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Between Iraq and a Hard Place: Letter of Credit Litigation Following the Gulf War

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BETWEEN IRAQ AND A HARD PLACE: LETTER OF CREDIT LITIGATION FOLLOWING THE GULF WAR¹

David Seligman

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Introduction

Saddam Hussein had no idea that his invasion of Kuwait on August 2, 1990 would result in his Gulf War defeat. The legacy of Hussein's expansionist desires are well documented: the destruction of Iraq's military forces, the most diverse and largest group of nations to unite in a military campaign since World War II, and a solid groundwork for a Middle East peace plan. All with only twenty-six American casualties. But the legacy of the Gulf War hits far closer to home than this. Hundreds of American companies that had contracted to export goods to Iraq have yet to be paid. Their export contracts were financed through irrevocable letters of credit issued by Iraqi banks and confirmed by American banks. Today these companies are fighting

¹ The author has found the phrase's use in: Barbara Demick, *PA. Furnace Maker Caught Between Iraq and a Hard Place*, JOURNAL OF COMMERCE, Feb. 9, 1993, at 10A.

an enemy far greater than Saddam Hussein. They are fighting the "mother of all battles" against American banks, the U.S. courts, and the U.S. government.

Before the Iraqi invasion of Kuwait, thousands of American companies manufactured goods for export to Iraq. They protected themselves by entering into letters of credit confirmed by U.S. banks.² In most cases, the issuing Iraqi bank deposited money in the American confirming bank's account. This money was either earmarked for paying the letter of credit beneficiary or for reimbursing the confirming bank once it honored the letter of credit. On August 2, 1990, these sellers were in various stages of completing their contracts. Sometimes a seller presented the proper shipping documents to the confirming bank and was a wire transfer away from payment. Other times a seller was almost finished manufacturing his products and was about to deliver them to an international shipper or freight forwarder. Then as part of America's response to Iraq's invasion, President Bush froze all Iraqi assets in the U.S. Confirming banks then claimed they could not pay letter of credit beneficiaries from the frozen Iraqi accounts earmarked for payment, lest they violate Bush's freezing orders.

This comment explores litigation where American exporters, with varying success, sought payment from American confirming banks and/or the unlocking of frozen Iraqi assets. Part I will argue that the U.S. judiciary responded to the competing interests of the Bush (and later Clinton) Administrations, the Treasury Department, the banking community, and the exporting community by upholding long-standing letter of credit legal doctrines, thereby siding with the exporters against the banks. However, courts did not go so far as to interfere with the Treasury's control over the Iraqi assets freeze program. The judicial balancing of these interests reflected both the law and the best practical solution to a no-win situation. Part II will

² A brief review of letter of credit transactions may be in order. Generally a letter of credit involves the following parties and transactions. A buyer and seller agree to a contract. The seller, concerned about payment, requires as part of the transaction a letter of credit—a promise, irrevocable for a stated period of time, to pay the seller upon the presentation of certain documents evidencing that the goods have been shipped to the buyer. The buyer then negotiates with its bank (in which it is an account party) to issue this letter of credit. Often in international transactions the seller (the letter of credit beneficiary) requires that an American bank confirm the letter of credit. When the seller has completed the goods and delivers them to a shipper, he receives in return shipping documents signifying delivery to the shipper. The seller then presents these documents to the confirming bank, which is obligated to pay pursuant to the letter of credit. The obligation to pay upon presentment of proper shipping documents is independent of whether the goods conform to the contract. Subsequently the confirming bank will be reimbursed from the issuing bank. In most situations the confirming bank requires the issuing bank to deposit the amount owed on the letter of credit in an account in its bank.

examine proposed Congressional bills that will satisfy American claimants with the frozen Iraqi assets. Part III will argue that the Treasury Department's behavior in this litigation reflected domestic political concerns and institutional biases rather than the neutral management of an assets freeze regime.

Part I: Letter of Credit Litigation

A. *The Assets Freeze Regime*

In response to Iraq's invasion of Kuwait, President Bush imposed sanctions pursuant to the International Emergency Economic Powers Act ("IEEPA")³ and the U.N. Security Council mandates.⁴ Bush signed Executive Order Nos. 12,722⁵ and 12,723,⁶ which invoked the authority of IEEPA and dictated that "all property and interests in property of the Government of Iraq, its agencies, instrumentalities and controlled entities and the Central Bank of Iraq" be blocked.⁷ The blocking applied to property within the United States or in control of U.S. persons.⁸

At the same time, the U.N. Security Council passed Resolution 661,⁹ which required U.N. members to impose economic sanctions on Iraq. Among these sanctions included a prohibition against providing funds "or any other financial or economic resources" to Iraq.¹⁰ President Bush later signed Executive Order 12,724¹¹ which "aligned U.S. sanctions against Iraq with the terms of the [U.N. R]esolution" and continued blocking assets of the Iraqi Government and its agencies.¹²

The party responsible for managing this frozen assets program is the Treasury Department's Office of Foreign Assets Control ("OFAC"). OFAC

³ 50 U.S.C. § 1701 (1977). See *Dames & Moore v. Regan*, 453 U.S. 654 (1981), and *U.S. v. Arch Trading Co.*, 987 F.2d 1087 (4th Cir. 1993), for discussions as to whether the IEEPA is a constitutionally permissible delegation.

⁴ MICHAEL P. MALLOY, *ECONOMIC SANCTIONS AND U.S. TRADE* 153 (Supp. 1996).

⁵ Exec. Order No. 12,722, 55 Fed. Reg. 31,803 (1990).

⁶ Exec. Order No. 12,723, 55 Fed. Reg. 31,805 (1990).

⁷ Exec. Order No. 12,722 § 1, 55 Fed. Reg. 31,803 (1990).

⁸ MALLOY, *supra* note 4, at 155.

⁹ S.C. Res. 661, U.N. SCOR, 45th Sess., 2933rd mtg. at §§ 3(a)-(c) and 4, U.N. Doc. S/RES/661 (1990).

¹⁰ *Id.* at 4.

¹¹ Exec. Order No. 12,724, 55 Fed. Reg. 33,089 (1990).

¹² MALLOY, *supra* note 4, at 161.

implemented the Executive Orders through the Iraqi Sanctions Regulations ("ISRs").¹³ These Regulations dictate that "no such property or interests in property of the [Government of Iraq] can be transferred, paid, exported, withdrawn, or otherwise dealt in, unless licensed by OFAC."¹⁴ One with a judgment against an Iraqi entity cannot execute that judgment without a license from OFAC—" [u]nless licensed or authorized . . . any attachment, judgment, lien . . . is null and void."¹⁵

A plaintiff must also obtain an OFAC license just to bring a suit involving frozen Iraqi assets.¹⁶ OFAC has considerable discretion to grant these licenses, and usually granted them liberally.¹⁷ This is the result of several decisions heavily scrutinizing OFAC's denial of a license to sue. Courts feel that for OFAC to deny a license to sue an Iraqi entity invades the power of the judiciary.¹⁸ Moreover, when one plaintiff brought suit without obtaining the proper license, OFAC deemed it "not terribly significant."¹⁹ But OFAC is extremely recalcitrant in granting licenses to execute a judgment against Iraqi property.

This prohibition on the transfer of any asset in which Iraq had a property interest apparently prevented the honoring of letters of credit. Certain beneficiaries had presented the appropriate shipping documents to their confirming banks but had yet to receive payment when Bush froze Iraqi assets. Other exporters obtained draws on the letters of credit and were in the process of finishing manufacturing goods for export. Once Iraqi assets (i.e., the issuing Iraqi banks' deposits in the confirming banks) were frozen, the confirming banks claimed that they could not honor these letters of credit without violating the freeze orders. Even if a beneficiary complied with the letter of credit by timely presenting the conforming shipping documents to the

¹³ Iraqi Sanctions Regulations, 31 C.F.R. § 570 (1991).

¹⁴ MALLOY, *supra* note 4, at 171.

¹⁵ Iraqi Sanctions Regulations, 31 C.F.R. § 575.202(b)-(e) (1991).

¹⁶ While this has been the case in practice, there is no express statutory language so requiring. It has been argued that OFAC is interpreting statutory language used in the Iranian assets freeze regime, "[u]nless authorized by a license expressly referring to this section, the acquisition, transfer . . . in any security (or evidence thereof) registered or inscribed in the name of any Iranian entity is prohibited" 31 C.F.R. § 535.202 (1991). Douglas M. Hottle, *Unblocking Frozen Assets—A Simple Solution*, 31 DUQ. L. REV. 329, 333 n.19 (1993).

¹⁷ See 31 C.F.R. § 575.202 (1991).

¹⁸ Dean Witter v. Fernandez, 741 F.2d 355, 361-62 (11th Cir. 1984); National Airmotive v. Iran, 499 F.Supp 401, 405 n.9 (D.D.C. 1980).

¹⁹ Ellen Pollack and Wade Lambert, *U.S. Concern Sues Iraq Raising Issues of Deciding Postwar Claims*, WALL ST. J., March 11, 1991, at B8.

confirming U.S. bank, OFAC's position was that to honor the letter of credit by paying out of the earmarked funds was a transfer of property in violation of the freeze orders.

Unlike the United States, the United Nations quickly enacted its own claims regime. The U.N. adopted Resolution 687 on April 3, 1991,²⁰ which enumerated the exact nature of its compensation regime. The U.N. created a Compensation Fund headed by a Governing Council. The Fund would be financed through U.N. sponsored sales of Iraqi oil and petroleum products, and the Fund would only accept consolidated claims by individual governments on their own behalf and on behalf of their citizens.²¹ These claims would be evaluated at the domestic level by each country's appropriate governing body, and then each government would present the claims in consolidated form to the Compensation Commission. The Commission would allocate lump-sum payments to countries who would then distribute the funds to individual claimants.²² This was never an avenue of compensation for the American letter of credit beneficiaries. This is because the Fund would only address claims for loss, damage or injury that resulted directly from Iraq's invasion of Kuwait. U.N. Resolution 687 stated that "[d]ebts and obligations of Iraq arising prior to August 2, 1990, are to be addressed through the normal mechanisms," meaning those claimants only had recourse with their individual governments.²³ This meant that any pre-war contract claim, of which the American letter of credit exporters had many, would be redressed either in the U.S. courts or through appropriate Congressional legislation.

B. Obstacles

American exporters were not content with knowing that they might have a recognized claim against Iraq. They did not want to wait until Congress enacted claims legislation or a created a claims tribunal. Moreover, these beneficiaries knew that it could be years before Congress passed claims legislation. For example, Cuban assets have been frozen for twenty-five years,

²⁰ S.C. Res. 687, U.N. SCOR, 46th Sess., 2981rd mtg., at 16-19, U.N. Doc. S/RES/687 (1991).

²¹ Massimo Galli, *Sue or Lose: An Agenda for American Corporations and Companies Seeking Compensation From Iraq*, 1993 COLUM. BUS. L. REV. 241, 243. At the rate of the U.N. plan, it will take twenty to thirty years for Iraqi oil sales to pay off those claims. Charles Brower, *International Law: Credibility Depends on Iraqi Reparations*, MIDDLE EAST EXEC. REPORTS (May 1992) at 12.

²² Galli, *supra* note 21, at 245, 248.

²³ Res. 687, U.N. SCOR, 46th Sess., 2981rd mtg., at 16, U.N. Doc. S/RES/687 (1991).

and yet there is still no Cuban claims legislation.²⁴ Finally, the beneficiaries knew how little Iraqi assets there were to pay off all the reported claims. Therefore, the exporters sought immediate payment, rather than a small percentage of their claim later.²⁵

In contrast, when President Carter froze Iranian assets in response to the hostage crisis at the U.S. embassy in Tehran, U.S. claimants were less urgent to recover because of the amount of frozen assets available. In 1979, there were nearly \$10 billion in Iranian funds in the United States, however, in 1990 there were only \$1.3 billion frozen Iraqi assets in the United States and \$4 billion worldwide. Almost immediately, there were \$80 billion worth of claims against Iraq for pre-war economic damages and \$100-200 billion for post-war damages.²⁶ Claimants would likely receive fractions of their claims. This fostered a "race to the courthouse," and due to the success of several early plaintiffs, there was hope that letter of credit beneficiaries could recover their claims in full.²⁷

While the U.N. Claims Compensation Fund gave the American exporters no help, the United States government chipped away at assets available to pay them. The U.N. enacted Resolution 778, which created a pool of money donated by member states for humanitarian efforts in Iraq.²⁸ The resolution limited individual state contributions to \$200 million. The U.S. contributed the \$200 million maximum, even though the only other contributors were Saudi Arabia and Kuwait. The Bush Administration transferred the \$200 million from blocked Iraqi accounts to the Federal Reserve, and then transferred \$50 million to the UN.²⁹

There were other problems facing the beneficiaries. To recover against a confirming bank that refused to honor a letter of credit, a beneficiary had to obtain an OFAC license to bring suit. Even if it won the suit, it would then have to obtain a second OFAC license to execute the judgment on Iraqi funds.³⁰ If an Iraqi defendant did not appear, and the beneficiary moved for a default judgment, OFAC often intervened on behalf of the Iraqi defendant and against the American exporter; OFAC claimed that it had an interest in the

²⁴ See generally, *Tagle v. Regan*, 643 F.2d 1058 (5th Cir. 1981).

²⁵ Galli, *supra* note 21, at 251, 254.

²⁶ *Id.* at 248.

²⁷ See, e.g., *Consarc Corp. v. Iraqi Ministry of Indus. and Minerals*, No. 90-2269, 1992 WL 415256 (D.D.C. Dec. 29, 1992) *rev'd*, 71 F.3d 909 (D.C. Cir. 1995).

²⁸ Res. 778, U.N. SCOR, 47th Sess., 31174 mtg., U.N. DOC. S/RES/778 (1992).

²⁹ 57 CONG. REC. H622-02, H623 (Feb. 16, 1993).

³⁰ See generally 31 C.F.R. §§ 575.305-313 (1991).

management of the frozen assets.³¹ OFAC's stated reasons for intervention were that default judgments compromised U.S. efforts to create an effective claims resolution process, and that if U.S. claimants bypassed the system and sought redress in the courts, no money would be left when Congress ultimately enacts claims legislation.³² Another procedural hurdle was the Foreign Sovereign Immunities Act ("FSIA"),³³ which enumerated detailed requirements for serving process on a foreign entity, including venue and evidentiary requirements in default judgment motions.³⁴ OFAC often intervened on behalf of the non-appearing Iraqi entity claiming that the beneficiary had not complied with the FSIA. Most importantly, suits against Iraq had to be commercial in nature, or Iraq had to waive its sovereign immunity. Although Iraq waived its sovereign immunity by accepting U.N. Resolution 687 as a condition of the Gulf War cease fire, that waiver only related to compensation for claims of injury *directly* resulting from the invasion of Kuwait. It was of no help for the exporters/plaintiffs.³⁵

C. Discussion

While each letter of credit case had its own facts, certain general themes remained consistent. For instance, the sellers often claimed that they complied with the letter of credit by presenting their conforming documents to the appropriate banking institution before the Iraqi invasion. The confirming banks claimed that to honor the letters of credit would violate the prohibition on the transfer of assets in which Iraq had a property interest.³⁶ In addition OFAC asserted that its intervention on behalf of the Iraqi entities was to protect the frozen assets until Congress enacted claims legislation. For instance, if a court found that a letter of credit beneficiary made proper presentment or complied with its contractual obligations, the court ordered the

³¹ OFAC has made its position known through the Justice Department which filed "Statements of Interest" in virtually all of these cases. Galli, *supra* note 21, at 241, 258 and n.61. *See also, e.g.*, International Housing Ltd. v. Rafidain Bank, 712 F. Supp. 1112 (S.D.N.Y. 1989); Commercial Bank of Kuwait v. Rafidain Bank, 15 F.3d 238 (2nd Cir. 1994). Justice or State Department "statements of interest" consist of a "written policy position taken by the appropriate department concerning the litigation; often these positions are politically motivated. Douglas M. Hottle, *Unblocking Frozen Assets—A Simple Solution*, 31 Duq. L. Rev. 329, 332 n.17.

³² Hottle, *supra* note 31, at 332 n.17.

³³ 28 U.S.C. §§ 1602 et. seq. (1972).

³⁴ *Id.*

³⁵ Galli, *supra* note 21, at 245, 252-53.

³⁶ *See, e.g.*, Engel Indus. v. First Am. Bank, N.A., 798 F. Supp. 9, 11 (D.D.C. June 2, 1992).

confirming bank to honor the letter of credit from its non-Iraqi assets. If a beneficiary brought suit directly against a non-appearing Iraqi entity, a court might enter a default judgment, including some substantial punitive damage awards if fraud was involved.³⁷ However, the courts did not compel OFAC to grant the plaintiff a license to execute that judgment against frozen Iraqi assets. Rather, the courts deferred to the administrative rulings of OFAC. The courts' use of several legal principles including the independence doctrine,³⁸ the fraud-in-the-transaction principle,³⁹ the strict compliance doctrine,⁴⁰ and a *Chevron*⁴¹ rationale, resulted in a consistent line of cases.

