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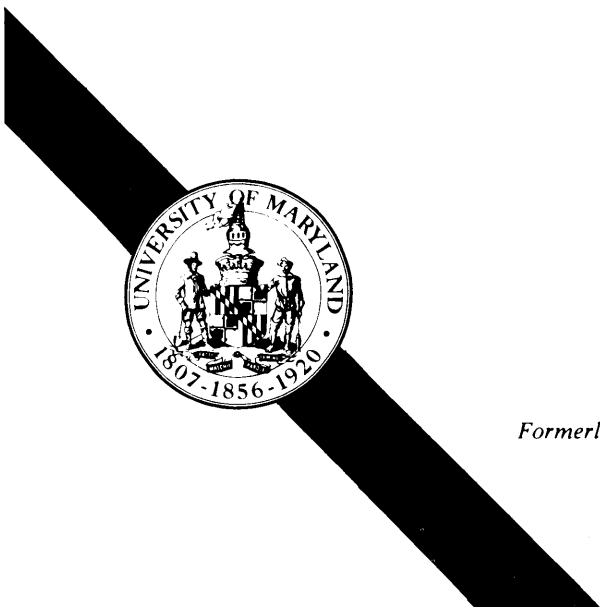
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COMITY AND SOVEREIGN DEBT LITIGATION: A BANKRUPTCY ANALOGY

Stephen Bainbridge



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COMITY AND SOVEREIGN DEBT LITIGATION: A BANKRUPTCY ANALOGY

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I. INTRODUCTION

During the 1970s private commercial banks dramatically ex-

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panded their international lending operations.[1] A significant percentage of these loans were made to sovereign borrowers, particularly to the less developed countries of Latin America.[2] By the mid-1980s loans to non-oil-exporting developing countries[3] (NODCs) comprised a significant percentage of many commercial banks' loan portfolios. In 1982, for example, the nine largest U.S. banks held NODC loans totalling 10.6 percent of their total assets and 222 percent of their total capital.[4] During the 1970s these loans had been extremely profitable, and for many U.S. banks in this period international loans accounted for half or more of annual earnings.[5] By 1979, however, the culminating effects of policy errors, rising oil prices, world-wide recession, declining prices for NODC exports, and high interest rates made it increasingly difficult for many NODCs to service their external debt.[6] As a result, many NODCs faced default and began rescheduling negotiations with the banks.[7]

This "debt crisis" produced a flood of popular[8] and academic[9]

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1. Reisner, *Default by Foreign Sovereign Debtors: An Introductory Perspective* 1982 U. ILL. L. REV. 2, 1-2 (between 1970 and 1981 international loans by U.S. banks increased from 50 billion dollars to over 400 billion dollars).

2. *Approximate Latin American Indebtedness in 1985*

(billions of dollars)

Country	Total Debt	Public Sector	Private Sector
Brazil	100.0	62.0	38.0
Mexico	94.0	76.0	18.0
Argentina	43.5	29.6	13.9
Venezuela	34.0	28.0	6.0
Chile	21.0	7.0	14.0
Peru	12.4	10.5	1.9
Colombia	10.5	6.7	3.7
Bolivia	5.3	3.8	1.5
Ecuador	6.8	5.2	1.6
Uruguay	4.6	5.3	1.3

Eskridge, *Les Jeux Soun Faits: Structural Origins of the International Debt Problem*, 25 VA. J. INT'L L. 281, 282 n.2 (1985).

3. The less developed countries (LDCs) whose debt problems are particularly acute are primarily non-oil-exporting less developed countries (NODCs). *Id.* at 282.

4. *Staff of Senate Subcomm. on Foreign Economic Policy of Senate Foreign Relations Comm.*, 95th Cong., 1st Sess., International Debt, the Banks, and U.S. Foreign Policy (Comm. Print 1977).

5. Reisner, *supra* note 1, at 4.

6. *See infra* notes 21-52 and accompanying text.

7. In 1983 alone, 30 NODCs completed or were engaged in debt renegotiations. *See* 13 IMF SURVEY 178 (June 18, 1984).

8. *See, e.g.*, N.Y. Times, Sept. 23, 1984, §3, at 1; Wash. Post, Aug. 29, 1984, at D8; N.Y. Times, Aug. 21, 1982, at D1, col. 6.

9. *See, e.g.*,T. ENDERS & R. MATTIONE, LATIN AMERICA: THE CRISIS OF DEBT

literature and government studies.[10] Interestingly enough, however, it has produced remarkably little litigation.[11] Commercial banks have been extremely reluctant to declare a NODC in default, and instead have almost uniformly agreed to restructure their loans.[12]

This willingness of the banks to restructure rather than litigate over a default is curious, but can be explained through an application of games theory to the problem. A variant of the classic games theory prisoner's dilemma, termed the creditors' dilemma, demonstrates that although creditors have strong incentives to begin collection action against a defaulting debtor rather than to renegotiate, such action produces the worst collective result.[13]

In domestic debtor-creditor relations, U.S. bankruptcy law provides an efficient escape from the creditors' dilemma.[14] In the international lending system, the NODC creditors' dilemma has thus far been avoided through a combination of economic incentives and powerful *ad hoc* political pressures; a costly and uncertain procedure that has

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AND GROWTH (1984); A DANCE ALONG THE PRECIPICE, (W. Eskridge ed. 1985); Brock, *Trade and Debt: The Vital Linkage*, 62 FOREIGN AFF. 1037 (1984); Eskridge, *supra* note 2; Kuczynski, *Latin American Debt*, 61 FOREIGN AFF. 344 (1982); Roett, *Democracy and Debt in South America: A Continent's Dilemma*, 67 FOREIGN AFF. 695 (1984); *Symposium: International Lending: The Case for Developing Nations*, VAND. J. TRANSNAT'L L. 551 (1974); *Symposium: Default by Foreign Government Debtors*, 1982 U. ILL. L. REV. 1; Solomon, *Developing Nations and Commercial Banks: The New Dependency*, 12 J. INT'L L. & ECON. 325 (1978).

10. *See, e.g.*, International Monetary Fund, Survey of Multilateral Debt Renegotiations Undertaken within the Framework of Creditor Clubs, I.M.F. Doc. No. Sm/80/174 (1980) [hereinafter cited as IMF Renegotiation Survey]; Staff of Senate Subcomm. on Foreign Economic Policy of Senate Foreign Relations Comm., *supra*, note 4; UNCTAD, Selected Issues Related to the Establishment of Common Norms in Future Debt Renegotiations, U.N. Doc. TD/AC.2/9 (1977).

11. The only significant exceptions are Allied Bank International v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440 (S.D.N.Y. 1983) [hereinafter cited as *Allied Bank*], *aff'd*, No. 83-7714 slip op. (2d Cir. Apr. 23, 1984) (per curiam) [hereinafter cited as *Allied Bank I, reprinted in* the Appendix immediately following this article], *rev'd on rehearing*, 757 F.2d 516 (2d Cir. 1985) [hereinafter cited as *Allied Bank II*] and Libra Bank Ltd. v. Banco National de Costa Rica, 570 F. Supp. 870 (S.D.N.Y. 1983) both of which arose out of the Costa Rican moratorium on foreign debt payments in 1981.

The Costa Rican decisions failed to resolve many of the important issues involved in NODC debt litigation. Nevertheless the controversy is a useful case study of the role of comity in NODC debt litigation. "The story of Costa Rica's rescheduling may one day become a case study for banking schools." *Step By Step Through the Costa Rican Saga*, EUROMONEY, Aug. 1982, at 33 [hereinafter cited as *Step by Step*].

12. IMF Renegotiation Survey, *supra* note 10, at 4.

13. *See infra* notes 76-83 and accompanying text.

14. *See infra* notes 76-83 and accompanying text.

worked in the short-term but is unsatisfactory as a long-term solution to a problem that is likely to reoccur.[15] A less costly and more certain method of avoiding the creditors' dilemma is urgently needed.

Unlike a domestic U.S. debtor who may resort to formal bankruptcy procedures upon default, a NODC facing default has no analogous procedure available for the initiation of renegotiations. The NODC must signal its difficulty to its creditors by promulgation of a debt moratorium temporarily suspending payment of its obligations to private lenders and requesting prompt renegotiation of its external debt. Adoption of a moratorium usually constitutes an event of default, and the resulting nonpayment is always a default. Should the NODC's creditors attempt to collect on the loans through litigation in U.S. courts, the NODC may plead the moratorium as a defense under the act of state or comity doctrines. Under current U.S. law neither doctrine necessarily protects a NODC from enforcement of its loans.[16]

This article argues that giving effect to a debt moratorium through comity is the only effective method of avoiding the creditors' dilemma and the resulting financial disaster that would befall both the NODC and its creditors if each creditor pursued an individual course of action. Moreover, the article argues that the NODC's creditors would — in the absence of the dilemma — agree *ex ante* to give effect to a moratorium. Of course, this does not mean that all moratoria should be enforced. A moratorium which is either repudiatory in effect or treats some creditors preferentially would not be acceptable to commercial banks, nor would it be consistent with U.S. policy.[17] A test to determine when to give effect to a debt moratorium is therefore necessary, since not all moratoria will meet the standards required by comity.[18]

Courts have had difficulty giving content to the comity doctrine because there are few clear guidelines as to when courts should give effect to foreign law.[19] This article proposes that sections 304 and 305 of the United States Bankruptcy Code[20] provide a test by analogy for the recognition of foreign debt moratorium laws. Part II briefly traces the origin of the NODC debt problems. Part III examines the debt restructuring process and applies the creditors' dilemma to NODC debt. Part IV sets forth a policy rationale and a test for granting comity to debt moratoria and uses the Costa Rica restructuring as a case

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15. *See infra* notes 106-08 and accompanying text.

16. *See Allied Bank II*, 757 F.2d 516; *see also, infra* notes 129, 171 and accompanying text.

17. *See infra* notes 118-25 and accompanying text.

18. *See infra* notes 126-32 and accompanying text.

19. *See infra* notes 120-32 and accompanying text.

20. 11 U.S.C. §§304-05 (1982).

study of its operation.

II. An Overview of the Sovereign Debt Problem

Although a variety of explanations for the NODC debt crisis have been advanced,[21] the most commonly accepted theory seems to be the "external shocks" hypothesis.[22] Under this view, the world-wide recession, high interest rates, declining prices for NODC exports, and especially the rapid rise in oil prices were the principal reasons for the shortage of currency and the debt crisis in the NODCs in the early 1980s. These external "shocks," however, are not fully explanatory. Similar effects were felt during the recession and oil price increases of 1973-74 but without the number of near defaults of 1979-82. Some additional factor is therefore necessary to explain the current crisis.

A growing body of evidence suggests that both the NODCs and their creditors made serious errors in responding to the external shocks of the 1970s and that these errors were at least as important in inducing the crisis as these shocks themselves.[23] The most important of the external shocks under this analysis was the dramatic increases in oil prices in both 1973 and 1979. In 1973 oil imports made up six percent of the value of total NODC imports, but by 1980 they constituted twenty percent of the total.[24] After adjusting for inflation, the NODCs paid out an additional 260 billion dollars to finance the rising cost of oil imports.[25] As a result, they faced substantial trade deficits.[26]

The NODCs could have responded to the problem in a variety of ways, by either curtailing non-oil-imports, adopting austere fiscal and monetary policies, increasing exports, encouraging additional foreign investment, or borrowing from foreign lenders. Although some NODCs chose a combination of the above responses in an attempt to address the underlying balance of payments problem, many NODCs — particularly the Latin American nations — relied principally on external borrowing from commercial lenders.[27] As a result, even allowing for infla-

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21. *See generally*, Eskridge, *supra* note 2.

22. *See, e.g., id.* at 281; Tapia, *Mexico's Debt Restructuring: The Evolving Solution*, 23 Colum. J. Transnat'l L. 1, 3-4 (1984); 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, 316-20 (1981).

23. W. Cline, International Debt: Systematic Risk and Policy Response 8 (1984).

24. *Id.* at 9.

25. *Id.* at 10.

26. Between 1973 and 1981 the total NODC deficit increased from 11 billion to 108 billion dollars. Eskridge, *supra* note 2, at 289.

27. Eskridge discusses the unhappy consequences of the NODCs' increase in bor-

tion, NODC external debt more than doubled,[28] as they paid their oil debts with borrowed dollars.

Historically, short-term balance of payment deficits had been financed by the International Monetary Fund (IMF).[29] The NODCs, however, were both unable and unwilling to obtain IMF financing of their oil imports, for several reasons. In comparison both to NODC needs and the amount of funds available from private creditors, the IMF's lending ability was minimal.[30] Moreover, the IMF requires borrowers to accept significant supervision of their economic policies. This "conditionality"[31] is intended to assure that the debt will be repaid and that the borrower will adopt economic policies intended generally to promote financial recovery and specifically to alleviate the underlying problems creating the balance of payments deficit.[32] Many NODCs were unwilling to accept rigorous IMF supervision and therefore looked instead to commercial lenders for their needs.[33]

Ironically, the same oil price increases that initially sent the NODCs to the banks permitted and, in fact, encouraged the banks to make these loans. The rapid price rise gave the oil exporting countries sizable current account surpluses. Most of these "petrodollars" were deposited with the major banks in the United States and Western Europe. At the same time, the demand for credit in the developed states

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rowing from foreign lenders during this period. Eskridge, *supra* note 2, at 288-94; *see also* Note, *supra* note 22, at 318-20.

28. Without discounting for inflation, NODC debt "nearly quintupled between 1973 and 1982, increasing at an average annual rate of 19%." Eskridge, *supra* note 2, at 289.

29. *See* Robichek, *The International Monetary Fund: An Arbiter in the Debt Restructuring Process*, 23 COLUM. J. TRANSNAT'L L. 143 (1984); Note, *supra* note 22, at 309-13.

30. Note, *supra* note 22, at 311 n.33.

31. "The word conditionality refers . . . to the policies that the Fund [IMF] wishes to see a member follow in order that it can use the Fund's resources in accordance with the purposes and provisions of the Articles [of Agreement of the IMF]." J. GOLD, CONDITIONALITY 2 (1979). For example, "[u]nder Article V, Section 3(a) of the original Articles, one condition on which a member was entitled to make purchases was that 'the member desiring to purchase' the currency represents that it is presently needed for making, in that currency, payments which are consistent with the provisions of this agreement." *Id.* at 3.

32. To accomplish these goals the IMF "imposes conditionality in all public policy areas that are relevant to a country's balance of payments performance." Robichek, *supra* note 29, at 149.

33. "[M]ember countries also have delayed coming to the IMF for help with framing of adjustment programs and for its financial support of such programs while foreign banks continued to finance them liberally, and turned to the IMF only when the banks cut off further credit." *Id.* at 148.

in which the banks operated was relatively low.[34] Moreover, the banks imposed only minimal conditions on their loans.[35] Thus, the banks and the NODCs were a natural match for each other. The banks had surplus petrodollars which they wanted to lend and which the NODCs desperately wanted to borrow. The NODCs made the initial misjudgments that aggravated the crisis. They believed that their balance of payments deficits were temporary and that painful long-term solutions to their problems were therefore unnecessary. The large, low real interest rate loans offered by the banks provided an attractive short-term solution to what was thought to be a short-term problem.[36] Within the NODCs themselves, the economic actors displayed little or no awareness of the dangers that balance of payments deficits pose to developing states. Enterprises grew accustomed to borrowing abroad, the elites continued their high level of import consumption, state enterprises and projects had insufficient incentives to economize, and the current account deficit increased each year. All this fueled additional borrowing. As a result, the payments deficits were no longer temporary, and the imbalance between exports and debts continued to grow.[37]

The banks also made serious errors of judgment. The pressure on the banks to put their enormous petrodollar deposits to profitable use caused many of them to make large loans to NODCs with minimal investigation or research.[38] Many banks actually encouraged such

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34. Note, *supra* note 22, at 315-16. The recession in the United States and other developed nations in the mid-1970s was the primary cause of reduced borrowing demand. Schirano, *A Banker's Point of View*, in A DANCE ALONG THE PRECIPICE 19 (W. Eskridge, ed. 1985). For a review of this book, see *infra* at page 167.

