his superior properly informed of his (inflammatory) activities.[29] During his 106 days in office, Correa had managed to ruin the government's access to external funding, but by wrapping himself in the national flag to confront the Washington multilateral agencies, supposedly on behalf of the dispossessed of Ecuador, he had also succeeded in gaining national name recognition—thereby setting the stage for his candidacy in the next presidential election. Upon departure, Correa's popular approval rating was fifty-seven percent, the highest among cabinet members and nearly twenty percentage points higher than President Palacio's own.[30]

Rafael Correa would go on to win the presidential election held in November 2006, and his inaugural address on January 15, 2007, presaged his get-tough attitude toward foreign bondholders. He stated that one of the main challenges facing Ecuador was to overcome a culture of issuing debt abroad, which had left the country saddled with "a very costly overindebtedness"—a gross factual misrepresentation. He said a country's debt service should be subject to a sustainability criterion; for example, debt-service burdens should not be incompatible with the achievement of the United Nations' Millennium Development Goals. He also stated that part of Ecuador's foreign debt was illegitimate, had been acquired under dubious circumstances, was not used for its intended purposes, and had been "repaid several times" already.[31] Ideally, President Correa acknowledged, governments should be

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[26] *Id.* at 34.

[27] *Rafael Correa Renunció al Ministerio de Economía*, EL UNIVERSO, Aug. 5, 2005, *available at* http://www.eluniverso.com/2005/08/05/0001/9/A99FF2FCCCAE4D70BE0A1E92B2AC69D1.html.

[28] *La Renuncia de Rafael Correa, Ministro de Economía de Ecuador: ¿Un Ejemplo de la Influencia de las IFIs?*, CHOIKE, Aug. 16, 2005 [hereinafter La Renuncia], *available at* http://ifis.choike.org/esp/informes/134.html.

[29] *Gobierno Niega Que Cambios en Áreas Económica y Petrolera Sean por Presiones*, EL UNIVERSO, Aug. 5, 2005, *available at* http://www.eluniverso.com/2005/08/05/0001/9/0C25A623318045EBB1606CD1656A467B.html?p=9A&m=2349.

[30] La Renuncia, *supra* note 28.

[31] Rafael Correa, President of Ecuador, Discurso de Rafael Correa Presidente de Ecuador [Inaugural Address] 4–5 (Jan. 15, 2007), *available at* http://www.coberturadigital.com/wp-content/uploads/2007/01/DISCURSO%20de%20Rafael%20Correa%20Presidente%20del%20Ecuador.doc (author's translation).

able to appeal to an impartial and transparent international tribunal that would determine which obligations should be serviced and a country's objective capacity to pay. He noted, however, that such an impartial third-party forum does not exist; there is only the IMF, "the creditors' representative."[32] This is why, Correa concluded, his administration would engage in a "firm and sovereign renegotiation of the external debt, above all of the inadmissible conditions that were imposed on us in the debt exchange of 2000."[33]

Nearly six months later, on July 9, 2007, President Correa issued a decree authorizing the creation of an Integral Auditing Commission for the Public Credit (CAIC) and charged it with determining the "legitimacy, legality, transparency, quality, efficacy and efficiency" of the domestic and foreign public debt contracted between 1976 and 2006, taking into consideration "the legal and financial aspects, and its economic and social impact on regions, the ecology and various nationalities and peoples."[34] The CAIC was to analyze not just each bond issued at home and abroad, but also each and every loan contracted with official bilateral and multilateral agencies, as well as with commercial banks and suppliers, during the past three decades. It was to determine who had authorized the indebtedness in question, whether the requisite feasibility studies had been conducted, what conditions had been imposed, to what purpose the funds had been allocated in actual practice, and the comprehensive ("integral") impact of each project thus underwritten, among other matters.[35] And it was to accomplish this mission within one year, although later on the CAIC was given an extra couple of months—until the end of September 2008—to achieve what any reasonable observer would regard as a "Mission Impossible." The CAIC was not even allocated any funding to hire a staff until December 2007. Nevertheless, it managed to deliver a preliminary report in February 2008, a second draft in July, and its final report in November 2008.[36]

The CAIC's designated members were four representatives of the Correa Administration, including the then finance minister plus six other Ecuadorians and three foreigners from social organizations who had worked on debt issues in Ecuador or elsewhere.[37] However, none were professional auditors, and all had a long history

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32 *Id.*

33 *Id.* at 6.

