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Renegotiation of External Debt: The Allied Bank Case and the Chapter 11 Analogy

Ruben Sklar

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RENEGOTIATION OF EXTERNAL DEBT: THE ALLIED BANK CASE AND THE CHAPTER 11 ANALOGY

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I. INTRODUCTION

Ever since Mexico's near default on its external debt in mid-1982, the international banking arena has taken on the appearance of a *de facto* bankruptcy court. Many third world nations, faced with lagging economies and steadily rising debts, teeter on the brink of default. Large scale reorganization and refinancing appear to be the only reasonable solutions.

In the recent case of *Allied Bank International v. Banco Credito Agricola de Cartago*,¹ (*Allied Bank II*) the U.S. Court of Appeals for the Second Circuit added a significant legal dimension to this economic comparison. In its original decision (*Allied Bank I*), the appellate court refused to enforce the contractual rights of an American bank against defaulting Costa Rican borrowers on grounds of international comity.² The court cited by analogy to Chapter 11 of the U.S. Bankruptcy Code of 1978.³ In effect, the court attempted to force the plaintiff bank to accept the terms of an agreement that restructured the Costa Rican external debt.

The Second Circuit subsequently vacated its own decision on rehearing (*Allied Bank II*).⁴ The court's decision was based on the arguments contained in the amicus brief filed by the U.S. Depart-

1. No. 83-7714 slip op. (2d Cir. April 23, 1984), *rev'd on rehearing*, 757 F.2d 516 (2d Cir. 1985).

2. See *Hilton v. Guyot*, 159 U.S. 113, 163-64 (1895).

3. *Allied Bank I*, No. 83-7714 slip op.

4. 757 F.2d at 518.

ment of Justice. Nevertheless, the court's rationale in *Allied Bank I* adds credibility to the Chapter 11 analogy as a means of analyzing the external debt crisis. This is especially so because the portion of the court's opinion dealing with the Chapter 11 analysis was not addressed in *Allied Bank II* and reversal was based on other grounds.⁵

This Comment will begin with a detailed discussion and analysis of the *Allied Bank* cases. It will provide the necessary background information about the external debt crisis and analyze the competing economic and political interests that have shaped the crisis. It will then discuss the inadequacies of the present renegotiation procedure as illustrated by the *Allied Bank* cases. Finally, this Comment will suggest some Chapter 11 principles that can be used as guidelines in improving debt renegotiation procedures.

Many preventative measures can be taken to avoid the need for, or lessen the extent of, external debt renegotiation.⁶ However, this Comment will focus on the steps that should be taken in order to avoid the ultimate crisis when these measures fail.

II. ALLIED BANK V. BANCO CREDITO AGRICOLA DE CARTAGO

A. *Facts and District Court Decision*

Allied Bank International (Allied) was the agent for a syndicate of 39 banks.⁷ Defendants were three Costa Rican banks wholly owned by the Republic of Costa Rica.⁸ In 1976, pursuant to the failure and reorganization of the Latin American Bank (LAB), the

5. *Id.*

6. See *infra* p.69 & note 55, p.79 & note 108.

7. The syndicate includes: American Fletcher National Bank, American Fletcher Bank (Suisse) A.G., Atlantic International Bank, Banco Exterior de Espana, Banco de Madrid, Bank of Miami, Intercontinental Bank of Miami Beach, Bank of Montreal, Bank of New Orleans, Bank of Virginia International, Bayerische Vereinsbank Int'l, S.A., Bayerische Vereinsbank, A.G., Bremar Holdings Limited, Cleveland Trust Company, Columbia Union National Bank, Credit Lyonnaise, Deutsche Bank A.G., Export-Import Bank of the United States, Federal Deposit Insurance Corp., Fidelity National Bank of South Miami, Fidelity Union Trust Company, First Commercial Bank of Taiwan, First National Bank of Fort Worth, First National City Bank (Interamerica), First Pennsylvania Bank, N.A., Hartford National Bank, International Commercial Bank of China, Irving Inter-American Bank, Irving Trust Company, Kyowa Bank Limited, National Westminster Bank Ltd., Overseas Investors Inc., The Royal Bank of Canada, The Sanwa Bank Limited, Equibank N.A., Southeast First National Bank of Miami, Stockholms Sparbank, and United California Bank.

8. Defendants were Banco Credito Agricola de Cartago, Banco Anglo Costarricense, and Banco Nacional de Costa Rica.

defendants assumed the debts that LAB owed to the Allied syndicate. LAB was chartered in the Cayman Islands but conducted most of its business in Costa Rica. The defendants issued new promissory notes to Allied totaling approximately \$10 million. In addition, they entered into side-letter agreements with Allied⁹ which called for repayment in semi-annual installments payable from 1978 to 1983.

Although most of the negotiations took place in Costa Rica and the Cayman Islands, payment was to be made in U.S. dollars in New York City. The agreements called for concurrent jurisdiction in New York and Costa Rica.¹⁰ The agreements also provided that failure of the Costa Rican Central Bank to supply the U.S. currency necessary for repayment would excuse default for only ten days.

The Costa Rican banks made payments on schedule until 1981, when Costa Rica found itself in serious economic trouble. The nation did not have sufficient foreign currency to pay its international debts as they became due.¹¹ Practically speaking, Costa Rica was insolvent.¹²

In response to this crisis, the Costa Rican government issued several decrees prohibiting all Costa Rican institutions from making any payments of foreign currency to foreign creditors without the approval of the Central Bank. The Central Bank informed the defendants that they would not be permitted to pay the debts in question until the country's entire external debt had been renegotiated. The President of Costa Rica cited the need for "harmony of decisions and centralization in the decision making process. . . ."¹³

9. Copies of the side-letter agreements can be found at Brief for Defendant at 37-50, 105-18, 130-43 app., *Allied Bank Int'l v. Banco Credito Agricola de Cartago*, 566 F. Supp. 1440 (S.D.N.Y. 1983) [hereinafter cited as Brief for Defendant].

10. The location of the property (i.e., the debt) was a major issue in the original litigation. Allied argued that the situs was New York because the debt was payable there. The Costa Rican Banks pointed to the fact that most of the negotiations took place outside of the United States and asserted that the provision for payment in New York was merely an incidental contact with the United States.

11. "Payments of long, medium, and short-term public debt in 1982 were expected to use over 90% of projected export earnings." Brief for Appellee at 12, *Allied Bank*, 757 F.2d 516 (2d Cir. 1985) [hereinafter cited as Brief for Appellee] (quoting DEPT. OF STATE REPORT, 97TH CONG., 2D SESS., COUNTRY REPORTS ON HUMAN RIGHTS PRACTICES FOR 1981 393-94 (Comm. Print 1982)).

12. Insolvency is defined in Black's Law Dictionary as "the condition of a person who is unable to pay his debts as they fall due, or in the usual course of trade and business." BLACK'S LAW DICTIONARY 716 (5th ed. 1979).

13. Brief for Appellee, *supra* note 11, at 11, (quoting Costa Rican Executive Decree

Allied brought suit on behalf of itself and the 39 syndicate banks in the United States District Court for the Southern District of New York.¹⁴ The district court held, *inter alia*,¹⁵ that the act of state doctrine¹⁶ mandated recognition of the sovereign acts of Costa Rica. The action was eventually dismissed.¹⁷

B. Renegotiation of Costa Rica's External Debt

During the pendency of the district court case, negotiations were being held between Costa Rica and National Trust and Savings Association (Bank of America)¹⁸ for the restructuring of Costa Rica's entire external debt. On September 9, 1983, these two parties signed a refinancing agreement (agreement) which required the consent of the holders of at least 98 percent of Costa Rica's external bank debt before it could become effective.¹⁹ Within two weeks, 170 creditors had approved the refinancing agreement.

All commercial bank creditors were treated equally under the refinancing agreement. Their interest payments were kept current and their principal payments were stretched out into the 1990's. As of June 1, 1984, Costa Rica had paid about \$118 million in current interest and about \$400 million in past due interest.²⁰

13103-H).

14. 566 F. Supp. 1440 (S.D.N.Y. 1983).

15. The court rejected the argument that Costa Rica was entitled to sovereign immunity because the execution of the promissory notes in question fell under the commercial activity exception. *Id.* at 1443.

16. "The act of state doctrine in its traditional formulation precludes the courts of this country from inquiring into the validity of the public acts a recognized sovereign power committed within its own territory." *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 401 (1964). This definition merely scratches the surface of the doctrine. For a more extensive discussion see Lengal, *The Duty of Federal Court to Apply International Law: A Polemical Analysis of the Act of State Doctrine*, 1982 B.Y.U.L. REV. 61; ACT OF STATE AND EXTRATERRITORIAL REACH (J. Lacey ed. 1983).