As an initial matter, when a letter of credit beneficiary applies to OFAC for a license to sue and OFAC refuses to grant such a license, can the beneficiary bring suit against OFAC (1) to obtain an OFAC license to sue, or (2) to unlock assets frozen pursuant to the IEEPA?⁴² *Tagle v Regan* answered this question.⁴³

In *Tagle*, heirs of a deceased Cuban national sought the release of estate funds frozen in 1963 pursuant to the Cuban Assets Control Regulations.⁴⁴ The heirs and the funds were in the United States, but a third heir still remained in Cuba. The court released estate funds to which the American heirs were entitled. As part of its holding, the court stated that:

if the assets are wholly or substantially owned by citizens and residents of the United States they should be unblocked, since it is possible that such assets may be placed in a fund at some future date and used to pay the claims of American citizens against the Cuban

³⁷ See, e.g., *Commercial Bank of Kuwait v. Rafidain Bank*, 15 F.3d 238 (2nd Cir. 1994); *Dibrell Bros. Tobacco Co. v. Rafidain Bank*, No. CIV.A.93-0993-LFO, 1994 WL 324331 (D.D.C. June 15, 1994); *First City, Texas-Houston, N.A. v. Rafidain Bank*, No. CIV.90-7360-JSM, 1992 WL 296434 (S.D.N.Y. Oct. 6, 1992); *National Bank of Kuwait, S.A.K. v. Rafidain Bank*, No. CIV. 93-3324-RPP, 1994 WL 376037 (S.D.N.Y. July 19, 1994).

³⁸ See, e.g., *Semetex Corp. v. UBAF Arab Am. Bank*, 853 F. Supp. 759, 770 (S.D.N.Y. 1994).

³⁹ See, e.g., *Consarc Corp. v. Iraqi Ministry*, 27 F.3d 695, 702 (D.C. Cir. 1994); *Rockwell Int'l Sys. Inc. v. Citibank S.A.*, 719 F.2d 583, 589 (2d Cir. 1983).

⁴⁰ *Engel*, 798 F. Supp. at 15.

⁴¹ See, e.g., *Consarc* 27 F.3d at 701 (citing *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 844-45 (1984)).

⁴² The same question is relevant to a blocking order pursuant to the Trading With the Enemy Act, the precursor to the IEEPA.

⁴³ *Tagle v. Regan*, 643 F.2d 1058 (5th Cir. 1981).

⁴⁴ Cuban Assets Control Regulations, 31 C.F.R. 515 (19__), n.1. These Regulations were issued pursuant to the Trading With the Enemy Act, 50 U.S.C. 5(b) (19__).

government. This would be tantamount to using the property of one U.S. citizen to pay the claim of another U.S. citizen.⁴⁵

Even though *Tagle* was not explicitly used as precedent in the letter of credit context, it does establish two important principles. First, it is possible to obtain a court order requiring OFAC to grant a license to release frozen assets. Second, courts are much more willing to grant access to frozen funds if American entities have significant property interests in those funds, or the foreign government entities to which the sanctions are addressed have negligible property interests in those funds.⁴⁶ *Tagle* also illustrates the legal concern that property legitimately belonging to one American citizen should not be used to satisfy the claims of another American citizen. While *Tagle* was an estate case, this theme is also relevant in the letter of credit context. The reason why these exporters required letter of credit financing was to shift the burden of non-payment to the banks, i.e., “pay now, argue later.” However, OFAC and the Administration favor claims legislation resembling a bankruptcy regime rather than a piecemeal, litigious solution. The U.S. government, through OFAC, wants to partially satisfy all claims against Iraq but at the expense of undermining the *raison d'être* of letter of credit financing. The fact that *Tagle* has not been mentioned in any of the letter of credit cases may explain why OFAC has never been ordered to grant a license to execute a judgment against blocked Iraqi funds.

In reviewing these letter of credit cases, the courts seem to have blanced the interests of the parties while simultaneously adhering to the law. As a result of this balancing test, the courts are able to manipulate the case law in favor of either party. For instance, the courts sometimes hold that incorrect flight information on shipping documents is not a “discrepancy” but merely “non-conforming.”⁴⁷

⁴⁵ *Tagle*, 643 F.2d at 1061 (discussing *Real v. Simon*, 510 F.2d 557, 563 (5th Cir. 1975), quoting SENATE COMM. ON FOREIGN RELATIONS, TRADING WITH THE ENEMY ACT, 22 U.S.C. 1643 et. seq.,) reprinted in 1965 U.S.C.C.A.N. §§ 3581, 3585. The court went on to hold that the operative factor making the account a “blocked account of a decedent of which a designated national had an interest” was that the decedent’s nationality, rather than the third heir’s nationality made the difference. In other words, it is only the interest of the decedent in the estate, and not the heirs’ interest, which prevents intestate succession. To deny a license to the decedent’s heirs would be arbitrary and baseless. Thus the court ordered OFAC to grant the heirs a license. *Tagle*, 643 F.2d at 1064.

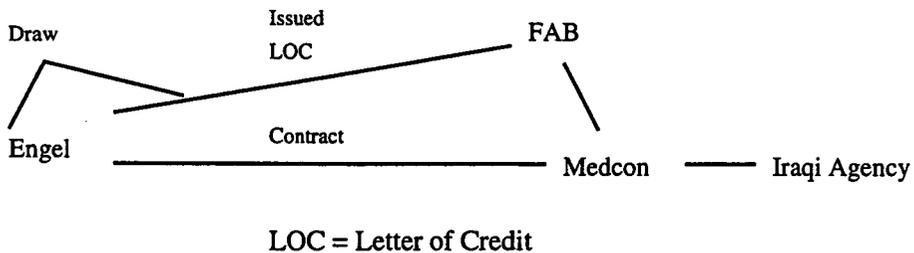
⁴⁶ See, e.g., *Nielson v. Secretary of the Treas.*, 424 F.2d 833, 842 (1970) (where Cuban refugees who owned 3/4 of a Cuban corporation could not unfreeze the corporation’s assets held in the United States).

⁴⁷ *Semetex Corp. v. UBAF Arab Am. Bank*, 853 F. Supp. 759, 770 (S.D.N.Y. 1994).

Other times, repudiation is termed anticipatory breach rather than unjustifiable breach because of *force majeure*.⁴⁸ While the courts have neither made new law governing letters of credit nor reallocated the risks inherent in these transactions, the courts have re-interpreted certain legalisms to reach their holdings. Thus it appears that the holdings of these cases are really based upon the economic, political, and legal concerns of the various groups concerned. Fortunately, a "realpolitik" compromise happens to conform to the "proper" legal result. Some might argue that this is coincidental, but others would argue that this makes perfect sense because that is what the law is supposed to do. If it did not properly balance the relevant interests, then the law would be ineffective. If the law is not leading to the most economically efficient result, then it should be changed.

For analytical purposes, these cases should be distinguished according to whether the beneficiary properly presented its shipping documents. Presentment is very crucial because it often determines whether a beneficiary is paid.

1. Engel Industries, Inc. v. First American Bank (Engel I)



*Engel Industries, Inc. v. First American Bank*⁴⁹ ("Engel I") involved a complicated letter of credit transaction. On May 23, 1990, Engel contracted to sell machinery to Medcon, an American middleman, who would later sell the equipment to an Iraqi entity. Medcon opened an irrevocable letter of credit in favor of Engel at First American Bank ("FAB") for approximately \$272,000. Pursuant to the contract, Engel drew a ten percent down payment of the amount of the letter of credit on July 27, 1990. Six days later Iraq invaded Kuwait and Bush signed Executive Order 12,722. On August 8, 1990, Medcon informed Engel that it was rescinding the contract due to *force*

⁴⁸ *Engel Indus. v. First Am. Bank*, N.A. 798 F. Supp. 9, 13-14 (D.D.C. 1992).

⁴⁹ *Engel*, 798 F. Supp. at 14.

majeure because the final sale to the Iraq company fell through. FAB also demanded the return of the ten percent draw. Engel mitigated its damages by completing the machinery, but Medcon refused Engel's presentment of its shipping documents.

Engel then brought suit against Medcon and FAB. Medcon claimed it was excused from performance because, in order for FAB to honor the letter of credit, FAB would have to violate the freeze orders. The court dismissed this argument by referring to an opinion letter issued by OFAC. OFAC stated that the assets freeze never prohibited the presentment or acceptance of documents, and that the Medcon-Engel contract was "incidental to a domestic transaction in unblocked property[; OFAC] would permit payment by [FAB] upon a court finding that all [letter of credit] conditions to payment by [FAB] were complied with."⁵⁰ The court held that Medcon's rescission was anticipatory breach and that Engel was justified in mitigating its damages by completing performance.⁵¹ The contract could not be voided by a claim of commercial impracticability because Medcon did not comply with state law by informing Engel of why it could not perform its obligations.⁵² The court also held that FAB anticipatorily breached the letter of credit by refusing to honor it.⁵³ The court noted that FAB had been free to request a specific license from OFAC to pay Engel, and that FAB's actions were nothing more than an attempt to avoid its responsibilities.⁵⁴ Because FAB and Medcon prevented Engel's proper presentment, they were estopped from claiming that presentment was not pursuant to the letter of credit.

The court noted that without letters of credit, a seller assumes the risk that a buyer will not perform its obligations. To rule for FAB would force sellers to "engage in exhaustive credit investigations and otherwise devise needlessly complex and prohibitively expensive financing arrangements Engel would not have engaged in this transaction without the benefit of a letter of credit or its equivalent."⁵⁵ The court further noted that while a bank's only protection is the requirement that documents strictly comply with the letter of credit, "to honor First American's defense would be to carry the concept of strict compliance to an extreme."⁵⁶

⁵⁰ *Id.* at 12.

⁵¹ *Id.*

⁵² *Id.* at 13; *See generally* U.C.C. § 2-616.

⁵³ *Engel*, 798 F. Supp. at 13.

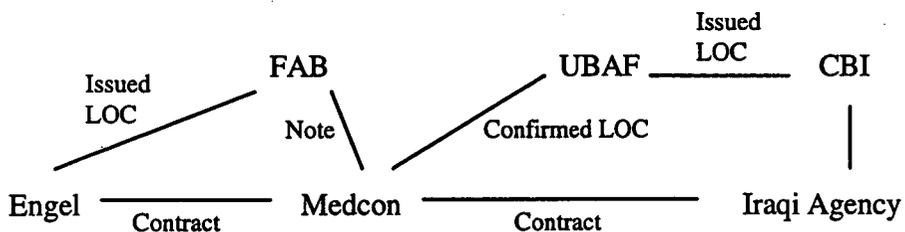
⁵⁴ *Id.* at 14.

⁵⁵ *Id.* at 15.

⁵⁶ *Id.* at 16.

The *Engel I* court confirmed long-standing contract and letter of credit law to reach its result. The analysis was easier because OFAC's opinion letter treated the entire transaction as a domestic matter, in which Iraq had no property interest. However, the same court faced a much more difficult question in the third party complaint filed by FAB ("*Engel II*").⁵⁷

Engel Industries v. First American Bank, N.A. (Engel II)



Medcon also entered into a second contract to resell Engel's machinery to an Iraqi agency. It issued a note to FAB to pay any money drawn by Engel on the original letter of credit. Medcon also required the Iraqi agency to open its own letter of credit. This second letter of credit was issued by the Central Bank of Iraq ("CBI") and confirmed by the UBAF Arab American Bank ("UBAF"). FAB then sued Medcon and UBAF for reimbursement of the ten percent advance to Engel. The court ordered Medcon to reimburse FAB. Medcon argued that if the freeze orders did not prohibit it from performing its contract with Engel in *Engel I*, then those same orders should not prohibit UBAF from honoring the letter of credit to Medcon.

The court agreed with OFAC that CBI's collateral posted with UBAF was blocked property.⁵⁸ But the court also declared that just because CBI's collateral was blocked did not prevent Medcon from obtaining a judgment against UBAF, for UBAF confirmed the letter of credit and undertook its own liability.⁵⁹ Because Medcon obtained a letter of credit to insure against this sort of liability, it should receive the same benefit of its bargain as did Engel

⁵⁷ *Engel Indus. v. First Am. Bank, N.A.*, 803 F. Supp. 426 (D.D.C. 1992).

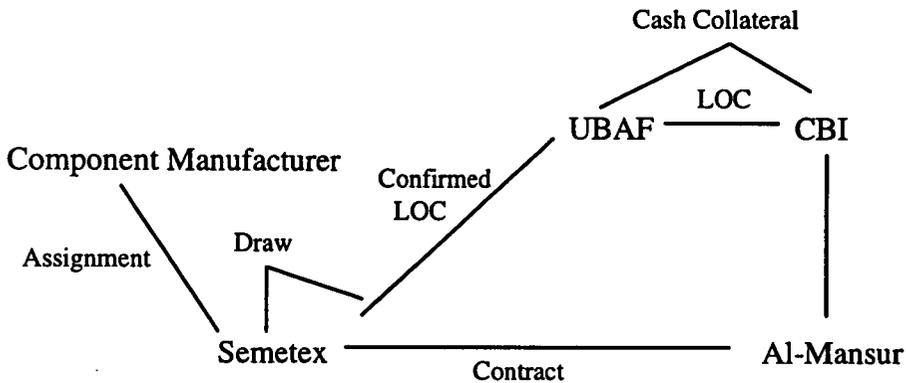
⁵⁸ *Id.* at 426.

⁵⁹ *Id.* at 428.

in *Engel I*. Thus the court noted that while Medcon could not recover against the Iraqi purchaser, it could recover against UBAF’s non-Iraqi assets. The *Engel II* court reached a solution that most courts faced with this litigation have followed: if a seller contracts to shift the risk of loss to a bank, the bank should absorb this liability irrespective of whether the bank is reimbursed. To deny the beneficiaries recovery puts an end to letters of credit and drastically inhibits the American export market.

Engel II’s holding also illustrates the independence principle, which dictates that a letter of credit represents an obligation independent of the contract for sale between buyer and seller.⁶⁰ The letter of credit becomes the seller’s obligation to present strictly conforming shipping documents, and the bank has an obligation to pay upon that presentment. The buyer’s complaint that the goods do not conform to the contract does not excuse the bank from paying upon proper presentment of the shipping documents. When the seller properly presents his documents, a confirming bank must pay the seller irrespective of whether that bank is reimbursed by the issuing bank.

2. Semetex Corp. v. UBAF Arab American Bank



Another case where a letter of credit beneficiary recovered from a bank’s non-Iraqi assets was *Semetex Corp. v. UBAF Arab American Bank*.⁶¹ *Semetex* involved a 1988 contract for Semetex to sell equipment to Al-Mansour, a state-owned Iraqi factory. The Central Bank of Iraq (“CBI”) issued an irrevocable letter of credit in favor of Al-Mansour, which was confirmed by UBAF Bank (“UBAF”). CBI also gave the UBAF cash collateral for the letter

⁶⁰ See *supra* note 36 and accompanying text.

⁶¹ *Semetex Corp. v. UBAF Arab Am. Bank*, 853 F. Supp. 759 (S.D.N.Y. 1994).

of credit. Semetex took a \$720,000 draw on the letter of credit, from which UBAF assigned to a component part manufacturer. The letter of credit required that UBAF pay upon the proper presentment of various documents. Semetex presented shipping documents to UBAF in July 1990, but they were rejected because of certain irregularities. With the goods in transit in the U.S., shipping documents were delivered to UBAF on August 1, 1990. The following day, the freeze orders came into effect, and UBAF refused to honor the letter of credit.

Semetex sought a license from OFAC so that UBAF could pay Semetex from CBI's collateral deposit.⁶² UBAF assisted in the license application by confirming that Semetex's documents satisfied the letter of credit's requirements.⁶³ OFAC denied the license request because the Iraqi Sanctions Regulations only allowed payment for goods *exported* before the invasion.⁶⁴ Semetex then applied for a second license to bring suit against UBAF to seek payment from UBAF's own assets rather than from the blocked Iraqi assets, which OFAC granted. Needless to say, UBAF did not assist in this license request.

The court first had to decide whether ordering UBAF to pay Semetex from its non-Iraqi assets, pursuant to its confirmation of CBI's letter of credit, was a transfer of property in which Iraq had an interest.⁶⁵ The court emphasized the importance of the independence principle, noting that "letters of credit 'represent separate contractual undertakings that are, in legal contemplation, wholly distinct from whatever performance they ultimately secure.'"⁶⁶ Thus, a confirming bank must pay upon proper demand even though "the beneficiary has breached the underlying contract, even though the insolvency of the account party renders reimbursement impossible, and notwithstanding supervening illegality, impossibility, war or insurrection."⁶⁷ The court concluded that neither Al-Mansour nor CBI had a property interest in UBAF's

⁶² *Id.* at 766.