34 COMISIÓN DE AUDITORÍA INTEGRAL DEL CRÉDITO PUBLICO [CAIC], INFORME FINAL DE LA AUDITORÍA INTEGRAL DE LA DEUDA ECUATORIANA: DECRETO EJECUTIVO 472, arts. 2, 3(a) at 156 (2007) (Ecuador) [hereinafter CAIC REPORT]. The Spanish version of the CAIC REPORT is available at http://www.auditoriadeuda.org.ec/images/stories/documentos/Libro_CAIC_Espanol. pdf.zip. The CAIC produced an English version of this report, which is *available at* http://www.auditoriadeuda.org.ec/images/stories/documentos/Libro_CAIC_English.pdf.zip, but the translation is so poor that all quotes from the report are translations by this author from the Spanish original.

35 *Id.* art. 3(b).

36 Hugo Arias Palacios, *La Deuda Ecuatoriana y la Auditoría*, in SOBRE LA DEUDA ILEGÍTIMA: APORTES AL DEBATE 129 (Gabriela Weber ed., 2008), *available at* http://www.flacsoandes.org/ biblio/shared/biblio_view.php?bibid=111618&tab=opac . Arias Palacios was a member of the CAIC.

37 *Id.* at 127.

of militancy in the debt-forgiveness or debt-repudiation movement.[38] The CAIC was chaired by Ricardo Patiño, an extreme leftist who in his early years had joined the Sandinista revolution in Nicaragua and had later held a post in the Sandinista government's land-reform agency. Upon returning to Ecuador, Patiño set up the country's Jubilee 2000 office, part of the international-coalition movement that called for the cancellation of third-world debt by the year 2000.[39] He was appointed finance minister in January 2007, but a couple of weeks after being named to chair the CAIC, he stepped down from this cabinet post because of a scandal involving the alleged manipulation of Ecuador's bonded debt. He was immediately given another cabinet post by Correa,[40] and despite the appearance of impropriety and of a conflict of interest, Patiño was kept as the chairman of the CAIC.[41]

The CAIC's report was written in great haste, without the benefit of having hired professional auditors; interviewing public credit officers, finance ministers, or living presidents from 1976 through 2006; or obtaining access to many important documents.[42] The report's authors reveal that they requested information from eighteen government agencies, but never heard back from three of them, were given information that was not relevant by eleven of them, and obtained the documents they were seeking from just four agencies.[43] In particular, the armed forces, known to have contracted many a foreign loan for the purchase of armaments (as confirmed by documents held by the finance ministry), had the audacity to issue a statement to the CAIC stating that they "had not found any documentation that details any loans received from foreign commercial banks during the period 1976–2006."[44]

As was to be expected given the circumstances, the CAIC report is incomplete, biased, and inaccurate. For example, the first misdeed it identifies involves none

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[38] For example, Jubilee, Eurodad, and LATINDADD. Id. *Comisionados con Historial Antideuda*, EL COMERCIO, Nov. 22, 2008 (on file with author).

[39] *Funcionarios "Clave" Están Más Cerca de Correa*, DIARIO HOY, Dec. 16, 2007, *available at* http://www.hoy.com.ec/noticias-ecuador/funcionarios-clave-estan-mas-cerca-de-correa-284778-284778.htm.

[40] As of this writing, Patiño in fact is holding his fourth cabinet post, as the country's minister for foreign affairs. See *Ricardo Patiño Es el Nuevo Canciller del Ecuador*, EL UNIVERSO, Jan. 21, 2010, *available at* http://www.eluniverso.com/2010/01/21/1/1355/ricardopationuevocancillerrepublica.html.

[41] A month after becoming finance minister, Patiño had said he might delay a $135-million interest payment on the foreign debt, but then did not. This led to "wild swings in the value of Ecuador's bonds and derivatives linked to them, raising suspicions of a deliberate market manipulation." In May 2007, a video surfaced of a meeting between Patiño and three others in which the minister appeared to discuss a plan that would enable certain investors to make a great deal of money from the bond price swings. Minister Patiño denied any wrongdoing, but after the Ecuadorian congress censured him in July 2007, another video surfaced showing him arranging a backroom deal with the head of Ecuador's congress, whereupon he moved to another cabinet post. See *Caught on Camera*, ECONOMIST, July 26, 2007, *available at* http://www.economist.com/node/9546462.