35. The private banks' focus differs sharply from that of the IMF. Rather than focusing on the impact of loan repayment on the economy of the borrower, the private banks focus on the ability of the NODC to technically comply with the loan agreement's terms. Robichek, *supra* note 29, at 149.

36. Eskridge, *supra* note 2, at 293.

37. The oil price increases and interest rate rises of the late 1970s were the primary factors in converting the balance of payments crisis from short-term to long-term. The amount of dollars needed by NODCs for importing oil and servicing debt increased dramatically as a result. The increases simultaneously cut demand for NODC exports, plunging the balance of trade ever deeper. *Id.* at 294-96.

38. "It may be that . . . supply-side pressures were even more important than demand side pressures in explaining why so many lent so much to [NODCs]. One recent account describes the leading international bankers as 'traveling salesmen' or 'hucksters' [who lent millions] based on little more than telexes describing the deals." Eskridge, *supra* note 2, at 292. This process was known as receptionist banking. "When you went out to lunch, you could have told the receptionist to watch the telex and take $5 million of any deal." D. DELAMIDE, DEBT SHOCK: THE FULL STORY OF THE WORLD CREDIT CRISIS 44-45 (1985).

loans.[39] This lack of attention to "country risk"[40] probably resulted from the banks' assumption that "countries don't go broke,"[41] but unfortunately the banks greatly underestimated the likelihood that the NODCs would be unable to repay the loans.

The banks' emphasis on sovereign lending increased the percentage of their assets that were at risk in NODCs. The huge portfolios of NODC loans held by the major banks[42] violated the fundamental investment principle of portfolio diversification.[43] By late 1983, loans to the major NODCs represented such a large percentage of the banks' assets that a default by any single state would have put several banks

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39. D. DELAMIDE, *supra* note 38, at 43-45; Eskridge, *supra* note 2, at 293. Professor Lowenfeld makes the following observation with regard to major U.S. banks: "I gained the impression that the way for ambitious persons to move up the ladder in a major money-center bank was to make loans, and that the bigger the loan, the faster it was approved." Lowenfeld, *Foreward: International Debt Crisis Symposium*, 17 N.Y.U. J. INT'L L. & POL. 485, 486 (1985).

40. "Even though the creditworthiness of a particular foreign borrower may have been established to the bank's satisfaction, events may occur that could prevent the borrower from meeting its obligations under the terms of the loan. For example, the economy of the country in which the borrower is located may take a sudden turn for the worse . . . [the country may experience] a balance of payments emergency . . . [or] violent political upheavals . . . ." Walter, *Country Risk and International Lending*, 1982 U. ILL. L. REV. 71, 71-72.

41. One noted banker describes the prevailing philosophy at the major banks this way: "Walter Wriston, the powerful head of Citicorp in the 1970s, told us that foreign sovereign loans were safe (look at the record), make us all rich, and they made Citibank (Citicorp's main enterprise) the largest bank in the United States. He also hired Irving Friedman, who made a lasting impression on international finance when he said: 'Countries don't go broke!' " Schirano, *supra* note 34, at 18.

42. *See supra* text accompanying note 4. Note the following exposures of the major U.S. banks:

Millions of Dollars in Loans

				Loans as Percent of	
Bank	Argentina	Brazil	Mexico	Venezuela	Capital
Citicorp	1090	4700	2900	1500	154.3
Bank America	300	2484	2741	1614	116.7
Mfg'rs Hanover	1321	2130	1915	1084	200.3
Chase Manhattan	755	2560	1553	1226	136.5
J.P. Morgan	741	1785	1174	464	102.9
Chemical	370	1276	1414	776	136.0
Bankers Trust	230	743	1286	436	119.4
Continental Ill.	401	476	699	436	83.9

reprinted in Eskridge, *supra* note 2, n.293, *citing* The Latin American Times, Apr. 16, 1984 (No. 58) at 8.

43. The banks failed to spread their risks widely to minimize large potential losses. *See* Eskridge, *supra* note 2, at 293.

in serious jeopardy of being unable to meet their cash flow requirements.[44] The problem was further exacerbated by the similar conditions confronting the NODCs; if one state defaulted more would likely follow.[45] The banks had therefore also become a prisoner of the crisis.

As a result, the NODCs and the banks were exceptionally vulnerable to the second wave of external shocks in 1979-82. Any economic setback was likely to push an NODC over the brink into default. In 1982 the banks awoke to the problem, responding by substantially curtailing new loans to the NODCs.[46] With the underlying problems unresolved, the resulting loss of external funds for the NODCs meant that they were unable to finance their current account deficits.[47] Even before the highly publicized Mexican Crisis in August 1982,[48] most of the Latin American NODCs were unable to make their scheduled debt payments, triggering a wave of renegotiations.[49] According to Professor Eskridge, a pattern of "external shocks, failure to cope, resultant inflation and (sometimes) capital flight; drying up of new bank credit; confession of inability to service debts, [and] a rescue package by the IMF, the banks, and (sometimes) the U.S. government,"[50] occurred

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44. "Had any one of [Brazil, Mexico or Argentina] defaulted, the bank's shareholders would have lost much of their investment, and several banks might have become insolvent themselves." *Id.*

45. From a risk perspective, separate NODCs would face default as a result of similar external shocks. Professor Walter explains: "To be reducible risk [of a country defaulting] must be unsystematic; [that is] the economic and political futures of the countries in which the bank is exposed must be substantially independent. Certain events, however, have worldwide impact. If, for example, OPEC doubles oil prices or global interest rates rise, numerous countries simultaneously may suffer economic troubles." Walter, *supra* note 40, at 73.

46. Commercial bank sovereign lending fell by 23 billion dollars in 1982. Eskridge, *supra* note 2, at 302 n.52. The banks moved in a more positive direction by forming the Institute of International Finance. The Institute, comprising 189 private commercial banks from 39 countries holding over 80 percent of private NODC loans, is intended to provide better country risk information to banks and to act as a liaison between the banks and NODCs. Surrey & Nash, *Bankers Look Beyond the Debt Crisis: The Institute of International Finance, Inc.*, 23 COLUM. J. TRANSNAT'L L. 111 (1984).

47. The underlying problems are discussed *supra* notes 37, 38 and accompanying text.

48. On the Mexican debt crisis *see* Gibbs, *A Regional Bank's Perspective: An Analysis of the Differences and Similarities in the U.S. Banking Community's Approach to and Participation in the Mexican Restructuring*, 23 COLUM. J. TRANSNAT'L L. 11 (1984); Tapia, *supra* note 22. Although Mexico, as an oil exporter, is not a NODC, it confronts problems similar to those facing NODCs.

49. Professor Eskridge discusses the renegotiations of Mexico, Argentina and Brazil in Eskridge, *supra* note 2, at 303-07.

50. *Id.* at 306 n.69.

throughout the region.

The world-wide economic recovery and the generally successful renegotiation process have alleviated the crisis considerably.[51] However, the underlying problems remain and several commentators have suggested that the crisis may recur.[52] Obviously, the legal issues raised by NODC debt moratoria remain of great importance.

III. RENEGOTIATION VS. LITIGATION

A. *The Restructuring Process*

Renegotiation of a NODC's debt involves a large number of players, each with differing agendas and incentives. Among the important potential participants are the NODC and its legal and financial advisors,[53] the commercial banks and their advisors,[54] the IMF and governments of the developed nations ("the official creditors").[55]

The crucial first step in most debt restructurings is an agreement between the NODC and the IMF. Official creditors will not participate in renegotiations until such an agreement has been concluded.[56] Generally, the commercial banks also require the conclusion of an agreement between the IMF and the NODC prior to opening negotiations with the NODC.[57] The price the NODC must therefore pay for debt relief

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51. Surrey & Nash note that the primary factors in the big three debtor nations easing the crisis were: twenty percent lower inflation in Mexico from 1982 to 1983; Brazil's three billion dollar increase in exports during the same period; and Argentina's emergency bridge financing arrangement with the IMF. The authors caution that problem areas remain. Surrey & Nash, *supra* note 46, at 127-30.

52. Eskridge, *supra* note 2, at 283, 350-51; Surrey & Nash, *supra* note 46, at 127-29; Balt. Sun, Mar. 28, 1986, at 30.

53. For a useful perspective on the role of legal and financial advisors to the NODCs, *see* Bogdanowicz-Bindert, *The Role of Financial Advisors in the Bank Debt Reschedulings*, 23 COLUM. J. TRANSNAT'L L. 49 (1984); Hurlock, *Advising Sovereign Clients on the Renegotiation of Their External Indebtedness*, 23 COLUM. J. TRANSNAT'L L. 29 (1984).

54. *See generally*, Mudge, *Sovereign Debt Restructure: A Perspective of Counsel to Agent Banks, Bank Advisory Groups and Servicing Banks*, 23 COLUM. J. TRANSNAT'L L. 59 (1984).

55. The IMF's role is detailed in Robichek, *supra* note 29, at 146-53; Note, *supra* note 22, at 320-28; Santucci, *Sovereign Debt Resolution Through the International Monetary Fund: an Alternative to the* Allied Bank *Decision*, 14 DEN. J. INT'L L. & POL'Y 1 (1985).

The developed nation creditor governments typically act through "creditor clubs," the best known of which is the Paris Club. *See* Rieffel, *The Paris Club, 1978-1983*, 23 COLUM. J. TRANSNAT'L L. 83 (1984); *see also*, Hurlock, *supra* note 53, at 38.

56. Rieffel, *supra* note 55, at 86.

57. Hurlock, *supra* note 53, at 37. Although the commercial banks have occasionally restructured NODC debts without an IMF agreement, those renegotiations were

is acceptance of IMF conditionality.[58]

Once the NODC reaches agreement with the IMF, it often will seek additional relief from the official creditors themselves. Negotiations are conducted through a creditor's club, usually the Paris Club.[59] The Paris Club has no fixed membership and is open to any official creditor. It is more an *ad hoc* procedure for restructuring negotiations than it is an institution, reflecting the official creditors' view that renegotiation is an extraordinary step and not a normal transaction.[60] Although Paris Club negotiations and decisions are conducted by the creditors themselves,[61] the IMF continues to play an important role as an advisor.[62] Successful negotiations are concluded with an "Agreed Minute" constituting the terms of the debt relief agreement between the Club and the NODC.[63] The Minute is then implemented by bilateral agreements between the NODC and each member of the Club (or their financial agencies).[64] Debt relief through the Paris Club can take a variety of forms: restructuring payment schedules of existing loans, extension of new credit,[65] and/or guarantees of commercial loans.[66]

The final stage of a full restructuring is renegotiation of the NODC's commercial loans.[67] These negotiations are complex, normally involving upwards of several hundred commercial banks.[68] The large

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exceptional. Rieffel, *supra* note 55, at 87.

58. The NODCs have objected to this requirement, but to no avail. *See* Note, *supra* note 22, at 322-23; *see supra* note 31 and accompanying text.

59. *See supra* note 55. In a few cases the NODCs have used direct bilateral negotiations with official creditors rather than the creditor club process. Hurlock, *supra* note 53, at 38. The most important example is probably the Nicaraguan restructuring, where "several major creditors (notably the United States) blocked any discussion of specific rescheduling terms and no Paris Club agreement was signed." Rieffel, *supra* note 55, at 86 n.12.

60. Rieffel, *supra* note 55, at 91-92.

61. *Id.* Rieffel discusses Paris Club procedures at 90-98.

62. *See id.* at 93-97; Note, *supra* note 22, at 321-22.

63. Typical clauses in a Paris Club Minute are set out in Rieffel, *supra* note 55, at 99-106.

64. *Id.* at 106.

65. *Id.* at 100.

66. The involvement of debtor governments in planning heightens the focus on long-term objectives of the debtor countries. *See* Hurlock, *supra* note 53, at 38; Note, *supra* note 22, at 328.

67. The order of negotiation is not necessarily fixed. As noted, *supra* text accompanying note 57, negotiations with the commercial banks have sometimes preceded IMF discussions. However, the typical restructuring proceeds on the order in the text. *See* Hurlock, *supra* note 53, at 37-38; *see also* Note, *supra*, note 22, at 323-28 (describing the Zaire and Peru restructurings: Zaire followed the IMF, Paris Club, commercial bank pattern; Peru initially did not, but finally did).

68. The number of banks involved in the Mexican restructuring was approxi-

number of banks involved naturally prohibits effective bargaining, so *ad hoc* steering committees or advisory groups are usually created to represent the commercial creditors.[69] Increasingly, the IMF again plays an important advisory and mediation role in this stage, as well.[70] As with official creditor debt relief, commercial loan restructuring agreements typically provide for new credit, and/or modification of the terms of existing loans.[71] The restructuring agreement worked out by the NODC and the steering committee becomes effective once the holders of a specified percentage of the sovereign's obligations have agreed to participate.[72]

B. *Why Restructure?: The Creditors' Dilemma*

Despite the fact that individual collection action could have yielded more favorable results for some of the creditor banks, the commercial banks were willing as a group to use the restructuring process rather than pursue individual collection remedies. This result is explained by referring to the "creditors' dilemma". As Eskridge has observed, the NODC debt crisis is a classic example of the "prisoner's dilemma."[73] The prisoner's dilemma is a games theory construct dealing with the clash between individual and collective behavior in an attempt to reach the optimal result. In its classic explanation, two burglars working together are arrested and charged with theft. The prosecutor offers a deal to both defendants: "If you plead guilty and testify, and the other does not, you will get off and your partner will get

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mately 180. Gibbs, *supra* note 48, at 11. The comparatively small Costa Rica renegotiation involved 170 banks. Brief of Defendants — Appellees on Rehearing at 14-15, Allied Bank International v. Banco Credito Agricola, 757 F.2d 516 (2d Cir. 1985) [hereinafter cited as Defendant's Rehearing Brief].

69. Mudge, *supra* note 54, at 64-65. This role may also be filled by the agent banks of the various loan syndicates involved; *see also* Clarke & Farmer, *Rights and Duties of Managing and Agent Banks in Syndicated Loans to Government Borrowers*, 1982 U. ILL. L. REV. 229, 242-44, 246-47.

70. Robichek, *supra* note 29, at 146-50.

71. Mudge, *supra* note 54, at 71.

72. The percentage of the sovereign's external debt that must be included is usually quite high. The Costa Rican agreement "required the holders of at least 98% of the Costa Rican external commercial bank debt to agree to participate before the restructuring could become effective." Defendant's Rehearing Brief, *supra* note 68, at 15 n.17.

73. Eskridge, *supra* note 2, at 346. The prisoner's dilemma is a classic concept in games theory. *See generally*, R. LUCE & H. RAIFFA, GAMES AND DECISIONS, 94-102 (1957); A. RAPOPORT & A. CHAMMAH, PRISONER'S DILEMMA (1965); J. WILLIAMS, THE COMPLEAT STRATEGIST (1966) (a useful lay introduction to games theory with a number of applications to legal analysis); *see also* C. GOETZ, LAW AND ECONOMICS 8-20, 400, 414 (1984).

five years in prison. If you both testify then you will both get three years, but if you do not testify and your partner does you get the five years and your partner goes free." What the prosecutor does not tell them is that if they both remain silent they can only be convicted of a lesser offense carrying a nine month sentence.[74] In this case, the optimum collective behavior is for both defendants to remain silent, but the individual optimum is for the defendant to testify. If the defendant testifies, the worst he can receive is a three year sentence, while if he remains silent he may receive five years. Unless the defendant's partner can be trusted or convinced to also remain silent, the defendant's incentive is to testify so as to minimize his potential loss. Games theory therefore predicts that both defendants will testify, producing the worst collective result (see figure 1).[75] The prisoner's dilemma illustrates that individual optimizing behavior, in the absence of cooperation, produces the worst collective result.

