# RECENT DEVELOPMENTS

## FOREIGN DEBT—ACT OF STATE DOCTRINE—UNILATERAL DEFERRAL OF OBLIGATIONS BY DEBTOR NATIONS IS INCONSISTENT WITH UNITED STATES LAW AND POLICY: *Allied Bank International v. Banco Credito Agricola de Cartago*

### I. FACTS AND HOLDING

Plaintiff, Allied Bank International,[1] brought an action in July 1983 against three banks owned by the Republic of Costa Rica[2] to recover $4.5 million in principal, plus accrued interest on a series of promissory notes.[3] Defendants began repaying the notes in 1978 in accordance with an agreed repayment schedule.[4] In 1981, Costa Rica experienced severe economic disruptions,[5] resulting in government directives that Defendants defer payment of external debt.[6]

---

[1] Allied Bank International is the agent for a syndicate of 39 commercial banks. The syndicate is comprised of banks from the United States, the People's Republic of China, Switzerland, West Germany, Spain, Taiwan, France, Japan, England, and Sweden. Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714 (2d Cir. April 23, 1984), *aff'g* 566 F. Supp. 1440 (S.D.N.Y. 1983), *vacated on reh'g*, 757 F.2d 516 (2d Cir. 1985), *petition for cert. filed*, 54 U.S.L.W. 3086 (U.S. July 26, 1985) (No. 85-146).

[2] Defendant banks are Banco Credito Agricola de Cartago, Banco Anglo Costarricense, and Banco Nacional de Costa Rica. *Allied Bank*, 566 F. Supp. at 1140.

[3] Defendants assumed the obligations at issue in 1976 after the failure of the Latin American Bank, a bank principally doing business in Costa Rica. Defendants issued new promissory notes upon their assumption of the Latin American Bank's obligations. *Allied Bank*, No. 83-7714, slip op. at 3218 (2d Cir., April 23, 1984).

[4] The repayment schedule provided for 11 "unconditional," semi-annual payments to be made in New York City with United States dollars. The schedule also provided that Defendants' failure to pay the required interest or principal within 30 days of a scheduled payment date would constitute default. Upon default, Plaintiff could demand full payment of the notes. *Allied Bank*, No. 83-7714, slip op. at 3218 (2d Cir. April 23, 1984).

[5] Costa Rican foreign debt totaled approximately $3 billion in 1984. Wall St. J., Apr. 5, 1984, at 34, col. 5.

[6] Foreign exchange transactions by Costa Rican banks require approval by the Central Bank of Costa Rica. On July 2, 1981, Defendants applied to the Central Bank for authorization to make the payment due the syndicate on July 1. On August 27, 1981, the Central Bank passed a resolution prohibiting banks from paying any interest or principal on debts to foreign creditors denominated in foreign currency.

On November 6, 1981, the President of Costa Rica and the Ministry of Finance published Executive Decree 13103-H, prohibiting any Costa Rican financial institution from making payment on an external debt without prior approval of the Central Bank. Subsequently, the Bank notified each defendant that all debt repayments were to be suspended indefinitely. Allied Bank International v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440, 1442

Consequently, Defendants failed to make their required payments.[7] Plaintiff then brought suit for full payment in the United States District Court for the Southern District of New York.[8]

The district court dismissed Plaintiff's petition, relying on the act of state doctrine.[9] The United States Court of Appeals for the Second Circuit affirmed the dismissal, but failed to address the act of state question.[10] The appellate court ruled that, regardless of act of state considerations, unilateral deferral of international debt is permissible since such deferral is consistent with United States law and policy.[11] On rehearing *held*: reversed. A foreign government's unilateral deferral of extraterritorial debt falls outside the scope of the act of state doctrine and is inconsistent with the law and policy of the United States. *Allied Bank International v. Banco Credito Agricola de Cartago*, No. 83-7714, slip op. at 3215 (2d Cir. April 23, 1984), *aff'g* 566 F. Supp. 1440 (S.D.N.Y. 1983), *vacated on reh'g*, 757 F.2d 516 (2d Cir. 1985), *petition for cert. filed*, 54 U.S.L.W. 3086 (U.S. July 26, 1985) (No. 85-146).

---

(S.D.N.Y. 1983), *aff'd*, No. 83-7714 (2d Cir. April 23, 1984), *vacated on reh'g*, 757 F.2d 516 (2d Cir. 1985), *petition for cert. filed* 54 U.S.L.W. 3086 (U.S. July 26, 1985) (No. 85-146).