[42] For example, former president Sixto Durán Ballén (1992–1996) said he was never contacted by the CAIC to hear his version of events surrounding the issuance of Brady bonds and that the CAIC report was full of inaccuracies. See *Sixto Durán Ballén Indignado por Informe de Deuda*, EL COMERCIO, Nov. 21, 2008 (on file with author).

[43] CAIC REPORT, *supra* note 34, RESUMEN EJECUTIVO 28 (2008).

[44] *Id.*

other than the United States Federal Reserve, which is accused of "illegally raising interest rates," thereby causing Ecuador's debt to snowball during the late 1970s and early 1980s.[45] The accusation of illegality is ridiculous, of course. Moreover, a factual analysis based on official Ecuadorian statistics, which are publicly available, reveals that the temporary hike in U.S. interest rates under Federal Reserve Chairman Paul Volcker may explain, at best, a small fraction of the debt buildup that took place in those years. Ecuador's public external indebtedness grew to $5 billion as of the end of 1982 from less than $2 billion at the end of 1978, but only about one-third of this increase could be justified by the need to borrow to cover the higher interest payments.[46] Besides, while U.S. interest rates were being hiked, Ecuador was simultaneously benefiting from a doubling in its oil-export revenues, such that the government should have been able to afford the higher interest bill without recourse to extra borrowing.[47] Indeed, despite a near halving of U.S. rates between the end of 1982 and the end of 1987, the government's external debt went on to double to $10 billion. In sum, there is no basis for pinning Ecuador's debt snowball on the Federal Reserve.

The other accusations of "illegality" made in the CAIC report target prior administrations, charging them with having violated either mostly unspecified Ecuadorian laws or "basic principles of international law."[48] Some examples of these transgressions are that prior administrations agreed to submit debt contracts to foreign jurisdiction (namely, New York and English law), to waive Ecuador's sovereign immunity, and to accept conditions imposed by official multilateral agencies "in violation of basic principles of international law such as the equality of sovereign states, the self-determination of peoples, the non-interference in the internal affairs of nations, the right to [economic] development, and the respect of human rights."[49] There are also multiple accusations of "irregularities," like prior administrations' prepaying debts (in the context of debt-refinancing agreements) when they were under no obligation to do so, and the government's taking over private-sector obligations from 1983 through 1984 in the midst of a major economic crisis without auditing the beneficiaries to check whether their obligations were indeed still outstanding.[50]

The CAIC report also censures loans obtained from foreign bilateral and

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[45] *Id.*, 26.

[46] If the average interest rate paid by the government on its external debt had remained at its 1977 level of 7.4%, the cumulative interest bill from 1979 through 1982 would have been $1.1 billion lower than it actually was; however, the stock of indebtedness during this period jumped by $3.2 billion. See BANCO CENTRAL DEL ECUADOR, *supra* note 3, at ch. 2 tbl.2.12.

[47] In fact, the central government's interest bill on foreign debt went up by $110 million between 1978 and 1981, but its oil-related revenues increased by $360 million. BANCO CENTRAL DEL ECUADOR, *supra* note 3, at ch. 3 tbl.3.5.

[48] CAIC REPORT, *supra* note 34, at 34.

[49] *Id.* Prior governments are also accused of failing to register Ecuador's bonds with the U.S. Securities and Exchange Commission—because they were issued under Rule 144A and Regulation S, in full compliance with U.S. securities laws. The CAIC took this type of bond issuance as evidence of a lack of transparency. *Id.* at 59.

[50] *Id.*, 28, 38.

multilateral agencies on a variety of grounds. For example, funding from the World Bank and the Inter-American Development Bank (IADB) was used to purchase collateral to back the Brady bonds, "thereby aiding and abetting the reallocation of funds for purposes other than those contemplated in the lending programs previously agreed."[51] Prior administrations had also accepted various conditions imposed by official foreign creditors, had not prevented cost overruns in various projects funded by foreign loans, and had not carried out the necessary environmental and other impact studies.[52] A number of specific projects are examined and sufficient objections raised about how they had been implemented to support the CAIC report's recommendation of the repudiation of the multilateral loans involved.[53]

