Banking by Kathy Burdman

Appeals court upholds moratorium

Costa Rica's 1981 debt moratorium is declared valid under U.S. Chapter 11 practice.

On April 23, Wall Street was shaken by a Second Circuit Court of Appeals decision validating the actions of the Costa Rican government to restrict payments on its foreign debt. In *Allied Bank International v. Banco Credito Agricola de Cartago, et al.*, the Circuit Court affirmed a District Court decision upholding a 1981 Costa Rican debt moratorium, on grounds different than the Circuit Court decision: principally, that Costa Rica's moratorium was a valid, Chapter 11 bankruptcy reorganization.

The decision potentially opens the way for the much-needed debt moratorium for all of Ibero-America, recommended by Lyndon H. LaRouche in his book, *Operation Juárez*. Although the court decision could be used by Swiss bankers and their friends as a bludgeon against the U.S. banking system, to force a further contraction in lending and thereby worsen the debt crisis, it also provides an opportunity for the exercise of natural law.

All too often, U.S. courts have ignored the principle of natural law upon which the Constitution and such laws as Chapter 11 are based, a principle expressed in Shakespeare's *Merchant of Venice*, in which a judge is compelled to acknowledge a usurer's right to his "pound of flesh"—but only if he does not spill a drop of the debtor's blood in the process. Debt obligations which mean massive suffering and death, as throughout Ibero-America, are not valid obligations.

The Costa Rican case involved a series of promissory notes executed in 1976 by three Costa Rican banks. The notes were payable to a syndicate of 39 U.S. banks and required payment in U.S. currency. As the economic crisis deepened, the Costa Rican government began to carry out a moratorium by refusing to authorize its central bank to disburse foreign exchange for debt payment. On July 2, 1981, when one of the three banks applied to the central bank for foreign exchange to make its semi-annual payment, the central bank notified all three that no foreign exchange would be available for that purpose until the entire Costa Rican debt situation was ameliorated.

On behalf of the syndicate, Allied Bank filed suit for the unpaid balance plus the accrued interest. The Costa Rican banks raised as their main defense that the failure to pay was based upon an act of a foreign state which is not subject to U.S. courts. But on July 8, 1983, Judge Griesa of the Southern District of New York decided in Costa Rica's favor because "the crucial factor . . . which prevented payment of the notes was public in nature, rather than commercial, and its purpose was to serve a governmental function."

Thirty-eight of the syndicate banks afterward reached a refinancing agreement with the Costa Rican government and its Central Bank. The holdout was Fidelity Union Trust Company of New Jersey, which appealed the Griesa decision, arguing that the act of state doctrine applies only to actions taken by a government within its boundaries, and not to foreign obligations.

The appeals court has now sidestepped the act of state doctrine by holding that the actions by Costa Rica were consistent with U.S. law and policy. Therefore, under the doctrine of comity—recognition by one country of the laws of another to the fullest extent possible—the Costa Ricans had stated a valid defense.

The Circuit found two grounds for extending comity to the Costa Rican situation. First, under the Foreign Assistance Act of 1961, further aid to a defaulting country is prohibited unless the President tells Congress that "assistance to such country is in the national interest." The Reagan administration apparently did so in letters to House Speaker Tip O'Neill, dated March 18 and Oct. 11, 1983.

But most striking, the Circuit said, "Costa Rica's prohibition of payment of its external debts is analagous to the reorganization of a business pursuant to Chapter 11 of our Bankruptcy Code, 11 U.S.C. 1101-74 (1982)." The court stressed that Costa Rica had not repudiated its obligations, but was rather deferring its payment "while it attempted in good faith to renegotiate its obligations." Therefore, "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 court."

Since this latter point is contained in the Discussion section of the opinion, it appears that the Chapter 11 analogy is legally sufficient by itself to sustain a defense. Debtor nations can use Chapter 11 in U.S. courts to demonstrate comity in the event of a debt moratorium against American banks.