[7] The Costa Rican economic crisis also resulted in Costa Rica's default during 1981 on loans granted to it by the United States under the Foreign Assistance Act of 1961, Pub. L. No. 87-195, 75 Stat. 424 (codified as amended in scattered sections of 22 U.S.C.), Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714, slip op. at 3220 (2d Cir. April 23, 1984).

[8] 566 F. Supp. 1440 (S.D.N.Y. 1983).

[9] Generally, the act of state doctrine gives effect to acts of a foreign sovereign done within its own territory. *See infra* notes 12-38 and accompanying text. The courts have, however, declined to apply the doctrine to a sovereign's purely commercial acts. *See, e.g.*, Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682 (1976); Hunt v. Mobil Oil Corp., 550 F.2d 68 (2d Cir.), *cert. denied*, 434 U.S. 984 (1977). Here, the district court stated that the actions of the Costa Rican government were clearly an exercise of a governmental, rather than a commercial function, permitting invocation of the act of state doctrine. *Allied Bank*, 566 F. Supp. 1440 (S.D.N.Y. 1983).

[10] On September 9, 1983, after the district court's dismissal, Defendants, the Costa Rican government, and the Costa Rican Central Bank signed a refinancing agreement with the coordinating agent for Costa Rica's external creditors. Only one of the 39 banks in the Allied Syndicate, Fidelity Trust Company of New Jersey, refused to accept the agreement. It is this lone bank that Allied International represented on appeal. Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714, slip op. at 3220 (2d Cir. April 23, 1984).

[11] *Id.* at 3215. As in the district court, Plaintiff argued that Costa Rica's actions should not be sanctioned under act of state principles because the government acted as a commercial entity and not as a sovereign. The court found that the Costa Rican government was "clearly acting as a sovereign in preventing a national fiscal disaster." Consequently, the court concluded that the act of state doctrine remained applicable. *Id.*

## II. LEGAL BACKGROUND

United States courts have long employed the act of state doctrine in sanctioning the seizure of property by foreign nations.[12] The classic statement of the doctrine articulated the sanctity of each nation's territorial sovereignty: "[E]very 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*"[13] (emphasis added). The theoretical basis upon which courts have applied the doctrine have included separation of power concerns[14] and considerations of international comity.[15]

While giving effect to intraterritorial takings by foreign governments on act of state grounds,[16] the United States judiciary has severely restricted foreign seizure of property within the United States.[17] Courts generally permit such extraterritorial expropriations only if they are consistent with the law and policy of the United States.[18] An early case, *Canada Southern Railway Co. v. Gebhard*,[19] implicitly applied this standard when the Canadian government attempted to bind United States bondholders to its reorganization of the government-owned Canadian Southern Railway's debt.[20] The United States Supreme Court dismissed the

---

[12] *E.g.*, Underhill v. Hernandez, 168 U.S. 250 (1897); Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964).

[13] Underhill v. Hernandez, 168 U.S. 250, 252 (1897).

[14] Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964). The *Sabbatino* court found the basis of the act of state doctrine in the "relationships between branches of government in a system of separation of powers." *Id.* at 423.

[15] United Bank Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868 (2d Cir. 1976); Oetjen v. Central Leather Co., 246 U.S. 297 (1918). " 'Comity,' in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and goodwill, upon the other. But it is the recognition which one nation allows within its territory to the . . . acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws." Hilton v. Guyot, 159 U.S. 113, 163-64 (1895).

[16] *See supra* note 12.

[17] Menendez v. Saks & Co., 485 F.2d 1355 (2d Cir. 1973), *rev'd on other grounds sub nom.* Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682 (1976). *See also* United Bank Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868 (2d Cir. 1976); Republic of Iraq v. First Nat'l City Bank, 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

[18] *E.g.*, United Bank Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868 (2d Cir. 1976); Republic of Iraq v. First Nat'l City Bank, 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

[19] Canada Southern Railway Co. v. Gebhard, 109 U.S. 527 (1883).