Ominously, the CAIC report criticizes prior administrations for having "overpaid" greatly when they restructured their foreign obligations, particularly during the two bond exchanges in 1995 and 2000.[54] With a perspective surely inspired by Argentina's harsh treatment of its own bondholders, the report points out the costly "mistakes" of recognizing and capitalizing interest arrears, and the failure to base their negotiation with creditors on prices for Ecuador's defaulted debt as observed in the secondary market.[55] Prior to the Brady bond exchange, the report noted, Ecuador owed $4.5 billion of principal plus $2.5 billion of past-due interest; but its obligations were trading in the secondary market at around twenty-five cents on the dollar, so that should have set the basis for the discount (seventy-five percent) applied during the debt-for-Brady-bonds exchange.[56] Likewise, in 2000, the Brady bonds and Eurobonds were trading at around thirty cents on the dollar, so they should have been restructured on that basis (a seventy percent "haircut"), in which case only $1 billion of 2012 and 2030 bonds would have been issued instead of nearly $4 billion.[57]

IV

THE DEFAULT AND ITS AFTERMATH

The CAIC report was formally delivered to President Correa on November 20, 2008, but by then, he was well aware of its contents—he had been handed a preliminary draft on October 23—and had already ordered that an upcoming $31 million coupon payment on the 2012 bonds be skipped.[58] A formal default on the

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[51] *Id.* at 151.
[52] *Id.* at 151–52.
[53] *Id.*, at 104, 152.
[54] See *id.* at 42, 46 (discussing the actual debt Ecuador had and the debt they incurred after the restructuring of the bonds).
[55] See *id.* at 46–47.
[56] *Id.* at 42.
[57] *Id.* at 46–47.
[58] Press Release, Ministerio de Finanzas del Ecuador, Ecuador se Acoge a Período de Mora Técnica de Bonos Global (Nov. 14, 2008), *available at* http://mef.gov.ec/pls/portal/docs/PAGE/MINISTERIO_ECONOMIA_FINANZAS_ECUADOR/SUBSECRETARIAS/DIRECCION_DE_COMUNIC

foreign debt was declared on December 12. Starting that day, Correa would justify the country's moratorium on the basis that Ecuador's debt obligations were "immoral," "illegal," or "illegitimate"—preferably, all of the above. On December 15, it was announced that an upcoming $30.5 million coupon payment on a ten-year sovereign bond that had been issued in December 2005 would likewise not be made.[59] Yet as the weeks and months passed, it became apparent that Ecuador's default would be highly selective rather than indiscriminate, and that it would lead neither to a repudiation of obligations as odious[60] or on other grounds, nor to a negotiated or even unilateral debt exchange (Argentine style) for the purpose of obtaining massive debt forgiveness.[61]

President Correa made clear on December 20 that all obligations to official bilateral and multilateral agencies would continue to be serviced in full and on time, notwithstanding the CAIC's damning report and his own prior announcement that even debts deemed "legitimate" would be subject to restructuring.[62] He and his finance minister, María Elsa Viteri, explained before and after the New Year that the default would be confined to the "commercial" debt, meaning Ecuador's three sovereign bonds. In mid-January 2009, however, the government surprisingly decided to pay the coupon on the 2015 bond just before the grace period ran out, saying that its issuance was different from that of the other two—even though the CAIC report had condemned the 2015 bond right along with the others.[63] By February, it became clear that the government was really targeting only the two bonds Correa had been despising for years, so it came as no surprise when the government failed to pay $135 million in interest due on the 2030 bonds.

The way the Correa Administration dealt with these undesirable obligations was to buy them back from intimidated investors, indirectly at first and then directly, paying cash for a fraction of their face value (or rather, their pre-default market value), for the purpose of extinguishing them. The government reportedly began to purchase the 2012 bonds in the secondary market after their price collapsed following the mid-November 2008 decision to default on them, using an Ecuadorian bank as the front man.[64] It then continued repurchasing its securities after defaulting

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ACION_SOCIAL/PRODUCTOS_COMUNICACION_PRENSA/ARCHIVOS_
2008_1/027.14NOVIEMBRE2008.PDF.

59 *Ecuador Suspendió Pagos de Intereses de Global 2015*, EL UNIVERSO, Dec. 15, 2008, *available at* http://www.eluniverso.com/2008/12/15/1/1356/C1E256567062492F936E2CA95EEE5F9A.htm.