FIGURE 1
The Prisoner's Dilemma
Joint Result in Parenthesis

Prisoner #2's Behavior	Prisoner #1's Behavior: SILENCE	Prisoner #1's Behavior: TESTIFY
SILENCE	-0.75, -0.75 (-1.5)	-5, 0 (-5)
TESTIFY	0, 5 (-5)	-3, -3 (-6)

Prisoner's dilemmas are common in debtor-creditor relationships. For example, assume a debtor (D) borrows $50,000 from each of two creditors (C1 and C2, respectively).[76] Further assume that the debtor has $60,000 in assets available in the event of default, and that individual collection remedies would cost each creditor $2,000. Upon default, if C1 and C2 act cooperatively and split the available assets equally, each will get $30,000 by choosing to liquidate damages immediately (assuming that acting cooperatively is costless).[77] If C1 and C2 choose to cooperate by reorganizing rather than liquidating, both of them will

74. The "deal" is laid out in full detail in C. GOETZ, *supra* note 73, at 8-9.

75. *Id.* at 13-14.

76. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargains*, 91 YALE L. J. 857, 862 (1982). This example and the following analysis is taken from Professor Jackson at 861-68.

77. Even if cooperative behavior is not costless, it will still be the joint optimum as long as it is less costly than individual behavior in the aggregate.

eventually be paid in full. If, however, both creditors pursue individual remedies, the first creditor to obtain a lien will collect the full $50,000 owed him (although it will only be worth $48,000 because of the $2,000 collection cost), but the second creditor will collect only $10,000 of the $50,000 owed him (worth $8,000). Thus, both C1 and C2 have an incentive to pursue individual collection action, "racing" to obtain the first lien and thereby assure full recovery, even though that behavior produces the worst collective result (see figure 2).

FIGURE 2
The Creditors' Dilemma
Joint Result in Parenthesis
Assumes that the cooperative action is reorganization and that Creditor #2 is first to obtain a lien when both litigate

Creditor #2's Behavior	Creditor #1's Behavior: COOPERATE	Creditor #1's Behavior: LITIGATE
COOPERATE	50000, 50000 (100000)	8000, 48000 (56000)
LITIGATE	48000, 8000 (56000)	48000, 8000 (56000)

The creditors could have agreed, prior to the default, that they would act cooperatively in the event of a default. Such an agreement would provide for an equitable repayment of principal and interest. In order to assure that no individual creditor will take independent collection action (thereby reducing the pool of assets the debtor may use to reorganize), the creditors would also agree to a freeze on all individual litigation. However, in an economy with many debtors, and new creditors arising with each transaction, bargaining costs of an *ex ante* agreement would be prohibitive.[78] The costs of policing such an agreement would also be high.[79] Thus, in a complex economy, no cooperative

78. Jackson, *supra* note 76, at 866.

79. For a discussion of monitoring and bonding problems in the similar context of relational contracts, *see* Goetz & Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981). Freeriding may occur whenever it is necessary to extract contributions from a group of individuals in order to carry out collective goals. The Freerider assumes that he need not contribute since others will contribute enough to carry out the transaction, conferring a benefit on those who do not participate, as well as those who do. If a sufficient number of group members so reason, the transaction will not occur. *See* DUKEMINIER & KRIER, PROPERTY 55 (1981). *Ex post* agreements are similarly unlikely. The first creditor to obtain a lien has no incentive to join a cooperative solu-

agreement will be reached and the creditors' dilemma will still result in the worst outcome.

In domestic debtor-creditor relationships U.S. bankruptcy law provides an escape from the creditors' dilemma "by making available a mandatory collective system after insolvency has occurred."[80] The mere presence of such a system means that the optimal collective result will be achieved even if the creditors make no conscious effort to agree with each other.[81]

The NODC debt crisis is an excellent real world example of the creditors' dilemma. Many of the smaller private creditors could have recovered their defaulted loans from attachable NODC assets. Thus, they had strong incentives to pursue individual collection action. Further, there is no system comparable to U.S. bankruptcy law for dealing with NODC debt problems.[82] Existing legal rules create virtually no barriers to pursuit of individual action. Most NODC loan agreements actually encourage individual action with elaborate acceleration and cross-default clauses, permitting creditors to accelerate their loans and

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tion and so must be bought out at full cost. If many creditors are involved, freeriding problems would make buying out the lien creditor virtually impossible. Jackson, *supra* note 76, at 865.

80. Jackson, *supra* note 76, at 867. The Bankruptcy Code's method of achieving this result is discussed *infra* at notes 160-68 and accompanying text.

81. The presence of a bankruptcy system does not mandate its use. The realization that a creditor could always initiate the bankruptcy process would deter attempts in any non-bankruptcy collective proceeding to provide any creditor with less than the minimum obtainable in a bankruptcy proceeding. The availability of a mandatory collective system in which distributions are governed by a set of statutory rules is, therefore, important because it stipulates a minimum set of entitlements for claimants that, in turn, provides a framework for implementing a consensual collective proceeding outside of the bankruptcy process. One would normally expect to see consensual deals among creditors outside of the bankruptcy process attempted first, at least to the extent that there are potential cost savings in remaining outside of the formal bankruptcy process, since those savings could be consensually allocated. The formal bankruptcy process would presumably be used only when individualistic "advantage-taking" in the setting of multi-party negotiations makes a consensual deal too costly to strike — which may occur frequently as the number of creditors increases.

> But because the bankruptcy rules set the stage against which consensual collective proceedings will be negotiated outside of bankruptcy, it is important that those rules be drawn in a fashion that is likely to minimize incentives for inefficient recourse to a collective proceeding.

Jackson, *supra* note 76, at 867.

82. Although formal restructuring plans have been proposed by some commentators, the NODC debt renegotiation remains *ad hoc* and noninstitutional. *See* Note, *supra* note 22, at 328-38, which suggests an institutionalized procedure based on an analogy to U.S. Bankruptcy Code Chapter 11 reorganizations.

pursue collection action upon event of default to any single creditor.[83]

Jurisdiction in a collection suit initiated by a creditor against a NODC or its agencies in a U.S. court is almost never difficult to establish. It is determined by reference to the Foreign Sovereign Immunities Act (FSIA).[84] Though the FSIA grants foreign states[85] immunity from suit in U.S. courts, it does so subject to several specified exceptions.[86] Where an exception applies to deny immunity, the FSIA grants U.S. district courts both personal and subject matter jurisdiction.[87] The most important exception in cases of NODC debt litigation is section 1605(a)(1), which provides that if a foreign state "has waived its immunity either explicitly or by implication" it is no longer immune to suit.[88] Because such waivers are standard in loan agreements, the waiver exception will usually be available to NODC creditors.[89]

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83. Hurlock, *supra* note 53, at 40-41. The right to initiate collection action does no good if it cannot be enforced, but there are currently no significant legal restraints on enforcement of NODC loans. *See generally*, Ryan, *Defaults and Remedies Under International Bank Loan Agreements with Foreign Sovereign Borrowers — A New York Lawyer's Perspective*, 1982 U. ILL. L. REV. 89.

84. Foreign Sovereign Immunities Act, Pub. L. No. 94-583, 90 Stat. 2891 (1976) (codified at 28 U.S.C. §§1330, 1332(a)(4), 1391(g), 1441(d), 1602-11 (1982)).

85. "[D]efined to include the State, its political subdivisions, and its agencies and instrumentalities." 28 U.S.C. §1603(a) (1982).

86. *Id.* §§1605-07.

87. *Id.* §1330. *See also Verlinden B.V. v. Central Bank of Nigeria*, 461 U.S. 480, 489 (1983). Combining immunity, personal jurisdiction, and subject matter jurisdiction into a single test — if the foreign state is not immune, both forms of jurisdiction are established automatically — has been criticized as "[a]n oddity (if not an idiocy)." Smith, *The Foreign Sovereign Immunities Act of 1976: A Plea for Drastic Surgery*, 1980 AM. SOC'Y INT'L L. PROC. 49, 50-69 (1981).

88. 28 U.S.C. §1605(a)(1).

89. Eskridge, *supra* note 2, at 344. A typical waiver agreement is contained in Ryan, *supra* note 83, at 113 n.111. Even if the loan agreement does not contain an express waiver clause, a finding that the NODC implicitly waived its immunity or that the loan was a commercial activity will also give rise to jurisdiction (28 U.S.C. §1605(a)). Ryan notes that a finding of implied waiver is a question of fact that is strictly construed in favor of the foreign state and therefore is an uncertain basis for jurisdiction. Ryan, *supra* note 83, at 112-13. A commercial activity is "either a regular course of commercial conduct or a particular commercial transaction or act" (28 U.S.C. §1603(d)). The foreign state is denied immunity with regard to any claim arising out of a commercial act having substantial contact with the United States (28 U.S.C. §§1603(e), 1605(a)(2)). Although the legislative history of the FSIA clearly indicates that sovereign borrowing was considered a commercial activity, there is some uncertainty as to when NODC loans would have sufficient contacts with the United States for immunity to be denied. (H.R. Rep. No. 94-1487, 94th Cong., 2d Sess. 10 (1976); Eskridge, *supra* note 2, at 345 n.183; Ryan, *supra* note 83, at 114 n.120.) Nevertheless, there will probably be few cases in which sovereign immunity is not denied a defaulting NODC under one of the exceptions. Under the Libra Bank Ltd. v.

Given the absence of mandatory restructuring procedures and the presence of readily available collection procedures the creditors' dilemma predicts that the banks would select individual rather than collective action.[90] Nevertheless, the collective optimum — restructuring — was uniformly achieved.[91] The banks avoided the creditors' dilemma because the official creditors and the IMF both recognized the urgency of the problem.[92] The private creditors also came to realize that a cooperative solution was in their interests.[93]

The major banks had powerful incentives to cooperate in avoiding the creditors' dilemma. Most NODCs had few assets that could be attached in U.S. collection proceedings.[94] Moreover, a NODC with insufficient foreign currency to meet even its debt-service obligations is unlikely to have sufficient funds to satisfy a sizable judgment for

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Banco National de Costa Rica, 570 F. Supp. 870 (S.D.N.Y. 1983), and *Allied Bank II* decisions, neither the act of state doctrine nor comity provide the NODC any more protection than does sovereign immunity. (*See infra* notes 129, 171 and accompanying text). Therefore, in most cases, foreign states can be successfully sued under current law if they default on their loan agreements with commercial banks.

90. *See supra* notes 76-101 and accompanying text.

91. *See supra* notes 49-51 and accompanying text.

92. *See, e.g.*, de Larosiere, *Remarks Before the Institute of Foreign Bankers*, 13 IMF SURVEY 145, 146 (1984) ("It was crucial that the [NODC debt] problems be tackled quickly, in a cooperative manner . . . .").

93. "[A] growing realization developed that any workable solution necessitated broad support and that it was in the vital interest of all parties to cooperate." *Id*; *see also* Hurlock, *supra* note 53, at 45. ("[S]overeign borrowers and their creditors now have begun to realize that to a considerable degree their interests converge.")

94. "The inadequacy of a legal remedy for creditors in such a scenario is evident from the events occurring subsequent to the *Libra* decision. Although the plaintiffs in *Libra* won a judgment against Costa Rican banks, they were unable to attach enough assets to satisfy the judgment. Eventually, the plaintiff banks voluntarily relinquished the judgment and acquiesced to the Costa Rican renegotiations." 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. Comment, *Renegotiation of External Debt: The Allied Bank Cases and the Chapter 11 Analogy*, 17 MIAMI INTER-AMER. L. REV. 59, 75 (1984).

"The modern restrictive theory of immunity gives foreign states greater protection against losing their assets through attachment than against being sued. Under the FSIA, only the 'property in the United States' can be attached if the judgment is against the country itself or its departments or subdivisions (28 U.S.C. §160(a) (1982)). Moreover, unless there is a waiver of attachment immunity, the property attached would have to be that 'used for the commercial activity upon which the claim is based,' namely the loans. (*Id.* §1610(a)(2)). The funds held by the state's central bank for its own account are expressly immunized by the FSIA. (*Id.* §1611(b)(1))." Eskridge, *supra* note 2, at 346.

default.[95] Individual action by the major banks could have only resulted in a full default by the NODCs and probable insolvency for some of the major banks and substantial losses for the rest. Cooperation was the major banks' only alternative.

The NODCs had strong incentives to cooperate, as well. If a NODC fully defaulted it would have been excluded from the international capital markets that are essential to the well-being of its economy. NODCs need to maintain essential imports and strengthen their export industries in order to resolve their underlying balance of payments problems, while at the same time servicing their existing external debts. Because their foreign currency flow was then inadequate even to service their existing debt, NODCs required new sources of capital to solve their underlying problems and maintain a minimal standard of living. The NODCs dependence on external funds therefore required that they renegotiate rather than disclaim their obligations.[96]

All this, however, does not explain the willingness of the smaller banks also to join the restructuring process. While the major banks felt compelled to extend new loans to the NODCs (in order to finance implementation of the conditionality process by the NODCs, and because only if the process succeeded in restoring the NODCs' economies would the major banks recover their original loans[97]), the smaller banks could have chosen to freeride on the major banks and thus refused to participate.[98] Thus, the NODC would have continued paying the freeriding banks (or be in default), but the smaller banks would not have extended risky new loans. Moreover, for some of the smaller banks, the funds available in the United States could have satisfied a judgment against the NODC. The smaller banks thus had strong incentives to pursue individual action. The creditors' dilemma in fact predicts that they would litigate rather than renegotiate, unless some external factor forced them to pursue the collective optimum. Fortunately, both the major banks and the governments of the developed nations recognized the potential problem posed by the smaller banks. The major banks,

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95. *But cf. Allied Bank II*, 757 F.2d at 522, where the court held "[t]he appellees' inability to pay United States dollars relates only to the potential enforceability of the judgment; it does not determine whether judgment should enter."

96. For a discussion of the NODC ideology on this point, see Eskridge, *supra* note 2, at 348-49.

97. This phenomenon is known as "involuntary lending." For an analysis of this see W. CLINE, *supra* note 23, at 71-73.

98. In the Mexican restructuring "the banks with very small exposures were reluctant to increase their exposure by a penny even if it meant writing off their existing portfolios. The banks with medium exposure were equivocal, and within this group many banks with significant private sector exposure were reluctant to commit more funds . . . ." Gibbs, *supra* note 48, at 18.

national bank regulators in the countries involved and the IMF applied political and financial pressure on the smaller banks to participate.[99]

This combination of economic and political incentives resulted in universal renegotiation of NODC debt.[100] It was, however, an extremely vulnerable process. The pressures exerted on the smaller banks were enormous: "from the perspective of a regional bank, 'cram down' is not an unduly harsh description of what in fact occurred, . . . the experience has been one that few would want to repeat."[101]

Unfortunately, this entire process entails numerous risks and the potential for a renewed crisis remains. Unforeseeable future external shocks — new oil price increases, wars, revolutions, natural disasters, recessions, or a surge in interest rates — could trigger another crisis. Fiscal austerity imposed by conditionality could trigger political upheaval in the NODCs.[102] Protectionist trade legislation by the developed nations, impairing the NODCs' access to export markets and exacerbating their balance of payments deficits, could also induce a crisis.[103] The new credit extended in the restructuring process further increases the risk of a new crisis. The new loans bear short maturity debts and high interest rates. Moreover, by increasing the NODC's debt to export ratios these new loans decrease the amount of foreign

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99. "The combined pressure of the Advisory Bank Group, the IMF and the U.S. regulating authorities was sufficient to convince the majority of banks to commit." Eskridge, *supra* note 2, at 349. *See also* Gibbs, *supra* note 48, at 19; Diaz-Alejandro, *Latin American Debt: I Don't Think We Care in Kansas Anymore*, 1984 BROOKINGS PAPERS ON ECONOMIC ACTIVITY 355.