⁶³ *Id.* (quoting the confirmation letter of May 7, 1991 by UBAF counsel Isam Salah).

⁶⁴ *Id.* at 766.

⁶⁵ *Id.* at 768. This letter of credit was governed by the "Uniform Customs and Practice for Documentary Credits promulgated by the International Chamber of Commerce, [which is a] . . . compilation of internationally accepted commercial practices, which may be incorporated into the private law of a contract between parties." *Id.* at 769.

⁶⁶ *Id.* at 770 (quoting *Rockwell Int'l Systems, Inc. v. Citibank, N.A.*, 719 F.2d 583, 587 (2nd. Cir. 1983)).

⁶⁷ *Id.* (citations omitted).

non-Iraqi assets, and so their interests were not dependent upon whether UBAF paid from its non-Iraqi assets.⁶⁸

The court also had to decide whether minor discrepancies in the shipping documents (certain misrepresentations of flight information) constituted sufficient fraud to justify UBAF's refusal to honor the letter of credit. *Semetex* argued that UBAF waived its fraud defense by stating that the documents complied with the letter of credit in its letter to OFAC regarding the first license application. The court determined that there was insufficient evidence of fraud.⁶⁹ The court recognized that fraud is a well established exception to a bank's absolute duty to pay a letter of credit beneficiary when presented with conforming documents.⁷⁰ But the court also recognized that such a defense is a narrow one and only available when intentional fraud is shown.⁷¹ Improper performance or breach of warranty is insufficient. Rather, there must be an "outright fraudulent practice."⁷² Not only was there no evidence of fraudulent intent, but any misrepresentations were immaterial.⁷³ The court concluded that the parties should end up with the rights they bargained for. *Semetex* contracted out of its risk of loss through the letter of credit, and UBAF, having admitted that the shipping documents complied with the letter of credit, had to pay from its non-Iraqi funds.

Semetex demonstrates that courts will award beneficiaries the right to collect from a confirming bank's non-Iraqi funds in the proper circumstances. The courts agree with exporters that "property interest of Iraq" does not include a confirmed letter of credit. Therefore, if a confirming bank has confirmed a letter of credit, the blocking orders should have no affect on an exporter's ability to recover. Even OFAC agrees with this. While OFAC granted *Semetex*'s second license request to seek recovery from UBAF's non-Iraqi assets, OFAC denied *Semetex*'s initial request for access to CBI's blocked collateral account, even though UBAF, as the confirming bank, joined in the initial license application.

⁶⁸ *Id.* at 771. The court relied upon the reasoning of *Engel I* and *Centrifugal* which both held in similar instances that the account party had no property interest in whether the confirming bank paid from its non-Iraqi assets.

⁶⁹ *Id.*

⁷⁰ *Id.* at 773. See generally *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10 (2d Cir.1979).

⁷¹ *Semetex*, 853 F. Supp. at 773 (citing *All Service Exportacao, Importacao Comercio, S.A. v. Banco Bamerindus do Brazil, S.A.*, 921 F.2d 32, 35 (2d Cir.1990)).

⁷² *Id.* at 773-74 (quoting *Rockwell Int'l Systems, Inc. v. Citibank, N.A.*, 719 F.2d 583, 588-89 (2d Cir. 1983)).

⁷³ *Id.* at 775.

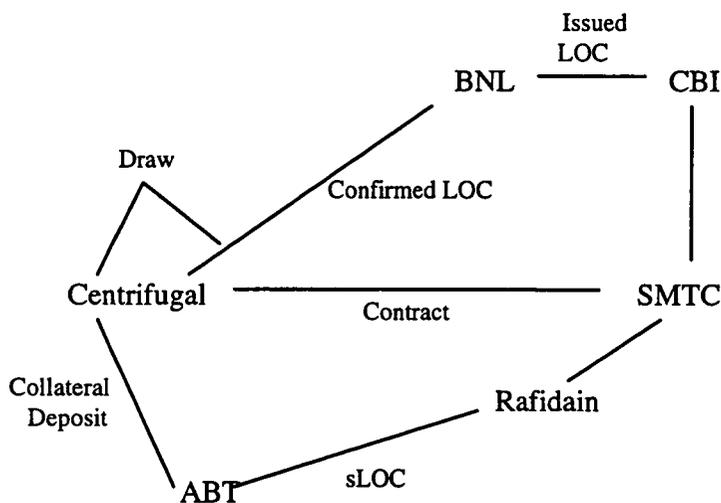
Semetex also reaffirmed the importance of letter of credit transactions in international trade. However, an analysis of the court's opinion shows that the court manipulated legal doctrine, precedent and principles to fashion its result. The court could have steadfastly held that *Semetex's* discrepancies in the presented documents were material enough to constitute a fraud. While it required a showing of intentional fraud, the court took its requirement from standby letter of credit cases involving Iranian buyers.⁷⁴ The court could have limited the intentional fraud requirement to the facts of those cases or to standby letters of credit in general. It appears from *Semetex's* facts that *Semetex's* freight forwarder intentionally used the wrong flight information, albeit only for the sake of convenience, and not to make UBAF approve a non-conforming product. However, the court chose to ignore these indiscrepancies and interpret the facts otherwise. The only explanation for this is that the court's decision is outcome determinative. The court's overriding objective was to uphold long-standing letter of credit principles and efficiently allocate the risk of loss in letter of credit transactions.

Nonetheless, both *Semetex* and *Engel II* clearly show that courts will order confirming American banks to honor letters of credit from their non-frozen funds. These cases maintain both the integrity of the assets freeze regime, and the rights for which the parties contracted. But what if the facts were slightly changed? What if the letter of credit beneficiary took a draw on a bank's confirmation of the letter of credit, and the invasion cut short the contract? Could the beneficiary keep the draw even though it did not perform its contractual obligations to manufacture the goods, let alone deliver shipping documents to the confirming bank? This question was answered in *Centrifugal Casting Machine Co., v. American Bank & Trust Co.*,⁷⁵ where the court decided who had rights to a down payment draw on a letter of credit.

⁷⁴ See, e.g., *Rockwell Int'l Systems, Inc. v. Citibank, N.A.*, 719 F.2d 583 (2d. Cir. 1983).

⁷⁵ *Centrifugal Casting Machine Co., v. American Bank & Trust Co.*, 966 F.2d 1348 (10th Cir. 1992).

3. Centrifugal Casting Machine Co., Inc. v. American Bank & Trust Co.



sLOC = Standby Letter of Credit

Prior to the invasion, Centrifugal contracted with the Iraqi State Machinery Trading Company (“SMTC”) to produce and deliver pipe plant equipment. The Central Bank of Iraq (“CBI”) issued a letter of credit in favor of Centrifugal, and it was confirmed by the Banca Nazionale del Lavoro’s Atlanta branch (“BNL”).⁷⁶ Centrifugal had BNL issue a standby letter of credit⁷⁷ to American Bank of Tulsa (“ABT”) in favor of Iraqi Rafidain Bank (“Rafidain”). Rafidain could collect on this standby letter of credit should Centrifugal breach the contract. Centrifugal also drew a 10% down payment on the letter of credit and deposited that money with ABT in case ABT had to honor the standby letter of credit.

When Iraq invaded Kuwait, it was clear that the contract could not be performed. Centrifugal, BNL and ABT brought suit over who had rights to the 10% draw on the letter of credit. In addition, OFAC intervened in the suit and claimed that Centrifugal’s deposit at ABT was blocked property under the

⁷⁶ See *supra* notes 174, 221 and accompanying text (discussing BNL’s role in funneling money to Iraq through illegal loans).

⁷⁷ The court explains the nature of a standby letter of credit as follows: “[The] beneficiary of an ordinary letter [of credit] may draw upon it simply by presenting documents that show that the beneficiary has performed and is entitled to the funds. In contrast, a ‘stand-by’ letter requires documents that show that the customer has defaulted on some obligation, thereby triggering the beneficiary’s right to draw down on the letter.” *Centrifugal Casting Machine Co., v. American Bank & Trust Co.*, 966 F.2d 1348, 1350 (10th Cir.1992) (quoting *Wood v. R.R. Donnelley & Sons Co.*, 888 F.2d 313, 317 (3d Cir.1989)).

freeze orders, since Iraq still had a property interest in the down payment draw.⁷⁸ The district court ruled that ABT was not liable on the standby letter of credit because no one made an appropriate claim prior to its expiration date. Since it was not liable, ABT interpled the Centrifugal deposit. Thereafter the parties reached a settlement agreement and the court ordered ABT to disperse the money according to that agreement. Presumably most of it would go to Centrifugal.⁷⁹ However, OFAC appealed the court order, claiming that the interpled Centrifugal deposit was property in which an Iraqi entity had an interest.

On appeal, the court recognized the goals of an assets freeze, including punishing Iraq by denying it the ability to transact with Americans, using assets as bargaining chips, and compensating U.S. claims from those assets.⁸⁰ The court held that to deny Iraq an asset in which it never had a property interest did not further these goals.⁸¹ OFAC argued that Centrifugal breached the contract by not completing the goods, and therefore Iraq still had a property interest in its 10% draw on the letter of credit. The court stated that such an argument ignored the legal relationships of the parties created by their financing mechanisms.

The court noted the importance of letters of credit and of the independence principle, stating that "courts have concluded that the whole purpose of a letter of credit would be defeated by examining the merits of the underlying contract dispute to determine whether the letter should be paid."⁸² The court rejected OFAC's argument that Iraq had a property interest in the draw by holding that OFAC "makes a breach of contract claim on behalf of Iraq that Iraq has never made, creates a remedy for the contracting parties in derogation of the remedy they themselves provided [, i.e., the standby letter of credit,] and most importantly, disregards the controlling legal principles with respect to letters of credit."⁸³

In effect the court held that the Iraqi entities, SMTC and Rafidain, had two remedies for Centrifugal's breach: (a) the standby letter of credit, which had already expired; and (b) a breach of contract suit. But the letter of credit in effect allowed Centrifugal to keep the down payment pending litigation.

⁷⁸ *Centrifugal*, 966 F.2d at 1350.

⁷⁹ Since the settlement agreement is confidential, one can only assume that most of the money went to Centrifugal.

⁸⁰ *Centrifugal*, 966 F.2d at 1350-51.

⁸¹ *Id.* at 1351.

⁸² *Id.* at 1352-53.

⁸³ *Id.* at 1353.

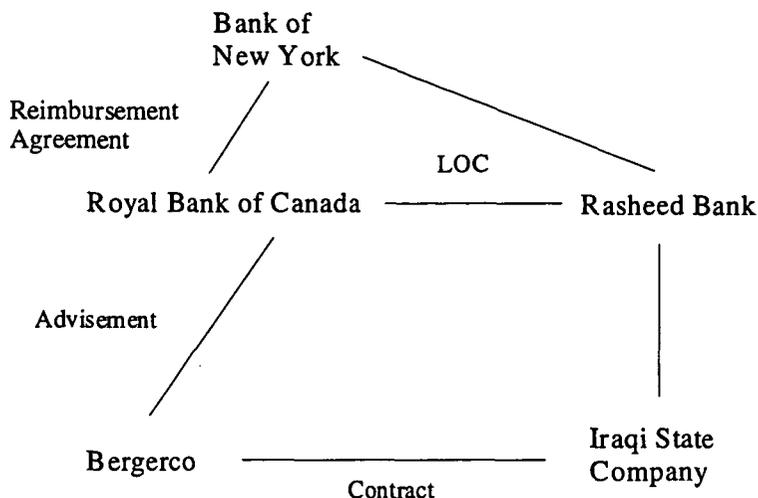
Since only BNL had expended any funds in the transaction, there could be no Iraqi property interest in the letter of credit draw. The court also noted that an account party on a letter of credit transaction does not gain a property interest in the beneficiary's payment simply because of the beneficiary's alleged breach of the underlying contract. To hold so would circumvent the independence principle. "The beneficiary's bargained for right to retain the payment pending contract litigation would be effectively defeated The national interest is not furthered by creating a property interest out of conditions that would not otherwise generate such an interest, particularly when we must do so at the expense of a critical and unique device of international trade."⁸⁴

Engel II, *Semetex*, and *Centrifugal* each involved letter of credit beneficiaries disputing with confirming American banks. But what if the transaction at issue did not involve a confirming bank? What if the Iraqi purchaser had an Iraqi bank issue the letter of credit directly to the American seller-exporter, with only an American advising bank to pass the seller's shipping documents along to the issuing Iraqi bank? Could the American seller seek relief from the advising bank? Alternatively, what if the parties envisioned the issuing Iraqi bank directing payment to the beneficiary from an account with an American bank that served as a reimbursing bank, and then, after the Iraqi purchaser received the goods, but before the issuing Iraqi bank authorized payment to the letter of credit beneficiary, Iraq invaded Kuwait and President Bush signed Executive Order 12722?⁸⁵ These issues were recently explored in *Bergerco Canada v. Iraqi State Company for Food Stuff Trading*.⁸⁶

⁸⁴ *Id.* at 1353-54.

⁸⁵ See *supra* notes 5 through 11 and accompanying text.

⁸⁶ 924 F. Supp. 252 (D.D.C. 1996), *rev'd.*, 129 F.3d 189 (D.C. Cir. 1997).

4. *Bergerco Canada v. Iraqi State Company for Foodstuff Trading et al.*

In February, 1990, Bergerco Canada, a Canadian corporation, and its American affiliate, Bergerco US (collectively, “Bergerco”), contracted with the Iraqi State Company for Food and Trading (“Iraqi State Company”) for the sale and delivery of two large shipments of food from Canada to Iraq.⁸⁷ The Iraqi State Company had its Iraqi bank, Rasheed Bank (“Rasheed”), issue an irrevocable letter of credit for four million dollars to Bergerco.⁸⁸ The Royal Bank of Canada (“Royal Bank”) served as an advising bank⁸⁹ and the Bank of New York (“BNY”) served as the reimbursing bank.⁹⁰ Bergerco made an initial shipment, which the Iraqi State Company paid without incident.⁹¹ Then Bergerco made a second shipment which arrived in Aqaba, Jordan on June 25,

⁸⁷ *Id.* at 255.

⁸⁸ *Id.*

⁸⁹ An advising bank is usually a bank located in the country of the shipper or letter of credit beneficiary who acts as an information transmitter, accepting the requisite shipping documents and delivering them to the issuing or confirming bank. *Id.* at 258. (citing Uniform Customs and Practice for Documentary Credits (1983), at Art. 8; U.C.C. §§ 5-103(1)(e); 5-107).

⁹⁰ *Bergerco*, 924 F. Supp. at 255. A reimbursing bank is usually a bank that is authorized by the issuing bank to pay under the letter of credit. However, unless the issuing bank has requested (and the reimbursing bank has given) an irrevocable promise to pay, the reimbursing bank is not required to pay under the letter of credit. This contrasts with the transactions in *Engel II*, *Semetex*, and *Centrifugal*, where the reimbursing bank was actually a confirming bank. See *supra* notes 58 to 84 and accompanying text. A confirming bank agrees to make payment from its own funds, or from the issuing bank’s pledged funds on account with the confirming bank, upon a proper request to the confirming bank or upon instructions from the issuing bank. *Bergerco*, 924 F. Supp. at 259 (citing Uniform Customs and Practice for Documentary Credits (1983), at Art. 10(b); U.C.C. § 5-107).

⁹¹ *Bergerco*, 924 F. Supp. at 255.

1990, just seven days before Iraq's invasion of Kuwait.⁹² The Iraqi State Company accepted this shipment, and Bergerco presented the requisite shipping documents to Royal Bank.⁹³ Royal Bank forwarded the shipping documents to Rasheed Bank, who received and accepted them on July 10, 1990.⁹⁴ However, it was not until September, 1990, one month after Iraq invaded Kuwait and President Bush signed Executive Order 12722, that Rasheed Bank instructed BNY to pay Bergerco.⁹⁵ However, by this time, BNY was prohibited from transferring any money from Rasheed's account.⁹⁶ Approximately two months later, Bergerco filed suit against the Iraqi State Company, OFAC,⁹⁷ BNY, and Royal Bank.⁹⁸ Bergerco and OFAC soon filed cross-motions for summary judgment.