[20] In 1871, the Canadian Southern Railway issued a series of negotiable bonds. Both principal and interest were payable at a New York bank. In 1873, the railway failed to meet its interest obligations to its bondholders. Numerous bondholders agreed to extend the time for the payment of the interest.

bondholder's suit, thus giving effect to the Canadian government's unilateral modification of its obligations.[21] The court reasoned that its action was in harmony with the spirit of United States bankruptcy law[22] and in keeping with a desire to preserve international comity.[23]

Conversely, modern cases addressing foreign seizure of private United States debts have uniformly rejected contentions that such action comports with domestic law and policy.[24] In *United Bank Ltd. v. Cosmic International*,[25] the newly formed government of Bangladesh issued decrees providing for the seizure of United States debts owed to the pre-revolution predecessor government. The Bangladesh government acknowledged that no compensation had been paid for the purportedly seized debts, but argued that the act of state doctrine precluded inquiry by the United States judiciary.[26] Noting that the doctrine is inapplicable to extraterritorial takings, the appellate court denied effect to the government's actions. The court stated that extraterritorial takings without just compensation could never be consistent with United States

---

The Parliament of Canada gained legislative authority over the Canada Southern Railway in 1874. In 1878, the Parliament approved legislation permitting the financially strapped railway to issue replacement bonds to its existing bondholders as a way of meeting its financial obligations. The old bonds of 1871, thus invalidated, "were to be exchanged for the new [bonds] at the rate of one dollar of principal of the old for one dollar of the new, nothing being given . . . for past due interest coupons . . . ." *Id.* at 529, 530.

[21] *Gebhard*, 109 U.S. 527 (1883).

[22] *Id.* at 539. The "spirit" of United States bankruptcy law as perceived by the *Gebhard* court "require[s] each individual to so conduct himself for the general good as [to] not unnecessarily injure another . . . . [E]very member of a political community must necessarily part with some of the rights which, as an individual, not affected by his relation to others, he might have retained." *Id.* at 536.

The basic purpose behind United States bankruptcy laws has not changed in the one hundred years since *Gebhard*. Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 1101-1174 (1982), is a debt reorganization procedure designed to maximize the yield from the debtor's assets without withdrawing control from the debtor or liquidating its assets for the creditor's immediate satisfaction. *See generally*, H.R. REP. No. 595, 95th Cong., 1st Sess. 220 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963.

[23] *Gebhard*, 109 U.S. 527 (1883).

[24] *E.g.*, Zwack v. Kraus Bros., 237 F.2d 255 (2d Cir. 1956); Republic of Iraq v. First Nat'l City Bank, 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966). *Compare* Comment, *Act of State Doctrine Does Not Enable Foreign Sovereign to Confiscate Debts with Situs in the United State*, 9 N.Y.U. J. INT'L L. & POL. 515 (1977).

[25] 542 F.2d 868 (2d Cir. 1976).

[26] *Id.* at 871-77. The court noted that the basic United States policy is derived from the United States Constitution. *Id.* at 877. The fifth amendment to the Constitution provides in pertinent part: "nor [shall any person] be deprived of . . . property, without due process of law; nor shall private property be taken for public use, without just compensation." U.S. Const. amend. V.

policy.[27]

Similarly, in *Libra Bank Ltd. v. Banco Nacional de Costa Rica*,[28] a case addressing facts virtually identical to those of *Allied Bank*, the United States District Court for the Southern District of New York considered whether a government-ordered default by a Costa Rican bank was subject to scrutiny by a United States court.[29] In that case, plaintiff Libra Bank and sixteen other banks loaned $40 million to defendant Banco Nacional de Costa Rica.[30] Defendant paid the first installment due under the loan but was unable to make further repayment because of a series of resolutions adopted by the Costa Rican government prohibiting payment of external debt.[31] In response to Plaintiff's motion for summary judgment, Defendant argued that the act of state doctrine required the court to give effect to the Costa Rican government's directives.[32] The court found this contention meritless based on its conclusion that the situs of the debt at the time of the Costa Rican decrees was not Costa Rica, but New York, thereby permitting judicial inquiry.[33] The court located the debt in New York because the Costa Rican banks had consented to jurisdiction in New York and had, pursuant to the loan contract, agreed to make all payments to an American bank in New York.[34] Citing numerous cases from the Second Circuit,[35] the court then held that the Costa Rican resolutions clearly violated United States law, since "a foreign

---

[27] 542 F.2d at 877.

[28] 570 F. Supp. 870 (S.D.N.Y. 1983).