17. In a case concerning the same Costa Rican decrees and almost identical facts, a different judge in the same district held that the act of state doctrine did not bar recovery. The rationale was that the situs of the debt was New York (*see supra* note 10) and that the doctrine applies only to a taking of property by a foreign government within its own territory. *Libra Bank Ltd. v. Banco Nacional de Costa Rica, S.A.*, 570 F. Supp. 870 (S.D.N.Y. 1983).

18. Bank of America was the coordinating agent for all of Costa Rica's external private creditors.

19. This is a typical requirement in this type of restructuring. Brief for Appellee, *supra* note 11, at 15.

20. *Id.* However, the agreement required that large portions of these interest payments be simultaneously loaned back to Costa Rica, which created an illusion of profits for the banks. *See* discussion of banking aspects, *infra* pp. 71-73.

Other classes of creditors were given preferential treatment. The debts of "multilateral financing organizations," such as the World Bank and the Inter-American Development Bank, were not rescheduled. Nevertheless, the negotiations were monitored by a creditor committee which approved the terms of the restructuring and assured that similarly situated creditors were treated equally.²¹

Fidelity Union Trust Company of New Jersey (Fidelity) was the only one of the 39 banks in the Allied syndicate to reject the refinancing agreement.²² Despite intense pressure from the larger banks, Fidelity stood its ground. Allied, representing Fidelity alone, took its case to the Court of Appeals for the Second Circuit.

C. *The Court of Appeals Decision (Allied Bank I)*

Faced with conflicting decisions in the same district court on the applicability of the act of state doctrine,²³ the court of appeals entirely sidestepped the issue. Instead, the court ruled that comity required the recognition of the Costa Rican actions.

In general terms, "comity . . . is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens."²⁴ This is hopefully a reciprocal recognition which applies "only if the acts are consistent with the law and policy of the United States."²⁵ Comity is generally considered to be broader and more discretionary than the act of state doctrine.²⁶

According to the circuit court, the two main requirements of comity in this case were: 1) the consistency of the Costa Rican acts

21. Brief for Appellee, *supra* note 11, at 13-14.

22. Fidelity's Robert M. Craig gave the following reasons for the bank's refusal to accept the Refinancing Agreement: a) the debt to Fidelity had already been renegotiated once in 1976, b) the restructuring required the extension of additional credit to Costa Rica, c) the debt to Fidelity was originally to have been repaid by 1983, but the restructuring stretched payments into the 1990's, and d) unlike most other banks in the Allied syndicate, Fidelity had no other outstanding loans to Costa Rica. Appellant's Reply Brief at 18, *Allied Bank*, 757 F.2d 516 (2d. Cir. 1985). In addition, Fidelity's Vice Chairman, Kevin Shanley, had hoped for a buy-out by the larger international lenders. See Sherrod, *Semitough*, FORBES, July 30, 1984, at 134.

23. The court was faced with conflicting decisions in *Allied Bank I* and *Libra* on the applicability of the act of state doctrine. See *supra* note 17.

24. *Hilton v. Guyot*, 159 U.S. 113, 163-64 (1895).

25. *Allied Bank I*, No. 83-7714 slip op. at 7-8.

26. *Hilton*, 159 U.S. at 163-164.

with U.S. foreign policy and 2) the consistency of those acts with U.S. domestic jurisprudence. Regarding the first requirement, the court cited the adamant support of Congress and the President for both the Government of Costa Rica and the renegotiation itself.²⁷ In the opinion of the court, a ruling for Fidelity would have interfered with vital U.S. foreign policy objectives. Perhaps the most significant finding, however, was that the Costa Rican acts were consistent with U.S. domestic jurisprudence as manifested in Chapter 11 of the U.S. Bankruptcy Act.²⁸ The court viewed "Costa Rica's prohibition of payment of its external debts as being analogous to the reorganization of a business" under U.S. law.²⁹ The Costa Rican decrees were found to be similar to the automatic stay of collection actions employed in Chapter 11 cases.³⁰

D. *Response to the Allied Bank I Decision*

The appellate court's decision in *Allied Bank I* created a great deal of unrest and uncertainty in international banking circles. After all, the defendants admitted they were in default under the terms of the loan agreement. Observers began to speculate whether similar loan agreements would be enforceable in U.S. courts.³¹ Fidelity moved for rehearing with the support of amicus curiae briefs from the New York Clearing House Association (NYCHA),³² the Rule of Law Committee and the National Foreign Trade Council,

27. The U.S. government took part in the restructuring of Costa Rica's intergovernmental debt and signed a document recommending that private lenders follow suit. For a discussion of creditor clubs, see *infra* notes 74-78 and accompanying text. In addition, the President has notified Congress that further economic aid to Costa Rica is vital to the national interest despite Costa Rica's failure to make timely repayment on previous loans. See discussion of Foreign Assistance Act, Brief for Appellee, *supra* note 11, at 17-18.

28. It appears that in referring to the Costa Rican acts the court considered the entire process, from the restrictive decrees of the Central Bank up to the actual renegotiation agreements, as being part of the same act. But see Brief for Appellant at 16, *Allied Bank* 757 F.2d 516 (2d. Cir. 1985) (arguing that the court should consider only the original decrees in determining their consistency with U.S. law).

29. *Allied Bank I*, No. 83-7714 slip op. at 5.

30. See 11 U.S.C. § 362 (1979).

31. See, e.g., *New York Law Unsafe For Loan Agreements*, The Financial Times (London), May 24, 1984; *Setting Latins Free*, *ECONOMIST* (May 5, 1984), at 15.

32. The members of the N.Y.C.H.A. are: The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Co. of New York, Manufacturers Hanover Trust Co., Irving Trust Co., Bankers Trust Co., Marine Midland Bank, N.A., United States Trust Co. of New York, National Westminster Bank USA, and European American Bank and Trust Co. Brief for N.Y.C.H.A. as amicus curiae, *Allied Bank*, 757 F.2d 516 (2d Cir. 1985) [hereinafter cited as Brief for N.Y.C.H.A.].

Inc. (RLC-NFTC),³³ and the U.S. Department of Justice.

On rehearing, Allied's supporters attacked the court's rationale on two basic points. First, they claimed the court misinterpreted U.S. foreign policy. Second, they argued that there were significant differences between this case and a true Chapter 11 reorganization which made the court's bankruptcy analogy inappropriate.

The first line of attack was particularly persuasive in light of the U.S. government's request for reversal.³⁴ The policy of the United States is to support voluntary renegotiations of international debts "within a context in which legal principles require enforcement of international loan agreements. Substantial alteration of these legal principles changes expectations in a way that renders contractual relations less certain, thereby discouraging needed further lending."³⁵

Other *amici* were concerned about the status of New York as a center for international banking.³⁶ They even suggested that the appellate court decision might have affected all multinational businesses that extend credit to their customers.³⁷

The big banks argued that the court's decision had "undercut the basic legal framework governing tens of billions of dollars of credits extended in United States dollars and payable in New York City . . ."³⁸ Some bankers feared that the decision would "encourage debtor countries to rely on this case to obtain concessions

33. These two organizations joined in filing one brief. The Members of the R.L.C. are: Atlantic Richfield Co., Bank of America, Bechtel Group, Inc., Bethlehem Steel Corp., Caterpillar Tractor Co., Chase Manhattan Bank, Chevron Corp., Exxon Corp., General Electric Co., Gulf Oil Corp., and Texaco, Inc. The N.F.T.C. is a New York not-for-profit corporation concerned with international trade and investment. Its 570 member firms account for over 70 percent of U.S. exports and over 70 percent of U.S. foreign direct private investment. Brief for R.L.C.- N.F.T.C. as *amicus curiae* at 1, *ALLIED BANK*, 757 F.2d 516 (2d Cir. 1985) [hereinafter cited as Brief for R.L.C.-N.F.T.C.].

34. It is noteworthy that the U.S. government's brief, submitted by the Department of Justice, was also signed by representatives of the Department of State, the Department of the Treasury, and the Board of Governors of the Federal Reserve System. Brief for U.S. Government, *Allied Bank* 757 F.2d 516 (2d Cir. 1985) [hereinafter cited as Brief for U.S. Government].

35. *Id.* at 6-7.

36. "New York courts have consistently held that impossibility . . . of performance produced by foreign exchange control measures . . . does not excuse the debtor's obligation to perform." Brief for R.L.C.-N.F.T.C., *supra* note 32, at 13. *See also, supra* note 31; *Setting Latins Free, supra* note 31.

37. *See* Brief for R.L.C.-N.F.T.C., *supra* note 33, at 2.