60 See Lee C. Buchheit, G. Mitu Gulati & Robert B. Thompson, *The Dilemma of Odious Debt*, 56 DUKE L.J. 1201, 1216 (2007).

61 See generally Porzecanski, *supra* note 4.

62 *Correa Promete Pagar Créditos a Organismos Regionales*, EL UNIVERSO, Dec. 20, 2008, *available at http*://www.eluniverso.com/2008/12/20/1/1356/C1C7C6EF017C47FF8703BC700C78146B.html.

63 The proceeds of that bond issue had been devoted by a prior administration to repurchase a portion of the 2012 bonds at par, in accordance with the commitment made at the time of the 2000 debt exchange. Because of this, the 2015 bond could have been regarded by President Correa as guilty of immorality, illegality, or illegitimacy by association—which was the view adopted by the CAIC. CAIC REPORT, *supra* note 34, at 47.

64 *Ecuador Habría Comprado Su Deuda*, EL COMERCIO, Dec. 11, 2008; Analytica Investments, ECUADOR WKLY. REP., Dec. 14–20, 2008 (on file with author). The bank was allegedly Banco del Pacífico, acting through a broker.

on the 2030 bond, such that by one estimate, the government picked up as much as half of the two bond issues in this manner.[65] On April 20, 2009, the government announced a buyback offer to repurchase the 2012 and 2030 bonds through a modified Dutch auction with a base price of thirty cents on the dollar.[66] A disclosure document was circulated by the deal's manager, Lazard Frères, with an expiration date of May 15 for all offers. The document made plain that Ecuador had "no intention of resuming payments on these bonds following the [e]xpiration [d]ate."[67] Despite an attempt to organize resistance among bondholders, ninety-one percent of the bonds outstanding were tendered—presumably including those in government hands—and were bought back at a discount of between sixty-five and seventy percent, thereby retiring nearly $3 billion in bonds for around $900 million in cash payments. Holdouts were then offered another chance to tender at thirty-five cents on the dollar, and in November 2009, an offer aimed at Italian investors was launched on identical terms. As a result, by the end of 2009, the government had successfully bought back about ninety-five percent of the 2012 and 2030 bonds.[68]

Obviously, this manner of dealing with a sovereign's debt burden hinges on having more ample cash resources on hand than necessary to meet the interest

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[65] See Lester Pimentel, *Ecuador Plays Bond Market for Fools, Aberdeen Says (Update2)*, BLOOMBERG NEWS, June 16, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601013&sid=aQ7ZViOQQ4mI. The Correa Administration has yet to admit or deny the allegations of these back-door purchases, but if they did they take place, that might help explain a portion of the precipitous drop in the central bank's international reserves, from over $6 billion just prior to the November 2008 announcement that the 2012 bond coupon would not be paid, to less than $3.5 billion by March 2009 after the 2030 bond coupon went unpaid. However, capital flight in the wake of the default announcement probably accounts for most of this drop in dollar reserves. For data on said reserves, see BANCO CENTRAL DEL ECUADOR, INFORMACIÓN MONETARIA SEMANAL, No. 155, at tbl.IMS2 (2010), *available at* http://www.bce.fin.ec/home1/estadisticas/bolsemanal/Coyuntura.jsp.

[66] See Lee C. Buchheit & G. Mitu Gulati, *The Coroner's Inquest*, INT'L FIN. L. REV., Sept. 2009, at 22, 22 ("It was the first time in modern history that a sovereign debtor had demanded that its external commercial creditors write off most of their claims . . . without advancing a plausible argument that financial distress warranted such extraordinary debt relief.").

[67] Ministerio de Finanzas del Ecuador, Noteholder Circular, Apr. 20, 2009, at 15, *available at* http://blogs.reuters.com/felix-salmon/files/2009/04/noteholder-circular-goe-bond-offer.pdf; see also Buchheit & Gulati, *supra* note 66, at 4–5 (discussing why the bonds' trustee did not exercise its discretion to accelerate either bond or to start an enforcement action, and the lessons learned about how a trustee indenture in sovereign documentation should read in the future).