[29] *Id.* The *Libra* case was decided one month after Allied Bank International v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440 (S.D.N.Y. 1983) (Griesa, J.), in the same United States District Court for the Southern District of New York.

[30] 570 F. Supp. at 874. The loan agreement provided *inter alia* for installment payments to occur on July 30, August 30, September 30, and October 30, 1981. *Id.*

[31] The resolutions were adopted in response to the Costa Rican government's fiscal difficulties. 570 F. Supp. at 874-75.

Costa Rica continues to suffer economic hardship. As recently as March 1984, Mexico provided a $50 million loan to Costa Rica to prevent its defaulting on interest payments on its intergovernmental debt, which totalled more than $3 billion at that time. Costa Rica owed an additional $200 million in interest due in 1984 to private banks. Wall. St. J., Apr. 5, 1984, at 34, col. 5.

[32] 570 F. Supp. at 876.

[33] *Id.* at 881-82.

[34] *Id.* The court also identified two other factors justifying designation of New York as the debt situs. These factors included Defendant's consent to having the letter agreement construed in accordance with New York law and the fact that Defendants had assets in the United States. *Id.*

[35] *E.g.*, United Bank, Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868 (2d Cir. 1976); Republic of Iraq v. First Nat'l City Bank, 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

state's effective confiscation of property, without compensation, is repugnant to the Constitution and laws of this nation."[36] Finally, addressing the traditional concern for international comity,[37] the court concluded that its effective reversal of the Costa Rican decrees would not alter United States relations with Costa Rica.[38] The court reasoned that Costa Rica could not have expected to have dominion over the bank's debts because of the inability of a foreign state to complete an expropriation beyond its borders.[39]

## III. THE DECISION

In its en banc rehearing of the *Allied Bank* case, the Second Circuit court refused to sanction the Costa Rican action under act of state principles.[40] The court stated that invocation of the doctrine depends exclusively on the situs of the debt at the time of the purported taking.[41] According the situs question a specialized analysis,[42] the court first noted that Costa Rica's purported taking could not "come to complete fruition within the dominion of the [foreign] government," mandating location of the debt within the United States.[43] The court then applied situs criteria applicable to tangible property, noting that the Costa Rican banks had conceded jurisdiction in New York and that they had agreed to pay the debt in New York in United States dollars.[44] The court concluded that under either analysis, the debt's situs was the United States, precluding application of the act of state doctrine.[45]

Having dispensed with any act of state protection for the Costa Rican action, the en banc panel then held that the directives contravened both United States law and policy.[46] The court found the

---

[36] 570 F. Supp. at 882.

[37] *Id.* at 882-83. For an explanation of the concept of international comity, see *supra* note 15.

[38] 570 F. Supp. at 883. For a discussion of United States - Costa Rican relations during the Costa Rican economic crisis, see *infra* note 46.

[39] 570 F. Supp. at 884.

[40] Allied Bank International v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985).

[41] *Id.* at 521.

[42] *Id.* Citing Tabacalera Serveriano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706, 715 (5th Cir.), *cert. denied*, 393 U.S. 924 (1968), the court stated that "the concept of the situs of a debt for act of state purposes differs from the ordinary concept," requiring a specialized situs analysis.

[43] *Id.*

[44] *Id.* at 521-22.

[45] *Id.* at 522.

[46] *Id.* at 522-23.

actions inconsistent with United States law on two grounds. First, the court noted that the debt deferral violated established United States procedure for resolving both intergovernmental and private debt difficulties.[47] Second, the panel stated that the Costa Rican directives simply violated express provisions of the loan contracts.[48] The court similarly concluded that the Costa Rican actions contravened United States policy, noting that recognition of the directives would be inconsistent with the orderly resolution of international debt problems and with the maintenance of the United States' status as a major source of international credit.[49]

## IV. COMMENT

By reversing its prior holding, the en banc Second Circuit properly refuted both the district court's and its own erroneous conclusions concerning the act of state doctrine. The en banc panel's refusal to affirm the district court's application of the doctrine reflected an understanding of the doctrine's territorial limitations. The court properly identified the Costa Rican banks' consent to jurisdiction and to payment in New York as crucial to its situs determination. As the Second Circuit had previously stated, "[F]or purpose of the act of state doctrine, a debt is not 'located' within a foreign state unless that state has the power to enforce or collect it."[50] That power "generally depends on jurisdiction over the person of the debtor."[51] Moreover, the Second Circuit had ruled that a debt's repayment site constitutes its situs for act of state purposes.[52] Accordingly, Cost Rica's attempted extraterritoral action

---

[47] *Id.* at 522.