38. *See* Brief for N.Y.C.H.A., *supra* note 32, at 3.

from their creditors . . .”³⁹ Indeed, Argentine negotiators had already alluded to the decision in their talks with banks.⁴⁰

In response to these formidable challenges, the Costa Rican banks asserted that the appellate court decision was an extremely narrow ruling, limited to the peculiar facts of the case. They claimed that suggestions that the case could set a broad precedent were based on “fears that someone in the future could misread the decision . . . to mean something that this court did not say and defendants never argued.”⁴¹

The Costa Rican banks also asserted that in spite of the U.S. Government’s position in the case, it was still significant that both the President and Congress wholeheartedly supported the renegotiation process.⁴² In addition, the Costa Rican banks argued that recent international lending statistics did not support the suggestion that the court’s ruling would discourage further lending to LDCs.⁴³

The second line of attack on the appellate court’s rationale was the asserted inappropriateness of the Chapter 11 analogy in this context. The court relied on *Canada Southern Railway Co. v. Gebhard*,⁴⁴ in which the reorganization of an insolvent Canadian corporation was given effect in a U.S. court. *Gebhard*, however, is distinguishable on the grounds that the Costa Rican banks in this case are not insolvent and there has been no foreign bankruptcy proceeding. Furthermore, while the U.S. Bankruptcy Act⁴⁵ allows the commencement of cases ancillary to foreign bankruptcy proceedings it does not apply to “bankrupt” sovereign nations.⁴⁶

Allied also claimed that the Costa Rican decrees were discriminatory because they applied only to debts owed to foreign creditors, and not to those owed to Costa Rican creditors.⁴⁷ The decrees

39. Brief for U.S. Government, *supra* note 34, at 7.

40. Sherrid, *supra* note 22, at 134.

41. Brief for Appellee, *supra* note 11, at 2.

42. *See supra* note 27.

43. In the few months following the *Allied Bank I* decision, between April and September of 1984, large loans were either made to or guaranteed by: Mexico, Chile, Brazil, Malaysia, Turkey, and Ireland. Brief for Appellee, *supra* note 11, at 24, (citing Weekly Fact Sheet, Euromoney Syndication Guide (Euromoney Publications, Ltd. 1984)).

44. 109 U.S. 527 (1883).

45. 11 U.S.C. § 304 (1979).

46. *See* 11 U.S.C. § 101 (12) (1979). *See generally* 2 COLLIER ON BANKRUPTCY ¶ 304 (15th ed. 1984).

47. Brief for Appellant, *supra* note 28, at 4. Of course, if the Costa Rican nation is viewed as the insolvent debtor because of its deficiency of foreign currency, then the distinc-

also excepted multilateral financing organizations. In addition, numerous procedural safeguards which are available to creditors under Chapter 11 were not available to Fidelity in this case.⁴⁸

E. *Reversal of the Allied Bank Decision on Rehearing (Allied Bank II)*

In March of 1985, the Court of Appeals for the Second Circuit reversed its original *Allied Bank* decision and remanded the case for entry of summary judgment in favor of Allied Bank International. The court's decision was merely a restatement of the U.S. Government's brief.⁴⁹ It emphasized the importance of maintaining lender confidence in the legal validity and enforceability of international loan agreements. Any renegotiation, to be effective, must be voluntary and bilateral.

The court stated frankly: "In light of the government's elucidation of its position, we believe that our earlier interpretation of United States policy was wrong."⁵⁰ The court had declared that consistency of the foreign sovereign's acts with U.S. foreign policy was a crucial factor,⁵¹ only to discover that its interpretation of the President's policy was mistaken. Thus, reversal was almost inevitable.⁵²

The court considered the applicability of the act of state doctrine for the first time and found that it too was inapplicable. Because the doctrine applies only "when the taking is wholly accomplished within the foreign sovereign's territory,"⁵³ the decision

tion between foreign and domestic creditors seems very logical.

48. *See id.* at 4. *See also, infra* p. 19 & note 102.

49. *See supra* notes 35-36 and accompanying text.

50. *Allied Bank II*, 757 F.2d at 520.

51. *See supra* notes 25 and 27 and accompanying text.

52. The court may have also considered the apparent subsidence of the debt crisis at the time of the rehearing. In the original decision, the court may have seriously considered the possibility that a successful suit by Fidelity could have disrupted the Costa Rican debt restructuring. At the time of the rehearing, however, the renegotiation seemed to be more firmly in place.

53. *Allied Bank II*, 757 F. 2d at 521. According to the Court of Appeals for the Second Circuit, the act of state doctrine applies only to a taking by a recognized government accomplished within its own territory. However, comity can still lead to the recognition of an extraterritorial taking if it is consistent with the law and policy of the United States. *See supra* note 25 and accompanying text. Thus, act of state appears to be more mechanical in that it arises from the practical difficulties inherent in an attempt by U.S. courts to reach across the borders of a sovereign nation. Decisions based on comity, however, are more vulnerable to variations and changes in U.S. foreign and economic policies. For a different view

turned on the situs of the debt. The court found that the debt was located in New York⁵⁴ and, therefore, the act of state doctrine did not apply.

Nevertheless, the reversal of *Allied Bank I* does not end the discussion raised by litigators and commentators alike. This case is important not merely because of the immediate effect it will have on the litigants, but because of the lessons which can be extracted from it. First, the *Allied Bank* cases highlight the shortcomings of the present system for dealing with the external debt crisis. More importantly, the Second Circuit has added credibility to the Chapter 11 analogy as a viable framework for improving the way banks and governments deal with external debt problems.

III. BACKGROUND

A. *Causes of External Debt Crisis*

The present inability of many Latin American borrowers to pay their international debts is a result of several interrelated factors, many of which have nothing to do with the countries' own economic policies.⁵⁵ Simply stated, the problem is that a combination of extremely high interest rates and a shortage of foreign currency has made it nearly impossible for many Latin American nations to pay their debts.

A dramatic rise in interest rates since the mid-1970s is the main cause of the external debt crises.⁵⁶ Because the interest rates on most international loans are tied to either the U.S. prime rate or the London Interbank Offered Rate (LIBOR),⁵⁷ payments due

of the act of state doctrine, see Halberstam, *Sabbatino Resurrected: The Act of State Doctrine in the Revised Restatement of U.S. Foreign Relations Law*, 79 AM. J. INT'L L. 68 (1985).

54. 757 F.2d at 521.

55. For a thorough discussion of the history of the Latin American external debt problem, see generally, Comment, *On Third World Debt*, 25 HARV. INT'L L. J. 83 (1984); D. DIMANCESCU, *DEFERRED FUTURE* (1984); Note, *Legal Aspects of the Latin American External Debt and its Ramifications for the Development and Integration of the Americas*, 16 LAW. AM. 109 (1984); Mendez, *Recent Trends in Commercial Bank Lending to LDC's: Part of the Problem or Part of the Solution*, 8 YALE J. WORLD PUB. ORDER 173 (1982); Cohen, *U.S. Regulation of Bank Lending to LDC's: Balancing Bank Overexposure and Credit Supply*, 8 YALE J. WORLD PUB. ORDER 200 (1982).

56. The average interest rates charged by private lenders on middle and long term loans to LDC's rose from under 8 percent in 1976 to over 14 percent in 1981. THE WORLD BANK, *WORLD DEBT TABLES XI* (1983-84).

57. LIBOR is the rate at which banks in London offer Eurodollars in the placement

on such loans are now much higher than originally expected.⁵⁸

The shortage of foreign currency for servicing these rising debts is a result of two factors. First, the world-wide recession of the late 1970's and early 1980's caused a sharp decline in both the price and volume of Latin American exports.⁵⁹ Second, the debt crisis itself has made lending to Latin American borrowers more risky, causing bankers to decrease the availability of credit to Latin American nations.⁶⁰ Thus, the two major sources of foreign currency, exports and new loans, have been curtailed. This leaves many nations with unexpectedly high interest payments and with less foreign currency to make those payments.

B. *IMF Stop-gap Measures*

In response to this dilemma, the International Monetary Fund (IMF) has implemented emergency programs to provide less developed countries (LDCs) with the credit they need to avoid defaulting on their debts.⁶¹ An IMF bailout, however, does not come without a heavy price.

In order to qualify for IMF credit, a country must agree to impose severe austerity measures aimed at decreasing government deficits and increasing trade surpluses.⁶² Nations that have agreed to these measures, such as Mexico,⁶³ have experienced some improvement in their debt situations, but at the cost of increased unemployment and a scarcity of food and goods.⁶⁴ Moreover, these

market. There is a different LIBOR rate for each deposit maturity.

58. For example, a 1 percent rise in interest rates would increase the current interest debt of Brazil by over \$700 million dollars and that of Chile by over \$130 million dollars. See WORLD DEBT TABLES, *supra* note 56 at 166, 170.