100. Even in the Costa Rican restructuring 170 of the 171 banks involved joined the restructuring agreement. Only Fidelity Union Trust Company of New Jersey initially refused to join. *Allied Bank II*, 757 F.2d at 519.

101. Gibbs, *supra* note 48, at 23-28. "The Fund has so far been remarkably successful in bringing lenders and borrowers together on the appropriate adjustment programs and in persuading private lenders to produce enough new credit to support them. The process, however, is constantly vulnerable to the demands of "holdout" or "rogue" banks, who can always resort to litigation to enforce their creditors' remedies. The size and number of these recalcitrant lenders might very well increase as the size and number of debt reschedulings increase. The process is therefore skewed, because the Fund's powerful leverage over debtor countries via conditionality is not paralleled by any direct authority of the Fund over private lenders. There are reasonable grounds to fear that the old instruments used by the Fund will not succeed in eliminating the risk of a system collapse." Santucci, *supra* note 55, at 33.

102. For a detailed discussion of this possibility, *see* Roett, *supra* note 9.

103. Brock, *supra* note 9, at 1055. "Debtor countries are being encouraged to devalue their currencies in order to promote exports. The access of their products to markets in industrialized countries, however, is being hindered by growing protectionist trends. It is estimated that about one-third of Brazilian exports to the U.S. is affected by some kind of formal restriction." Amaral, *The Debt Crisis from the Point of View of a Debtor Country*, 17 N.Y.U. J. INT'L L. & POL. 633, 637 (1985).

currency available to address the underlying structural problems.[104] If the NODCs must expend their foreign currency reserves on debt service rather than on building up their export industries, the balance of payments deficits will remain unresolved. The pessimism of many commentators therefore seems well taken.[105]

Should a new crisis occur a new round of restructuring may be necessary. Absent some change in the present renegotiation process the creditors' dilemma and the incentives of the various parties will remain unchanged. Thus, the smaller banks must again be subjected to intense political and economic pressure to join restructurings. Such pressures are not only risky, because they may not always succeed, but also because they dramatically increase the costs of renegotiation by increasing the costs of bargaining.[106]

In U.S. bankruptcy law the existence of mandatory reorganization reduces the cost of achieving the collectively optimal result by eliminating the need for bargaining between creditors.[107] The absence of such a procedure in NODC debt restructuring complicates renegotiation unnecessarily. Although formal bankruptcy-like procedures in the NODC context are unlikely and probably impractical,[108] a more certain method for compelling restructuring than presently exists is necessary to reduce the cost of achieving collective behavior. Enforcement of NODC debt moratoria provides such a method.

IV. Debt Moratoria and Comity

The creditors' dilemma has important implications for sovereign debt litigation. It provides both a compelling policy rationale for giving effect to NODC debt moratoria legislation under the proper circumstances and suggests how a court may structure a test to determine when such moratoria should be given effect.

A. *A Policy Basis for Comity in NODC Debt Litigation*

A NODC facing default may choose to signal its difficulty to its creditors by promulgating a debt moratorium.[109] Typical moratoria de-

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104. Roett, *supra* note 9, at 697-98.

105. *See supra* note 91 and accompanying text.

106. The continued litigation against Costa Rica in *Allied Bank II* is an excellent example of this potential problem. Reduction of bargaining costs is one of the law's basic purposes. *See* Note, *Trade Usages in International Sales of Goods: An Analysis of the 1964 and 1980 Sales Conventions*, 24 VA. J. INT'L L. 619, 650 (1984).

107. *See supra* notes 76-81 and accompanying text.

108. *See* Ryan, *supra* note 83, at 128-31.

109. *See supra* notes 46-52 and accompanying text.

clare that the state and/or its agencies have insufficient foreign currency or are otherwise unable to make scheduled loan payments. Such moratoria were declared by a number of troubled NODCs during the 1979-82 crisis.[110] In most cases declaration of moratoria constituted an event of default,[111] even if no payments had yet been missed.

In the event of litigation by the banks against a defaulting NODC, the NODC may raise the debt moratorium legislation as a defense in the courts of this country under either the act of state doctrine or the international legal doctrine of comity. Under current law, the act of state doctrine almost certainly will be inapplicable to NODC debt litigation.[112] Comity, however, provides an independent rationale for giving effect to the debt moratorium.

1. *Comity*

Comity rests upon entirely different policy considerations than does the act of state doctrine. The act of state doctrine is not a norm of international law,[113] but rather a domestic rule of judicial abstention "aris[ing] out of the basic relationships between branches of government in a system of separation of powers."[114] The doctrine reflects the constitutional commitment of foreign relations to the Executive and "the strong sense of the Judicial Branch that its engagement in the task

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110. *See, e.g., Allied Bank II*, 757 F.2d at 519 (Costa Rica); Gibbs, *supra* note 48, at 14-16 (Mexico).

111. *But see* Ryan, *supra* note 83, at 97 (noting, however, that some loan agreements "surprisingly" omit a clause specifying a moratorium as an event of default).

112. The act of state doctrine is inapplicable where the situs of the affected property is outside the acting state. Tabacalera Severtiano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706, 715 (5th Cir. 1968), *cert. denied*, 393 U.S. 924 (1968). In *Allied Bank II*, 757 F.2d at 521, the court held that "Costa Rica could not wholly extinguish the Costa Rican banks' obligation to timely pay United States dollars to Allied in New York." The court reasoned that because the debt was payable in New York, the agent bank was located in New York, some of the negotiations took place in the United States, and the United States interests outweighed those of Costa Rica, that "[u]nder either analysis [act of state doctrine or ordinary situs analysis], the situs of the debt was in the United States." *Id.* at 522. Since most NODC loan agreements are structured similarly, the court's analysis is applicable generally. The court's decision with regard to the act of state question is at the least debatable, but lies beyond the scope of this article. For a more detailed discussion of the problem of the application of the act of state doctrine in cases involving indefinitely situated property, *see* Note, *The Resolution of Act of State Disputes Involving Indefinitely Situated Property*, 25 VA. J. INT'L L. 901 (1984).

113. Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 422 (1964) ("No international arbitral or judicial decision discovered suggests that international law prescribes recognition of sovereign acts of foreign governments.").

114. *Id.* at 423.

of passing on the validity of foreign acts of state may hinder rather than further this country's pursuit of goals . . . in the international sphere."[115] Where applicable, the doctrine therefore requires U.S. courts to abstain from review of foreign state actions.[116]

In contrast to the act of state doctrine, comity is a rule of international law requiring the court not to abstain from reviewing the foreign law or decision, but rather affirmatively to give that law effect in the forum country.[117] Comity has been defined in a number of ways, but the definition first given it in *Hilton v. Guyot*[118] remains the starting point of any comity analysis. In *Hilton*, the Supreme Court defined comity as

> 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. . . .[119]

Hilton held that the law of another nation is presumptively valid in the United States, "unless some special ground," such as "showing that it

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115. *Id.* "The policy concerns underlying the doctrine focus on the pre-eminence of the political branches, and particularly the executive, in the conduct of foreign policy." *Allied Bank II*, 757 F.2d at 520.

116. *See* First National City Bank v. Banco Nacional de Cuba, 406 U.S. 759, 769 (1972) ("The act of state doctrine . . . is a judicially accepted limitation on the normal adjudicative processes of the courts . . . ."); International Association of Machinists and Aerospace Workers v. Organization of Petroleum Exporting Countries, 649 F.2d 1354, 1358 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982) ("The act of state doctrine declares that a United States court will not adjudicate . . . the sovereign act of a foreign state."); *Hunt v. Mobil Oil Corp.*, 550 F.2d 68, 73 (2d Cir. 1977), *cert. denied*, 434 U.S. 984 (1977) ("[t]he political act complained of here was clearly within the act of state doctrine and [therefore] . . . is non-justiciable.").

117. As part of customary international law, comity is "part of our law," and, like any doctrine of customary international law, in the absence of a controlling statute, treaty, or constitutional provision compelling a different result, it must be given effect. *See* The Paguete Habana, 175 U.S. 677, 700 (1900). THE RESTATEMENT OF FOREIGN RELATIONS LAW OF THE UNITED STATES §135(1) (Tent. Draft No. 1, Apr. 1, 1980) grants comity, as part of customary international law, an even more expansive role: "A rule of international law . . . supersedes any inconsistent law of the several states of the United States, as well as any inconsistent preexisting provision in the law of the United States." *See also* Fernandez v. Wilkinson, 505 F. Supp. 787 (D. Kan. 1980), *aff'd on other grounds sub. nom* Rodriguez-Fernandez v. Wilkinson, 654 F.2d 1382 (10th Cir. 1981). *But see* Goldklang, *Back on Board the Paguete Habana: Resolving the Conflict Between Statutes and Customary International Law*, 25 VA. J. INT'L L. 143 (1984).

118. 159 U.S. 113 (1895).

119. *Id.* at 164.

was affected by fraud or prejudice"[120] is established by the party seeking to persuade the court to withhold comity.

Comity "summarizes in a brief word a complex and elusive concept — the degree of deference that a domestic forum must pay to the act of a foreign government not otherwise binding on the forum."[121] The overriding of ordinary choice of law rules to give effect to a foreign law or decision is based on the "recogni[tion] that comity serves our international system like the mortar which cements together a brick house."[122]

> Comity is a necessary outgrowth of our international system of politically independent, socio-economically interdependent nation states. As surely as people, products and problems move freely among adjoining countries, so national interests cross territorial borders. But no nation can expect its laws to reach further than its jurisdiction to prescribe, adjudicate, and enforce. Every nation must often rely on other countries to help it achieve its regulatory expectations. Thus, comity compels national courts to act at all times to increase the international legal ties that advance the rule of law within and among nations.[123]

Comity is not, of course, completely unbounded. Where giving effect to the foreign act would be contrary to some fundamental policy of the forum, comity is not obligatory. Most of the case law governing the application of comity has emerged from the federal courts and the state courts of New York. These courts require that the foreign act must be "fundamentally prejudicial" to "the strong public policies of the forum" for comity to be refused.[124] Justice Cardozo, in an early New York opinion, stated flatly that comity should be granted unless to do so "would violate some fundamental principal of justice, some prevalent conception of morals, [or] some deep-rooted tradition of the common weal."[125]

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120. *Id.* at 205.

121. Laker Airways Ltd. v. Sabena Belgian World Airlines, 731 F.2d 909, 937 (D.C. Cir. 1984).

122. *Id.* at 937.

123. *Id.* (footnote omitted).

124. *Id.*; Intercontinental Hotels Corp. v. Golden, 15 N.Y.2d 9, 203 N.E.2d 210, 212 (1964) ("[f]oreign-based rights should be enforced unless [to do so] . . . would be the approval of a transaction which is inherently vicious, wicked, or immoral, and shocking to the prevailing moral sense.").

125. Loucks v. Standard Oil Co., 244 N.Y. 99, 111, 120 N.E. 198, 202 (1918). Justice Cardozo does not use the term "comity," though his discussion is predicated on

Judicious application of Justice Cardozo's public policy exception to the comity doctrine would serve both the United States' policy interests and those of the international economic system. The Supreme Court has long recognized that the United States "cannot have trade and commerce in world markets and international waters exclusively on [its] own terms, governed by [its] laws, and resolved in [its] courts."[126] Yet, many foreign observers and policy makers remain frustrated with what they perceive as the refusal of U.S. courts to recognize foreign governmental acts with effects in the United States.[127] This frustration impedes the efficient functioning of the international economic system and is fueled by the growing tendency of U.S. courts to assert the predominance of its laws and policies over individuals and businesses abroad. Comity, when granted in those cases that legitimately do not fall within the public policy exception, will aid the efforts of U.S. courts and policy-makers to assert jurisdiction and enforce judgments abroad, because foreign lawmakers will be more willing to effectuate the rulings of U.S. courts if they can rely on U.S. courts to recognize the validity of foreign laws. Without the cooperation of foreign lawmakers, U.S. judicial rulings are more difficult to enforce abroad. Comity is thus an important tool available to U.S. courts in their efforts to assert U.S. law abroad.

Further, comity does not require U.S. courts to abdicate to the Executive Branch their responsibility to insure that the effects of foreign acts meet fundamental principles of justice. Exercise of this responsibility by the Judicial Branch rather than the Executive will produce a more consistent and stable standard for foreign acts to meet than would result from a standard produced by a procession of ideologically disparate Executive's. This also allows the Executive to deflect pressures to intervene from sovereign nations.[128] Such considerations have already prompted the Supreme Court to reduce the amount of deference paid to the Executive in applying the act of state doctrine and other doctrines of international law.[129]

When determining whether foreign acts comport with U.S. public policy or standards of justice, U.S. courts are rightfully beginning to conclude that: "International comity is not [solely] reserved for foreign proceedings that obtain results identical to those under American

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the same concept.

126. The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1972).

127. Campbell, *A Non-U.S. Perspective*, INT'L FIN. L. REV., Aug. 1985, at 28.

128. *Id.* at 30.

129. First National City Bank v. Banco Nacional de Cuba, 406 U.S. 759 (1972); *see infra* note 204 and accompanying text.

Law."[130] Particularly where another state's economic policies are concerned, U.S. courts have consistently recognized the foreign state's interest in winding up the affairs of its own domestic business entities.[131]

Although no general, universal "talismanic tests" exist, or are appropriate, in determining whether comity should be afforded a foreign act,[132] sovereign debt litigation is one specific area susceptible to such a test by virtue of the analogy to bankruptcy law.

2. *Public Policy Interests of the NODC and the United States in Debt Litigation*

The NODC's policy concerns in a debt moratorium are reasonably straightforward. A NODC with insufficient foreign currency to service its external debt and resolve its balance of trade problem has few alternatives. In some way it must signal its creditors that a restructuring is urgently needed. The NODC must do this while maintaining its access to new capital. It also must assure that the creditors' dilemma will be resolved; if the NODC *must* pay some creditors now the purpose of restructuring may be defeated. A nonrepudiatory moratorium may thus appear to the NODC as the only way to achieve its goals.

U.S. policy with regard to moratoria is more complex. The United States has been strongly supportive of the restructuring process.[133] U.S. law has also long recognized that although outright repudiations are unlawful, sovereign governments have the power to affect contractual obligations through moratoria or similar legislation in an economic emergency.[134] Moreover, U.S. bankruptcy law permits and, in fact, en-

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130. Drexel Burnham Lambert v. A. W. Galadari, 610 F. Supp. 114, 119 (S.D.N.Y. 1985), *rev'd on other grounds*, 777 F.2d 877 (2d Cir. 1985). *But see Allied Bank II*, 757 F.2d at 516.