Bergerco argued that it was entitled to a release of the funds held at BNY. Bergerco claimed that Iraq (through Rasheed) had no interest in the funds at BNY because Bergerco had already presented the requisite shipping documents to Rasheed before President Bush signed Executive Order 12722, which froze Rasheed's account.⁹⁹ Bergerco claimed that if Iraq no longer had an interest in the funds, then Executive Order 12722 did not apply. The court agreed that the issue was whether Iraq had an interest in the BNY account on

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.* The Court determined that Rasheed Bank, as a result of accepting the shipping documents, became obligated under the terms of its letter of credit to pay Bergerco. In fact, Bergerco sought and obtained a default judgment against the Iraqi State Company and Rasheed Bank. *Id.* at 257.

⁹⁵ *Id.* at 256; *see also supra* notes 5 through 11 and accompanying text.

Although the letter of credit documents speak of Royal Bank paying the contract price to Bergerco and then obtaining reimbursement from Rasheed's bank account at BNY, the final transaction was slightly different. Once Rasheed accepted the shipping documents, Royal Bank, instead of paying Bergerco and then seeking reimbursement, requested that BNY transfer the contract price from Rasheed's account at BNY to Royal Bank's New York City branch. However, at that point, President Bush had already signed Executive Order 12722, which prevented BNY from releasing any of Rasheed Bank's funds. *Id.* at 255-56.

Moreover, although the parties disputed when BNY first learned that it was to pay Bergerco, all agreed that BNY did not learn of Rasheed's direction until after the invasion and Executive Order 12722, at which time BNY could no longer transfer Rasheed's funds. *Id.* at 256.

⁹⁶ *See supra* note 7 and accompanying text.

⁹⁷ *Id.* at 256. Bergerco first requested a license from OFAC that would permit BNY to pay the amounts due Bergerco from Rasheed's account at BNY, which OFAC denied. *Id.* Bergerco sought a declaration against OFAC that it is entitled to a license under the Iraqi Sanctions Regulations to be paid from Rasheed's account at BNY.

⁹⁸ *Id.* at 256.

⁹⁹ *Id.* at 257. *See supra* note 11.

August 2, 1990, but disagreed that Iraq had no interest.¹⁰⁰ The court first held that Rasheed's acceptance of the requisite shipping documents on July 10, 1997 immediately obligated Rasheed to pay the contract price, and this obligation was reflected in the court's default judgment entered against Rasheed and the Iraqi State Company.¹⁰¹ However, the court held that Rasheed's acceptance of these documents did not entitle Bergerco to Rasheed's BNY account.¹⁰² This was because BNY, as a reimbursing bank, was merely authorized to pay in accordance with the letter of credit, but unlike a confirming bank, was not obligated to do so.¹⁰³ Moreover, Rasheed never instructed BNY to honor Bergerco's claim until after the freeze orders were in effect.¹⁰⁴ As the court explained, "[a]ny time prior to payment by [BNY], Rasheed Bank retained every right to transfer the funds from its account. Unless and until the funds were transferred, Rasheed Bank's interest remained not only viable, but paramount."¹⁰⁵ Once the freeze orders were in effect, BNY could no longer release the funds to Bergerco.¹⁰⁶

Bergerco also argued that Royal Bank made a reimbursement request to BNY in one particular piece of correspondence on July 11, 1990, which Bergerco claimed was sufficient to divest Iraq of its interest in the funds. The court rejected this argument for two reasons. First, the evidence was insufficient to establish even the existence of a genuine issue of material fact that this piece of correspondence qualified as a request for reimbursement.¹⁰⁷ Second, and more importantly, even if Royal Bank submitted a proper and timely request, BNY had no obligation to reimburse the Royal Bank as a matter of law, because BNY was not a confirming bank.¹⁰⁸

Finally, Bergerco argued that OFAC's regulations, upon which OFAC relied in denying Bergerco a license which would allow BNY to pay Bergerco

¹⁰⁰ *Bergerco*, 924 F. Supp. at 260.

¹⁰¹ *Id.* at 260. *See supra* note 162.

¹⁰² *Id.*

¹⁰³ *Id.* at 259-260. *See supra* note 158.

¹⁰⁴ *Id.* at 260.

¹⁰⁵ *Id.* at 262.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 261.

¹⁰⁸ *Id.* at 261-62 (citing Uniform Customs and Practice for Documentary Credits (1983), at Arts. 10(b) and 11(c)). The court also distinguished *Centrifugal* on the ground that it involved a confirming bank that paid the beneficiary prior to August 2, 1990. *See supra* note 77 and accompanying text. The court stated that if BNY "had confirmed the letter of credit and paid Bergerco (via [Royal Bank]) prior to August 2, 1990 . . . Iraq would no longer have an interest in the funds in its account." (citing *Centrifugal*, 966 F.2d at 1353).

from Rasheed's account, violated the International Emergency Economic Powers Act.¹⁰⁹ Specifically, Bergerco argued that OFAC should have applied an earlier version of its regulations to Bergerco's license request which were in effect at the time of Bergerco's application, and that for OFAC to apply subsequently created regulations was an impermissible retroactive application.¹¹⁰ The court disagreed with most of Bergerco's points, but did find that OFAC should have decided Bergerco's license request under the earlier version of its regulations in effect at the time of Bergerco's application.¹¹¹ The court remanded the matter to OFAC to reconsider Bergerco's license request under the earlier version of the regulations. However, OFAC appealed the district court's order. On appeal, the Court of Appeals held that the earlier version of OFAC's regulations did not create a "right" in Bergerco, who therefore could not claim that OFAC's retroactive

¹⁰⁹ *Id.* at 257. *See supra* note 3.

¹¹⁰ *Id.* at 264.

¹¹¹ An analysis of Bergerco's arguments that OFAC exceeded its authority in promulgating its regulations under the IEEPA, and misapplied those regulations, is beyond the scope of this Article.

Regarding which version of OFAC's regulations should have applied, OFAC regulations state that funds in a blocked account, defined as "any account or property in which the Government of Iraq has an interest," 31 C.F.R. § 575.301, may be transferred or withdrawn, *inter alia*, "pursuant to an authorization or license from OFAC authorizing such action." 31 C.F.R. § 575.201(a). OFAC originally implemented General License 7, which stated:

specific licenses may be issued on a case-by-case basis to permit payment, from a blocked account or otherwise, of amounts owed to or for the benefit of a U.S. person for goods or services exported by a U.S. person or from the United States prior to the effective date of the blocking order, August 2, 1990.

OFAC General License No. 7 (August 15, 1990). *See Bergerco*, 924 F. Supp. at 265. After Bergerco submitted its application for a license, but before OFAC made a final decision, OFAC amended General License No. 7 to read:

[s]pecific licenses may be issued on a case-by-case basis to permit payment involving an irrevocable letter of credit issued or confirmed by a U.S. bank, or a letter of credit reimbursement confirmed by a U.S. bank, from a blocked account or otherwise, of amounts owed to or for the benefit of a person with respect to goods or services exported prior to the effective date.

OFAC General License No. 7, as amended (October 18, 1990). 31 C.F.R. § 575.510(a).

The Court found that the original General License No. 7 should have applied to OFAC's decision to grant Bergerco a license to allow BNY to transfer Rasheed's funds to Bergerco. *Bergerco*, 924 F. Supp. at 267-69. However, OFAC decided (and denied) Bergerco's request under the amended General License No. 7, which did not allow OFAC to even consider granting a license unless a U.S. bank confirmed the relevant letter of credit. *Id.* at 264-65. Because under the original General License No. 7, Bergerco may have been entitled to a license, the court remanded the matter to OFAC to reconsider Bergerco's application. *Id.* at 269. *Cf. Banque San Paolo v. Iraqi State Company for Food Stuff Trading*, 1996 WL 735505 (S.D.N.Y. 1996) (finding that where the confirming bank was not a United States bank, OFAC regulations, allowing for a license to exempt a transaction from the ISR's purview, were inapplicable).

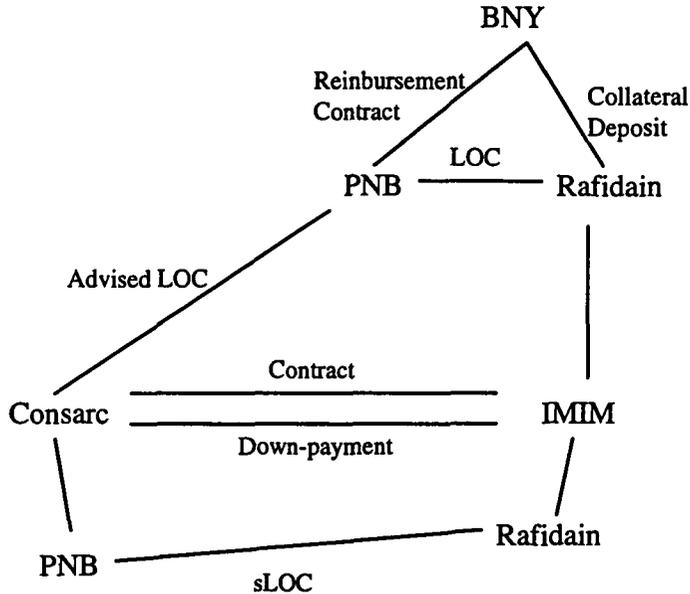
application of its own regulations improperly infringed on Bergerco's "right" to a license.¹¹²

The *Bergerco* court, like the *Engel II*, *Semetex*, and *Centrifugal* courts, ruled in accordance with long-standing letter of credit principles. *Bergerco* refused to allow a letter of credit beneficiary to have access to funds to which it was not entitled. *Bergerco* contracted with the Iraqi State Company and decided not to require that there be a confirming United States bank involved in the transaction. As a result, *Bergerco* assumed the risk that the Iraqi State Company and the Rasheed Bank would not pay. Even though the Royal Bank, as an advising bank, and BNY, as a reimbursing bank, were willing to complete the transaction, they could not do so in the face of Executive Order 12722. The court correctly refused to shift the risk of loss away from *Bergerco*. *Bergerco* was left with only a default judgment against Rasheed and the Iraqi State Company. These disputes differed whether the beneficiary sought payment from the confirming bank or vice versa. However, what if a beneficiary could not bring suit against the confirming bank? What if the beneficiary had neither drawn on the letter of credit (such that it could wait to be sued by the confirming bank) nor completed the goods (such that it could seek a court order that the confirming bank honor the letter of credit)? In these circumstances, the beneficiary's only choice would be to sue the Iraqi purchaser directly. Many letter of credit beneficiaries have done so and obtained default judgments, but then OFAC has not granted them licenses to execute their judgments. They are instead forced to wait to file claims in an ultimate claims legislation regime. However, in *Consarc Corp. v. Iraqi Ministry of Industry and Minerals*,¹¹³ one beneficiary sought further relief. It requested the court to order OFAC to grant it a license allowing it to execute its judgment against Iraqi frozen assets.

¹¹² *Bergerco Canada v. United States Treasury Department, Office of Foreign Assets Control*, 129 F.3d 189, 193-95 (D.C. Cir. 1997). A more detailed analysis of the administrative procedure and constitutional aspects of which version of OFAC's regulations apply, and whether OFAC's retroactive application of the amended General License No. 7 was appropriate, is beyond the scope of this Article.

¹¹³ 27 F.3d 695 (D.C. Cir. 1994).

5. Consarc Corp. v. Iraqi Ministry of Industry and Minerals



In May 1989 Consarc contracted with the Iraqi Ministry of Industry and Minerals (“IMIM”) to build three custom-made furnaces for manufacturing prosthetics. IMIM had Rafidain Bank issue a letter of credit in favor of Consarc for \$6.4 million, which was advised¹¹⁴ by the Pittsburgh National Bank (“PNB”). Rafidain entered into a second contract with the Bank of New York (“BNY”) where BNY would reimburse PNB if PNB honored the letter of credit and paid Consarc upon the proper presentment of shipping documents.¹¹⁵ Rafidain earmarked money in its BNY account to reimburse BNY if BNY paid PNB. IMIM also made a direct down payment to Consarc for \$1.1 million. To secure this down payment, Consarc had PNB issue a standby letter of credit payable to Rafidain if Consarc breached the contract.

As part of its application for an export license, Consarc included certification from IMIM that the furnaces would not be used for nuclear or military purposes. Shortly before shipment, however, the Department of

¹¹⁴ PNB, as an advising bank, would not incur legal liability if it did not pay upon the presentment of shipping documents; it could simply pass the shipping documents along to Rafidain. Although PNB would only advise the letter of credit, if it paid Consarc the \$6.4 upon the proper presentment of the appropriate shipping documents, then it would be reimbursed by Rafidain.

¹¹⁵ This transaction, is similar to Royal Bank’s advisement and reimbursement by Bank of New York, and is called a “confirmed reimbursement credit”. *Consarc Corp. v. Iraqi Ministry*, 27 F.3d 695, 702 (D.C. Cir. 1994).

Defense notified the Customs Service that IMIM actually intended to use the furnaces in its nuclear weapons program. The Commerce Department revoked the export licenses. Shortly thereafter Iraq invaded Kuwait and President Bush instituted the assets freeze program.

Consarc brought suit against IMIM and Rafidain bank seeking damages for breach of contract. OFAC granted Consarc a license to seek monetary damages but did not allow "the transfer of blocked [frozen] funds, or entry or execution of any judgment."¹¹⁶ Neither Rafidain nor IMIM appeared and the district court entered a default judgment. The court declared that Consarc was entitled to the blocked account at BNY because IMIM, by virtue of its fraud and breach, lost its legal interest in the funds prior to the freeze order. The court also held that PNB was not liable on the standby letter of credit and that Consarc rightly owned the down payment. The court awarded Consarc \$6 million in compensatory damages and \$55 million in punitive damages.¹¹⁷

Initially one must ask why Consarc did not sue the confirming banks (PNB and BNY), as did the beneficiaries in *Semetex* and *Centrifugal*, or as the beneficiary in *Bergerco* tried to do, for it would seem easiest to recover from BNY's or PNB's non-Iraqi assets. The answer is two-fold. First, although Consarc had delivered the furnaces to the shipper, it never had the opportunity to present its shipping documents. Perhaps the shipper had not signed the proper documents, or perhaps the documents were void when the Commerce Department revoked Consarc's export license. Second, even if Consarc had the opportunity to present shipping documents, neither PNB nor BNY ever assumed liability if Rafidain failed to pay. PNB served as an advising bank and only had to deliver the documents to the issuing bank. A confirming bank is obligated to pay upon presentment and then seek reimbursement from the issuing bank. PNB had the option to pay Consarc upon proper presentment. Moreover, BNY's liability derived from PNB's liability, for it only had to reimburse PNB if PNB honored the letter of credit. BNY's responsibilities never ripened because PNB had not yet made any payment. Consarc, as a potential third party beneficiary, could not sue because the condition precedent in the contract—presentment—never happened.

After the court's default judgment against IMIM and Rafidain, OFAC issued two directive licenses. One required Consarc hold onto the furnaces and to deposit the proceeds from the sale of one furnace in a frozen account.

¹¹⁶ *Id.* at 698 (quoting the OFAC license).

¹¹⁷ *Id.* at 699. *See also*, *Consarc Corp. v. Iraqi Ministry of Indust. & Minerals*, No. 90-2269-SS, 1991 WL 534917 (D.D.C. Apr. 10, 1991).

OFAC determined that the furnaces were blocked property pursuant to the Iraqi Sanctions Regulations. OFAC's second license prohibited the transfer of the \$6.4 million frozen BNY account. Moreover, OFAC filed a "Statement of Interest of the United States" and moved to modify and/or vacate the default judgment, claiming that it violated the assets freeze order.¹¹⁸ Consarc filed a supplemental complaint against OFAC, seeking: (1) an injunction against OFAC's directive licenses, and (2) an order allowing Consarc to execute against the blocked Rafidain account at BNY. The court held that title to the blocked account already transferred to Consarc before the freeze orders, and therefore OFAC could not freeze it because Iraq had no property interest in it. Specifically, the court held that,

Consarc fulfilled its obligations under the [c]ontract; the actual shipment of the furnaces to Iraq was prevented by Iraq's fraudulent actions and the U.S. Government's interventionTherefore, having fulfilled its end of the bargain, the blocked funds in Rafidain's account passed to Consarc . . . [and IMIM] and Rafidain had no right to, or interest in, those funds on August 2, 1990 or thereafter.¹¹⁹

The court ordered OFAC to issue a license allowing Consarc to execute on the blocked account at the BNY, enjoined the United States from transferring or disposing of the blocked account, and ordered that the furnaces and proceeds thereof were properly frozen under the ISRs.¹²⁰ OFAC appealed.

The Circuit Court dismissed OFAC's untimely appeal of the district court's order extinguishing Iraq's property interest in the standby letter of credit.¹²¹ However, the court determined that the district court's order allowing Consarc to execute on the frozen assets was a "transfer" of Iraqi property under § 575.317 of the Iraqi Sanctions Regulations.¹²² The key inquiry was whether this transfer "deprived Iraq of 'property or interests in property' that it held on the date of the freeze order."¹²³

¹¹⁸ *Id.* at 699.