59. See WORLD BANK ANN. REP. 32 (1984).

60. See *id.* at 38.

61. One of the main functions of the IMF is to make the Fund's resources temporarily available to troubled nations, "thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." Articles of Agreement of the I.M.F., July 28, 1968, art. I, para. v.

62. Such measures may include: Setting limits on imports, increasing exports, cutting wages significantly, devaluating the nation's currency, increasing taxes, and cutting public spending. See Smith, *A Global Chapter 11?*, FORBES, April 30, 1984, at 56.

63. See generally, Mercaldo, *Mexico, One Country's Attempt at Dealing with the International Liquidity Crisis*, 3 THE WORLD OF BANKING 9 (1984) (for a description of Mexico's external debt restructuring).

64. By artificially increasing exports and decreasing imports, a government deprives its people of access to domestic products and hurts domestic industry by hindering access to foreign equipment and replacement parts. See D. DIMANCESCU, *supra* note 525 at 68. See also Wall St. J., Aug. 14, 1984, at 44, col. 6 (regarding the effects of external debt on food

programs are merely stop-gap measures designed to put off major defaults until economic conditions change and these nations are better able to service their loans.

C. *Banking Aspects*

On the other side of this crisis are the banks in the wealthier nations that loaned enormous amounts of money to Latin American borrowers and are now facing the possibility of unprecedented defaults. The urge to lend was mainly sparked by large bank deposits made by the OPEC countries in the early 1970's.⁶⁵

In general, U.S. banks have approached the problem in the following manner: they accept the fact that they will not receive any principal payments in the near future; they agree to put up new loans to alleviate the liquidity problems; they require the borrower nation to implement IMF austerity measures; and they require the borrower nation to service the debt by keeping interest payments current and paying market rates.⁶⁶

Bankers usually prefer this refinancing approach because it keeps the desperate reality from being reflected in profit figures.⁶⁷ From an accounting point of view it is business as usual, despite the fact that as one commentator observed "the banks are paying themselves."⁶⁸

Banks have been receiving increased pressure to take measures that would more accurately reflect this delicate situation.⁶⁹ Federal regulators have suggested the creation of larger reserves to

imports).

Although Mexico's President de la Madrid was able to implement IMF austerity measures, leaders in less stable democracies may find it difficult to survive the political consequences of these measures. The most obvious example is Argentina, where President Raul Alfonsin is just beginning to establish the foundations of democracy in a country with little democratic tradition. The economic ramifications of IMF austerity measures could threaten Alfonsin's fragile political base. See Smith, *supra* note 62.

65. Banks were eager to lend large sums of money to Latin American countries in light of the high rates of economic growth these nations were experiencing. From 1970 to 1979, the average annual real rate of growth in total GNP for Latin America and the Caribbean was 6 percent. However, this figure dropped to -1.4 in 1982 and was still lower in 1983. WORLD BANK ANN. REP., *supra* note 59, at 150. This recession left most large U.S. banks overexposed in the region.

66. Smith, *supra* note 62 (quoting Citibank Executive Vice President George J. Clark).

67. Only the interest portion of a debt is considered in calculating profits.

68. D. DIMANESCU, *supra* note 55, at 135.

69. Agencies which have applied pressure on U.S. banks include the Federal Reserve Board, the Comptroller of the Currency, and the Securities and Exchange Commission.

protect against possible defaults on shaky Latin American loans. European banks have already taken such a step, but the large U.S. banks are reluctant to follow suit, because the reserves would have to be taken out of their profits.⁷⁰ It is unlikely that federal regulators will impose high reserve requirements for loans to particular LDCs because that would make it much more difficult for those countries to obtain desperately needed new loans.

Commentators have suggested that the banks reduce the interest rates on LDC loans regardless of the current market rates, thereby alleviating the burden on Latin American borrowers. This, however, would also have a significant effect on profits.⁷¹ In addition, bank accountants may be forced to declare loans nonperforming to the extent of the forgiveness of interest debt. On the other hand, there is the danger that a country's entire loan portfolio may have to be declared nonperforming if alleviatory measures are not taken. This situation has created a schism between the major money-center banks and the smaller regional banks as to their willingness to take such alleviatory measures. The simple reason for this is that the money center banks have a much greater percentage of loans attributable to third world countries.

Any significant increase in loan reserves, or decrease in interest payments, would devastate the book profits of some of the largest American banks.⁷² A decrease in the interest rate payable by major Latin American debtors to 6 percent would have reduced the average 1984 profits of money center banks by as much as 35 percent.⁷³ Almost all of the banks in the United States and Europe that have either created substantial loan reserves or encouraged lower interest payments have relatively little exposure in Latin America.

Another important difference between money-center banks and smaller regional banks is the fact that the smaller banks may be less eager to go along with the restructuring of an LDC's external debt. Having little LDC exposure, the smaller regional banks have less to lose from a lawsuit and a better chance of attaching

70. An increase in reserves against loans to Argentina, Brazil, Mexico, and Venezuela equal to 1% of their face value would have cut 1984 profits of money center banks by an average of 6%. Some European banks have raised reserves against LDC loans to well over 10% of face value, while the reserves of major U.S. banks remain at about 1 percent. Hector, *The True Face of Bank Earnings*, *FORTUNE*, April 16, 1984, at 84.

71. See *supra* note 67.

72. See generally, Hector, *supra* note 70.

73. *Id.* at 86.

enough of the debtor nation's assets to satisfy its relatively small loan. The *Allied Bank* cases are an illustration of this situation.

IV. INADEQUACY OF PRESENT RENEGOTIATION PROCEDURE

A. *Background of Present Procedure*

External debt restructuring generally involves the formation of "creditor clubs."⁷⁴ With the assistance of the IMF, creditor clubs attempt to negotiate mutually acceptable refinancing terms with debtor nations.⁷⁵ Typically, the first step taken by a financially distressed nation is to call on the IMF for short term assistance.⁷⁶ Such assistance is generally conditioned on an agreement by the debtor nation to implement austerity measures aimed at controlling its deficit.⁷⁷ If, as is often the case, the debtor nation still requires a restructuring of its debt, the major creditor countries may organize a creditor club to carry out the negotiations. The IMF continues to play an important role throughout the renegotiation process. The creditor nations generally require that the debtor nation implement an IMF austerity program as a condition of refinancing. At the creditor club meeting, an IMF representative usually reports on the cooperation and progress of the debtor in that regard.⁷⁸ The IMF may also act as an intermediary between the parties. The Fund's access to financial information, "even if the debtor nation regarded it as sensitive and was not publishing it,"⁷⁹ is vital to the renegotiation process.

B. *Flaws in Present Procedure*

The most obvious shortcoming of the creditor club system is that it does not include private creditors.⁸⁰ Generally, as in the Costa Rican case, only official government creditors are party to

74. See, e.g., Paris Club, *Agreed Minute on the Consolidation of the Debt of the Republic of Costa Rica*, January 11, 1983. A copy may be found at Brief for Defendant, *supra* note 9, at app. B.

75. For a discussion of the present renegotiation frame work, see Note, *Procedural Guidelines For Renegotiating LDC Debt: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act*, 21 VA. J. INT'L L. 305, 320-28 (1981); Comment, *supra* note 55.

76. But see, Mendez, *supra* note 55, at 176 (on increased role of private lenders).

77. See e.g., Paris Club, *supra* note 74, at § I, ¶¶ 2-4.

78. See *id.* at § I, ¶ 3.

79. F. SOUTHARD, *THE EVOLUTION OF THE INTERNATIONAL MONETARY FUND* 2 (1979).

80. The uncertainty and limited scope of the creditor club system have led commentators to call for reforms. See, e.g., Comment, *supra* note 55; Note, *supra* note 75.

the creditor club agreements. These agreements often contain provisions recommending that the debtor nation reschedule its debt to private lenders on similar terms and in an equitable fashion.⁸¹ Debtor nations have voiced dissatisfaction with this renegotiation format. One major complaint is that the negotiations focus on the terms of repayment rather than on the long term political⁸² and economic⁸³ goals of the debtor nations. It would be in the best interests of both the LDCs and the banks to strive toward long-term stability and productivity in the Third World. Debtor nations also complain that the ad hoc nature of the creditor club process inhibits their ability to formulate effective economic policies.⁸⁴ The exclusion of private creditors from the process simply adds complexity and uncertainty to the problem.

C. *Inadequacy of Legal Remedy*

The *Allied Bank* cases indicate the inadequacies in the existing renegotiation procedure. This is highlighted by the U.S. Government's paradoxical position.⁸⁵ On the one hand, the Government recognizes that the renegotiation "necessitated broad support and that it was in the vital interest of all parties to cooperate."⁸⁶ To achieve this end, the Government has put intense pressure on banks to cooperate. On the other hand, it has come to the aid of Fidelity because a successful renegotiation requires "a context in which legal principles require enforcement of international loan agreements."⁸⁷ Thus, the U.S. Government has put itself in a position whereby it supports a legal right that is meaningful to the possessor only if no one else exercises it.