131. Cunard Steamship Company v. Salen Reefer Services, 773 F.2d 452, 458 (2d Cir. 1985).

132. *See Laker*, 731 F.2d at 956 (Starr, J., dissenting). ("Few hard-and-fast rules or talismanic tests are to be found.") At one time some courts balanced the foreign state's interest against the forum's interest under the factual circumstances. However, this balancing test has led to unfortunate results and has fallen into disfavor. *Id.* at 950. Further, reciprocity is not a necessary factor in granting comity. "As Judge Learned Hand explained, the Supreme Court in *Hilton v. Guyot* 'certainly did not mean to hold that an American court was to recognize no obligations or duties arising elsewhere until it appeared that the sovereign of the loan reciprocally recognized similar obligations existing here. That doctrine I am happy to say is not a part of American jurisprudence.' " Direction der Disconto-Gesellschaft v. United States Steel Corp., 300 F.2d 741, 747 (S.D.N.Y. 1924), *aff'd*, 267 U.S. 22 (1925), *quoted in Cunard*, 773 F.2d at 460.

133. *See infra* notes 168-75 and accompanying text.

134. *See infra* notes 192-98 and accompanying text.

courages the extension of comity to foreign bankruptcy proceedings,[135] which are directly analogous as a matter of policy to debt moratoria.[136]

The commercial banks have maintained that debt moratoria are attempts by the NODCs to repudiate their debts and that, therefore, giving legal effect to these moratoria in U.S. litigation arising out of a default would place "billions of dollars of loans . . . at the complete mercy of foreign governments around the world."[137] Neither claim is correct. Despite assertions that debt moratoria give NODCs "complete freedom to defer unilaterally" their debt payments and "strengthen immensely" their bargaining position,[138] as a practical matter they do neither.[139]

The NODCs have not used moratoria to repudiate their debt. Moratoria have been declared only to suspend payments temporarily while the NODC is unable to make them because of urgent foreign currency shortages resulting from their balance of trade deficits. For example, Costa Rica would have been forced to expend ninety percent of its export earnings to service its public debt.[140] Concurrent with a promulgation of the moratoria, the NODCs have requested prompt renegotiation.[141] The NODCs' continuing need for external credit compels this request. They simply cannot afford to be cut off from the international credit market due to their repudiation.[142] Thus, a debt moratorium is not a repudiation of contractual obligations but rather a

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135. *See* 11 U.S.C. §§304-05 (1982).

136. *See infra* notes 156-57 and accompanying text.

137. Brief of the New York Clearing House Association as *Amicus Curiae* at 26, *Allied Bank I*, No. 83-7714, slip op. (2d Cir. Mar. 18, 1985). *See also* Brief of the New York Clearing House Association as *Amicus Curiae* on Rehearing at 29, *Allied Bank II*, 757 F.2d at 516. ("Costa Rica's indefinite suspension of principal and interest payments . . . is clearly . . . an effective confiscation of property . . . .") (*quoting* Libra Bank Ltd. v. Banco Nacional de Costa Rica, 570 F. Supp. 870, 882 (S.D.N.Y. 1983)). The banks' claims have been echoed by the press, *see, e.g.*, Hermann, *New York Law Unsafe for Loan Agreements*, Fin. Times, May 24, 1984, at 34, col. 4, and domestic business interests, *see, e.g.*, Brief of the Rule of Law Committee and the Komal Foreign Trade Council, Inc. as *Amicus Curiae*, *Allied Bank I*, No. 83-7714, slip op.

138. Hermann, *supra* note 137, at 34, col. 4.

139. *See infra* note 180 and accompanying text.

140. *Country Reports on Human Rights Practices, 1981: Submitted to the House Comm. on Foreign Affairs and the Senate Comm. on Foreign Relations*, 97 Cong., 2d Sess., 393-94 (1982).

141. Costa Rica, for example, stated that it desired "to negotiate the restructure of its external debt, so as to be able to pay all its creditors in full, with interest, on an equitable and nonpreferential basis." Defendant's Rehearing Brief, *supra* note 68, at 12. In the Mexican restructuring the government entered into negotiations with its creditors almost immediately, and announced a restructuring program a few months after its moratorium. Tapia, *supra* note 22, at 4-5.

142. *See supra* notes 54-72 and accompanying text.

signal from the NODC to its creditors that restructuring of its obligations is urgently needed. This signal is necessitated by the absence of formal procedures for a NODC to initiate a restructuring.[143]

The same compelling economic and political reasons that require a NODC to maintain access to foreign capital markets also mean that recognizing a debt moratorium will not give the NODC unilateral control of the bargaining process. A tenuous balance of power exists between the major banks and the NODCs; if the NODC defaults then the banks cannot recover their losses from available attachable assets, but if the banks refuse the NODC additional credit then the NODC faces economic and perhaps political collapse.[144] When a U.S. court gives legal effect to a debt moratorium it does not affect this balance of power. The major banks thus are forced to renegotiate whether the NODC formally declares a moratorium or simply defaults.[145] Where the smaller banks are concerned, giving effect to a moratorium does not destroy the balance of power but rather creates a balance in a manner directly analogous to U.S. bankruptcy law and policy.[146]

Section 301 of the U.S. Bankruptcy Code[147] allows a debtor facing default to voluntarily enter bankruptcy by filing a petition with the appropriate federal bankruptcy court. Once the debtor so files, all collection procedures by individual creditors are automatically stayed,[148] so as to permit the insolvent debtor an opportunity to formulate a reorganization plan while protected "from [a] mad scramble of creditors for assets" of the debtor.[149] Thus, subject to court approval of its plans, a debtor may not only suspend payment to its creditors but also compel its creditors to join a reorganization.[150] The law permits this reorgani-

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143. *See supra* notes 56-76 and accompanying text.

144. *See supra* notes 96-108 and accompanying text.

145. *See supra* notes 97-98 and accompanying text.

146. *See infra* notes 209-44 and accompanying text.

147. 11 U.S.C. §301 (1982). Three or more creditors, holding aggregate claims worth $5,000 more than the value of their security interests, if any, may petition the court for involuntary proceedings against the debtor. *Id.* §303(b)(1). If the debtor contests the petition, the creditors must show either that the debtor failed to make due payments or that a custodian administering the debtor's estate was appointed within 120 days of the filing of the petition. *Id.* §303(h).

148. 11 U.S.C. §361 (1982).

149. *In re* Frigitemp Corp., 8 B.R. 284, 289 (S.D.N.Y. 1981) *quoting* Fidelity Mortgage Investors v. Camellia Builders, Inc., 550 F.2d 47, 55 (2d Cir. 1976), *cert. denied*, 429 U.S. 1093, *reh'g denied*, 430 U.S. 976 (1977); *Allied Bank I*, No. 83-7714 slip op.

150. Under the Bankruptcy Code, a confirmed reorganization plan is binding on any creditor of the debtor, whether or not the creditor accepted the plan. For a reorganization plan to be confirmed, it must have been accepted by each class of creditors where the holders of "at least two-thirds of allowed claims in amount and more than

zation to bind even dissenting creditors because in many cases the debtor's value as a going concern is greater than the liquidated value of its assets. Moreover, reorganization is essential to reaching the optimal solution to the creditors' dilemma.[151]

Even if the bankruptcy proceedings are initiated by a debtor in a foreign country, the Bankruptcy Code permits the same result. Under sections 304 and 305, the court may enjoin U.S. collection actions against the debtor or dismiss an involuntary petition brought in the United States if foreign proceedings meeting certain basic fairness norms of a bankruptcy proceeding are underway in the foreign state.[152] U.S. courts are "not obliged to protect the positions of fast-moving American and foreign attachment creditors over the policy favoring uniform administration in a foreign court."[153] U.S. courts have generally extended comity to foreign bankruptcy laws, both under section 305 and general comity rules, that are not identical in operation to U.S. bankruptcy law, provided "there is nothing inherently vicious, wicked, immoral or shocking to the prevailing American moral sense" in the foreign law.[154] Indeed, it is "the firm policy of American courts [to stay] actions against a corporation which is the subject of a bankruptcy proceeding in another jurisdiction."[155]

Though there are no formal bankruptcy procedures for foreign nations, a debt moratorium serves as the functional equivalent.[156] Giving effect to a moratorium that does not repudiate the NODC's debt but rather merely defers payment while a restructuring is negotiated has the same effect as the automatic stay of domestic bankruptcy proceedings under section 362 or as the abstention of U.S. courts during foreign proceedings under section 305. The debtor NODC — like the private debtor under the Code — simply obtains a brief deferral of its obligations and protection from a "mad scramble of creditors" while negotiations proceed. Thus, as the Second Circuit held initially in *Al-*

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one-half in number of the allowed claims" have approved the plan. Note that the court will confirm such a plan only if the requirements of §1129 are also met. *Id.* §1126(c).

151. *See supra* notes 76-81 and accompanying text.

152. 11 U.S.C. §§304-05 (1982). *See infra* notes 209-31 and accompanying text.

153. *In re* Culmer, 25 B.R. 621, 629 (Bkrtcy. S.D.N.Y. 1982).

154. *Id.* at 631. *See also* Cornfield v. Investors Overseas Services, Ltd., 471 F. Supp. 1255 (S.D.N.Y. 1979) (extending comity to Canadian bankruptcy proceedings).

155. *Cornfield*, 471 F.Supp. at 1259. *See, e.g., Drexel Burnham Lambert*, 777 F.2d at 877.

156. "The bankruptcy-equivalent for a foreign state itself is the purported declaration by its government of a moratorium on the payment of indebtedness, external or otherwise, or other public admission by the government of an inability to pay indebtedness when due." Ryan, *supra* note 83, at 97. *See also Allied Bank I*, No. 83-7714, slip op. at 8.

lied Bank I,[157] a nonrepudiatory moratorium is fully consistent with U.S. bankruptcy procedures and is not "shocking to the prevailing American moral sense." The decision to grant comity was therefore correct.[158]

B. *The Allied Bank Cases*

1. *Facts*

The *Allied Bank* cases were a product of the Costa Rican debt restructuring of 1983. Similar to many other Latin American NODCs, Costa Rica confronted a crippling balance of payments deficit as a result of external economic shocks and ill-fated domestic policy responses. This balance of payments deficit caused Costa Rica to experience a shortage of foreign currency with which to repay its external debt,[159] including debt owed to the thirty-nine banks in the Allied Bank Syndicate. The Central Bank of Costa Rica and the President of Costa Rica, in an effort to alleviate the crisis, ordered a temporary suspension of payment of the external debt.

Two years of negotiation produced a debt restructuring agreement satisfactory to 170 out of 171 of Costa Rica's creditors. Initially, however, the thirty-nine banks comprising the Allied syndicate chose not to join the restructuring and filed suit against the Costa Rican debtors seeking payment of the debt in U.S. District Court for the Southern District of New York. After the district court dismissed Allied's com-

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157. *Allied Bank I*, No. 83-7714, slip op. at 8. The *Allied Bank I* court denied relief on the reasoning of the U.S. Supreme Court in Canada Southern Railway Co. v. Gebhard, 109 U.S. 527 (1883) which held, by analogy to U.S. bankruptcy law, that a Canadian Act of Parliament binding dissenting creditors to a reorganization of a Canadian government owned railway barred suit by U.S. citizens who held bonds of the railway. *See infra* notes 192-98 and accompanying text.

158. Professor Quale notes the anomaly the *Allied Bank II* decision creates on this point:

> A sovereign nation and, generally, state-owned banks and other state agencies cannot be the subject of bankruptcy proceedings in their own countries. Therefore, they would not be eligible to invoke section 305 to enjoin an action such as that brought by Allied. Ironically, a private borrower that was eligible for bankruptcy proceedings in its home country could, on the other hand, invoke section 305 to enjoin a collection action brought against it in the United States. Yet if a private debtor could obtain the benefits of section 305 a court might, under appropriate circumstances, be justified, in extending the same benefits, by analogy, to a sovereign or state-owned debtor.

Quale, Allied Banks' *Effect on International Lending*, INT'L FIN. L. REV., Aug. 1985, at 30.

159. *See supra* notes 20-52 and accompanying text.

plaint on the basis of the act of state doctrine,[160] all except one of the members of the Allied syndicate joined in the restructuring. The lone dissenting creditor, Fidelity Union Trust Bank, appealed the district court's dismissal.[161]

On appeal, the Second Circuit affirmed.[162] The court did not rule on the act of state issue relied on by the district court, and based its opinion instead on the doctrine of comity,[163] applying the reasoning of the Supreme Court in *Canada Southern Railway Co. v. Gebhard*,[164] in reaching its decision.[165]

At this point the plot developed some curious twists. Fidelity successfully petitioned for a rehearing by the court of appeals. The court also granted the petition of the New York Clearing House Association (NYCHA) to file a brief as *amicus curiae*, supporting Fidelity. The NYCHA is a group of twelve of the major U.S. banks, most of whom had large sovereign debt portfolios. At first glance, the position taken by the NYCHA seems inexplicable, as it would have been contrary to their interests to undermine their own restructuring agreement. The major banks, in fact, likely perceived Fidelity as a loose cannon, potentially blocking the restructuring of several hundred million dollars of debt. Therefore, the NYCHA's position can only be explained by long-term legal considerations. The NYCHA likely desired to use the legal precedent that would be established by an opinion favorable to Fidelity in future negotiations with sovereign debtors. This would enable U.S. banks to seize what assets of a sovereign debtor they could, which

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160. *Allied Bank*, 566 F. Supp. at 1440.

161. In their petition for certiorari, the Costa Rican debtor banks challenged the wisdom of a U.S. court allowing a sole recalcitrant creditor, who refused to join the restructuring agreement, to secure a judgment for payment of the debt from possibly nonexistent funds. Although at that time, and at present, a paucity of case law on this issue existed, a recent New York state court decision has strongly implied that the general welfare of syndicated lending limits the right of individual creditors in the syndicate to by-pass a restructuring agreement between the syndicate and the debtor by litigating. The court held that "disparate and mutually antagonistic claims . . . [make] impossible an orderly approach to the financing of the debt." The court reached its decision in the context of the Venezuelan restructuring where "[a] majority of the constituent banks and the depositors evidently have agreed to go along with the situation and not insist on precipitating a crisis. Only one bank, the plaintiff, holding 12 percent of the entire obligation, is insisting on immediate payment." Credit Francais International, S.A. v. Sociedad Financiera de Comerei, C.A., 490 N.Y.S.2d 670, 684 (Sup. Ct. 1985).

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

163. *See supra* notes 116-32 and accompanying text.

164. 109 U.S. 527 (1883).

165. For a fuller account of the facts presented in this case, see Defendants' Rehearing Brief, *supra* note 68.

would further cripple a struggling NODC's economy. The mere possibility of such action could be used as a bargaining chip by creditor banks, particularly if used in conjunction with the banks' ability to cut off new credit to the NODCs.

The Executive Branch of the United States, which had not previously entered the case, also successfully petitioned for leave to file a brief as *amicus curiae* in support of Fidelity. The position of the United States also appeared to be self-contradictory because the United States had previously been a strong supporter of both the restructuring process generally and the Costa Rican restructuring specifically. Presumably, the intervention of the United States was the result of political pressure by the banks, both directly and indirectly through Congress.

On rehearing, the court of appeals reversed itself,[166] now holding that Costa Rica's debt moratorium was contrary to U.S. law and policy and therefore not entitled to recognition in U.S. courts. The court also held that the act of state doctrine was inapplicable. The Costa Rican banks withdrew their petition for certiorari before the Supreme Court because Fidelity, presumably as a result of pressure from the United States and the NYCHA, joined the restructuring agreement, after the agreement was filed.

2. *Analysis*

In reversing its earlier position, the Second Circuit stated that its prior conclusion that the Costa Rican moratorium was consistent with U.S. policy "arose primarily from [its] belief that the legislative and executive branches of our government fully supported Costa Rica's actions" but that on rehearing the Department of Justice's *amicus* brief had persuaded it otherwise.[167] Prior to the decision in *Allied Bank I*, both Congress and the Executive expressed strong support for the Costa Rican restructuring. The Executive, pursuant to the Foreign Assistance Act, twice certified that continued aid to Costa Rica was "in the national interest."[168] The Foreign Assistance Act prohibits U.S. aid to any state in default of its loan obligations to the United States unless the President certifies that such aid is in the national interest. Congress responded by approving increased economic assistance for Costa

166. *Allied Bank II*, 757 F.2d at 516.