[48] *Id.*

[49] *Id.*

[50] Menendez v. Saks & Co., 485 F.2d 1355, 1364 (2d Cir. 1973), *rev'd on other grounds sub nom.* Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682 (1976).

[51] *Id.* at 1365 (citing Harris v. Balk, 198 U.S. 214 (1904)).

[52] United Bank, Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868, 872 (2d Cir. 1976). *See also* Garcia v. Chase Manhattan Bank, N.A., 735 F.2d 645 (2d Cir. 1984); Vishipco Line v. Chase Manhattan Bank, N.A., 660 F.2d 854 (2d Cir. 1981). *But see* Perez v. Chase Manhattan Bank, 61 N.Y. 2d 460, 463 N.E.2d 5, 474 N.Y.S. 2d 689 (1984). In *Garcia*, Plaintiff purchased certificates of deposit from Chase Manhattan, a U.S. bank with a Cuban branch office. The bank's officers guaranteed payment upon demand in U.S. dollars at any Chase branch worldwide. When the revolutionary government of Cuba seized Plaintiff's account, Plaintiff instituted an action against Chase Manhattan seeking payment. Chase asserted that the act of state doctrine extinguished its liability. 735 F.2d at 646-49.

In rejecting Chase's claim, the court held that the act of state doctrine did not apply, noting that the case simply involved a private dispute between a United States bank and one of its depositors. 735 F.2d at 6451. The court did reaffirm, however, the rule that a

was impermissible under well-settled act of state principles.

The court's reversal of its ruling that the Costa Rican decrees were consistent with United States law is likewise accurate. As the court notes, recognition of the decrees would require the court to vitiate an express provision of the contract between the parties in violation of fundamental contract law principles. The debtor banks expressly guaranteed repayment, notwithstanding any future action by the Costa Rican government to bar external payment of United States dollars.[53] The risk of unavailability of foreign exchange had therefore been allocated to the debtor, not to the creditor.[54] Consequently, Plaintiff justifiably demanded payment after the Costa Rican government took the precise action envisioned by the contract.[55]

---

debt's situs is where the debt is payable and where the debtor can be found. "[W]here a foreign government has both the parties and the *res* before it and alters their relationship thereto, our courts realize that there is little that they can do to change the legal relationship." *Id.* at 650 n.5.

[53] The loan contracts contained the following language:

> 7. Events of Default:
>
> If any of the following events of default should occur and is not remedied within a period of 30 days as of the date of occurrence, the Agent Bank may, by a written notice to the Borrower[,] declare the promissory notes to be due and payable. In such an event, they shall be considered to be due without presentment, demand, protest or any other notice to the Borrower, all of which are expressly waived by this agreement:
>
> 7.1 Any payment of principal or interest under this transaction shall not have been paid on its maturity date. If the Borrower shall not effect any payment of principal or interest on the promissory notes at maturity, due solely to the omission or refusal by the Central Bank of Costa Rica to provide the necessary U.S. Dollars, such an event shall not be considered to be an event of default which would justify the demandability of the obligation, during a period of 10 days after such maturity date.

757 F.2d 516, 522 n.4.

[54] *See* Brief for the United States Government as *Amicus Curiae* at 16, Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714 (2d Cir. April 23, 1984), *vacated on reh'g*, 757 F.2d 516 (2d Cir. 1985).

[55] Defendants argued on rehearing that private contracts may be subject to modification in the public interest. Cited examples include the government's interference with private contracts during period of severe inflation pursuant to the Economic Stabilization Act of 1970, 12 U.S.C. § 1904 (1982). Defendants also noted that states have enacted debt moratoriums under the Constitution's contract clause, with the Supreme Court's blessing. *See* Home Building and Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934) (Supreme Court upheld a Minnesota "mortgage moratorium law" enacted in response to the Depression, precluding mortgage holders from foreclosing on mortgagors); *accord*, East New York Savings Bank v. Hahn, 326 U.S. 230 (1945) (upholding similar New York legislation). The contract clause, U.S. Const. art. I, § 10, Cl. 1, by its terms applies, however, only to the states of the United States and not to the federal government. Louisville Bridge Co. v. United States 242 U.S. 409, 418 (1917); Mitchell v. Clark, 110 U.S. 633, 643 (1884). Accordingly, the contract clause