If, under circumstances analogous to those in *Allied Bank*, a

81. See, e.g., Paris Club, *supra* note 71, at § III, ¶ 1.

82. It is often suggested that by insisting on strict austerity measures, the banks and the IMF ignore the tragic consequences this may have on the populace of debtor nations. This, in turn, could destabilize the fragile democracies of Latin America. See, e.g., de Zevallos, *Democracy in Peru Threatened by Terrorism and Debt*, Wall St. J., Aug. 27, 1984, at 21, col. 3; N.Y. Times, Aug. 31, 1984, at A3, col. 2 (concerning reaction to austerity measures).

83. See Riding, *Clash of Views on Latin Plight*, N.Y. Times, July 20, 1984, at D2, col. 1; Note, *supra* note 75, at 322.

84. See Note, *supra* note 75, at 322-23.

85. See *supra* notes 34 and 35 and accompanying text.

86. Brief for U.S. Government, *supra* note 34, at 8, n.4, (quoting J. de Larosiere, Managing Director of the IMF, Remarks before the Institute of Foreign Bankers, May 2, 1984, 13 IMF SURVEY 145, 146 (May 21, 1984)).

87. Brief for U.S. Government, *supra* note 34, at 6.

substantial number of creditors sued to enforce their right to payment,⁸⁸ there would not be nearly enough assets of the debtor available to satisfy all claims. More importantly, there would be a danger of a worldwide banking crisis. It is unlikely that the U.S. Government would support the right of creditors to sue in such a situation.

The inadequacy of a legal remedy for creditors in such a scenario is evident from the events occurring subsequent to the *Libra* decision.⁸⁹ Although the plaintiffs in *Libra* won a judgment against Costa Rican banks, they were unable to attach enough assets to satisfy the judgment.⁹⁰ Eventually, the plaintiff banks voluntarily relinquished the judgment and acquiesced to the Costa Rican renegotiation.⁹¹

An effort to attach the assets of a defaulting LDC could lead to a disastrous chain of events. Because most external public loans contain cross-default clauses,⁹² a lender could put all loans to a particular country in technical default by declaring a relatively small loan to be in default. The possibility of a loss of depositor confidence in the banks would be very strong. A run on even one bank could lead to a global crisis. "Should perceptions of any single bank's fragility get out of hand because of overextended loans to foreign borrowers, the vast interlocking network of financial institutions could face an unbridgeable liquidity crisis."⁹³ Bankers are well aware of the similarities between the debt situation today and the defaults of the depression era, when every Latin-American country except Argentina and Haiti defaulted on its external debt.⁹⁴

88. There are, of course, economic factors which deter the major banks from taking such actions. See discussion of banking aspects, *supra*, pp. 71-73.

89. See *supra* note 17.

90. Although the outstanding balance in *Libra* exceeded \$30 million, plaintiffs succeeded in attaching only \$800,000 from Costa Rican bank accounts in New York City. There is evidence that Costa Rica removed at least \$2.5 million from U.S. bank accounts in order to avoid attachment. 570 F. Supp. at 874-75.

91. Brief for Appellee, *supra* note 11, at 65.

92. A cross-default clause usually provides that the loan containing the clause shall be in default if the borrower defaults on any of its other loans, including those from other creditors. Mendez, *supra* note 55, at 193-94.

93. D. DIMANESCU. *supra* note 55, at 127.

94. *Id.* at 141-2.

D. *Inadequacy of Presidential Action*

Some commentators have noted that the President could intervene by nullifying attachments of a country's assets and suspending creditors' legal actions against a particular country as was done during the Iranian hostage crisis.⁹⁵ In *Dames & Moore v. Regan*,⁹⁶ the Supreme Court upheld the President's actions during the hostage crisis partially on the ground that they were specifically authorized by the International Emergency Economic Powers Act (IEEPA).⁹⁷ Nevertheless, there are serious flaws with a renegotiation procedure which relies on Presidential intervention as an alternative solution.

In addition, the IEEPA can only be invoked when a national emergency already exists.⁹⁸ In the context of the debt crisis, this means that the President may have to wait until a major banking crisis has already begun. His actions, therefore, would be ipso facto futile. Moreover, if the President declares a national emergency for IEEPA purposes before a major crisis actually occurs,⁹⁹ then such a declaration may unintentionally hasten a crisis by undermining the public's confidence in the banks.

Presidential intervention under the IEEPA is simply not an appropriate way to deal with the LDC debt problem. The potential

95. In order to facilitate negotiations with Iran, President Carter suspended all actions of creditors against Iran and nullified all attachments of Iranian assets located in the United States. See generally Swan, *Reflections on Dames & Moore v. Regan and the Miami Conference*, 13 LAW. AM. 1 (1981) (for a more detailed discussion of the President's actions during the hostage crisis).

96. 453 U.S. 654 (1981).

97. 50 U.S.C. §§ 1701-06 (1978). The Court held that the nullifying of attachments was specifically authorized by the I.E.E.P.A. The power to suspend claims, however, was gleaned from the history of Congressional acquiescence in the President's settlement of claims of U.S. nationals against foreign countries. See generally, 453 U.S. at 678-88.

98. 50 U.S.C. § 1701 provides:

a) Any authority granted to the President by section 1702 of this title may be exercised to deal with any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States, if the President declares a national emergency with respect to such a threat.

b) The authorities granted to the President by section 1702 of this title may only be exercised to deal with an unusual and extraordinary threat with respect to which a national emergency has been declared for purposes of this chapter and may not be exercised for any other purpose. Any exercise of such authorities to deal with any new threat shall be based on a new declaration of national emergency which must be with respect to such threat.

99. For example, after a serious breakdown in negotiations with a debtor nation, but before a major attempt by its creditors to attach its assets.

consequences of the problem are too grave and there are too many economic, political, and psychological uncertainties to rely on last minute solutions.

V. SUGGESTED IMPROVEMENTS

A. *Formal Procedure Needed*

Economic and political realities require a procedure for debt renegotiation that is sensitive to both the financial security of creditors and the long term economic health of debtor nations. An analysis of the respective arguments of both parties in *Allied Bank* suggests that it is possible to frame a procedure reflecting each party's major objectives.

The Costa Rican banks' argument was that the Costa Rican economy was in the midst of a serious crisis which necessitated the restrictive actions of the Government. Rather than repudiating its debts, Costa Rica insisted it was making a good faith effort to pay them. By attempting to attach Costa Rican assets, defendants claimed that Fidelity was attempting to obtain more favorable treatment than other creditors, a result that may have hindered the on-going renegotiation process.¹⁰⁰ Recognizing their obligations under the loan agreement, the defendants asserted that the extreme facts of the case merited an exception.

Fidelity, on the other hand, claimed that a Costa Rican decree could not suspend a debt payable in New York.¹⁰¹ In addition, Fidelity objected to the court's Chapter 11 analogy. It alleged that the Costa Rican decrees were "enacted without notice to or consultation with any creditors, . . . proffered no plan . . . nor any safeguards for the protection of the targeted creditors, . . . contained no time limit, . . . and . . . no procedures for creditors to be heard."¹⁰² Thus, Fidelity implied that the existence of a structured procedure with Chapter 11-type safeguards would have mitigated its objections to the Costa Rican actions.

These considerations point to the desirability of a formal renegotiation procedure that resembles a domestic bankruptcy proceeding. Although it is obvious that Chapter 11 cannot simply be

100. See Brief for Appellee, *supra* note 11, at 15; but compare Brief for Appellant, *supra* note 28, at 17-18.

101. See *supra* note 10.

102. Brief for Appellant, *supra* note 28, at 4.

internationalized in its entirety, its main goals and principles are quite appropriate in the LDC debt context. Moreover, some useful analogies to specific Chapter 11 provisions can also be made.¹⁰³

B. *Guidelines For Procedure Based On Chapter 11 Principles*

Any viable procedure should be based on the following principles: in order to avoid a major disruption of present international banking practices, the procedure must only be initiated by nations with severe economic difficulties as determined by a fairly objective formula; the procedure should be efficient and expeditious; high priority should be placed on the long term economic growth and political stability of the debtor nation; creditors should be treated reasonably and equitably; and, ideally, there should be a neutral international entity with the authority to supervise the negotiations and enforce these principles.

1. Initiation of Procedures

When the Costa Rican officials called the first meeting with their country's commercial creditors in June, 1981, to ask for debt relief, the atmosphere was one of distrust and confusion.¹⁰⁴ The Costa Ricans advised the lenders that they were experiencing a critical currency shortage. The banks, however, were unwilling to accept the asserted severity of the problem. They asked for detailed economic data to confirm the situation, but the Costa Ricans could not provide it. Serious negotiations were not resumed for several months Costa Rica's credit deteriorated further and its currency shortage worsened.