¹¹⁹ *Id.*

¹²⁰ *Id.* at 699 (referring to the district court's order in *Consarc Corp. v. Iraqi Ministry of Indust. & Minerals*, No. 90-2269-SS, 1992 WL 415256 (D.D.C. Dec. 29, 1992)).

¹²¹ *Id.* at 700.

¹²² Namely, and most importantly, that "no property or interests in property of the Government of Iraq that are in the United States . . . may be transferred." ISRs, 31 C.F.R. § 575.201(a) (1997); *See also*, *Consarc Corp. v. Iraqi Ministry*, 27 F.3d 695, 702 (D.C. Cir. 1994).

¹²³ *Consarc*, 27 F.3d at 701.

Consarc argued that this issue was governed by New York state law, and that the letter of credit created a trust with a condition subsequent (presentment of the shipping documents), and the revocation of the export licenses made the condition illegal and void. Since state law mandated that a voided trust automatically becomes the property of the beneficiary, Consarc claimed that at the time of the invasion Iraq had no interest in the BNY account.¹²⁴ Consarc was not making the trust argument to show that it had exclusive rights to the BNY account. Rather, it was making this argument to show that Iraq had *no* rights to the BNY account. Thus Consarc, like any other judgment creditor, could execute its judgment on those funds without violating the ISRs. OFAC argued the court should apply federal common law of international letters of credit, and that the executive orders, IEEPA, and the ISRs all define "property" as including letters of credit.

The court overruled the district court and held that OFAC had the discretion to define "property interests" as it wished, subject to deferential judicial review.¹²⁵ The Emergency Powers Act declared that the President had the power to "prohibit any . . . transfer [of] . . . any property in which any foreign country or a national thereof had any interest."¹²⁶ The President properly delegated his power to define these terms to the Secretary of the Treasury and OFAC.¹²⁷ The court decided it should defer to the ISRs in the absence of contradictory statutory language or pure unreasonableness.¹²⁸ Here OFAC's definition of property as including letters of credit survived judicial review.¹²⁹ Finally, the court rejected Consarc's argument that the "fraud in the transaction" principle should include the concept that an account party's fraud in the underlying sales contract allows a beneficiary to draw on a letter of credit without presenting conforming documents.¹³⁰ As of the date of the

¹²⁴ *Id.*

¹²⁵ *Id.* (citing *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 844-45 (1984)). One should query whether a citation to *Chevron* is an appropriate reference. It is built on the assumption that OFAC is the best entity to determine whether it has the proper authority to administer the statute.

The court also notes that New York State property law would be important in an action in the Court of Claims if Consarc argued that OFAC's application of the Emergency Powers Act was a constitutional taking of Consarc's property that requires compensation. But so long as inverse condemnation is available, Consarc's request for injunctive relief does not lie against a statutorily authorized action. *Consarc*, 27 F.3d at 701 n.5.

¹²⁶ 50 U.S.C. § 1702(a)(1)(B) (1977).

¹²⁷ *See supra* note 10.

¹²⁸ *Consarc*, 27 F.3d at 701 (citing *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837, 844-45 (1984)).

¹²⁹ *Id.* at 702.

¹³⁰ *Id.*

freeze orders, Iraq had a reversionary interest in the funds irrespective of whether the revocation of the export licenses excused Consarc from complying with the letter of credit.¹³¹

Before it was reversed on appeal, *Consarc* radically changed letter of credit law. While the appeal was pending, *Consarc* exemplified how to circumvent an assets freeze regime by executing against blocked property held in an American bank without involving the confirming bank. *Consarc* enabled a seller who complied with a contract for sale, but not the letter of credit, to recover against the buyer if the buyer prevented the seller's performance of its letter of credit obligations.¹³² For example, suppose that some foreign conflict results in a freeze order that halts the performance of an export contract. Normally before presentment is made, a beneficiary has no right to payment because it has not complied with the letter of credit. If the district court opinion was upheld, then a beneficiary could claim that before the freeze order, the foreign entity had no property interest in the letter of credit (assuming the beneficiary performed the underlying contract). Perhaps one could expand the concept of fraud as used in *Consarc* to include a buyer's knowledge of an impending foreign conflict when it enters a contract. Then courts might allow a non-presenting beneficiary to bypass the confirming bank's funds and go right to the frozen assets earmarked for reimbursing the confirming bank. Instead, with the reversal of the district court, the appellate court gave OFAC the discretion to determine how to define "Iraqi property." On remand, the district court ruled that if Consarc did not get the blocked accounts held at the BNY, then Consarc should get title to the furnaces, because the contract was effectively void.¹³³ Moreover, the court held that Consarc could keep the proceeds from the sale of one of the furnaces and sell

¹³¹ *Id.*

¹³² This case is peculiar in that the facts never spell out whether presentment was ever made. It was probably not made because once the Department of Defense withdrew Consarc's export license, presentment became impossible. However, in a conclusory fashion, the court noted "[e]ven on Consarc's view . . . the funds would have reverted to Rafidain when the letter of credit expired unless Consarc had made a timely (albeit non conforming) demand. In fact Consarc made no demand of any kind until January 22, 1991. *Consarc*, 27 F.3d at 702. But earlier, in reciting the facts, the court stated "[the letter of credit] obligated Rafidain to pay Consarc the named amount if and only if Consarc presented shipping documents showing that the furnaces had been exported to Iraq. Consarc's right to draw on the letter [of credit] expired on February 1, 1991." *Consarc*, 27 F.3d at 698. Why the court did not expound on the fact that apparently Consarc did make a proper demand, while the letter of credit was irrevocable, is unclear.

¹³³ *Consarc Corp. v. United States Treasury Department, Office of Foreign Assets Control*, 871 F. Supp. 1463, 1465-66 (D.D.C. 1994).

the other one.¹³⁴ Consarc had to place the \$6.4 million contract price in a blocked account, but the court allowed Consarc to have a claim against that account.¹³⁵ Not to be outdone, OFAC even appealed this order. OFAC first objected to the fact that Consarc placed the \$6.4 million into a blocked account in a different bank account than Rafidain's original BNY account.¹³⁶ Moreover, OFAC objected to the district court's vacation of OFAC's blocking order which blocked the one unsold furnace and the proceeds from the second furnace.¹³⁷ On appeal, the court held that Consarc would have to place the \$6.4 million back into Rafidain's account at BNY, and that Consarc would only have a general claim against Iraq and not against the specific BNY account.¹³⁸ Moreover, the court held that, pursuant to IEEPA and the ISR's, Iraq still held an interest in the furnaces, which were goods specially manufactured for export to Iraq.¹³⁹ Therefore, the court ordered that the district court permit OFAC to block both the remaining furnace and the proceeds from the sale of the other furnace.¹⁴⁰

The five aforementioned cases demonstrate how the courts handle the problems created when letters of credit intersect with asset freezes. *Engel II* and *Semetex* illustrate how a beneficiary that has performed its contractual and letter of credit obligations can recover the contract price. Such a beneficiary can recover from the confirming bank, irrespective from where or how the confirming bank is reimbursed. *Centrifugal* illustrates how a beneficiary that has drawn funds on a letter of credit but has not performed its obligations can keep those funds pending litigation. *Bergerco* illustrates that a beneficiary can not recover from an American bank unless that bank is a confirming bank. Finally, *Consarc* shows that a beneficiary which has complied with its contract, but not the letter of credit, cannot recover from either the confirming bank or the foreign purchaser directly. The cases are logically consistent with one another. They allocate the risks of losses according the parties' contractual relationships and long-standing letter of credit principles. At the same time, the cases allow international lending and international commerce to continue because the expectations of what will happen when there is a

¹³⁴ *Id.*

¹³⁵ *Id.* at 1465.

¹³⁶ *Consarc Corp. v. United States Treasury Department, Office of Foreign Assets Control*, 71 F.3d 909 (D.C. Cir. 1995).

¹³⁷ *Consarc*, 71 F.3d at 912.

¹³⁸ *Id.* at 913.

¹³⁹ *Id.* at 914.

¹⁴⁰ *Id.* at 915.

foreign conflict remain the same. The courts' holdings are not just in accordance with the law, but represent practical solutions to the problem of an assets freeze. The exporters contracted out of their risk of loss, and the confirming received a premium for their agreement to accept that risk of loss and honor the letters of credit even when there is *force majeure*. Moreover, the courts appeased OFAC in its desire to keep the Iraqi assets whole.

Part II: Proposed Iraqi Claims Legislation

While American exporters tried to collect under on their letters of credit, Congress was considering legislation to solve their problems. As of this writing, Congress is considering three bills to satisfy claims against Iraq. These bills address two problems: (1) how to administer the U.N. Compensation Program, and (2) how to liquidate Iraqi assets and distribute them to claimants outside of the U.N. Compensation Program. The U.N. program does not cover: (1) pre-August 2, 1990 claims and (2) post-August 2, 1990 claims where the loss, damage, or injury was the *indirect* result of Iraq's invasion of Kuwait.¹⁴¹

The Secured Payment Act of 1993 was introduced into the Senate on June 16 1993. Its sponsors included Robert Dole, Oren Hatch, and Jesse Helms.¹⁴² The single purpose of this Act was to amend the International Emergency Economic Powers Act¹⁴³ so that letters of credit could be satisfied without judicial intervention. Had this passed, a *Semetex*-type letter of credit would have been honored without difficulty. This Act would have denied the Treasury Department jurisdiction over frozen Iraqi funds earmarked to pay letter of credit beneficiaries that (a) engaged in lawful trade with Iraq, and (b) fulfilled their contractual and/or letter of credit obligations before August 2, 1990.¹⁴⁴ Accordingly, IEEPA would be amended to immediately release these

¹⁴¹ It must be remembered in analyzing the three pieces of proposed legislation that there have been at least 1,400 claims reaching billions of dollars that are not recoverable under the U.N. program. Daniel Magraw, *Claims Against Iraq*, 86 AM.SOC'Y OF INT'L L. 486 (1992).

¹⁴² S. 1119, 103rd Cong., 1st Sess. (1993). It is interesting that the co-sponsors include 6 Democrats and 9 Republicans. The bill was sponsored by Senator Charles Robb, D-Va., to solve the problem of the "half-dozen or so companies that were 'just a computer transaction away from getting their money.' Their claims against Iraq total less than \$30 million—a drop in the bucket against the \$1.2 billion in frozen Iraqi assets held in U.S. financial institutions." Richard Alm, *Dallas Exporter Faces Quagmire of Red Tape*, DALLAS MORNING NEWS, January 24, 1994, at 1D.

¹⁴³ 50 U.S.C. § 1701 (1977).

¹⁴⁴ S. 1119, 103rd Cong., 1st Sess. § 2(a)(1-3) (1993).

particular frozen assets to the appropriate beneficiaries.¹⁴⁵ This simple amendment would have saved numerous suits against banks and Iraqi entities. However, after being referred to the Senate Banking, Housing, and Urban Affairs Committee on June 16, 1993, no more action has been taken.¹⁴⁶

One can only speculate as to why this bill has languished in the Senate. Perhaps legislators concluded that honoring these letters of credit would deplete more Iraqi assets than first suspected. Perhaps the Clinton Administration announced it would veto the bill since it needed the Iraqi funds to pay out other claimants, who, if not satisfied, would turn to the U.S. for compensation.¹⁴⁷ Moreover, the banking community and the Treasury were always against this bill.¹⁴⁸ The Treasury Department opposed the "piecemeal approach represented by legislation addressing only small segments of the claimant community, such as the proposed Secured Payment Act of 1993."¹⁴⁹ Because the Act would pay letter of credit beneficiaries even when no U.S. bank had an obligation to pay, other claimants would go uncompensated. More importantly, Treasury Secretary Lloyd Bentsen noted that the Act's inconsistency with established international letter of credit principles would make U.S. financial institutions less competitive because the Act would give U.S. beneficiaries greater rights than beneficiaries in other countries.¹⁵⁰

In contrast, the proposed "Iraqi Claims Act of 1994"¹⁵¹ has a very different agenda. In addition to adjudicating claims for the U.N. Commission, it authorizes the validation and adjudication of claims of U.S. nationals not compensable by the U.N. The bill gives first priority to non-commercial claims of individuals arising directly from the invasion of Kuwait and the 1987 attack on the U.S.S. Stark.¹⁵² This represents a substantial amount of money that the U.S. government would otherwise have to pay as veterans' benefits.

¹⁴⁵ *Id.* at § 2(b)

¹⁴⁶ Lexis-Nexis Bill Tracking Report, S. 1119, 103rd Cong., 1st Sess. (1993).

¹⁴⁷ Letter from Lloyd Bentsen, Secretary of the Treasury, to Lee Hamilton, Chairman, House Foreign Affairs Committee (Oct. 7, 1993), in Marian Nash (Leich), *Claims Settlement Legislation*, 88 AM. J. INT'L L. 314, 318 (1994).

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ H.R. 3221, 103rd Cong., 2d Sess. (1994). This bill, sponsored by Lee H. Hamilton, D-IN, was introduced on October 6, 1993. The corresponding Senate bill, S. 1401, 103rd Cong., 2d Sess. (1994), was introduced on August 6, 1993.

¹⁵² *Id.* at § 2(D) (1994).

This Act gives the President the authority to liquidate all blocked assets to satisfy claims of U.S. nationals and the U.S. government.¹⁵³ These claims, assuming they are validly certified, will be paid out as follows. Each claimant is paid the lesser of \$10,000 or the amount of its claim. Non-commercial claims arising from the invasion of Kuwait and the U.S.S. Stark incident will initially receive \$90,000. Then all claimants will be paid from time to time on a pro-rata basis (i.e. the amount of their claim relative to the whole amount of claims). Once all the principal is paid, pro-rata interest payments will be made, and any money remaining will go to the U.N. Compensation Fund. Any unsatisfied claimants will have the right to bring an action directly against the Government of Iraq.¹⁵⁴ This legislation creates a structure similar to a Bankruptcy Code,¹⁵⁵ in terms of creating a pool of assets from which to pay out creditors on a pro rata basis with some creditors paid on a prior basis.

This legislation raises some interesting issues. First, it is quite extraordinary that the United States gives its own claims the same priority as individual claims. Among other liabilities, the United States has over the course of the past three years paid out nearly \$6 billion in loan guarantees upon which Iraq defaulted. The government's claims may be as much as half of the total amount of claims against Iraq, and the government hopes to recoup as much of this loss as possible.¹⁵⁶ Second, it is almost certain that no claimant will receive any interest payments. The State Department has indicated that their "best estimate is that the volume of pre-war U.S. claims will substantially exceed the value of the Iraqi assets blocked in the United States."¹⁵⁷ Thus, confirming banks that currently hold onto blocked accounts can count that money as assets on their books, loan out more money, and make considerable profit off the interest.¹⁵⁸ They will not have to reimburse claimants with interest because no claim will ever be fully compensated. Third, the United States Government allows U.S.S. Stark victims to collect from Iraqi assets rather than, or also, from the United States government.

This legislation passed the House of Representatives on April 28, 1994, and a concurrence in the Senate was requested on May 2, 1994. This bill had

¹⁵³ *Id.* at § 4 (1994).

¹⁵⁴ *Id.* at § 6 (1994).

¹⁵⁵ 11 U.S.C. § 101 (1994) et seq.

¹⁵⁶ See *infra* notes 194-221 and accompanying text for a more in depth discussion.

¹⁵⁷ Letter from State Department to Thomas S. Foley, in Warren Strobel, *Iraqi Assets Won't Go Around; Private Firms, Uncle Sam Vie for Dibs on Frozen Funds*, WASH. TIMES, (October 20, 1992) at A1.

¹⁵⁸ See *infra* notes 222-236 and accompanying text for a more in depth discussion.

considerable support from OFAC and the banking community. OFAC Director Richard Newcomb testified that "there is no reason that one class of unsecured creditors, such as those holding certain letters of credit, should rate more highly than other unsecured creditors with receivables or breach of contract claims."¹⁵⁹ A trade association comprised of international lenders also testified that to grant a special status to letter of credit beneficiaries would undermine international lending, because it would satisfy beneficiaries in the absence of the proper documentation. The association argued that to allow a special status to these exporters would "cast a cloud of uncertainty over the willingness of U.S. banks to participate in letter of credit transactions financing U.S. exports."¹⁶⁰ However, while the House of Representatives passed the bill and approved the Conference Committee report by floor vote on April 28, 1994, the bill has yet to pass the Senate Committee on Foreign Relations.¹⁶¹

Senator Charles Robb, D-Va., who introduced and sponsored the Secured Payment Act of 1993, introduced yet another piece of Iraqi claims legislation into Congress on June 9, 1997.¹⁶² This bill, the Iraqi Claims Act of 1997, also created an Iraqi claims fund, comprised of all Iraqi assets in the United States and vested in the President, to be distributed by the Foreign Claims Settlement Commission on a pro-rata basis.¹⁶³ However, in contrast to the Iraqi Claims Act of 1994, private claims would have priority over U.S. government claims.¹⁶⁴ Initially, this bill seemed very likely to pass both houses of

¹⁵⁹ *Iraqi Claims Legislation, 1994: Testimony on S. 1401 Before the Subcomm. on Int'l Econ. Policy, Trade, Oceans and Env't of the Senate Comm. on Foreign Rel.* (September 21, 1994) (testimony of R. Richard Newcomb), in 1994 WL 515371 (F.D.C.H.). Newcomb emphasized that he believed this legislation was better than a "race to the courthouse."