[68] *Ecuador Retiró Unos $50 Millones de Bonos Globales 2012 y 2030*, EL UNIVERSO, Dec. 31, 2009, *available at* http://www.eluniverso.com/2009/12/30/1/1356/ecuador-retiro-unos-millones-bonos-globales.html. According to official statistics, the government's principal due on 2012 and 2030 bonds dropped from a combined $3.21 billion at the end of 2008 to $223 million a year later, a ninety-three-percent reduction. See Ministerio de Finanzas del Ecuador, *Boletines Deuda Externa*, MÓDULO DE INFORMACIÓN DE FINANZAS PÚBLICAS, Dec. 2008, at tbl.1 [hereinafter *Deuda Externa Dec. 2008*], *available at* http://mef.gov.ec/stgcPortal/faces/uploads/bulletin/DE_DIC2008.htm; Ministerio de Finanzas del Ecuador, *Boletines Deuda Externa*, MÓDULO DE INFORMACIÓN DE FINANZAS PÚBLICAS, Dec. 2009, at tbl.1 [hereinafter *Deuda Externa Dec. 2009*], *available at* http://mef.gov.ec/stgcPortal/faces/uploads/bulletin/DE_DIC2009.htm.

payments falling due. It is neither an affordable strategy for a sovereign that is experiencing an acute liquidity crisis nor a smart strategy for a solvent sovereign able to refinance its obligations at lower interest rates—the far more common situations encountered in the practice of sovereign international finance. It also presupposes attaching little cost to damaging the issuer's (already tattered) reputation as a debtor, as well as having no intention of regaining access to the international bond markets—at least not for many years. The government of Ecuador had been able to tap the international bond markets on one occasion (in December 2005), six years after its prior default, when the 2015 bond was issued. However, the Correa Administration soon made it known that it did not intend to return to the international private-capital markets. Its plan has been to rely on external financing from governments such as China, Iran, and Russia and from official multilateral agencies—preferably other than the IMF and the World Bank, regarded with long-standing animosity by President Correa.[69]

Evidently, the authorities did not care that their default would cause collateral damage, triggering capital flight and impairing the ability of Ecuadorian banks and corporations to access financing from foreign commercial creditors at a time of global financial turmoil. According to central-bank data, the private sector in Ecuador was able to borrow much less from abroad after the default than it had borrowed before, such that because repayments exceeded disbursements, the stock of its external-debt obligations dropped by over fifteen percent between September 2008 and December 2009.[70] Surveys of foreign banks' exposure to banks and corporations in Ecuador reveal an absolute drop of twelve percent in the year after September 2008 versus a fall of six percent to these obligors throughout Latin America during the same period.[71]

The deplorable fact is that no leading government or any official multilateral agency based in Washington or Latin America went on record to express any dismay at Ecuador's latest default and alleged bond-market manipulation. On the contrary, the local representatives of the regional development banks uttered words of moral support, and their headquarters provided an indirect blessing to the default and debt buyback by ramping up their lending to the government—despite an obvious deterioration in Ecuador's creditworthiness and macroeconomic fundamentals in 2009. The Inter-American Development Bank's representative in Ecuador, Carlos Melo, stated that "[t]he good results obtained [in the restructuring] will benefit all

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[69] Press Release, Ministerio de Finanzas del Ecuador, Ministra de Finanzas Comparece a Comisión de lo Económico y Tributario (Nov. 18, 2009), *available at* http://mef.gov.ec/pls/portal/docs/PAGE/MINISTERIO_ECONOMIA_FINANZAS_ECUADOR/SUBSECRETARIAS/DIRECCION_DE_COMUNICACION_SOCIAL/PRODUCTOS_COMUNICACION_PRENSA/BOLETINES_DE_PRENSA/BOLETINES_2009/BOLETINES/BOLETIN32_19_NOV_2009.PDF. In 2007, President Correa expelled the World Bank and IMF resident representatives from Ecuador.

[70] Banco Central del Ecuador, *Movimiento de la Deuda Externa Privada*, INFORMACIÓN ESTADÍSTICA MENSUAL, Jan. 2010, at tbl.3.3.2, *available at* http://www.bce.fin.ec/documentos/PublicacionesNotas/Catalogo/IEMensual/m1895/IEM-332.xls.

[71] See Bank for Int'l Settlements, *Consolidated International Claims of BIS Reporting Banks*, CONSOLIDATED BANKING STATISTICS, 3d Quarter 2009, at tbls.9A:A, 9A:G, *available at* http://www.bis.org/statistics/consstats.htm.