The resulting delay and confusion in convincing creditors that debts could not be paid as scheduled, served only to postpone the remedy while the patient's illness steadily worsened. An effective international renegotiation system would facilitate the availability of economic data and utilize a fairly objective formula for accepting a debtor nation's petition.¹⁰⁵

The IMF is presently in the best position to provide detailed

103. See Note, *supra* note 75, at 332-38.

104. For a detailed account of these negotiations, see *Step by Step Through the Costa Rica Saga*, EUROMONEY, August 1982, at 33.

105. Under Chapter 11, creditors may also file petitions. See 11 U.S.C. § 303 (1979).

economic information concerning a debtor country's ability to pay its foreign debt. Its access to confidential financial data makes it ideal for this role.¹⁰⁶

Chapter 11 does not require a specific showing of insolvency in order for the debtor's petition to be accepted.¹⁰⁷ In contrast, such a showing is desirable in the external debt context. A lender's willingness to provide crucial loans to LDCs is undermined if the debtor nations initiate formal reorganization proceedings at the slightest sign of financial trouble.

Creditors should be required to submit to a renegotiation procedure only upon a debtor nation's showing of "insolvency" as determined by an objective formula. Such a formula could be based on, *inter alia*, the ratio of a country's external debt to its export earnings.¹⁰⁸

2. Procedure Should be Efficient and Expeditious

Another key factor of the procedure should be the avoidance of delays that make economic planning by LDC governments more difficult. An efficient and expeditious procedure would also benefit creditors. Swift and effective renegotiation would heighten public confidence in the financial stability of the banks.¹⁰⁹ The first and most important step toward that end should be the inclusion of all creditors, official and private, in one renegotiation process.¹¹⁰ A creditor's committee, such as that provided for in Chapter 11,¹¹¹ would be appropriate in this context. The committee could supervise and investigate the debtor's economic progress as well as re-

106. See F. SOUTHARD, *supra* note 79.

107. See ANDERSON, CHAPTER 11 REORGANIZATIONS § 3.02 (1983).

108. A similar formula has been suggested for limiting annual lending to particular countries. Lending limitations would mitigate overexposure by banks in a particular country or region but it would be unwelcome by LDCs in times of strong economic growth. See D. DIMANCESCU, *supra* note 55, at 130. See also Cohen, *supra* note 55, at 225-35 (suggesting a system of country exposure limits).

109. Nevertheless, efficiency must not be obtained at the cost of equity. U.S. bankruptcy law recognizes that "the equity tradition complicates the struggle for efficiency." NELSON, CORPORATIONS IN CRISIS 24-25 (1983).

110. See Note, *supra* note 72, at 329.

111. 11 U.S.C. § 1102(a)(1) (1979) requires the appointment of a creditors committee in every Chapter 11 proceeding. 11 U.S.C. § 1102(b)(1) (1979) provides that the seven creditors with the largest unsecured claims will be on the committee if they so desire (secured creditors would presumably be given priority in the international, as well as the domestic, context).

present creditors in the formulation of a restructuring plan.¹¹²

A neutral study group, composed of experts in international economics and banking, could also be formed to investigate the debtor nation's financial situation and make suggestions to the creditor's committee. Such a group was used with some success in the Costa Rican renegotiation.¹¹³

3. Long-Term Focus of Renegotiation

New renegotiation guidelines should take into consideration that it is in the best interests of all parties to have a productive Third World. The importance of political stability in fragile democracies, especially those in Latin America, must be given high priority when considering the imposition of strict austerity measures. "It is better, common sense has taught us over the centuries, to have a productive member of a community than one punished and banished from further social or economic intercourse."¹¹⁴

LDCs have often complained that the terms of recent renegotiations focus too much on the creditor bank's short-term profits and not enough on the long term health of the debtor nations.¹¹⁵ Chapter 11 recognizes the need for long-term solutions to debtor problems by specifically requiring that a plan must propose long range solutions in order to be confirmed.¹¹⁶

4. Fair and Equitable Treatment of Creditors

Perhaps the most important factors considered by U.S. bankruptcy courts are that creditors in general be treated fairly and that similarly situated creditors be treated similarly. Such considerations are even more important in the international context where there is a greater variety of interests involved.

112. See 11 U.S.C. § 1103(c) (1979) for a description of the powers of the creditors committee in Chapter 11 cases.

113. See EUROMONEY, *supra* note 104, at 40-45.

114. D. DIMANCESCU, *supra* note 55, at 16.

115. See Riding, *supra* note 83.

116. 27 U.S.C. § 1129 (1979) provides:

(a) The Court shall confirm a plan only if all of the following requirements are met: . . .

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

In this regard, creditors could be classified according to the nature and/or amount of their claims.¹¹⁷ Voting rules for approving an agreement similar to those of Chapter 11, including class voting rules, could also be adopted.¹¹⁸

Protection of a dissenting minority of creditors must be a key function of a renegotiation system. Section 304 of the U.S. Bankruptcy Code provides for the commencement of cases ancillary to foreign bankruptcy proceedings.¹¹⁹ It authorizes U.S. bankruptcy courts to protect a foreign debtor's assets in this country against creditor suits and attachments if, *inter alia*, such action is consistent with "just treatment of all holders of claims against or interests in such estate; . . . protection of claimholders in the United States against prejudice and inconvenience . . . ; (and) prevention of preferential or fraudulent dispositions of such estate. . . ."¹²⁰ Although this section does not apply to sovereign debtors, these principles are equally appropriate in the sovereign debt context.

Appellants argued that the facts in *Allied Bank* were analogous to a Chapter 11 "cramdown",¹²¹ but without the accompanying "elaborate procedural safeguards to protect the interests of minority creditors."¹²² "Cramdown" refers to the procedure by which a bankruptcy court may confirm a reorganization plan even though it has been rejected by one or more impaired classes.¹²³ The court may confirm the plan only if it "does not discriminate unfairly, and is fair and equitable" with respect to each impaired class that has rejected the plan.¹²⁴

117. 11 U.S.C. § 1122(a) (1979) provides that a claim may be placed in a particular class only if it is "substantially similar" to the other claims in the class.

118. The present custom in external debt renegotiation is to require a higher degree of creditor consent than is required by Chapter 11. See *supra* note 19 and accompanying text. But compare 11 U.S.C. § 126(c) (1979), which requires the consent of only two-thirds in dollar amount of the claims in a class to constitute class approval. However, there is also a requirement for the approval of a majority in number of creditors in a class.

119. See 11 U.S.C. § 304 (1979); see generally 2 Collier on Bankruptcy ¶ 304 (15th ed. 1984).

120. *Id.*

121. See 11 U.S.C. § 1129(b)(1) (1979).

122. Brief for U.S. Government, *supra* note 34, at 13, n. 9. The analogy to a "cramdown" is questionable since the holders of over 98 percent of the claims accepted the plan.

123. See 11 U.S.C. § 1124 (1979) (for a definition of impairment).

124. 11 U.S.C. § 1129(b)(1) (1979). See generally Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 BUS. LAW 441 (1984); Klee, *All You Ever Wanted to Know About Cram Down Under the Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979).

The "fair and equitable" standard does not apply in Chapter 11 cases where all impaired classes accept the plan¹²⁵ (i.e., where there are dissenting creditors in a class which accepts the plan).¹²⁶ This distinction, however, need not be made in the international context if deemed inappropriate. The "fair and equitable" standard could then be used even where there is only one dissenting creditor.

Some type of international judicial entity would be the ideal mechanism to enforce this standard and the other general principles mentioned above. The U.S. Government's brief in *Allied Bank II* noted that "no procedures exist to assure that minority creditors could petition an *impartial third party* any time they considered their interests were not adequately protected."¹²⁷ (emphasis added).

VI. ENFORCEMENT MECHANISM

A. *International Tribunal*

The ideal mechanism for the promotion of the previously discussed principles is an international tribunal. Dissenting creditors or debtor nations complaining of particularly harsh renegotiation terms could then bring their objections before the tribunal. Every major creditor nation should participate in the creation of the tribunal. Its function would be to either confirm the renegotiation plan or require changes in it.

Although there are several existing international arbitration formats,¹²⁸ an agreement creating a new format designed specifically for this purpose would avoid several problems. First, no major Latin American debtor has signed the convention creating the International Center for Settlement of Investment Disputes (IC-

125. "Apparently the drafters intended that a Chapter 11 plan could discriminate unfairly among various classes of claims, so long as all classes vote in favor of the plan." Broude, *supra* note 124 at 444.