¹⁶⁰ *Iraqi Claims Legislation, 1994: Testimony on S. 1401 Before the Subcomm. on Int'l Econ. Policy, Trade, Oceans and Env't of the Senate Comm. on Foreign Rel.* (September 21, 1994) (testimony of Thomas Block), in 1994 WL 513060 (F.D.C.H.).

¹⁶¹ The Senate Subcommittee on International Economic Policy, Trade, Oceans, and Environment concluded hearings on September 21, 1994. One service estimates the Senate Committee's likelihood of passing the bill at 75%. Westlaw Bill Cast Report, H.R. 3221, 103rd Cong., 2d. Sess. (1994).

¹⁶² S. 856 105th Cong., 1st Sess. (1997). See 1997 CQ US S. 856 Summary. Upon introducing the bill, Mr. Robb stated:

Mr. President, these frozen assets were blocked to prevent Iraq from using the funds to support its aggression against Kuwait and its allies. That freeze — designed to hurt Iraq — is now hurting American companies. Some of those firms were a mere electronic transfer, a keystroke on a computer, away from receiving their payments when the emergency freezes were imposed. After 7 years, it is time to act expeditiously in their favor.

143 Cong. Rec. S5413-02 at *S5420 - 21 (1997).

¹⁶³ S. 856 105th Cong., 1st Sess. (1997) §§ 1(a) and (b).

¹⁶⁴ Id. at § 1(c).

Congress. Senator Jesse Helms, R-N.C., head of the Senate Foreign Relations Committee, added the bill as an amendment to the 1998-99 Senate foreign appropriations bill, which passed the Senate Committee.¹⁶⁵ The bill was also added as an amendment to the 1998-99 House Foreign Relations Authorization Act, which passed both houses of Congress in floor votes in June, 1997 before going to the Conference Committee.¹⁶⁶

However, at this point, the bill became hostage to two of the most popular political issues of the day—Gulf War Syndrome and the Big Tobacco Lobby. The bill, although it called for the payment of private claims before the payment of U.S. government claims, did not include within the definition of “private claims” the claims of U.S. soldiers against Iraq.¹⁶⁷ Instead, the claims of servicemen and servicewomen would be given the same priority as the U.S. government’s claims, which were subordinate to all other private claims of U.S. citizens.¹⁶⁸ Apparently, not only would “private claims” encompass the claims of the letter of credit beneficiaries of the type discussed in this article, but it would also include the claims of many large cigarette manufacturers who had exported tobacco products to Iraq. Many felt that there would be very little money left for veterans if their claims were subordinated.¹⁶⁹ There was an immediate outcry from numerous veterans’ groups claiming that Helms and Robb, both from tobacco producing states, were favoring Big Tobacco at the expense of veterans.¹⁷⁰ Government officials also complained that the bill

¹⁶⁵ S. 903, 105th Cong., 1st Sess. (1997) § 1601; Westlaw Bill Cast Report, S. 903, 105th Cong., 1st Sess. (1997).

¹⁶⁶ Westlaw Bill Cast Report, H.R. 1757, 105th Cong., 1st Sess. (1997).

¹⁶⁷ S. 856 § 1(c)(1), 105th Cong., 1st Sess. (1997) states that “[a]fter payment has been made in full out of the Fund on all private claims . . . , any funds remaining shall be made available to satisfy claims of the United States Government against the Government of Iraq. . . .” “Private claims” means “claims of United States persons.” S. 856 § 1(g)(2). The term “United States person . . . does not include . . . any officer or employee of the United States Government acting in an official capacity.” Therefore, because U.S. soldiers are employees of the United States Government acting in an official capacity, they are not entitled to “private claims” status with priority over claims of the United States Government. S. 856 § 1(g)(4)(B).

¹⁶⁸ S. 856 § 1(c)

¹⁶⁹ One commentator stated that there was expected to be nearly \$5 billion in business claims against Iraq, of which half were agricultural export claims (i.e., tobacco), to be compensated from only \$1.3 billion in frozen assets. Carol D. Leonnig, *Veterans Fight Helms on Claims to Iraqi Assets*, THE NEWS & OBSERVER, Sept. 11, 1997, at A13. Therefore, there would be nothing left for veterans or the U.S. government.

¹⁷⁰ See John Hanchette, *Helms Bill Favors Tobacco Firms Over Vets*, USA TODAY, Sept. 10, 1997, at O1A (quoting one lawyer representing veterans as saying “[t]o cut out courageous gulf war veterans who have been ill since the war, and to reward instead the somewhat ignoble profits of the tobacco industry, would be something our country would be ashamed of.”).

would subordinate government claims.¹⁷¹ Helms responded that the Veterans Administration, not Iraq, has the responsibility of taking care of U.S. veterans.¹⁷² However, due to the political explosiveness of the issue, no Congressman was willing to vote for such a bill, and the House overwhelmingly instructed its members on the Conference Committee to reject any inclusion of Iraqi claims legislation in the appropriations bill.¹⁷³ Moreover, two Congressmen recently informed Senator Helms that they planned to introduce legislation in January, 1998 "granting priority to all retired, reserve, or active duty members of the U.S. Armed Forces who may wish to file claims against Iraq."¹⁷⁴

There is, however, one question that has not been addressed in any discussion concerning these three proposed claims acts—the issue of a Fifth Amendment takings. Suppose that Congress does pass some sort of Iraqi claims legislation which distributes Iraqi assets on a pro rata basis? Bergerco and Consarc will file claims based on their unpaid contracts, and the banks in *Engel II*, *Semetex*, and *Centrifugal* will also file claims for reimbursement for satisfying letters of credit. However, what if, but for Executive Order 12722 and such claims legislation, the letter of credit beneficiaries would have been paid in full? If they are not fully compensated (an extremely likely possibility), do they now have claims against their government because they have suffered a Fifth Amendment taking by virtue of not being fully compensated?¹⁷⁵

Many Congressmen also came forward and expressed outrage at a bill that put private commercial claims (especially tobacco companies) above those of Gulf War Veterans. See 143 CONG. REC. H8164-01 (1997) (Speech of Rep. Doggett); 143 CONG. REC. H8262-02 (1997) (Rep. Doggett's Motion to Instruct Conferees on H.R. 1757 to reject portion of bill relating to Iraqi Claims Act of 1997). Extensive Congressional debate on this issue is located at 143 CONG. REC. H8271-02 et seq (1997).

¹⁷¹ Norm Brewer and John Hanchette, *Daschle Asks Helms to Let Veterans Make Claims on Iraqi Money*, GANNET NEWS SERV., Sept. 11, 1997, 1997 WL 8836748. The Commodity Credit Corporation expended about \$2.5 billion in export guarantees to American farmers to export food to Iraq before the war. See *infra* notes 165 through 193 and accompanying text for a discussion of the Commodity Credit Corporation's role in the arming of Iraq.

¹⁷² Leonnig, *Veterans Fight Helms on Claims to Iraqi Assets*, at A13 (quoting Helms as saying, "[t]o include veterans in this legislation would set a dangerous precedent that veterans need to look to a hostile power, rather than their own government, for the care, compensation and benefits they have earned.").

¹⁷³ Norm Brewer and John Hanchette, *House Votes to Challenge Helms on Persian Gulf Veterans' Claims*, GANNET NEWS SERV., Oct. 1, 1997, 1997 WL 8838219.

¹⁷⁴ John Hanchette, *Bill Would Let Vets Claim Iraqi Money*, FLA. TODAY at 10A (noting that Rep. Doggett had urged the House to "'stand with GI Joe and GI Jane, who defended our democracy, not Joe Camel, who exploited our children.'").

¹⁷⁵ There is a taking when claimants are without "access to any tribunal where they [could] be

The answer appears clearer in a *Semetex* situation. There, in the absence of a freeze order, after a court orders a confirming bank to honor a letter of credit from its non-Iraqi assets, a bank could then reimburse itself from the issuing bank's earmarked account for that purpose.¹⁷⁶ However, if the bank is under a freeze order, it must then bring its own suit against the issuing bank, obtain a default judgment, prove that Iraq has no property interest in the earmarked funds, and then hope that OFAC will grant it a license to execute its judgment.¹⁷⁷ Alternatively and more likely, since these assets are frozen, the bank will file a claim with OFAC and wait until Congress passes the claims legislation. In all probability, the bank will not recover the full amount of its claim. However, it would appear that the bank would have an action against the United States in the Court of Claims for the amount that it was not reimbursed pursuant to any claims legislation.¹⁷⁸

In a *Bergerco* or *Consarc* type case, however, the confirming reimbursing, or advising bank is not liable to the beneficiary. A *Bergerco* or *Consarc* beneficiary that obtains a default judgment against a foreign entity and then seeks to execute that judgment has a different claim than a *Semetex* beneficiary. Instead of claiming a contingent or vested interest¹⁷⁹ as a beneficiary of a letter of credit, the exporter-beneficiary can make a claim as a judgment creditor against the Iraqi judgment debtor itself. However, if the *Bergerco* or *Consarc* beneficiary was not fully compensated by the claims legislation, it is unlikely that it could claim a constitutional taking in the Court of Claims. This is because the beneficiary, as soon as it obtained a default judgment against Iraq, no longer is a claimant with a property interest in Iraqi funds. In contrast, a *Semetex* beneficiary can show a property interest in the earmarked accounts, i.e., that it has some interest in those funds comparable to the Iraqi account party. The *Semetex* beneficiary could point to a specific bank account and say, "we have an interest and/or claim to those specific

assured of enforcement of their contract rights." *New York v. Republic of Palau*, 680 F. Supp 99, 106 (S.D.N.Y. 1988).

¹⁷⁶ This is not an issue of subrogation. The confirming bank was not a surety, agreeing to pay the beneficiary if the issuing bank would not pay upon presentment. See *In re Davis*, 115 B.R. 346, 350 (Bankr. N.D. Fla. 1990); *In re Carley Capital Group*, 118 B.R. 982, 991 (Bankr. W.D. Wis. 1990); *In re Valley Vue Joint Venture*, 123 B.R. 199, 204 (Bankr. E.D. Va. 1991); 11 U.S.C. § 509(b)(2) (1994).

¹⁷⁷ Recall that the banks have taken a different route by lobbying the Treasury Department. The Treasury has released roughly \$100 million to a consortium of banks that have honored confirmed letters of credit as confirmations. See *infra* notes 222-232 and accompanying text.

¹⁷⁸ See *infra* note 150 and accompanying text.

¹⁷⁹ Whether the interest is vested or contingent depends on whether the beneficiary has presented the shipping documents.

funds." But a *Bergerco* or *Consarc* beneficiary, as a judgment creditor, is attempting to attach a bank account just like any other creditor with a default judgment against the Iraqi judgment debtor. Even though a *Bergerco* or *Consarc* beneficiary can point to a specific account from which it was to be paid, once it obtains a default judgment, it has no more right to that account than any other judgment debtor. The *Bergerco* or *Consarc* beneficiary may have an action in the Court of Claims, but to the extent that it is less than fully reimbursed, it would seem that it has not suffered a constitutional taking because it has not suffered a deprivation of a property interest. As a judgment creditor, its specific property interest in frozen Iraqi assets would probably be too remote to be considered property.¹⁸⁰

Some would disagree that a *Consarc* beneficiary has not suffered a taking such that he has no remedy in the Court of Claims. For example, Richard Epstein's takings clause theory¹⁸¹ would lead him to argue that even if a *Consarc* beneficiary never obtained a default judgment, and claims legislation awarded it less than what it would have received had it presented its proper shipping documents prior to the invasion, there would still be a taking requiring just compensation. Epstein took issue with *Dames & Moore v. Regan*,¹⁸² which held that a general creditor's claim is not a property interest unless that claim is perfected.¹⁸³ Epstein believes that the distinction between perfected and unperfected liens is not a distinction between property and no property. Instead it is a distinction not unlike that between vested and contingent remainders; both are property, albeit in different forms and with different values.¹⁸⁴ Therefore, a *Consarc* beneficiary still had a contingent property interest after it completes its contract but before it complies with the letter of credit by presenting its shipping documents. If a court holds in favor of OFAC, and any claims legislation has the ultimate effect of withholding from a *Consarc* beneficiary less than full compensation of its claim, then it probably has suffered a compensable taking by the government.

¹⁸⁰ Commentators have suggested that the Supreme Court has rarely found a compensable taking "unless the property interest involved is tangible, such as land, or vested, such as a right under a valid and performed contract." Juliana J. Keating, *Does the Fifth Amendment Takings Clause Mandate Relief for Victims of Diplomatic Immunity Abuse?*, 17 HASTINGS CONST. L. Q. 567, 591 (1990).

¹⁸¹ RICHARD EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN*, 224-28 (Harvard Univ. Press, 1985).

¹⁸² *Id.* at 226. See *infra* note 146 et seq. and accompanying text for a discussion of the facts of this case.

¹⁸³ *Id.*

¹⁸⁴ *Id.*

In a *Semetex*-type case, Epstein's theory would lead to the conclusion that a *Semetex* confirming bank has a contingent interest in the frozen Iraqi account even if the letter of credit beneficiary never presented its shipping documents to the bank.¹⁸⁵ If one assumes that the freezing orders prevented the presentation of documents, then that confirming bank's interest would vest but for the Executive Order 12,722. Contractually, the bank is entitled to reimbursement from the earmarked funds on deposit in its accounts. In this context, Epstein's theory is supported by *Dames & Moore v. Regan*.¹⁸⁶ Prior to *Dames & Moore*, President Reagan suspended all claims against Iranian entities pending in U.S. courts and most attachments on Iranian property. This was part of the hostage release agreement with Iran in 1981. One issue in *Dames & Moore* was whether the President's suspension of the claims and attachments was a taking of property violating the Fifth Amendment in the absence of just compensation. The court majority felt that this question was not ripe for review stating, "[w]e express no views on petitioner's claims that it has suffered a taking."¹⁸⁷ However, the Court did state that "we do not suggest that the settlement has terminated petitioner's possible taking claim against the United States."¹⁸⁸ Moreover, in his concurrence, Justice Powell wanted to:

leave [the] 'taking' claims [issue] open for resolution on a case-by-case basis in actions before the Court of Claims...The Government must pay just compensation when it furthers the Nation's foreign policy goals by using as 'bargaining chips' claims lawfully held by a relatively few persons and subject to the jurisdiction of our courts. The extraordinary powers of the President and Congress upon which our decision rests cannot, in the circumstances of this case, displace the just Compensation Clause of the Constitution.¹⁸⁹

¹⁸⁵ A *Semetex* beneficiary would have a stronger argument that it has a property interest in a frozen Iraqi account than a *Bergerco* or *Consarc* beneficiary for the purpose of takings analysis. See *Mennonite Board of Missions v. Adams*, 462 U.S. 791 (1983) (finding that a mortgagee's lien constituted a property interest under the Fifth Amendment); *Armstrong v. United States*, 364 U.S. 40 (1960) (holding that the government's destruction of a materialman's lien was a taking of a property interest protected by the Fifth Amendment).

¹⁸⁶ *Dames & Moore v. Regan*, 453 U.S. 654 (1981).

¹⁸⁷ *Id.* at 689, n.14.

¹⁸⁸ *Id.*

¹⁸⁹ *Dames & Moore v. Regan*, 453 U.S. 654, 690 (1981) (Powell, J., concurring); see also *Armstrong v. United States*, 364 U.S. 40, 49 (1960); *Agins v. Tiburon*, 447 U.S. 255, 260-61 (1980).

This language supports a *Semetex* confirming bank's argument that it should get the difference between the amount of earmarked, blocked funds and any award received pursuant to any claims legislation. The Tucker Act provides that the Court of Claims shall have the jurisdiction to render judgment upon any claim against the United States founded upon the Constitution.¹⁹⁰ Only if a remedy is not available in the Court of Claims is the Takings Clause violated.¹⁹¹ If the Tucker Act remedy was available in *Dames & Moore*, then it would be available for a confirming bank who received less through claims legislation than it would have from earmarked funds meant for its reimbursement. This reasoning is consistent with *Consarc*, which stated that, while *Consarc* could not enjoin the transfer of the frozen assets to the Federal Reserve by claiming that that would be a taking, *Consarc* was free to bring suit in the Court of Claims arguing that it was denied a property interest that required compensation.¹⁹² One can only speculate as to whether the Court of Claims would agree.