While identifying controlling contract law, the court wisely chose not to discuss a possible analogy between the Costa Rican directives and the United States bankruptcy law. Significantly, this analogy was the principal ground on which the court based its prior holding that the directives comported with United States law.[56] The bankruptcy analogy, while attractive at first glance, disintegrates upon careful scrutiny. Section 304 of the Bankruptcy Code (11 U.S.C. § 304 (1982)), premised on comity considerations, provides that a United States creditor's rights may be subordinated to a restructuring of foreign debt under certain circumstances.[57] In this case, however, no authentic debt rescheduling

---

is inapplicable to Costa Rica by its terms or by analogy. *See* Brief for Defendants - Appellees on Rehearing at 29-32, Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714 (2d Cir. April 23, 1984), *vacated on reh'g*, 757 F.2d 516 (2d Cir. 1985) [hereinafter cited as Brief for Defendant-Appellee on Rehearing].

Moreover, the courts of New York and of the Second Circuit have, as a policy matter, rejected defenses to payment on New York debts based on foreign moratorium decrees or other acts by debtor nations. *See, e.g.*, Central Hanover Bank & Trust Co. v. Siemens & Halske Aktiengesellschaft, 14 F. Supp. 927, 929 (S.D.N.Y.), *aff'd* 84 F.2d 993 (2d Cir.), *cert. denied*, 299 U.S. 585 (1936); Egyes v. Magyar Nemzeti Bank, 165 F.2d 539, 541 (2d Cir. 1948). This policy of giving effect to the "justified expectations of the parties to the contract" is of paramount importance to New York's preeminent position within the financial community. J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda), Ltd., 37 N.Y. 2d 220, 226-27, 333 N.E.2d 168, 172-73, *cert. denied*, 423 U.S. 866 (1975).

[56] Allied Bank International v. Banco Credito Agricola de Cartago, 733 F.2d 23 (2d Cir. 1984). The court stated that Costa Rica's prohibition on external payment resembled Chapter 11 of the U.S. Bankruptcy Code, 11 U.S.C. §§ 1101-1174 (1982).

[57] 11 U.S.C. § 304 (1982). This section is designed to aid in the "administration of assets of the foreign debtor located in this country, the prevention of dismemberment of assets located here by local creditors, and the provision of other relief appropriate under the circumstances." *See* 2 COLLIER ON BANKRUPTCY § 304.01 *et seq.* (15th ed. 1984). Courts are to be guided by principles of comity in fashioning relief under the Code. *See* H.R. REP. No. 595, 95th Cong., 1st Sess. 325 (1977); S. REP. No. 989, 95th Cong., 2d Sess. 35 (1978).

To ensure § 304 protection, a foreign representative (trustee, administrator, or other representative of an estate in a foreign proceeding) must file a petition with a United States bankruptcy court. United States creditors' rights may then be subordinated to a foreign debt reorganization if such relief would guarantee the:

> (1) just treatment of all holders of claims against or interests in such estate;
>
> (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
>
> (3) prevention of preferential or fraudulent dispositions of property of such estate;
>
> (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
>
> (5) comity; and
>
> (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

11 U.S.C. § 304 (1982).

For a related discussion of the applicability of United States bankruptcy principles to

proceeding[58] had been initiated by the Costa Rican banks, precluding § 304's application. Moreover, the banks never sought § 304 protection, evidencing their perceived inability to satisfy the provision's requirements.

Application of § 362 of the Bankruptcy Code[59] is similarly inappropriate. This provision, cited by the appellate court in its initial opinion,[60] provides a variety of safeguards for creditors forced to participate in debtor-initiated bankruptcy proceedings.[61] The Costa Rican decrees did not, however, provide any procedures resembling those found in § 362.[62] Consequently, comparison of the Costa Rican directives with § 362 is inapposite.

While therefore apparent that the Costa Rican actions contravened United States law, that the directives were inconsistent with United States foreign policy is less certain. One strong indicia of United States government policy is, however, the views expressed by the United States as *amicus curiae* on rehearing.[63] In its *amicus*

---

foreign debt rescheduling, see Note, *Procedural Guidelines for Renegotiating LDC Debt: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act*, 21 VA. J. INT'L L. 305 (1981).