126. This situation actually comes closer to describing the *Allied Bank* case than does the cramdown analogy. Use of cramdown procedures are not common and would probably entail a lesser degree of unanimity than the 98% vote in favor of the Costa Rican agreement in *Allied Bank*. See *id.* at 441; 11 U.S.C. § 1129.

127. Brief for U.S. Government, *supra* note 34, at 14, n. 9.

128. For detailed discussion and analysis of the existing international arbitration formats see WETTER, *THE INTERNATIONAL ARBITRAL PROCESS PUBLIC AND PRIVATE* (1979); J.G. MERRILLS, *INTERNATIONAL DISPUTE SETTLEMENT* 70-89 (1984); J. CHERIAN, *INVESTMENT CONTRACTS AND ARBITRATION* (1975).

SID).¹²⁹ In addition, many LDCs have biases against the other major arbitral organizations.¹³⁰ Second, the external debt renegotiation process requires continuous oversight and investigation by experts in international finance and economics. Finally, it would be easier to designate the desired substantive law guidelines in a new specialized format created specifically for this situation.

An arbitral tribunal could be formed under the auspices of the IMF,¹³¹ thus keeping a close link between the information gathering mechanism and the enforcement mechanism. Nevertheless, the tribunal should have complete autonomy in the decision making process. The administration of ICSID and its relationship to the World Bank could be a useful guide.¹³²

The selection of arbitrators is a very important step. It determines the amount of trust the parties will have in the tribunal. In the typical tribunal, both sides appoint an equal number of arbitrators who then select the remaining "neutral" arbitrators.¹³³ It would be more efficient to appoint a pool of permanent arbitrators¹³⁴ than to select members on a case by case basis. Each side could be allowed to select one-third of the arbitrators who will preside over their case from the pool. This process would minimize the parties' objections concerning the biases of arbitrators. These arbitrators could then select the remaining one-third. Although permanent arbitrators could be named in the initial agreement, it would be better to establish a procedure for their selection. A similar procedure was utilized in the creation of the Iran-United States Claims Tribunal.¹³⁵

Arbitration, whether between states or individuals, is contractual in nature.¹³⁶ A consensual agreement between debtor and

129. See 17 I.C.S.I.D. ANN. REP. 6-7 (1982-83).

130. See J. CHERIAN, *supra* note 128, at 47-62.

131. This is wholly consistent with the purposes of the IMF. See Articles of Agreement of the IMF, *supra* note 61, art. I.

132. See generally J. CHERIAN, *supra* note 128, at 65-74; SZASZ, *The Investment Dispute Convention Opportunities and Pitfalls*, V J.L. & ECON. DEV. 1 (1970).

133. See, e.g., J.G. MERRILLS, *supra* note 128, at 73; Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran, January 19, 1981, art. III, para. 1, 1 IRAN-U.S. C.T.R. 7 (1981-82) [hereinafter cited as Iran-U.S. Claims Tribunal Agreement].

134. See Iran-U.S. Claims Tribunal Agreement, *supra* note 133.

135. *Id.*

136. See WETTER, *supra* note 128, at Vol. I, 5.

creditor nations¹³⁷ whereby the parties submit to permanent jurisdiction is preferable to determining jurisdiction on a case by case basis. Such an agreement would be easier to obtain by setting narrow and clearly defined limits on the subject matter jurisdiction of the tribunal and on the substantive law which it must apply. The subject matter jurisdiction of the tribunal¹³⁸ should be limited to questions regarding the legitimacy of the debtor's asserted need for renegotiation,¹³⁹ questions having a direct bearing on the confirmation of the particular plan, and questions referred to the tribunal by the parties.¹⁴⁰

Choice of law questions frequently cause significant disagreement in international arbitrations. Tribunals often look to international law or equity as a basis for their decisions.¹⁴¹ In the external debt context, however, the applicable substantive law must be limited to clearly defined principles such as the bankruptcy reorganization principles discussed in this Comment.

Framing the substantive law guidelines of a tribunal with reference to U.S. bankruptcy law would be consistent with the fact that "reference to municipal law is . . . particularly common" in international commercial arbitration.¹⁴² Perhaps it would be more practical, however, to borrow guidelines from the bankruptcy laws of the various nations involved. In either case, the substantive law guidelines should be spelled out in the charter of the tribunal, limiting the interpretive powers of the arbitrators as much as is practicable.

The degree to which an arbitral decision binds the parties is determined mainly by the terms of the agreement, but partly by general principles of international law. Each party generally agrees to be bound by the decision, as long as it is within the tribunal's jurisdiction.

Nevertheless, "there is no way . . . of getting finality by action of the arbitrators."¹⁴³ Courts can deny effect to an arbitral award

137. Jurisdiction over private creditors is discussed *infra* at pp. 26-28.

138. For a discussion of jurisdiction in international arbitration see WETTER, *supra* note 128, at Vol. II, 287-92; J.G. MERRILLS, *supra* note 128, at 76.

139. The tribunal should have the authority to decide if the requirements for initiating the formal renegotiation procedure has been met. See *supra* note 105 and accompanying text.

140. See J.G. MERRILLS, *supra* note 128, at 77.

141. See WETTER, *supra* note 128, at Vol. II, 298-99.

142. J.G. MERRILLS, *supra* note 128, at 79.

143. Statement of Dean Soia Mentschikoff regarding the Iran-U.S. Claims Tribunal,

if, *inter alia*,¹⁴⁴ the tribunal exceeds its jurisdiction or violates some fundamental principle of judicial procedure.¹⁴⁵ This poses the constant threat that a resourceful party can challenge almost any arbitral award.

B. *Role of U.S. Courts*

1. If Tribunal is Created

It will likely be easier to obtain consent for binding arbitration from the nations involved than from private creditors. It is therefore necessary to examine the role U.S. courts must assume when a private creditor chooses to sue in a U.S. court rather than abide by a renegotiation plan that has been confirmed by the tribunal.

If the dissenting creditor has submitted itself to the arbitration and lost, then it is bound by the decision and the court can generally give no relief. The creditor's only remedy would be to challenge the decision as a nullity. On the other hand, if the dissenting creditor sues without first submitting to arbitration, the legal implications are very different. The President could agree, by prior agreement or treaty, to suspend creditors' claims against a particular country upon the initiation of the arbitration procedure.¹⁴⁶ Dissenting creditors would thereby be induced to seek relief from the tribunal. Relief could then be obtained by showing that the renegotiation agreement treated the creditors prejudicially or unreasonably.¹⁴⁷

The question of presidential power arises when such action is initiated by executive agreement. The argument could be made that, as in the Iranian hostage situation, creditors have been provided with "an alternative forum . . . which is capable of providing meaningful relief."¹⁴⁸ It should be noted, however, that the *Dames & Moore* Court expressly refused to rule that the President has a plenary power to settle claims, even those against foreign govern-

Transcript of the Conference on the Settlement with Iran Held at the University of Miami School of Law, 13 LAW. AM. 1, 39 (1981). This statement refers to the doctrine of nullity. For more information, see generally WETTER, *supra* note 128, at Vol. III, 187-214; J.G. MERRILLS, *supra* note 128, at 84; REISMAN, NULLITY AND REVISION (1971).

144. See WETTER, *supra* note 128.

145. See J.G. MERRILLS, *supra* note 128, at 84-86.

146. See discussion of initiation of renegotiation procedure, *supra* pp. 78-79.

147. See *supra* pp. 80-81.

148. 453 U.S. at 687.

ments.¹⁴⁹ If suspension of claims is agreed to by a treaty and is approved by the Senate, then the question of presidential authority does not arise.¹⁵⁰

The other creditor nations would have to use similar methods, in accordance with their own laws, to preclude their courts from adjudicating a case which has been accepted by the international tribunal. To ensure equitable treatment of creditors, all creditors must be denied the traditional legal remedies.

2. If Tribunal is not Created

Until a formal renegotiation procedure is created, U.S. courts have three alternative ways of dealing with cases such as *Allied Bank*. First, they can simply rely on the doctrine of *pacta sunt servanda*¹⁵¹ and allow creditors to attach the assets of the debtor in an attempt to satisfy the debt. This was the result in *Allied Bank II*. The practical and political problems of such an inflexible approach have already been addressed.¹⁵² Second, the courts can refuse to scrutinize the acts of the foreign nation as was done in *Allied Bank I*.¹⁵³ However, this gives Chapter 11-type protection to the debtor without providing corresponding safeguards to the creditors.¹⁵⁴ If deference is given to the acts of other nations because they are consistent with U.S. law as manifested in Chapter 11, then the court should go a step further and inquire into the treatment of the dissenting creditor.

149. *Id.* at 688.