167. *Id.* at 519.

168. H. R. EXEC. DOC. NO. 671, 129 CONG. REC. H1461 (daily ed. Mar. 21, 1983); H. R. DOC. NO. 1990, 128 CONG. REC. H8243 (daily ed. Oct. 17, 1983). The aid to Costa Rica was certified pursuant to 22 U.S.C. § 2370(q) (1982).

Rica,[169] and by twice passing concurrent resolutions expressing "full support of the Congress for the Republic of Costa Rica and its democratic institutions as that country responds to the current economic crisis."[170] Such Presidential and Congressional joint actions are the clearest expression of government policy.[171]

In addition to providing economic assistance and political support to Costa Rica, the U.S. government also participated in the rescheduling of Costa Rica's external debt. In January 1983, the U.S. government joined the other members of the Paris Club in signing an Agreed Minute recommending a rescheduling of principal and interest owed by the Costa Rican government and its public sector institutions to the creditor governments. The creditor governments, including the United States, also required that Costa Rica seek comparable rescheduling by its commercial bank creditors and avoid inequitable treatment of different categories of creditors.[172]

The United States has generally been a strong supporter of the restructuring process throughout the developing world.[173] It has been an important source of funds for the NODCs both through direct loans and guarantees of private bank loans.[174] The government also played a key role in many of the negotiations and was an active participant in the Paris Club process. Most importantly, it was a key figure in the

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169. Costa Rica received an aggregate of $320 million in financial aid in fiscal years 1982-84. *Review of Proposed Economic and Security Assistance Requests for Latin America and the Caribbean: Hearings and Markup Before the Subcomm. on Western Hemisphere Affairs of the House Comm. on Foreign Affairs*, 98th Cong., lst Sess. 23 (1983).

170. H.R. CON. RES. 423, 97th Cong., 2d Sess., 128 CONG. REC. H8508 (1982) (daily ed. Nov. 17, 1983). *Accord* H. R. CON. RES. 194, 98th Cong., 1st Sess., 129 CONG. REC. H8575 (daily ed. Nov. 17, 1983).

171. Youngstown Sheet and Tube Co. v. Sawyer, 343 U.S. 579, 635-36 (1952) (Jackson, J., concurring); *see* Dames & Moore v. Regan, 453 U.S. 654, 674 (1981) ("When the President acts pursuant to an express or implied authorization of Congress, his authority is at its maximum, for it includes all that he possesses in his own right plus all that Congress can delegate. In these circumstances, and in these only, may he be said (for what it may be worth) to personify the federal sovereignty.").

172. *Allied Bank I*, No. 83-7714, slip op. at 6.

173. *Proposals for Legislation to Increase the Resources of the International Monetary Fund: Hearings before the Subcomm. on International Finance and Monetary Policy of the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 1st Sess. 7-8 (1983) (statement of Donald T. Regan, Secretary of the Treasury). *See also, Hearings before the House Comm. on Banking, Finance, and Urban Affairs*, 98th Cong., 1st Sess. 41-68 (1983) (statement of Paul A. Volcker, Chairman, Federal Reserve Board of Governors).

174. *See* Tapia, *supra* note 22, at 5. The U.S. Department of Energy loaned Mexico $1 billion, while U.S. Commodity Credit Corporation — a governmental agency — guaranteed an additional $1 billion loan.

political process that pressured the small banks into joining the restructuring process.[175]

Despite these expressions of policy, the U.S. government filed an *amicus* brief following *Allied Bank I*, urging a reversal.[176] The government's brief recognized the urgent need for restructuring NODC debt and stated that the United States was "strongly supportive" of the restructuring process.[177] The government argued, however, that giving effect to NODC debt moratoria would upset the restructuring process by discouraging additional lending by the commercial banks and by encouraging NODCs to use moratoria to obtain concessions from their creditors rather than to negotiate lasting solutions to their financial problems.[178] The government argued further that moratoria differ from bankruptcy proceedings because no neutral tribunal arbitrating between the creditors and the NODC exists.[179] Both the government's argument and the court's adoption of it are flawed in a number of respects.

The government's brief ignores the creditors' dilemma and the incentives which led to its resolution. As noted, the NODCs have strong political and economic incentives to renegotiate.[180] The small banks, however, have strong incentives not to renegotiate but rather to pursue individual collection action. These incentives are inherent in the creditors' dilemma, and were overcome only through political pressure and, as the government acknowledges, "peer pressure from fellow creditors."[181] Thus, it is not the NODCs that must be provided with incentives to renegotiate, but rather the small banks.

Enforcing a debt moratorium provides incentive necessary to induce the small banks to negotiate; the small banks will not be able to pursue individual action because the NODC moratorium will be a complete defense to such an action. Thus, as in Chapter 11 reorganizations, the small creditor is compelled to join, thereby eliminating the credi-

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175. *See supra* notes 99-101 and accompanying text.

176. Brief for the United States as *Amicus Curiae*, *Allied Bank I*, No. 83-7714, slip op. [hereinafter cited as U.S. Brief].

177. *Id.* at 7-12.

178. *Id.* at 6-7, 11-12.

179. *Id.* at 13-14.

180. *See supra* note 96 and accompanying text.

181. U.S. Brief, *supra* note 176, at 17 n.12. *See generally supra* notes 97-101 and accompanying text. As the government brief notes, in some cases the incentive to pursue individual collection action is reduced by clauses in the syndicated loan agreement requiring the individual litigant to share any sums recovered with all loan participants. U.S. Brief, *supra* note 176, at 17 n.12. However, such clauses are not always included. *Id.* Moreover, these clauses would not eliminate the incentives to pursue individual actions or actions by a syndicate composed of small banks.

tors' dilemma and promoting the collective optimal result.[182] Such a procedure provides a more certain method of reaching the "best" result than *ad hoc* political pressure, and, therefore, reduces both the uncertainty and the costs of achieving a restructuring. If the small creditor knows it can not pursue individual action, the costs of bargaining are reduced because lengthy negotiations between the governments, the major banks, and small creditors are eliminated.[183] The creditors' ability to exclude the NODC from external capital markets in turn assures that the NODC will also pursue the collective optimum.[184] Moreover, as with domestic bankruptcy law,[185] the mere presence of a regime under which moratoria are enforced will provide such incentives. The moratorium thus creates a balance of power, rather than destroying one. The need for such a balance of power is inherent in the recognition that the United States cannot expect to have international trade conducted solely on its own terms, a recognition which underlies comity.[186]

Giving effect to a debt moratorium also will not discourage additional lending. As a practical matter, lending will continue because there is no alternative. Lending continues whether the loans can be enforced or not because the major banks can only recoup their losses by renegotiation and the extension of new credit, and not by litigation.[187] As a result, substantial foreign sovereign lending continued in the wake of *Allied Bank I*.[188]

The government's argument that debt moratoria should not be considered as equivalent to bankruptcy proceedings because of the lack of a neutral tribunal is also flawed. It unnecessarily exalts form over substance. Despite proposals to the contrary, it is generally recognized that a formal tribunal dealing with NODC debt would be impractical and unnecessary.[189] Moreover, the IMF's increasingly important role as an intermediary between the banks and the NODCs fills essentially the

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182. *See supra* notes 76-81 and accompanying text.

183. Jackson, *supra* note 76, discusses the similar problem in domestic creditor bargaining situations. The entire Jackson article presents a thorough analysis of the creditor's dilemma in the domestic context.

184. *See supra* note 96 and accompanying text.

185. *See supra* note 81 and accompanying text.

186. *See supra* note 126 and accompanying text.

187. *See supra* notes 94-95 and accompanying text.

188. 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 the foreign sovereigns of Mexico, Chile, Brazil, Malaysia, Turkey, and Ireland. *See* Defendants' Rehearing Brief, *supra* note 68, at 24 n.32.

189. Ryan, *supra* note 83, at 128-31 (discusses the problems inherent in setting up an arbitration panel); Note, *supra* note 22, at 332-33.

same role.[190] The IMF's role is directly "analogous to that of a court in a Chapter 11 proceeding because it reviews and typically endorses the rehabilitation plan on which the renegotiation process is based."[191]

U.S. courts have long recognized the existence of a governmental power analogous to a court's bankruptcy powers even in the absence of formal bankruptcy proceedings. This power of both federal and state governments to affect their prior contractual obligations and those of their residents has long been recognized by U.S. courts.[192] In the early case of *Canada Southern Railway Co. v. Gebhard*,[193] the Supreme Court held that a Canadian reorganization of a government-owned railway was binding on dissenting U.S. creditors. The creditors' objected that:

> For the future to uphold the defence, the Court must say to investors: though before purchasing bonds of foreign countries you examine carefully their laws, and find no restriction on the issue of such bonds, and no reservation of power to the legislative authority to destroy such bonds by an after act, yet whenever the Legislature of such foreign country may see fit to pass an act invalidating your bonds, you must forthwith deliver them up, notwithstanding you are beyond the jurisdiction of such country; notwithstanding your bonds were payable at your own place of residence; and notwithstanding you invoke the aid of your own Courts in the premises.[194]

The Court justified this unilateral reorganization by drawing an analogy to bankruptcy proceedings:

> [u]nder such circumstances [the sovereign's act] is no more than is done in bankruptcy when a 'composition' agreement with the bankruptcy debtor, if assented to by the required majority of creditors, is made binding on the nonassenting minority. In no just sense do such governmental regulations deprive a

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190. *See supra* note 70 and accompanying text; Santucci, *supra* note 55 (discussing Art. VIII, §2, of the IMF agreement and how this agreement can give the IMF equal leverage over both lenders and borrowers).

191. Note, *supra* note 22, at 333 n.160.

192. *See, e.g.*, 12 U.S.C. §1904 (1982) (granting the federal government the power to control extensions of credit); Home Building and Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934) (upholding state mortgage moratorium); Ropico, Inc. v. City of New York, 425 F. Supp. 970 (S.D.N.Y. 1976) (upholding moratorium on payment of city bonds).

193. *Canada Southern*, 109 U.S. at 527.

194. Brief and Points for Defendant in Error at 32-33, *Canada Southern*, 109 U.S. at 527.

> person of his property without due process of law. They simply require each individual to so conduct himself for the general good as not unnecessarily to injure another.[195]

The Supreme Court reached this holding despite the absence of a neutral tribunal — the reorganization was imposed by legislative act of the government owning the debtor, not by judicial process — and despite the absence of any notice or opportunity for the creditors to be heard.[196] The Court reasoned that unless all creditors could be bound by the reorganization the plan would fail, and, therefore, the lack of a neutral tribunal and notice were immaterial. Giving effect to the reorganization was required by "the true spirit of international comity."[197]

NODC moratoria are considerably less intrusive on creditors' rights than the reorganization at issue in *Canada Southern*. Typically, these moratoria do not include a unilateral restructuring plan but simply request mere negotiation of a bilateral agreement. Thus, they provide both notice and an opportunity to be heard,[198] and should be

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195. *Canada Southern*, 109 U.S. at 527.

196. *Id.* at 542-43 (Harlan, J., dissenting). The government's brief argued that *Canada Southern* should be distinguished from NODC debt moratoria because the Canadian Parliament substituted for a bankruptcy court and did not purport to affect its own debts. U.S. Brief, *supra* note 176, at 13. Neither contention is persuasive. Just as the Canadian Parliament substituted for a bankruptcy court, so does the government of the NODC. Second, the Canadian Parliament was not neutral. It determined that the railway "affected the public interests, and the keeping of the railway opened for traffic was of the utmost importance to the people of the Dominion." *Canada Southern*, 109 U.S. at 538. Such a finding is no more or less neutral than a NODC's determination that public policy requires a temporary suspension of debt payment. Third, the Canadian Parliament was in fact modifying the obligations of a government *owned* agency — just as a NODC may suspend payments by one of its agencies.

197. *Canada Southern*, 109 U.S. at 539.

198. Fidelity and the NYCHA argued that the *Central Hanover* (Central Hanover Bank and Trust Co. v. Siemens and Halske Aktiengesellschaft, 15 F. Supp. 927 (S.D.N.Y.), *aff'd* 84 F.2d 993 (2d Cir.), *cert. denied*, 299 U.S. 585 (1936)) line of cases provide a basis for an exception to *Canada Southern*. This line of cases, holding that German exchange control laws were not a defense to contract suits, is inapplicable to nondiscriminatory, nonrepudiatory NODC debt moratoria. These cases involved discriminatory repudiations of debts and contractual obligations (15 F. Supp. at 930), which are not involved in typical NODC moratoria. *See supra* notes 140-42 and accompanying text. Moreover, they have been implicitly overruled by the adoption of the Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, art. VIII, §2(b), 60 Stat. 1401, T.I.A.S. No. 1501 (providing that exchange control regulations contrary to the member's exchange control regulation are unenforceable). *See* Banco Frances E. Brasileiro S.A. v. Doe, 36 N.Y.2d 592, 598, 331 N.E.2d 502, 506-07 (1975), *cert. denied* 423 U.S. 867 (1975) (questioning whether New York would adhere to *Central Hanover* in light of the Agreement).

granted comity under *Canada Southern.*

The Second Circuit's deference to the U.S. government is equally subject to criticism.[199] Although the opinion does not refer to it, the reasoning invokes the rationale behind the *Bernstein* doctrine. In *Bernstein v. N.V. Nederlandsche Amerikaansche*,[200] the court deferred to a U.S. State Department letter suggesting that the act of state doctrine need not be applied to the case in controversy. The court then proceeded to address the merits. The Second Circuit's reversal of its comity decision in *Allied Bank I* upon receipt of the government's brief is directly analogous to *Bernstein*, in that both courts considered the Departments of Justice and State to represent the official U.S. position.

The *Bernstein* doctrine and similar judicial deference in other areas — such as sovereign immunity or the standing in U.S. courts of unrecognized governments — has largely been repudiated. In *First National City Bank v. Banco Nacional de Cuba*, six Justices rejected the *Bernstein* approach to the act of state doctrine.[201] In the area of sovereign immunity, judicial deference to the views of the Executive has been similarly criticized. The adoption of the Foreign Sovereign Immunities Act was largely motivated by a desire to end this practice.[202] The judiciary's long standing tradition of deference to the government's position concerning an unrecognized foreign government's standing to bring suit in U.S. courts has also been criticized by both judicial and academic authority.[203]

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199. In reversing itself, the court's views underwent a remarkable change. For example, in *Allied Bank I*, No. 83-7714, slip op. at 8, the court stated that "Costa Rica's prohibition of payment of debt was not a repudiation of the debt, but rather was merely a deferral of payments while it attempted in good faith to renegotiate its obligations." In *Allied Bank II*, 757 F.2d at 519, the court held the same action to be an "attempted unilateral restructuring of private obligations. . . ." *See also Id.* at 521 n.3 (describing the action as a "taking"). All of which was done without citation of authority.

200. 210 F.2d 375 (2d Cir. 1954).

201. 406 U.S. 759, 773 (1972) (Douglas and Powell, JJ., concurring); *Id.* at 776-77 (Brennan, Stewart, Marshall, and Blackmun, JJ., dissenting).

202. *See Hearings on H.R. 11315 before the Subcomm. on Administrative Law and Governmental Relations of the House Comm. on the Judiciary*, 94 Cong., 2d Sess. 24, 26-27 (1976) (testimony of Monroe Leigh, Legal Advisor, Department of State) ("In virtually every other country in the world, sovereign immunity is a question of international law decided exclusively by the courts and not by institutions concerned with foreign affairs [*e.g.*, the Justice Department]").