Ecuadorians during difficult times. . . . The IADB reiterates its predisposition to work alongside Ecuadorians to promote economic development."[72] Sure enough, the IADB stepped up its approval of new loans to Ecuador, agreeing to $515 million in new loans in 2009 versus a mere $50 million in 2008.[73]

The Colombia-based Latin American Reserve Fund (FLAR), for its part, made a general-purpose $480-million loan to Ecuador in July 2009; it had not lent anything to the government in the three prior years.[74] And the Venezuela-headquartered Andean Development Corporation (CAF) approved $873 million in loans to the Correa Administration in 2009, an increase from $604 million in 2008.[75] The CAF's representative in Ecuador, Luis Palau-Rivas, said in May 2009 that the regional lender saw the defaulted-debt restructuring "positively because it's a voluntary process [that is] helping to solve a difficult situation . . . and will benefit everyone."[76] The idea that Ecuador's bondholders were participants in "a voluntary process" is ludicrous, of course. As one veteran financial reporter rightly commented at the time, since the bondholders had no say whatsoever in the unilateral destruction of the value of their investments, their only "choice" was whether to accept Ecuador's risible offer or to hold onto defaulted Ecuadorian paper indefinitely.[77] Beyond the supportive signals they sent to the government of Ecuador throughout the default, the multilateral agencies ended up disbursing nearly $860 million to the country in 2009, 152% more than the $340 million they had disbursed in 2008.[78]

The Correa Administration requested no loans or other support from the International Monetary Fund and World Bank in 2008 or 2009, and probably did not consult with them, either. But when a reporter asked the IMF about its attitude towards Ecuador's default, the institution's spokeswoman lamely said,

> It is longstanding [IMF] policy to encourage our members to, wherever possible, be current in servicing debt obligations, and when they are economically unsustainable to enter into productive negotiations [with their creditors]. We understand that Ecuador's decision to default on these bonds is based on a dispute about [their] legal validity rather than [on] debt sustainability

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[72] Alexandra Valecia & Alonso Soto, *Regional Lenders Back Ecuador in Debt Talks*, REUTERS, May 18, 2009, *available at* http://www.reuters.com/assets/print?aid=USTRE54H58220090518.

[73] INTER-AMERICAN DEVELOPMENT BANK, ANNUAL REPORT 2008, at 38, *available at* http://www.iadb.org/ar/2008; INTER-AMERICAN DEVELOPMENT BANK, ANNUAL REPORT 2009, 45, *available at* http://www.iadb.org/ar/2009/.

[74] Economic Studies Division, FLAR, *Member Countries: About Ecuador*, FONDO LATINOAMERICANO DE RESERVAS [FLAR], at tbl. Loans Granted, https://www.flar.net/ingles/contenido/contenido.aspx?catID=216&conID=669 (last visited Sept. 27, 2010).

[75] *CAF in Figures*, ANDEAN DEVELOPMENT CORPORATION [CAF], at tbl. [Loan] Approvals, http://www.caf.com/view/index.asp?ms=19&pageMs=62012 (last visited Nov. 9, 2010).

[76] Valecia & Soto, *supra* note 72.

[77] Felix Salmon, *Is the Obama Administration Condoning Ecuador's Default?*, REUTERS, May 18, 2009, *available at* http://blogs.reuters.com/felix-salmon/2009/05/18/is-the-obama-administration-condoning-ecuadors-default/.

[78] *Deuda Externa Dec. 2008*, *supra* note 68; *Deuda Externa Dec. 2009*, *supra* note 68.

[grounds], and of course we don't take sides on the merits."[79]

All things considered, the official community's tacit approval of Ecuador's default is deeply troubling.[80] In practice, only governments and multilateral organizations, rather than any group of private-sector bondholders, banks, or suppliers, could have reined in a wayward sovereign debtor such as Ecuador in 2009—or Argentina from 2002 through the present, for that matter. As became evident in the 1980s, 1990s, and again during the recent global financial crisis, only the official community can exercise the kind of collective diplomatic pressure and put forth the financial incentives and disincentives necessary to motivate sovereigns to comply with their financial obligations—or at least to treat private creditors in a relatively responsible manner. This much was obvious even before bondholders obtained their many pyrrhic victories in New York and European courts in the wake of Argentina's gigantic default. Legal precedents and plenty of indenture innovations notwithstanding, even the best of contract intentions cannot prevent investors from going through a hellish experience at the hands of a sovereign debtor unwilling to honor the spirit and the letter of its legal commitments.