The issue of what constitutes a taking is especially delicate in this situation, where the President is conducting foreign policy. When a court finds that there is an unconstitutional taking requiring just compensation, that places a significant burden on the President's ability to make treaties or impose assets freeze regimes. It is true that *Dames & Moore* found that the "treaty exception" to the Tucker Act did not preclude the Court of Claim's jurisdiction over the petitioner's takings claim.¹⁹³ But that determination was only because the Government conceded that point at oral argument; thus it is of questionable precedential value.¹⁹⁴ While the *Meade* doctrine¹⁹⁵ is supposed to bar judicial reexamination of international arbitration awards, even in the takings context, it seems that some courts have taken the hint from *Dames & Moore* and reviewed the political decisions of the President's

¹⁹⁰ Tucker Act, 28 U.S.C. § 1491 (1948).

¹⁹¹ See *Duke Power Co. v. Carolina Environ. Study Group, Inc.*, 438 U.S. 59 (1978).

¹⁹² *Consarc Corp. v. Iraqi Ministry*, 27 F.3d 695, 701 n.5 (D.C. Cir. 1994).

¹⁹³ The Court in *Dames & Moore* was faced with a unique dilemma—hampering Presidential authority by invalidating the Algerian Agreement enjoining all actions against Iran pending in United States courts, or giving sweeping power to the President. The Court was able to reach a compromise by upholding the agreement with Iran while allowing slightly endorsing actions in the Court of Claims against the United States. Phillip R. Trimble, *Foreign Policy Frustrated—Dames & Moore, Claims Court Jurisdiction, and a New Raid on the Treasury*, 84 Colum. L. Rev. 317, 324 (1984).

¹⁹⁴ *Dames & Moore*, 453 U.S. at 688-89.

¹⁹⁵ *Meade v. United States*, 2 Ct. Cl. 224 (1886).

foreign policy.¹⁹⁶ It would appear that *Dames & Moore* did not mean to implicate such a wide review of Presidential action. The courts have long deferred to Presidential authority to conduct foreign policy primarily to avoid political embarrassment and because of the belief that the executive and legislative branches are the most appropriate government bodies to decide these issues.¹⁹⁷

The scope of judicial review of foreign policy within the confines of the takings clause has been most clearly addressed in *Sardino v. Federal Reserve Bank of New York*.¹⁹⁸ Here a Cuban citizen residing in Cuba sought to invalidate the Cuban Assets Control Regulations,¹⁹⁹ which denied him access to money in a New York bank account. The court found judicial support for a wartime seizure of a non-enemy alien's assets²⁰⁰ so as to prevent assets from being used to assist an enemy government.²⁰¹ Moreover, the court held that it could apply those frozen assets to compensate Americans with claims against Cuba without there being a takings problem. The court held, "if Congress should ultimately choose to apply the blocked assets of Cuban nationals to [compensate American claims against Cuba], the Fifth Amendment [takings clause] would not stand in its way."²⁰² This implies that courts should not be quick to hold that a claimant has suffered a taking when his assets have been frozen pursuant to a Presidential repines to a foreign affairs crisis.

The question of how far a court should expand the takings analysis remains unsettled. While a court might find that a *Bergerco*, *Consarc* or *Semetex* beneficiary has a remedy in the Court of Claims to the extent it is not fully reimbursed by ultimate claims legislation, there is a strong argument to be made that a court should refrain from so finding. A court's review of the foreign policy initiatives of the President on the basis of takings analysis only

¹⁹⁶ See, e.g., *Causey v. Pan American World Airways*, 684 F.2d 1301, 1311-13 (9th Cir. 1982) (holding that persons with rights against international air carriers limited by the Warsaw Convention have actions in the Court of Claims, notwithstanding a statute barring such jurisdiction).

¹⁹⁷ *Trimble*, *supra* note 156, at 363. See, e.g., *Mora v. McNamara*, 389 U.S. 934 (1967). Cf. *New York Times v. United States*, 403 U.S. 713 (1971); *Youngtown Steel v. Sawyer*, 343 U.S. 579 (1952)).

¹⁹⁸ 361 F.2d 106 (2d Cir. 1966).

¹⁹⁹ 31 C.F.R. 515.201 (1997) (issued pursuant to the Trading With the Enemy Act, 50 U.S.C. App. 5(b)(1) (1997)).

²⁰⁰ The court found that the fact that the plaintiff was an alien did not afford him any less protection than an American citizen. 361 F.2d at 111.

²⁰¹ *Id.* at 112 (citing *Silesian-American Corp. v. Clark*, 332 U.S. 469, 476 (1947)).

²⁰² *Id.* at 113.

hampers a President's ability to conduct foreign affairs. It seems that *Dames & Moore* indicates otherwise, albeit only in dicta and in a concurrence.

Part III: OFAC's Interests

OFAC's position in these letter of credit cases is perplexing. Why does OFAC intervene on behalf of Iraq, especially in motions for default judgments? Why is OFAC so against the proposed Secured Payment Act of 1993 and the Iraqi Claims Act of 1997? OFAC has always called for the Iraqi assets freeze to be equitably administered, and OFAC contends that engaging in piecemeal litigation fully compensates some parties at the expense of others. But has this been OFAC's only goal in opposing the honoring of these letters of credit?²⁰³ At one level, OFAC has been acting earnestly as a trustee to keep Iraqi assets together as one estate so that they can be equitably distributed. However, it also seems that OFAC's positions have been driven by two other interests: the President's political agenda and the special relationship between the Treasury Department and the banking industry.

A. *Iraqgate*

OFAC, as part of the executive branch, is a tool of the presidency. Some of these letter of credit cases were litigated prior to the November 1992 presidential election. A major election issue was *Iraqgate*. The issue was whether the Reagan and Bush Administrations illegally assisted Saddam Hussein in his weapons procurement programs and later covered up the extent of this assistance. OFAC's "anti-recovery" posture was influenced by two concerns: (1) to limit publicity resulting from an exporter's large recovery against frozen Iraqi assets, and (2) to keep the frozen assets intact so that the U.S. government, which guaranteed over \$6 billion worth of loan guarantees upon which Iraq defaulted, could recoup its own losses.

With the start of the Iran-Iraq war in 1981, Ronald Reagan and George Bush supported Saddam Hussein as a counter-weight to Iran. While Hussein was an "odious figure," he had the potential to be a regional policeman.²⁰⁴ The United States assisted Hussein in numerous ways, including military and economic assistance and ignoring the extent of Hussein's nuclear weapons program. When George Bush became President, he continued to fund

²⁰³ See *supra* note 29.

²⁰⁴ ALAN FRIEDMAN, *SPIDER'S WEB* xvi-xvii (1993).

Hussein. Bush signed the National Security Directive 26 in October 1989, which ordered government agencies to strengthen economic ties with Iraq. It also called for other executive agencies to be stalled in their investigations of Iraq's weapon procurement program and fraudulent foreign aid programs. Quasi-CIA contractors obtained falsified end-user certificates to export sophisticated weapons technology to Iraq. The White House assisted in covert arms transfers with Saudi Arabia, Chile, and South Africa.²⁰⁵ Iraq was prematurely removed from the list of countries sponsoring international terrorism.²⁰⁶ Hussein received so much help from the United States that he probably believed that the West would not care if he invaded Kuwait.²⁰⁷

American troops, which later fought in Iraq, even faced American military technology in the hands of the Iraqis.²⁰⁸ After Operation Desert Storm, the Bush Administration stalled Congressional inquiries into this U.S. policy. High level White House officials met on a regular basis to discuss methods to stonewall Congress and limit access to embarrassing documents.²⁰⁹ The officials who disclosed that the Bush Administration may have known of Iraq's nuclear weapons program, and yet still sold weapons to Iraq, were fired.²¹⁰

Perhaps the greatest Iraqgate debacle was the Commodity Credit Corporation's ("CCC") loan program. It provided financing for American grain sales overseas. The CCC guaranteed 98% of loans made to foreign entities. It would also guarantee a bank's discount of a letter of credit or guarantee a confirming bank's promise to honor a letter of credit.²¹¹ With this guarantee, the exporter could assign the letter of credit to an American bank and obtain financing. In 1983, when diplomatic relations were re-established with Iraq, Iraq was allocated \$230 million in annual CCC loan guarantees. By 1988 this figure rose to \$1.1 billion.²¹² At least \$6 billion in credit guarantees was extended through 1990.²¹³ The Bush Administration took advantage of a weakly managed CCC program so that Iraq could purchase grain and other commodities for free, because Iraq's only "payment" were letters of credit.

²⁰⁵ *Id.* 33-34, 44, 63-64, 148.

²⁰⁶ *Id.* at 26.

²⁰⁷ *See Supra* note 183.

²⁰⁸ William Arkin, *U.S. Arms in Iraq*, WASH. POST, Oct. 24, 1992, at A20.

²⁰⁹ FRIEDMAN, *supra*, note 182, at 207-16.

²¹⁰ *Id.* at 178. (1993).

²¹¹ Kenneth Juster, *The Myth of Iraqgate*, 94 FOREIGN POL'Y 105-07 (1994).

²¹² *Id.*

²¹³ Galli, *supra* note 21, at 241, 256.

Iraq did not have to put up any money, since the CCC guaranteed the payment of those letters of credit. Iraq's ability to obtain grain for free allowed other Iraqi resources to go towards purchasing arms. Lenders and sellers conspired with Iraqi purchasers to inflate the prices of grain. This enabled Iraqi purchasers to get more CCC credits and thus purchase more grain. Then grain shipments were diverted to other ports and exchanged for arms or sold for cash that would then be used to purchase arms.²¹⁴

The Bush Administration always pressed for Congressional approval for a higher loan limits for Iraq. Federal Reserve Bank of New York president Gerald Corrigan once stated, "if every citizen of Iraq had eaten the eggs that had been officially exported, they would have had to eat 100 eggs every day for three years."²¹⁵ Even after the Administration had clear evidence of Iraq's nuclear acquisitions and practice of inflating grain sales prices,²¹⁶ Bush "pushed through" another \$500 million in guarantees just a few months before the invasion.²¹⁷ Additionally, a secret 1983 State Department memo suggested using the CCC to promote business with Iraq. It stated, "[a]lthough commercial bank financing is beyond [U.S. government] control, we could take some minor steps . . . to swing loans for Iraq through friends in the private sector."²¹⁸

The Commerce Department routinely granted "dual-use licenses" for products that had both military and non-military uses. When Consarc's bid to build furnaces for Iraq was selected, the U.S. embassy in Iraq even telexed Consarc a congratulatory note.²¹⁹ Then, when Consarc relayed concerns to the Commerce Department in February 1989 that the furnaces could be used in nuclear reactors, the Commerce Department replied that its concerns were unfounded.²²⁰ In fact, the Commerce Department even sent Consarc a brochure entitled "Helpful Hints to Exporters."²²¹ It was only later, when those same furnaces were about to be exported to Iraq, that the Defense Department decided that those furnaces possessed nuclear capabilities.

²¹⁴ FRIEDMAN, *supra*, note 182, at 112-14.

²¹⁵ Peter Mantius, *Let Debate on Iraqgate Continue*, THE ATLANTA JOURNAL AND CONSTITUTION, May 1, 1994, at R1.

²¹⁶ *All Things Considered* (National Public Radio broadcast, Nov. 11, 1993).

²¹⁷ Jim Lobe, *US: Democrats Want Special Inquiry on "Iraqgate"*, INTER PRESS SERVICE, July 9, 1992.

²¹⁸ Mantius, *supra* note 192, at R1.

²¹⁹ Liz Sly, *Baghdad Sued over Foiled Deal; U.S. OKed Furnaces Earmarked for Nuclear Buildup*, CHI. TRIB., Sept. 14, 1990, at C1.

²²⁰ *Id.*

²²¹ Henry Rowan, *Left Holding the Bad in Iraq*, N.Y. TIMES, Oct. 14, 1992, at A25.

Consarc alleged that the Commerce Department altered documents in order to delete references to military applications of the furnaces.²²²

Once Iraq invaded Kuwait, Iraq repudiated its foreign debts, and American sellers and lenders demanded the government guarantee the CCC loans. To date, the government has paid out roughly \$6 billion in loan guarantees. The government's only chance at reimbursement comes through the frozen Iraqi assets. It appears that OFAC feels pressure from the Administration to keep the frozen assets whole for as long as possible until Congress passes the claims legislation that treats government claims as equal to individual claims. The Bush Administration once declared that its intention was "to recover this [CCC] debt from Iraq's frozen assets."²²³ Moreover, OFAC wants to prevent large awards that publicize past foreign policy mistakes. Bill Clinton continues this strategy; because he does not want to embarrass the Republicans whose votes he needs in the Republican controlled Congress. Even Consarc's lawyer has stated, "the government's ultimate purpose appears to be to take all the frozen assets to pay off illegal CCC payments to foreign banks and leave nothing for U.S. businesses who were encouraged by this administration to do business with Iraq."²²⁴

The Atlanta branch of the Banca Nazionale del Lavoro ("BNL") heavily financed CCC guaranteed loans to Iraq. This branch also participated in the Centrifugal loan transaction. BNL made many illegal loans through off the books lending rarely scrutinized by the Federal Reserve or BNL's senior management. In actuality, the Bush Administration gave BNL tacit approval. The Justice Department claimed that BNL Atlanta branch manager, Christopher Drougol, was the sole mastermind of these loans and brought criminal charges against him for defrauding government regulators. BNL made roughly \$5 billion in fraudulent loans to Iraq, of which at least \$2 billion was guaranteed by U.S. taxpayers.²²⁵ The Federal Reserve called it "the biggest bank fraud in U.S. history." Drougol alleges that senior BNL officials and much of the U.S. intelligence community knew of his loan activities. Drougol claimed that the BNL loans were part of a covert operation with Italian and American officials to finance the secret arming of Hussein to tip

²²² *All Things Considered* (National Public Radio broadcast, Oct. 20, 1992).

²²³ Warren Strobel, *Iraqi Assets Won't Go Around*, WASH. TIMES, Oct. 20, 1992, at A1.

²²⁴ *Id.*

²²⁵ Brian Duffy, Stephen Hedges, and Elizabeth Pezzullo, *Cover-Up*, U.S. NEWS, Oct. 26, 1992, at 51.

the scales in the Middle East against Iran.²²⁶ Drougol introduced evidence showing Bush's knowledge of the illegal loans as far back as 1987. Judge Shoob, who had presided over Drougol's criminal case, stated after the trial that:

I think the government entered into an effort early on to support Iraq as a matter of national policy. They used the CIA and Italy to effectuate that purpose. Many of the things that were done were in violation of acts of Congress and U.S. arms export laws. They were aware of the law, and they skirted it. It was an effort to arm Iraq, and then, when things got out of hand, they didn't want that information to come out.²²⁷

The Justice Department originally brought a 347 count indictment carrying a maximum sentence of 900 years.²²⁸ Drougol pleaded guilty on the condition that he be allowed to make a public statement disclosing how much the Bush Administration knew and approved of his lending activities. When the judge agreed to let Drougol speak, the government surprisingly offered a plea bargain of 60 counts if Drougol would delay his press conference until after the November 1992 presidential elections.²²⁹ In July 1993, Drougol subpoenaed George Bush, James Baker and Lawrence Eagleburger. After this bombshell, the prosecution offered Drougol a new deal—the government would drop all charges if Drougol pled guilty to one count of wire fraud and two counts of making false statements to the Federal Reserve.²³⁰ One commentator has suggested that this plea bargain, coupled with leaks of a Clinton Justice Department report that there was insufficient evidence to support a Bush Administration conspiracy, was an attempt to appease Republicans whose votes Clinton needed on NAFTA and health care

²²⁶ Stephen Pizzo, *A Gift for George; why is Bill Clinton's Justice Department so Desperate to Bury Bush's Iraq-gate Scandal?*, MOTHER JONES, Nov. 1993, at 62, 63-65.

²²⁷ FRIEDMAN, *supra*, note 182, at 228-31. Judge Shoob became so convinced of a cover-up and conspiracy, and was so angered by the prosecution, that he ultimately recused himself, claiming that he could not be impartial.

²²⁸ United States v. Drougol, 91-CR-078 (N.D. Ga. 1992) (unpublished).