150. *Dames & Moore* dealt only with Executive actions. Nevertheless, even under a treaty such suspensions may run afoul of the taking clause of the fifth amendment. U.S. CONST. amend. V.

Dames & Moore did not decide whether the suspension of claims constituted a "taking" because of lack of ripeness. 453 U.S. at 688, n. 14. However, the Court did rule that petitioners could bring an action in the United States Court of Claims under the Tucker Act. 28 U.S.C. § 1491 (Supp. III 1979).

151. *Pacta sunt servanda* is the policy which dictates that contracts and treaties should be binding on the parties and courts should give effect to the reasonable expectations that arise from such agreements.

152. See *supra* pp. 78-79.

153. Note that the result in *Allied Bank II* depends on U.S. foreign and economic policies, which are subject to change and interpretation. See *supra* note 50 and accompanying text. Thus, *Allied Bank II* could be cited in a future case to support an opposite result. For example, if a case were to arise under circumstances which indicated a strong possibility of a run on a country's assets, a court may find that in that particular case U.S. policy would support the debtor nation.

154. See objections of Fidelity, *supra* note 102 and accompanying text.

Because consistency with U.S. law is one of the requirements for respecting an extraterritorial taking, a dissenting creditor such as Fidelity should have a remedy if it can show that it was prejudiced in a way that made the renegotiation inconsistent with Chapter 11 principles. If after such an inquiry it is found that the creditor was treated properly, then there would be a stronger basis for respecting the foreign sovereign's actions.

This points to the third, and previously unexplored, judicial alternative in an *Allied Bank* scenario. The courts could allow a foreign debtor to proffer the acts of its government as a defense under circumstances similar to those in *Allied Bank*. The courts, however, could frame the characteristics and conditions of the defense in a manner which incorporates the Chapter 11-type policies previously discussed. This would require that the courts conduct extensive inquiry into the handling of the renegotiation process in each case. Essentially, federal courts would perform functions similar to some of those performed by bankruptcy courts in the domestic context.

As a starting point, the courts should require a showing of "national insolvency" before the defense can be asserted. Courts could establish specific standards, perhaps even a formula,¹⁵⁵ to assist in this initial determination.

Once the defense is allowed, the courts could set conditions and limitations on its use to ensure consistency with Chapter 11-type principles. Rather than allow an absolute defense to a creditor suit as was done in *Allied Bank I*, the court would retain jurisdiction until the renegotiation is completed. The defense would be subject to attack by dissenting creditors if, at any time during the renegotiation, the conditions of the defense are breached. Thus, the creditor in an *Allied Bank* situation is precluded from obtaining a legal remedy unless it can show that it was treated in a manner that violates Chapter 11 principles. For example, a creditor should have a remedy if it can show unfair or discriminatory treatment.¹⁵⁶

There is authority to support the creation of such a body of law by the federal courts. Although there is no "federal general

155. See *supra* note 105 and accompanying text.

156. See *supra* pp. 80-81 (for a discussion of Chapter 11 standards for protecting creditors). In particular, see the discussion of the standards under Section 304, *supra* notes 119 and 120, and accompanying text.

common law,"¹⁵⁷ it is widely recognized that there exist areas of "special" federal common law.¹⁵⁸ One of the most important areas in which federal common law is applied is in those cases dealing with international issues.¹⁵⁹

In *Banco Nacional de Cuba v. Sabbatino*,¹⁶⁰ the Supreme Court invoked the act of state doctrine in refusing to inquire into the validity of a seizure by the Cuban Government of assets in Cuba owned by U.S. citizens. In so doing, the Court recognized that "[p]rinciples formulated by federal judicial law have been thought by this Court to be necessary to protect uniquely federal interests."¹⁶¹

In essence, the Court of Appeals for the Second Circuit, in *Allied Bank I*, was espousing federal common law when it cited Chapter 11 to support its decision. Federal courts could go a step further and create a body of law that more accurately reflects Chapter 11 principles.

There are significant limitations, however, to this type of judicial solution. A crucial aspect of Chapter 11 law is that all creditors are bound by the decisions of the bankruptcy court. In the external debt context, however, it would be very difficult for a U.S. court to join all of a debtor nation's creditors in one action.¹⁶² These creditors are usually dispersed throughout the globe and it would be impossible to obtain jurisdiction over all of them. Even if it were possible to do so, each separate loan transaction would require a different choice of law determination. In addition, it would be difficult for courts of one nation to affect the legal status of a debtor's assets located in another nation.¹⁶³

Accordingly, an active role by U.S. courts would involve a piecemeal solution and could only be partially effective. Nevertheless, it may be preferable in some cases to use an *Allied Bank I*

157. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938).

158. See generally WRIGHT, *THE LAW OF FEDERAL COURTS* 387-97(4th ed. 1983).

159. See JESSUP, *The Doctrine of Erie Railroad v. Tompkins Applied to International Law*, 33 AM. J. INT'L L. 740 (1939).

160. 376 U.S. 398 (1964).

161. *Id.* at 426.

162. See Fed. R. Civ. P. 20(a) (1981).

163. There were similar jurisdictional problems during the early stages of American bankruptcy law. "The main inadequacy of the state insolvency laws . . . was the inability to give a discharge which would be effective in other states." 1 COLLIER ON BANKRUPTCY ¶ 0.03 (14th ed. 1976). This led to the establishment of a federal bankruptcy system which transcended jurisdictional boundaries.

type of rationale than to mechanically apply *pacta sunt servanda* without considering economic and political realities.

In the ultimate analysis, a solution on the international level is needed. It is noteworthy, however, that a large part of U.S. bankruptcy law was originally common law doctrine, formulated by courts long before it was embodied into statutes. Similarly, a federal judicial body of law could be the predecessor of, and lay the groundwork for, an international solution of the type suggested in this Comment.

VII. CONCLUSION

The international debt crisis is presently one of the most significant threats to the economic welfare of the world and, ultimately, to world peace. Every person from Sao Paulo to Tokyo to New York would be affected by a "worst case" scenario. Executives of the world's largest financial institutions are far more worried about the vulnerability of the international banking system than they can publicly acknowledge.

Aside from the possibility of disastrous defaults, the manner in which banks and governments attempt to deal with the ongoing debt crisis may influence economic and political events in many significant ways. In debtor countries, the economic effects of austerity provide fertile soil for the birth of political upheaval. On the other hand, failure by LDCs to take serious steps toward economic self-discipline would discourage further lending, and thereby cripple their economies. Somewhere between these equally undesirable alternatives lies the desired balance. The ultimate question is whether that precarious balance can be long maintained by an ad hoc renegotiation process dominated mainly by self-interested parties.

It is unclear whether the major hurdles of the most recent crisis have been overcome through this ad hoc process. Nevertheless, as is the case with all types of refinancing, it is impossible to know whether the day of reckoning has been completely avoided or merely deferred.¹⁶⁴ Moreover, the general problems of Third World

164. The World Bank now predicts that developing countries are entering another critical stage of the ongoing debt crisis. Approximately two-thirds of Third World debt will come due within the next five years. World Bank President, A.W. Clausen, recently stated that "[i]n the next five years about 60% of the debt of the developing countries will need to be rolled over or amortized." Seaberry, *Debt Crisis Takes Turn for Worse*, The Miami Her-

debt will continue as long as there are less developed countries in need of outside financing to support their efforts to become developed countries. Thus, the need for restructuring LDC debt from time to time, as nations move from periods of growth to periods of recession, is likely to continue into the foreseeable future.

In the domestic setting, the Chapter 11 framework has been successful in balancing the interests of debtors and creditors whose goals are very similar to those of their counterparts in the international context. The most important feature of the Chapter 11 scheme is that it seeks to restore the debtor to a position of economic productivity. It imposes the need for broad, long term considerations upon creditors in a situation where their natural instincts would otherwise lead them to think in terms of narrow, short term solutions.

Although the task would be difficult, it is possible to create an international entity to enforce Chapter 11-type principles in cases of extreme external debt difficulties. The Second Circuit's decision in *Allied Bank I* lends support to the need for such a system. In addition, both the U.S. Government and U.S. banks have cited the lack of Chapter 11-type safeguards as one of their main objections to the *Allied Bank I* result. In the absence of such a system, federal courts should give effect to sovereign debt moratoria when exigencies require it and when doing so would be consistent with Chapter 11 principles.

History has taught us that unfettered economic interaction between self-interested parties does not always lead to the enhancement of the public welfare. Because the fortunes of the players in the international setting are so interrelated and the consequences of failure so staggering, there is a greater need for cooperative action now than there ever was in the domestic area. It is time to initiate a formal procedure for external debt renegotiation that will help find solutions to the debt crisis and, at the same time, ensure that the solutions to today's economic crises do not become the causes of tomorrow's political crises.

Ruben Sklar