Interestingly, just as Ecuador's selective default and buyback attracted no opprobrium in official or multilateral circles, it did not gather any plaudits from the debt-cancellation movement either. From 2007 through 2008, virtually all national, regional, and international non-governmental organizations (NGOs), agitating for massive forgiveness of developing-country debt, hailed Ecuador's decision to conduct a thorough "independent" audit of its external indebtedness. Dozens of such organizations sent an open letter to President Correa in 2008 expressing their support for the audit, and favorable declarations along the same lines were made by legal experts meeting in Quito that July as well as by participants in a symposium on illegitimate debt that gathered in Oslo in October 2008, among others.[81] To our knowledge, though, not one of these organizations has expressed its approval of how Ecuador went about dealing with the results and recommendations of the CAIC audit. In fact, a November 2009 meeting of nearly thirty organizations—in Ecuador, of all places—made no mention in its Guayaquil Declaration of how the host country had dealt with its "immoral," "illegal," and "illegitimate" debt obligations.[82]

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[79] Caroline Atkinson, Dir. of External Relations, International Monetary Fund, Remarks at the Regular Press Briefing (Dec. 18, 2008), *available at* http://www.imf.org/external/np/tr/2008/tr121808.htm.

[80] Some would say that the United States and other leading governments, as well as the multilateral organizations, were too distracted and worried about the world financial crisis that erupted in September 2008 to concern themselves with Ecuador's default. The international financial context may have played a role in explaining the lack of official reaction in December 2008, when the default was announced, but not throughout the first half of 2009, when the worldwide crisis eased and the Correa Administration could have been taken to task.

[81] CAIC REPORT, *supra* note 34, 161–64. INTERNAL AUDITING COMM'N FOR PUB. CREDIT OF ECUADOR, FINAL REPORT OF THE INTEGRAL AUDITING OF THE ECUADORIAN DEBT 165–68 (containing declarations of support that do not appear in the Spanish version of the report).

[82] Declaración de Guayaquil, RED LATINOAMERICANA SOBRE DEUDA, DESARROLLO Y DERECHO [LATINDADD] (Nov. 13, 2009), http://www.latindadd.org/index.php?option=com

This deafening silence on the part of the advocates for across-the-board debt cancellation is understandable. The case of Ecuador does not fit the odious-debt doctrine or related grounds for repudiation. To begin with, the country has been under continuous civilian, constitutional rule since mid-1979. Though it has been mismanaged, it was not plundered by an egomaniacal dictator. The greatest build-up in foreign public indebtedness took place from 1980 through 1994, when the sum total of obligations (including arrears) skyrocketed from less than $3 billion to nearly $14 billion, tripling even in relation to rising government revenues and GDP.[83] During this extended period, duly elected civilians were in charge, none of whom has been found guilty of any illegal conduct. Issues of state succession, war-related debts, widespread corruption, the absence of informed consent, or collusion on the part of creditors to divert funds for contrary purposes—none of these criteria seem applicable here. Nor are the charges of illegitimacy made by the CAIC and President Correa those usually offered as strong arguments for debt cancellation, such as obligations that involve predatory terms, that cannot be serviced without violating basic human rights, or that go against widely accepted legal, financial, or ethical standards.

What is a supporter of debt cancellation to make of the very arbitrary manner in which the Correa Administration proceeded—accepting responsibility for every loan made to Ecuador by every official (bilateral and multilateral) foreign lender, even though the CAIC documented plenty of irregularities involving many of them? And what about the decision to default selectively on two bonds, but not on a third one that the CAIC had tarred and feathered just the same? How could someone from that camp express approval for a government that spent its "hard-earned money" buying back supposedly immoral, illegal, and illegitimate obligations, thereby validating them?

V

CONCLUSION

The story of Ecuador's repudiation of its debt in this unprincipled way is the cautionary tale of the bad things that can happen to good sovereign debt contracts. It is one that even experienced international lawyers, bankers, analysts, and investors would be well advised to heed.

_content&view=article&id=552:declaracion-de-guayaquil&catid=37:pronunc&Itemid=115. Participating institutions included CADTM, CLAI, Jubilee, and LATINDADD.

[83] Author's calculations based on BANCO CENTRAL DEL ECUADOR, *supra* note 3, at ch. 2 tbl.2.12.