203. *See e.g.*, Alder, *The Unrecognized Government in the Courts of the United States*, 5 VA. J. INT'L L. 36 (1964) ("[t]hough the political branch refuses *de facto* recognition, *de facto* judicial recognition may be given in determining the rights and obligations of private parties."); Lubman, *The Unrecognized Government in American Courts*: Upright v. Mercury Business Machines, 62 COLUM. L. REV. 275 (1962)

This trend away from the *Bernstein* doctrine's unthinking deference to the Executive is based on the recognition that the *Bernstein* approach is "an abdication of the judicial function. . . requiring blind adherence . . . to the Executive."[204] In *First National City Bank*, Justice Brennan wrote:

> The consequence of adopting the *Bernstein* approach would only be to bring the rule of law both here at home and in the relations of nations into disrespect. Indeed, the fate of the individual claimant would be subject to the political considerations of the Executive Branch. Since those considerations change as surely as administrations change, similarly situated litigants would not be likely to obtain even-handed treatment.[205]

The enforceability of loan agreements, extension of comity to foreign law, choice of governing law, and examination of precedent and policy are judicial questions.[206] Even prior to *First National City Bank*, Justice Stewart noted, "[r]esolution of [such important issues] . . . cannot vary from day to day with the shifting winds at the State Department."[207]

Rather than simply deferring to the position of the U.S. government as an *amicus* party to litigation, the courts should undertake a careful examination not only of the policies expressed by the United States both as a party and in its recent actions and more broadly as an actor in the international economic system, but also of the legitimate interests of the foreign state and its creditors, and the facts and equities

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("[Courts should] restrain the judicial proclivity for unthinking deference to what the courts consider to be, or are told is, national policy."); Recent Decision, 14 VA. J. INT'L L. 329 (1974); Upright v. Mercury Business Machines Co., Inc., 13 A.D.2d 36, 213 N.Y.S.2d 417 (1961).

204. First National City Bank v. Banco Nacional de Cuba, 406 U.S. 759, 790-92 (1972) (Brennan, J., dissenting) While Justice Brennan dissented from the ultimate holding that was dispositive of the case, he and five other Justices advocated the rejection of the *Bernstein* doctrine. In his concurring opinion Justice Powell also found that "[t]he reasoning of *Sabbatino* implicitly rejects the [*Bernstein*] exception. Moreover, I would be uncomfortable with a doctrine which would require the judiciary to receive the Executive's permission before invoking its jurisdiction. Such a notion, in the name of the doctrine of separation of powers, seems to me in conflict with that very doctrine." *Id.* at 773 (Powell, J., concurring).

205. *Id.* at 790.

206. *See* Anderson v. N.V. Transandine Handelmaatschappij, 289 N.Y. 9, 15, 43 N.E.2d 502, 504 (1942) ("The scope and effect within this state of a decree promulgated by the [foreign] government are judicial questions. . . .").

207. Zschernig v. Miller, 389 U.S. 429, 443 (1968) (Stewart, J., concurring).

of the case.[208] Such an examination in the *Allied Bank* litigation would have considered the bankruptcy analogy, the creditors' dilemma and the correct interpretation of its resolution, the urgent need of Costa Rica to restructure its external debt, and the interests of Costa Rica's creditors. This examination would have revealed that Costa Rica's actions did not fall within Justice Cardozo's public policy exception to the comity doctrine. The analysis of general U.S. law and policy above suggests that debt moratoria should be granted comity in at least some circumstances.

C. *A Test for Comity in NODC Debt Litigation*

Not all debt moratoria, of course, will necessarily be consistent with U.S. policy and with the proper resolution of the creditors' dilemma. However, extension of the analogy between U.S. commercial bankruptcy law and NODC debt restructuring suggests a workable test.

Under section 305 of the Bankruptcy Code a U.S. court may decline to exercise jurisdiction over a debtor if the interests of the debtor and creditors so require or if there is a foreign proceeding pending, and if the following six factors — specified in section 304(c) — are met:[209]

(1) just treatment of all holders of claims against or interests in such estate;
(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
(3) prevention of preferential or fraudulent dispositions of property of such estate;
(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;

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208. "In a decentralized world, . . . a significant interest exists in having domestic courts maintain a neutral role in the resolution of international disputes and the development of international law." Davis, *Domestic Development of International Law: A Proposal for an International Concept of the Act of State Doctrine*, 20 TEX. INT'L L. J., 341, 362 (1984). "In the *Bernstein* context, Professor Abram Chayes, Legal Advisor to the State Department of 1961-1964, stated, 'I submit that the best possible position for the [State] Department *vis à vis* the foreign government in these circumstances is to be able to show that we have an independent judiciary in this country. It adjudicates whatever comes before it, and there is no way the Department can interfere.' " *Id.* at 362 n.88 *quoting* Chayes, *The Aftermath of Sabbatino, Background Papers and Proceedings of the Seventh Hammarskjold Forum*, The Association of the Bar of the City of New York, p. 73, Jan. 11, 1965. *Cf.* Recent Decision, *supra* note 203, at 332-37, which advocates the same approach in unrecognized government contexts.

209. 11 U.S.C. §305(a) (1982).

(5) comity; and
(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.[210]

These factors are guidelines only, and the legislative history of the statute indicates that Congress intended "to give the court the maximum flexibility in handling [such] cases."[211] The courts are "to make the appropriate orders under all the circumstances of each case, rather than being provided with inflexible rules."[212] The courts have used their abstention power where the debtor and a majority of the creditors have reached an acceptable reorganization but a few recalcitrant creditors seek to overturn it, interpreting the factors flexibly and in favor of the debtor.[213]

The factors specified in section 304(c) reflect the basic norms of equality and nondiscrimination that underlie U.S. bankruptcy law. They also reflect an appropriate resolution of the creditors' dilemma.[214] As noted, creditors would agree — absent the creditors' dilemma — to a reorganization that provided for no individual collection efforts and equitable repayment of principal and interest. This bargain is imposed by domestic bankruptcy law.[215] A NODC's debt moratorium can serve the same function. The principles of bankruptcy law thus suggest an appropriate test for U.S. courts to use in determining the validity of a NODC's debt moratorium.

1. *Comity*

It is odd that section 304 includes comity as one of the factors to be considered by courts in declining to exercise jurisdiction over a debtor, since relief under section 305 amounts to the extension of comity to the foreign proceeding.[216] Recognizing that the extension of com-

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210. *Id.* §304(c).

211. S. REP. No. 989, 95th Cong., 2d Sess. 35 (1978), *reprinted in* U.S. CODE CONG. & AD. NEWS 5787, 5821 (1978).

212. *Id.*

213. *See, e.g., In re* Rimpull Corp., 26 B.R. 267 (Bkrtcy. W.D. Mo. 1982) (dismissing an involuntary petition filed by a minority of creditors dissenting from a reorganization plan); *In re* Luftek, Inc., 6 B.R. 539 (Bkrtcy. E.D.N.Y. 1980) (dismissing where debtors and most creditors had arranged a reorganization and additional loans).

214. *See generally supra* notes 76-81 and accompanying text.

215. *See supra* notes 78-79 and accompanying text.

216. *See Culmer*, 25 B.R. at 629 ("All of the factors listed in Section 304(c) have historically been considered within a court's determination of whether to afford comity to a proceeding, in a foreign nation.")

ity is subject to the public policy exception, one court has held that it would "look to the other relevant factors enumerated in section 304(c) to determine whether the evidence presented as to [the foreign] law indicates that its application . . . would be wicked, immoral, or [would] violate American law and public policy."[217] This interpretation of section 304(c) seems sound given the absence of applicable legislative history. Thus, if the moratorium meets the five other section 304(c) factors it should be given effect under the doctrine of comity.

2. *Just Treatment*

The first factor for a court to consider in evaluating a NODC's debt moratorium is whether the moratorium provides for "just treatment of all holders of claims against"[218] the NODC. "Just treatment" requires provisions for equitable repayment of all creditors.[219]

To require the moratorium to provide a detailed restructuring plan would be inconsistent with the function of the moratorium: the moratorium should be intended to signal creditors that restructuring negotiations are necessary and not to restructure the debt unilaterally. Just treatment can be assured in several ways, without unilaterally restructuring the debt. First, the debt moratorium should be nondiscriminatory. It can be required to provide that debts owed to citizens of the debtor will not be paid in foreign currency until renegotiation is complete.[220] Second, the moratorium should call for prompt negotiations. Third, the NODC should agree only to an equitable distribution. Last, the court can review the agreement once renegotiations have concluded, if requested to do so by the litigating creditors, to assure that it provides for repayment of all creditors in full and with interest on an equitable and nonpreferential basis. Consistent with domestic application of sections 304 and 305, these requirements — and those that follow — should be interpreted flexibly and in favor of the debtor.

3. *Avoidance of Prejudice*

The moratorium and the resulting renegotiation should protect creditors from "prejudice and inconvenience"[221] in restructuring the NODC's debt. This can be assured by imposing several requirements.

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217. *Id.*

218. 11 U.S.C. §304(c)(1) (1982).

219. *Cf. Culmer*, 25 B.R. at 629 (In liquidation, a foreign bankruptcy law provides just treatment if it "[p]rovides a comprehensive procedure for the orderly and equitable distribution of [the debtor's] assets among all the creditors.").

220. *Cf. id.* at 630 ("No preference is given to the claims of Bahamian citizens.").

221. 11 U.S.C. §304(c)(2) (1982).

First, the court shall require adequate notice to all creditors of the moratorium and restructuring negotiations.[222] IMF participation in renegotiations could also be required. The IMF can act as would the trustee or examiner under a Chapter 11 reorganization[223] and, in fact, increasingly does so.

Formation of a creditors' committee to represent the creditors in negotiations with the NODC is also necessary. Obviously, the hundreds of banks involved in NODC restructuring can not all be represented at the negotiation. However, the current *ad hoc* process provides for formation of bank steering groups which perform a function directly analogous to Chapter 11 creditor committees. These bank steering groups should be required to include representatives of all classes of affected creditors.[224]

Fourth, the court should require preparation of an equitable plan of repayment analogous to repayment rules under Chapter 11. Last, it should also require approval of such plan by at least the majority required by the Bankruptcy Code.[225] Requiring these provisions would assure that the moratorium protects the creditors' interests and minimizes inconveniences to them.

4. *Nonpreferential Treatment*

A basic postulate of bankruptcy law is avoidance of preferential payments to some creditors. However, not all payments are considered preferential.[226] In the NODC debt context, several classes of transfers should not be considered preferential. Payments to citizens of the debtor should only be considered preferential if made in foreign currency. (Payments made in the NODC's currency are acceptable if payment to foreign creditors in domestic currency is not prohibited.) Only if the NODC is actively paying its citizens in foreign currency are external creditors' interests affected. Payment to citizens in domestic currency cannot have a significant impact on the creditors' rights, but suspending them would bring the NODC's economy to a standstill

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222. *Cf. Culmer*, 25 B.R. at 630 ("Adequate notice of the [foreign] proceeding, is required.").

223. *See* Note, *supra* note 22, at 334-35.

224. *See supra* note 69 and accompanying text. *See also* Note, *supra* note 22, at 335-36. *Cf.* 11 U.S.C. §1102 (providing that the seven creditors with the largest claims are automatically included in the committee and that the court has discretion to include other representative creditors.)

225. *See supra* note 150 and accompanying text. Typically, the percentages required by the loan agreement will be significantly higher. *See supra* note 72 and accompanying text.

226. *See* 11 U.S.C. §547 (1982).

(particularly in centralized economies), and this would in turn have a significant impact on the NODC's ability to repay the foreign creditors.

Continued payment to official creditors, including the IMF and other quasi-governmental bodies, should also not be considered preferential. NODC-official creditor negotiations normally proceed on separate and prior tracks from the private bank loan restructuring.[227] Because official creditor debt relief, especially IMF conditional relief, has been required by the banks as a condition precedent to their renegotiation and provides essential interim funding,[228] payments to the official creditors do not impair and may ultimately promote the private creditors' interests. Clearly no preferential payments to private bank creditors should be made, however. Provided that the moratorium prohibits such payments, it should be held consistent with nonpreferential treatment.

5. *Payments*

The Bankruptcy Code provides an elaborate priority scheme for repayment of allowed claims.[229] In a reorganization, all creditors should be repaid, as much as possible, in full. Similarly, the debt moratorium and the following restructuring should provide a repayment schedule analogous to that of the Code and assure that all creditors will eventually be paid in full with interest.[230]

6. *Fresh Start*

The final section 304(c) factor, "the opportunity for a fresh start,"[231] is inapplicable to sovereign debt restructuring. However, in a sense restructuring does permit a "fresh start," by permitting the NODC time to regain economic stability. Thus, perhaps the moratorium should state that the NODC will accept IMF conditionality and otherwise seek economic security.

D. *The Costa Rican Restructuring: A Case Study*

Had the Second Circuit applied the preceding test to the Costa Rican moratorium, it would have had to conclude that the decree deserved recognition. The Central Bank decrees of August 27, 1981, provide that effective August 28, 1981, foreign exchange would not be

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227. *See supra* notes 57-72 and accompanying text.
228. *See supra* note 58 and accompanying text.
229. *See* 11 U.S.C. §§507, 726 (1982).
230. *Cf. Culmer*, 25 B.R. at 630-31.
231. 11 U.S.C. §304(c)(6) (1982).

available for the servicing of external debt, except for payment to official creditors, which would be made "as long as the availability of foreign exchange in the country permits."[232] The government decree of November 24, 1981, states that, to assure "harmony of decisions and centralization of the decision making process" in the ongoing renegotiations, external debt payments are not to be made without the approval of the Central Bank and the Ministry of Finance.[233]

The decrees comply with the requirements of just treatment. The decree is nondiscriminatory in effect, if not in language, because all internal debt to citizens or other creditors is payable in domestic currency.[234] Thus, the limitation of the decree to external debt does not discriminate against foreign creditors. Throughout the process Costa Rica consistently sought to restructure its debt on an equitable basis providing for equal treatment of similarly situated creditors and full repayment of all obligations.[235] Last, the complete agreement provides for such repayment.[236]

The decrees also comply with the tests for avoidance of prejudice. Costa Rica first approached its external creditors with a request for restructuring on June 7, 1981.[237] All creditors were notified on July 27, 1981, that repayment of short-term debt was to be suspended.[238] The banks thus had adequate notice of the forthcoming Central Bank decree and the request for renegotiations. The IMF had been approached by Costa Rica in early 1981, and on June 17, 1981, an agreement with

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232. Resolution adopted by the Board of Directors of the Central Bank of Costa Rica at meeting No. 3662-81, art. II. (Aug. 27, 1981), *reprinted in* Joint Appendix of Plaintiff's - Appellant's and Defendant's - Appellee's Briefs at 198, 200-01, *Allied Bank I* No. 83-7714, slip op. [hereinafter cited as Joint Appendix].

233. Executive Decree No. 13103-H, Nov. 24, 1981, La Gaceta No. 225, art. 2., *reprinted in* Joint Appendix, *supra* note 232, at 204, 206.

234. *See* Defendants' Rehearing Brief, *supra* note 68, at 11. ("The Costa Rican decrees on their face apply only to external debt, debt payable in foreign currency . . . because that was the practical problem faced. Costa Rican debtors are generally able to pay foreign currency denominated debts in Costa Rica in colones [the Costa Rican currency].")