²²⁹ *BNL Atlanta Branch Manager Pleads Guilty to Reduced Charges Regarding Iraqi Loans*, B.N.A. BANKING DAILY, June 4, 1992. It was at this time that Judge Marvin Shoob demanded a special prosecutor, a call that was never heeded by the Justice Department. Shoob stated, "I do not believe for one minute that Chris Drougol handled all these complex transactions on his own." *Id.*

²³⁰ Pizzo, *supra* note 203, at 62, 63-5.

reform.²³¹ Henry Gonzalez, D-TX, who had conducted a three year investigation of the BNL scandal, said of Clinton's handling of the investigation, "[I] can't get up much enthusiasm. I fear he's a shallow man."²³²

The White House and Justice Department also slowed down a Congressional investigation. The General Accounting Office request for a CIA briefing on the BNL affair was denied. Instead the GAO was referred to the Justice Department, which relinquished only five out of thousands of documents GAO requested.²³³ Senator Gonzalez, chairman of the Senate Banking Committee, issued subpoenas for Federal Reserve documents, but the Justice Department withheld them.²³⁴ Attorney General Barr refused calls for an independent prosecutor.²³⁵

²³¹ *Id.* In January 1995, John Hogan, assistant to Attorney General Janet Reno, completed a report of the Iraqgate scandal. *BNL Task Force—Final Report to the Attorney General*, October 21, 1994 (published January 16, 1995), John M Hogan, Acting U.S. Att'y, No. District of Ga. This was to be the definitive report on whether there were illegal loans to Iraq and whether there was a cover-up. The report found no evidence of any secret arming of Iraq and subsequent cover-up, especially in relation to the BNL scandal. *Id.* at 119. It is interesting to note that at one point Hogan states:

I have carefully considered whether to take testimony from former high level officials at the NSC and the Departments of State, Commerce, and Agriculture, and concluded that it was unnecessary to do so. Many of these officials were examined extensively by congressional committees. In addition, [National Security Advisor] Brent Scowcroft, [Legal Counsel to President Bush] C. Boyden Grey, [White House lawyer] Charles Nicholas Rostow, [Bush's Secretary of Commerce] Robert Mosbacher, [Bush's Secretary of Agriculture] Clayton Yeutter, and [Bush's Deputy Secretary of State] Lawrence Eagleburger were interviewed by the FBI in connection with the request for an independent counsel, and Eagleburger and [Secretary of State] James Baker were also examined by Judge Lacey. After reviewing earlier statements, I concluded that they adequately covered the relevant subject matter. No evidence has surfaced to contradict them, and there is no reason to believe they would now testify differently than before. Under these circumstances, no investigative purposes would be served by additional examinations. *Id.* at 91, n.71.

How an investigation can claim to be thorough and complete and yet not bother to interview the very people alleged to be the engineers of an alleged conspiracy to cover-up and stonewall a Congressional investigation is beyond this author's understanding.

At the same time, the Justice Department announced that it would not prosecute Honeywell Corp. or Cargill Inc. for supposedly violating U.S. export laws by supplying military technology to Iraq using BNL as a financier. Greg Gordon, *US Wont Prosecute Honeywell or Cargill*, STAR TRIB., January 28, 1995, at 1A.

²³² *BNL Task Force—Final Report to the Attorney General*, October 21, 1994, at 64 (published January 16, 1995).

²³³ FRIEDMAN, *supra*, note 182, at 226. (provides a thorough investigation and review of the Iraqgate affair and its cover-up by the Bush Administration).

²³⁴ *Id.* at 206. ("We are being obstructed blatantly, premeditatedly, and coldly," charged Gonzalez, 'and in defiance of the plain constitutional prerogative of the Congress to know.')

(quoting CONG. REC. H1114 (daily ed. February 21, 1991) (statement of Sen. Gonzalez)).

²³⁵ *Id.* at 244.

The government has also refused to pay approximately \$370 million in BNL loans and letter of credit confirmations guaranteed under the CCC program, claiming that they were illegally obtained. BNL initiated a suit against the government in the U.S. Court of Claims for approximately \$350 million in CCC guarantees.²³⁶ Meanwhile, the CCC paid every other bank claim for defaulted Iraqi loans.²³⁷ The Justice Department was forced to make conflicting arguments in the Drougol criminal case and the BNL case in the Court of Claims. In the criminal case, the Justice Department argued that Drougol was a rouge manager getting kickbacks from Iraqi officials, without official BNL knowledge. However, in the Court of Claims suit,²³⁸ the Justice Department argued that BNL's Rome headquarters knew of the fraudulent nature of the loans and helped coordinate them.²³⁹

Even President Clinton continued Bush's tough stance against any admission of fault. This proves why OFAC, even under a new Administration that could not be accused of covering its tracks, still takes a tough position in the letter of credit cases. The government needs the money frozen by President Bush as much as the letter of credit beneficiaries. This is the only way to explain, for example, why OFAC appealed the remanded Consarc case where the district court case held that Consarc was free to dispose of the finished furnaces as it saw fit. It should be noted that just before the presidential elections, Bill Clinton stated, "I give credit where credit is due, but the responsibility was in coddling Saddam Hussein when there was no reason to do it and when people at high levels in our government knew he was trying to do things that were outrageous."²⁴⁰

As stated above, the only issue remaining was the approximately \$350 billion in defaulted loans made by BNL, and for which BNL brought suit against the U.S. in the Court of Claims. In February 1995, for reasons unknown, the Clinton Administration settled with BNL, and paid BNL \$400 million in satisfaction of the loan guarantee claim. This represented the final payment on over \$2 billion in loan guarantees for BNL-made defaulted Iraqi loans.²⁴¹

²³⁶ See *Supra* notes 197 and 213.

²³⁷ Mantius, *supra* note 192, at A5.

²³⁸ Banca Nazionale Del Lavoro v. U.S., No. 92-847C (Ct. Cl., filed 1992).

²³⁹ Liza Kaufman, *Plea Bargain leaves BNL Scandal Unexplained*, LEGAL TIMES, Sept. 9, 1993, at 10-14.

²⁴⁰ *All Things Considered* (National Public Radio Broadcast, October 20, 1992).

²⁴¹ Jeffrey Smith, *U.S. to Pay \$400 Million To Cover Iraq's Bad Debt*, WASH. POST, February 2, 1995 at A9.

The motivations and driving forces that influenced the Reagan, Bush, and Clinton Administrations to support Saddam (officially and unofficially, legally and illegally), to overlook his drive for regional conquest, and then to cover-up and impede any investigations into their policies, may never be known. But two things are certain. First, Presidents Bush and Clinton wanted all civil and criminal litigation under wraps. This included the Drougol, the letter of credit, and the Court of Claim cases. When Consarc won at the district court level and OFAC had to issue a license to allow Consarc to execute on frozen funds, the legal and banking communities were in a furor. United States businesses championed the claim-adjudication process as a strategy to recover funds quickly before Congress passed claims legislation.²⁴² The only publicity the OFAC wanted from these cases was that plaintiffs could not recover from the frozen assets. Second, the government wanted the frozen Iraq assets as much as the letter of credit beneficiaries. While there were only \$1.3 billion in Iraqi assets, the government's claims equaled all other pre-invasion claims combined. Even though the government could, at best, recover \$600 million from the assets to compensate it for the \$6 billion worth of defaulted CCC loans to Iraq, it was still better than nothing. But the government's hopes of getting that money could only be realized if OFAC could keep the letter of credit beneficiaries from chipping away at those assets. Any money that the government could recover for itself would soften any publicity showing how ten years of misguided foreign policy towards Iraq cost the U.S. government financially, militarily, and politically.

B. The Banking Relationship

OFAC's behavior was also driven by the close relationships between the Treasury Department, Federal Reserve, and the banking industry. These three groups have closely interacted with each other in such a way that creates an institutional bias towards banks at the expense of the export community. This favoritism might be one reason why OFAC refused to grant Consarc a license to execute its judgment, or why OFAC often intervenes on behalf of Iraq on motions for default judgments.

Banks that have confirmed letters of credit have been favored by the Treasury Department in several ways. First, the Iraqi Sanctions Regulations provide a limited basis for the unblocking of Iraqi government property where

²⁴² See e.g., Galli, *supra* note 21, at 241.

payment under a letter of credit is required to reimburse a mandatory and binding payment obligation of a U.S. bank.²⁴³ Therefore, a confirming bank in a *Semetex* scenario that must pay a letter of credit beneficiary from its non-Iraqi assets may request from OFAC permission to reimburse itself from frozen Iraqi assets in its account. The Treasury, as of September 1994, had issued 74 specific licenses authorizing the release of almost \$90 million from blocked Iraqi accounts to reimburse confirming banks.²⁴⁴ Of this, \$76 million "was released to U.S. banks to satisfy obligations of Iraqi banks or the Iraqi government to reimburse the U.S. banks for payments the U.S. banks made out of their own funds pursuant to letters of credit involving goods shipped to Iraq before August 2, 1990."²⁴⁵ While OFAC wants to maintain the integrity of the Iraqi assets against letter of credit beneficiaries, it is willing to reimburse confirming banks.

Moreover, OFAC's regulations dictate that licenses for reimbursement from frozen accounts should not be issued for beneficiaries in which Iraq owns more than a 5% interest. However, OFAC granted a reimbursement license for \$470 million to the Gulf International Bank, a bank in which Iraq used to own a 15% interest.²⁴⁶ Also, OFAC granted a license to withdraw funds from blocked accounts to the Arab Banking Corporation, of which Libya, on the list for state-sponsored terrorism, owns a 26% interest.²⁴⁷

These regulations are discriminatory. If a U.S. confirming bank honors a letter of credit, it may be reimbursed upon obtaining a license to execute from OFAC. But if the bank refuses to honor a letter of credit unless out of the frozen accounts, the exporter is forced to bring suit against the bank to pay from its non-Iraqi assets, as in *Semetex*. The Treasury has released money to reimburse banks honoring letters of credit, but those banks have an obligation to pay out of their own funds anyway. Thus, it appears that the "legal principle that justifies releasing frozen Iraqi assets to U.S. confirming banks is no more compelling than the legal principle that justifies releasing frozen Iraqi assets to U.S. exporters."²⁴⁸ The Treasury has cited a "policy" (not reflected in its regulations) which allows a confirming bank that honors a

²⁴³ Iraqi Sanctions Regulations, 31 C.F.R. § 575.510 (1991).

²⁴⁴ *Iraqi Claims Legislation, 1994: Testimony on S. 1401 Before the Subcomm. on Int'l Econ. Policy, Trade, Oceans and Env't of the Senate Comm. on Foreign Rel.* (September 21 1994) (testimony of Thomas Parish), in 1994 WL 513034 (F.D.C.H.), at 4.

²⁴⁵ *Id.*

²⁴⁶ Colin MacKinnon, *Consarc Wins*, MID. EAST EXEC. REP., Jan. 1993, at 4.

²⁴⁷ *Id.*

²⁴⁸ *Id.* at 6.

letter of credit to be reimbursed if that bank had an earmarked account to reimburse itself (i.e., specific collateral) as opposed to just a legal obligation to be reimbursed from the issuing bank.²⁴⁹ But this is an arbitrary distinction that denies U.S. exporters payment. Unlike the confirming banks, exporters have had no opportunity to earmark funds to pay for their exports. Perhaps this was a “sweetheart deal”²⁵⁰ between OFAC and the banks.

Treasury Secretary Lloyd Bentsen justified this policy by stating that confirming banks have a binding legal obligation to pay a beneficiary who has fulfilled the terms of the letter of credit; this obligation exists whether or not the confirming bank is reimbursed from the Iraqi issuing bank.²⁵¹ He contrasts this with an advising bank, which has no such legal obligation to honor a letter of credit even if the beneficiary fully complies.²⁵² But that does not explain the bias in favor of U.S. banks. When banks honor a letter of credit, they may be reimbursed from their earmarked account. But if a letter of credit beneficiary cannot perform its obligations because of *force majeure*, all it gets is what future claims legislation may give it. If a letter of credit beneficiary cannot get a confirming bank to honor the letter of credit and it cannot afford to go to court the way Semetex and Engel did, it will submit its claim to OFAC and, most likely, receive a small award. This race to the courthouse still remains, because the government wants the beneficiaries to sit back and wait for legislation and then get 10 cents on the dollar. If those beneficiaries bring suit, they will probably win, and the confirming banks will have to pay from their non-Iraqi assets. It is not until after such time that the banks may be reimbursed from the asset pool if the Treasury approves the appropriate license. This still results in less money available for other U.S. claimants. As a result, the Treasury’s discrimination gives the exact incentives that the proposed claims legislation and assets freeze regime is supposed to prevent.²⁵³

²⁴⁹ *Id.* at 7.

²⁵⁰ *Id.*

²⁵¹ Letter from Lloyd Bentsen, Secretary of the Treasury, to Lee Hamilton, Chairman, House Foreign Affairs Committee (Oct. 7, 1993), in Marian Nash (Leich), *Claims Settlement Legislation*, 88 AM. J. INT’L L. 314, 318 (1994).

²⁵² *Id.*

²⁵³ One might argue that the government’s preference of the banking industry over the export industry violates the equal protection clause. U.S. CONST. amend. V; *Bolling v. Sharpe*, 347 U.S. 497 (1954) (finding an equal protection component in the Fifth Amendment due process clause). However, the Supreme Court’s current position is that in the area of socio-economic legislation, a statutory classification that neither proceeds along suspect lines nor infringes fundamental Constitutional rights must be upheld against equal protection challenges if there is any reasonably conceivable state of acts that could provide a rational basis for the classification. *FCC v. Beach Communications, Inc.* 508 U.S. 307 (1993).

Another example of the close relationship between the banks and OFAC relates to Bush's October 21, 1992 order instructing all financial institutions holding frozen Iraqi assets coming from the sale of oil or petroleum related products after August 6, 1990 to transfer that money to the Federal Reserve.²⁵⁴ This amounts to roughly \$700 million, about half of all frozen assets. This money is supposed to go towards the \$200 million that is to pay for various U.N. inspection programs pursuant to U.N. Resolution 778.²⁵⁵ A week before the announcement, Treasury officials met with representatives of six major banks holding the most Iraqi assets. Rather than having to transfer all \$700 million, the government agreed that the banks only had to pay \$200 million on a pro-rata basis.²⁵⁶

A final example of favoritism is that while all parties concerned are waiting for Congress to pass claims legislation, the banks that currently hold the frozen assets are profiting off the interest that those assets generate. Banks can loan out more money because they can record those frozen accounts as assets. It is true that the proposed Iraqi claims bills will allow for the payment of interest to claimants.²⁵⁷ However, interest is only paid after all the principle of a claim is paid. There is no way that claimants will receive anywhere near to all of their principle. In effect, the banks have free money to loan.

Conclusion

No one would disagree that the Reagan and Bush Administrations pursued an unwise policy in supporting Saddam Hussein during the 1980's. How legally sound was this support, and whether evidence of this support was suppressed for political gain, may never be known. But while the political winds of foreign policy may change direction every few years, there has been one constant: international trade and commerce through letters of credit. One can speculate as to why OFAC took the position it did; whether it was to dampen publicity that would come from a successful suit, or whether it was

²⁵⁴ *Bush Orders Transfer of Iraqi Assets to Federal Reserve Bank*, 9 INT'L TRADE REPORTER 1846, 1846-48 (1992).

²⁵⁵ *Id.* These assets were from the sale of oil already in transit before the sanctions were imposed and from oil payments that could not yet be made to Iraq and were then frozen. Most of the oil is sitting in Saudi Arabian tanks or pipelines. See *Executive Briefing*, 15 MIDDLE EAST EXEC. REPORTS 6 (1992).

²⁵⁶ These banks include Arab Banking Corp., Gulf International Bank., Chase Manhattan, Bank of America, Union Bank of Switzerland, and BBL-Bank of Brussels Lambert. *Bush Orders Transfer of Iraqi Assets to Federal Reserve Bank*, 9 INT'L TRADE REPORTER 1846, 1846-8 (1992).

²⁵⁷ See *supra* note H.R. 3221, 103rd Cong., 2nd Sess., § 6(a)(4) (1994).

to retain the frozen Iraqi assets to satisfy the government's own claims against Iraqi stemming from their loan guarantees. But one thing that is clear. The courts were able to decide these cases in a way that took into account the interests of all the parties involved—the exporters, the banks, and the government—and then fashion a result that was the best compromise between these positions. The exporters, by virtue of requiring letters of credit, contracted out of the risk of non-payment; they should receive the benefit of that bargain, so long as they completed their contractual obligations. At the same time, however, those exporters that had not performed their contractual obligations could not expect to get the benefit of their bargain. Thus, while Consarc obtained a default judgment against the Iraqi buyer, it could not execute that judgment against a blocked account because it did not perform its letter of credit obligations. The courts recognized the importance of letters of credit to international trade while at the same time realizing the importance of an assets freeze regime to the foreign policy of the United States. Hopefully, there will not be another foreign policy debacle like Iraqgate for years to come. If there is, exporters should rest assured that the courts will allow as few inroads as possible upon the sanctity of letters of credit.