[58] " '[F]oreign proceeding' means proceeding, whether *judicial* or *administrative* and whether or not under the bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or *effecting a reorganization*. . ." 11 U.S.C. § 101(20) (Supp. II 1984) (emphasis added).

The Costa Rican banks' action was neither a judicial nor administrative proceeding, but merely a sudden cessation of payments to its creditors. Consequently, Defendants could not rely on § 304's protections.

[59] 11 U.S.C. § 362 (1982 & Supp. II 1984).

[60] Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714, slip op. at 3223 (2d Cir. April 23, 1984).

[61] Section 362 of the Bankruptcy Code provides for an automatic stay, upon the filing of a bankruptcy petition, of a variety of actions which would affect the property of a debtor. *See* 2 COLLIER ON BANKRUPTCY § 362.01 *et seq.* (15th ed. 1984). The section also provides, however, a procedure by which a claimant may seek relief from the stay. The process includes, *inter alia* an opportunity for creditors to file a claim, and a chance to be heard at a hearing. *See* 2 COLLIER ON BANKRUPTCY § 362.08, *et. seq.* (15th ed. 1984).

[62] "The decrees were enacted without any notice to or consultation with creditors. They contained no provision for giving notice to creditors, the filing of claims or the opportunity to be heard. They contained no mechanism for either proving or disproving insolvency. They contained no provision for the marshalling of assets. They contained no provision for the fair and equal treatment for creditors. They contained no prohibition against preferential payments to creditors, or other safeguards. They contained no provision for judicial administration or review. They were simply a bald, discriminatory cessation of the payment of debts to a targeted group of creditors." Brief of Plaintiff-Appellant on Rehearing at 22, Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714 (2d Cir. April 23, 1984), *vacated on reh'g*, 757 F.2d 516 (2d Cir. 1985), *petition for cert. filed*, 54 U.S.L.W. 3086 (U.S. July 26, 1985) (No. 85-146).

[63] The U.S. government's position in *Allied* was formulated by the Department of State,

briefs, the United States advanced essentially two legitimate reasons why the Costa Rican actions conflicted with United States policy interests. First, the government noted that the United States seeks to promote financial stability and economic growth in debtor nations.[64] Such prosperity, the government notes, will result from policies designed to encourage new loans to debtor nations by external creditors. Sanction of the Costa Rican actions, which denied foreign creditors their express contractual rights, could only discourage future lending.[65] Second, the government correctly asserts that United States approval of the Costa Rican directives would postpone a debtor nation's adoption of needed economic reforms.[66] Consequently, the debtor could use United States courts to avoid swift resolution of international debt problems, to the detriment of creditors in the United States and manifestly inconsistent with United States policy aims.[67]

Notwithstanding the United States' explicit condemnation of the Costa Rican directives as amicus, there is evidence that both the executive and the legislative branches endorse the Costa Rican actions. The Costa Rican government had previously failed to pay its intergovernmental debt,[68] triggering the Foreign Assistance Act of 1961.[69] The Act prohibits aid to defaulting nations absent presidential determination that further assistance to such countries "is in the national interest."[70] Pursuant to this language, the President twice advised Congress that it should grant continued aid to Costa Rica.[71] Moreover, the House of Representatives expressed support

---

the Department of Treasury, and the Board of Governors of the Federal Reserve System in collaboration with the Department of Justice. *See* Brief for the United States as Amicus Curiae, Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714 (2d Cir. April 23, 1984), *vacated on reh'g*, 757 F.2d 516 (2d Cir. 1985) [hereinafter cited as United States Amicus Brief]; Tigert, *Allied Bank International: A United States Government Perspective*, 17 N.Y.U. J. INT'L L. & POL. 511, 513 at n.7, (1985) [hereinafter cited as Tigert, *Government Perspective*].

[64] United States Amicus Brief at 2-3.

[65] *Id.*

[66] *Id. See also* Tigert, *Government Perspective*, *supra* note 63, at 521.

[67] United States Amicus Brief at 2-3. *See also* Tigert, *Government Perspective*, *supra* note 63.

[68] Allied Bank International v. Banco Credito Agricola de Cartago, No. 83-7714 (2d Cir. April 23, 1984).

[69] Foreign Assistance Act of 1961, PUB. L. No. 87-195, 75 Stat. 424 (codified as amended in scattered sections of 22 U.S.C.).

[70] 22 U.S.C. § 2370(q) (1982).