235. *Id.* at 12. *See also* Step-by-Step, *supra* note 11, at 33-45 (describing the restructuring process and the efforts to achieve an equitable result). Professor Quale also notes that "[t]he Costa Rican decrees did not repudiate or confiscate the debts of Costa Rican borrowers payable in a foreign currency. Those decrees did affect the *timing* of the repayment of the Costa Rican banks' obligation but they did not purport to affect the underlying obligation to pay which remained valid and enforceable." Quale, *supra* note 158, at 26-27.

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

237. Step-by-Step, *supra* note 11, at 34.

238. *Id.* at 36.

the IMF was concluded.[239] IMF participation is therefore also satisfied. Similarly, the requirement of formation of a bank steering group was satisfied on September 25, 1981.[240] Last, the restructuring agreement was approved by 170 of 171 banks,[241] a percentage much higher than that required by the Bankruptcy Code. The decrees thus avoid prejudice to the affected creditors and satisfy this prong of the test to determine their validity and enforceability in U.S. courts.[242]

The requirement of nonpreferential treatment is also satisfied. Equally situated creditors were treated equally, and only the official creditors received additional payments. The continued payment of internal debt was necessary to keep Costa Rica's economy functioning. Because the decrees prohibited all foreign bank debt servicing, no creditor received payments that could be considered preferential.

Last, the moratorium provided Costa Rica with the necessary time to regain its economic stability and organize a restructuring providing for full, equitable repayment of its debts.[243] All prongs of the test were therefore met and extension of comity to the decrees would have been appropriate.[244]

V. CONCLUSION

There is currently no formal method for a fiscally troubled NODC to initiate negotiations with its private creditors. Debt moratoria serve a useful signaling function in lieu of such a formal procedure. Moreover, debt moratoria are the only practical way of assuring that the creditors' dilemma inherent in sovereign debt renegotiations will be resolved in the collectively optimal way at minimal cost.

Properly limited nondiscriminatory, nonrepudiatory moratoria should, therefore, be given effect by U.S. courts. The test proposed by

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239. *Id.* at 34, 45. A second IMF agreement was concluded in June of 1982.

240. *Id.* at 36.

241. *See supra* note 100 and accompanying text.

242. Costa Rica also continued to pay its bondholders, but the banks eventually agreed to permit such payments. Step-by-Step, *supra* note 11, at 43-45. Generally, bondholders are not considered to be equally situated with bank lenders and most countries' laws give them preference. *Id.* at 34. Thus, the payments to bondholders should not prevent extension of comity to the decrees.

243. *See* Defendants' Rehearing Brief, *supra* note 68, at 12-16.

244. Similarly, the U.S. District Court for the Southern District of New York has held that the foreign exchange control regulations adopted by Mexico in August of 1982 "cannot be construed as simply a repudiation of a government entity's 'commercial debt' but were rather a conventional [device] of civilized nations faced with severe monetary crises rather than the crude and total confiscation by force of a private person's assets." Braka v. Bancomer, 584 F. Supp. 1465 (S.D.N.Y. 1984), *aff'd*, 762 F.2d 222 (2d Cir. 1985).

this article provides a coherent procedure for determining when comity should be extended and would assure that the interests of all parties are protected.

VI. APPENDIX

The original opinion of the U.S. Court of Appeals for the Second Circuit before rehearing in *Allied Bank* is not printed in the bound volumes of the Federal Reporter. The Court's opinion is reproduced here because of its significant references to the analogy between sovereign debt litigation and domestic bankruptcy law.

Opinion of Court of Appeals dated April 23, 1984

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Argued March 12, 1984 — Decided April 23, 1984

No. 651, Docket 83-7714.

ALLIED BANK INTERNATIONAL, For Itself and As Agent For American Fletcher National Bank, American Fletcher National 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 Lyonnais, 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 (Inter-America), 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,

Plaintiffs.

Allied Bank International,

Plaintiff-Appellant,

v.

BANCO CREDITO AGRICOLA DE CARTAGO, Banco Anglo Costarricense and Banco Nacional De Costa Rica,

Defendants-Appellees.

Robert B. McKay, New York City (Salvatore A. Ranieri, Michael S. Allen, Santora, McKay & Ranieri, New York City, of counsel), for plaintiff-appellant.

Opinion of Court of Appeals dated April 23, 1984

Jeffrey Barist, New York City (Robert M. Kelly, F. Ellen Zeifer, White & Case, New York City, of counsel), for defendants-appellees.

John L. Warden, II. Rodgin Cohen, Michael Straus, Steven H. Reisberg, Sullivan & Cromwell, New York City, for amicus curiae The New York Clearing House Ass'n.

Before MESKILL and PIERCE, Circuit Judges, and METZNER,* District Judge.

PER CURIAM:

This appeal arises from the dismissal of an action by the United States District Court for the Southern District of New York, Griesa, *J.*, on the basis of the act of state doctrine. Appellant, alleging default on the obligations owed to it by appellees, sought to recover $5,233,453.82, plus interest, attorneys' fees and costs.

We agree that the action should have been dismissed. We need not address the question of whether the act of state doctrine applies because the actions of the Costa Rican government that caused the default are consistent with the policy and law of the United States. Therefore, comity requires that the actions should be given effect in United States courts.

BACKGROUND

Appellant Allied Bank International (Allied) is the agent for a syndicate of thirty-nine banks. Appellees are three Costa Rican banks which are owned by the Republic of Costa Rica and are subject to the control of the Central Bank of Costa Rica (Central Bank). Appellees maintain no employees or offices in New York. Neither do they conduct banking business there.

Appellees assumed the obligations at issue here in 1976 after the failure of the Latin American Bank, a bank principally doing business in Costa Rica, and pursuant to its subsequent reorganization. Appellees issued new promissory notes and executed side letter agreements (agreements) with appellant on June 30, 1976. Most of the negotiations leading to the agreements and the actual execution of the agreements occurred outside of the United States.

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* Honorable Charles M. Metzner, United States District Judge for the Southern District of New York, sitting by designation.

Opinion of Court of Appeals dated April 23, 1984

Under the agreements, appellees were to make "unconditionally" eleven semi-annual payments in New York City with United States dollars. The agreements also recognized that the obligations were registered with the Central Bank, which would provide the necessary United States currency. Although the agreements did not specify governing law, they did provide for concurrent jurisdiction over disputes in New York and in Costa Rica.

Under the agreements, appellees' failure to pay the required interest or principal within thirty days of the payment date would constitute default. Upon default, appellant could demand full payment of the promissory notes. If failure to pay was due to the omission or refusal of the Central Bank to release United States currency, default would be excused for an additional ten days.

Appellees made the required payments until 1981 when the Republic of Costa Rica found itself in a severe economic crisis. On August 27, 1981, in response to the crisis, the Central Bank resolved that it would release no foreign currency for the payment of debts (with minor exceptions inapplicable here). On November 24, 1981, the President of Costa Rica decreed that the appellees and other public sector entities could pay external debts only with the express approval of the Central Bank. The decree stated that such measures were necessary because "presently the Government of Costa Rica is renegotiating its External Debt and for this purpose there should be harmony of decisions and centralization in the decision-making process." J.App. at 205. The Central Bank informed appellees that the payment of external debt in United States dollars was to be deferred. Consequently, appellees failed to make the required payments on the subject obligations. Appellant brought this suit for full payment under the agreements.

In the district court action, appellees did not contest their failure to pay their obligations, but moved to dismiss appellant's action under Fed.R.Civ.P. 12(b) for lack of subject matter jurisdiction because of sovereign immunity, lack of *in personam* jurisdiction, insufficiency of process and insufficiency of service of process. Appellant moved for summary judgment pursuant to Fed.R.Civ.P. 56. Appellees' defense to the summary judgment motion was that payments on the obligations had been prevented by the actions of the Republic of Costa Rica.

The court denied all of the motions. 566 F.Supp. 1440. It explained that the act of state doctrine barred the entry of summary judgment for appellant. Entering such a judgment, the court explained, would question the validity of a foreign state's action and would risk embarrassment to the relations between the governments of the United States and Costa Rica. Because the appellees raised actions of the

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Costa Rican government only as a defense to the summary judgment motion, the court did not dismiss the action. Subsequently, on July 22, 1983, the action was dismissed by agreement of the parties after they stipulated that no factual issues remained with respect to the act of state doctrine.

While the action was still pending in the district court, negotiations began for the rescheduling of payments of appellees' obligations. On September 9, 1983, after the district court's dismissal, the appellees, the government of Costa Rica and the Central Bank signed a refinancing agreement with the coordinating agent for Costa Rica's external creditors. Only one of the thirty-nine banks in the Allied Syndicate, Fidelity Union Trust Company of New Jersey, refused to accept the agreement. It is this lone bank that Allied now represents on appeal. Appellees have made payments to the other thirty-eight banks as required in the refinancing agreement.

Costa Rica's economic crisis also caused its default on payments of its intergovernmental obligations. When a country defaults on a loan granted to it by the United States under the Foreign Assistance Act of 1961, Pub.L. No. 87-195, 75 Stat. 424 (1961) (codified as amended in scattered sections of 22 U.S.C.), further aid to the defaulting country is barred unless the President advises Congress that "assistance to such country is in the national interest." 22 U.S.C. § 2370(q) (1982). President Reagan and the Congress reacted sympathetically to Costa Rica's financial crisis and its default on Foreign Assistance Act loans. The President advised that

> [c]ontinuation of U.S. assistance to Costa Rica is consistent with the commitment of this Administration and in Congress to help Costa Rica regain economic viability. We therefore regard such assistance, which is designed to help the Government with financial and management reforms and with needed credit to the private sector, as vital and in the national interest. We are hopeful that bilateral debt restructuring will be completed within the next several months.

Letters from Secretary of State George P. Shultz to Speaker of the House Thomas P. O'Neill (Mar. 18, 1983 and Oct. 11, 1983), *reprinted in* Br. of Appellees, App. A. The House of Representatives also expressed "full support for the Republic of Costa Rica and its democratic institutions as that country responds to the current economic crisis." H. Con. Res. 423, 97th Cong., 2d Sess., Cong. Rec. H. 10206 (Dec. 17, 1982); *see also* H.Con.Res. 194, 98th Cong., 1st Sess.,

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Cong.Rec.H. 10350 (Nov. 17, 1983). In January 1983, the United States joined several other nations in the signing of the Paris Club Agreed Minute which rescheduled the intergovernmental debt of Costa Rica. The Agreed Minute contained a provision recommending the rescheduling of Costa Rica's commercial obligations. Br. of Appellees, App.B. at 3.

DISCUSSION

Appellant argues that the act of state doctrine is inapplicable to the present action because the situs of the obligations is New York. The act of state doctrine precludes the examination of a foreign sovereign's confiscation of property within its own territory. *United Bank Ltd. v. Cosmic International Inc.*, 542 F.2d 868, 872 (2d Cir. 1976) (quoting *Republic of Iraq* v. *First National City bank*, 353 F.2d 47, 51 (2d Cir. 1965) (citations omitted), *cert. denied*, 382 U.S. 1027, 86 S.Ct. 648, 15 L.Ed.2d 540 (1966)). Thus, if the situs of the obligations is Costa Rica, the district court properly dismissed the action. We need not address appellant's argument, however, because the location of the debts is not determinative of the outcome of the action. When the property or contractual obligations affected by the foreign government's actions are located within the United States, our courts will give effect to those actions "only if they are consistent with the policy and the law of the United States." *United Bank*, 542 F.2d at 872 (quoting *Republic of Iraq*, 353 F.2d at 51). Thus, if the situs of the obligations is the United States, as the appellant claims in arguing that the act of state doctrine is inapplicable, the actions of the Costa Rican government will still be recognized as valid in United States courts if they are consistent with the law and policy of the United States. *See United States* v. *Belmont*, 301 U.S. 324, 57 S.Ct. 758, 81 L.Ed. 1134 (1937); *Canada Southern Railway Co.* v. *Gebhard*, 109 U.S. 527, 3 S.Ct. 363, 27 L.Ed. 1020 (1883); *Banco Nacional de Cuba* v. *Chemical Bank New York Trust Co.*, 658 F.2d 903, 908-09 (2d Cir. 1981); *cf. Central Hanover Bank & Trust Co.* v. *Siemens & Halske Aktiengesellschaft*, 15 F.Supp. 927, 930 (S.D.N.Y.), *aff'd*, 84 F.2d 993 (2d Cir.) (per curiam), *cert. denied*, 299 U.S. 585, 57 S.Ct. 110, 81 L.Ed. 431 (1936) (German bond laws not given effect, because they did not involve "insolvency" and were discriminatory).

The actions of Costa Rica that resulted in the prohibition of payments on external debt are consistent with the law and policy of the United States. In *Canada Southern Railway Co.* v. *Gebhard*, 109 U.S. 527, 3 S.Ct. 363, 27 L.Ed. 1020 (1883), the Supreme Court bound

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New York bondholders to the Canadian government's reorganization of the debts of the government-owned Canada Southern Railway. In ordering the dismissal of the bondholders' suit on the old bonds, the Court stated:

> [The plan] is in entire harmony with the spirit of bankrupt laws, the binding force of which, upon those who are subject to the jurisdiction, is recognized by all civilized nations. It is not in conflict with the Constitution of the United States, which, although prohibiting States from passing laws impairing the obligation of contracts, allows Congress "to establish . . . uniform laws on the subject of bankruptcy throughout the United States." . . . Under these circumstances the true spirit of international comity requires that schemes of this character, legalized at home, should be recognized in other countries.

Id. at 539, 3 S.Ct. at 371.

Similarly, Costa Rica's prohibition of payment of its external debts is analogous to the reorganization of a business pursuant to Chapter 11 of our Bankruptcy Code, 11 U.S.C. §§ 1101-74 (1982). Under Chapter 11, all collection actions against a business filing an application for reorganization are automatically stayed to allow the business to prepare an acceptable plan for the reorganization of its debts. 11 U.S.C. §§ 103(a), 362, 901(a) (1982). *See In re Frigitemp Corp.*, 8 B.R. 284 (D.C.S.D.N.Y. 1981) (purpose of § 362 is to give insolvent debtor opportunity to formulate plans for repayment and reorganization with protection from mad scramble of creditors for assets). Costa Rica's prohibition of payment of debt was not a repudiation of the debt but rather was merely a deferral of payments while it attempted in good faith to renegotiate its obligations. That Costa Rica's renegotiation of its debts is also consistent with our foreign policy is indicated by the support voiced for the renegotiation by both the legislative and executive branches of our government. Because the decree and resolutions of the Costa Rican government that resulted in appellees' default were consistent with the law and policy of the United States, their validity should be recognized in United States courts. *Canada Southern Railway Co.*, 109 U.S. at 539, 3 S.Ct. at 371.

Appellant also argues that Costa Rica's actions should not be given effect because the government of Costa Rica was acting as a commercial entity and not as a sovereign nation. Although the actions of Costa Rica affected commercial activity, Costa Rica was clearly acting as a sovereign in preventing a national fiscal disaster. *See Hunt* v.

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Mobil Oil Corp., 550 F.2d 68, 73 (2d Cir.), *cert. denied*, 434 U.S. 984, 98 S.Ct. 608, 54 L.Ed.2d 477 (1977); *see also International Association of Machinists and Aerospace Workers* v. *Organization of Petroleum Exporting Countries*, 649 F.2d 1354, 1360 (9th Cir. 1981) ("[T]he act of state doctrine remains available . . . regardless of any commercial component of the activity involved."), *cert. denied*, 454 U.S. 1163, 102 S.Ct. 1036, 71 L.Ed.2d 319 (1982).

The actions of Costa Rica as a sovereign nation that prevented the timely payment of appellees' obligations are consistent with our law and policy. Comity considerations demand that the actions of Costa Rica be recognized in the courts of the United States. Therefore, the action was properly dismissed.

Affirmed.