[71] In an official message to leaders within the executive and legislative branches concerning Costa Rican loan defaults, the President advised that "[a] continuation of U.S. assistance to Costa Rica is consistent with the commitment of this administration and in Con-

for Costa Rica in two concurrent resolutions.[72] This exercise of presidential authority, taken with the explicit approval of Congress, is presidential authority at its zenith.[73] In these circumstances, the President's action may possibly be seen to have personified the policy of the federal government.[74]

That this expression of support came in an intergovernmental debt context does not alter the analysis. Section 2370(e)(1) of the Foreign Assistance Act *requires* the President to suspend aid to any country confiscating the *private property* of any citizen or corporation or taking "steps to repudiate or nullify existing contracts or agreements" with United States subject[75] (emphasis added). To date, neither the President nor Congress has invoked this provision with reference to the Costa Rican action, giving rise to an inference of presidential and congressional approval.

Weighing the statements of the government as *amicus* and the conflicting acts by the President and Congress, the United States policy appears to forbid unilateral deferral of international debt. Regardless of presidential, congressional, and statutory mandates to maintain foreign assistance to Costa Rica, the United States government simply has not endorsed the unilateral abrogation of private commercial loan contracts by debtor governments. Although in limited circumstances courts have ignored public policy formulation by the Department of State,[76] in this case the governing policy concerns are clear: the promotion of loans to debtor

---

gress to help Costa Rica regain economic viability. We therefore regard such assistance . . . as vital and in the national interest. We are hopeful that bilateral debt restructuring will be completed within the next several months." Letter from Secretary of State George Shultz to Speaker of the House Thomas P. O'Neill, Jr., Oct. 11, 1983, 129 CONG. REC. H8243 (daily ed. Oct. 17, 1983) (Executive Communications No. 1990); Letter from Secretary of State George Shultz to the Speaker of the House of Representatives Thomas P. O'Neill, Jr., March 18, 1983, 129 CONG. REC. H1461 (daily ed. March 21, 1983) (Executive Communications No. 671).

[72] H.R. Con. Res. 423, 97th Cong., 2d Sess., 128 CONG. REC. H10,205 (daily ed. Dec. 16, 1982). *See also* H.R. Con. Res. 194, 98th Cong., 1st Sess., 129 CONG. REC. H10,350 (daily ed. Nov. 17, 1983).

[73] *See* Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 635-37 (1952) (Jackson J., concurring) (cited in Brief for Defendants - Appellees on Rehearing at 18, n.21).

[74] 343 U.S. at 636.

[75] 22 U.S.C. § 2370(e)(1)(1982).

[76] "While the recognition and maintenance of diplomatic relations with a foreign government are political matters within the province of the executive department of the federal government, questions regarding the administration of estates and the determination of rights and interests in property in the United States ordinarily are matters for determination by the courts of competent jurisdiction." Republic of Iraq v. First Nat'l City Bank, 353 F.2d 47, 52 n.5 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

nations through protection of the justified expectations of the parties to the loan agreements, and the consequent return of debtor nations to financial stability.

With its decision in *Allied Bank*, the Second Circuit has delineated the parameters of the act of state doctrine and the extent to which unilateral foreign debt deferrals are inconsistent with United States law. The accuracy of the court's ruling that the Costa Rican action violated United States foreign policy is also apparent, though muddied by the presidential and congressional response to Costa Rican economic hardship. The holding can be viewed in great part as a reaction to the concerns of the commercial banking community.[77] Latin American nations continue to experience economic difficulties,[78] creating great risks for international lenders. Consequently, the en banc Second Circuit has responded by restoring a measure of certainty to Latin American lending, purportedly ensuring a reasonably safe loan market for lenders and a resulting supply of funds for cash-strapped debtor nations.

*Marc J. Lewyn*

---

[77] *See generally* Rowe, *Three Years of Belt Tightening and There's No Payoff in Sight*, Wash. Post (National Weekly Edition), October 21, 1985, at 19; A. Lewis, *Debts and Reality*, N.Y. Times, June 25, 1984, at A15, col. 5; Kissinger, *It's A Crisis: It Can Be Solved*, Wash. Post, June 24, 1984, at 138.

[78] *See generally* Rowe, *Three Years of Belt Tightening and There's No Payoff in Sight*, Wash. Post (National Weekly Edition), October 21, 1985, at 19.