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LEGAL PROTECTION OF LOANS TO DEVELOPING COUNTRY BORROWERS

*Lajos Schmidt**

I. Introduction

At the Bretton Woods Conference in July 1944, in introducing the proposal for what is today the World Bank, John Maynard Keynes predicted: "In the dangerous and precarious days which lie ahead, the risks of the lender will be inevitably large and most difficult to calculate. The risk premium reckoned on strict commercial principles may be beyond the capacity of an impoverished borrower to meet, and may itself contribute to the risks of ultimate default."[1] Three decades later this problem of the gap between the developed-country lender's required risk premium and the developing-country borrower's ability to generate an investment return sufficient to pay that premium still confronts the world despite 28 years of World Bank operation, billions of dollars of foreign aid spent by the United States and other nations to strengthen developing countries' economic infrastructure and despite the activities of the Export-Import Bank, the Overseas Private Investment Corporation and analogous institutions in other Western countries.

Nonetheless, the problem, while still present, has contours quite different from those visible to Keynes in 1944. The pace of development in the Third World has been uneven; certain countries, notably Brazil and Indonesia, appear to have accelerated growth and borrowers in those countries are attracting foreign loans with relative ease. On the other hand, the landlocked countries of sub-Saharan Africa confront an immense struggle to develop; a struggle all the more exacerbated by the energy crisis and the concomitant cost increase in almost all things necessary for development.

On the other hand, the advent of the Euro-dollar market has greatly increased the potential source of funds available for

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1. Quoted in Hang-Sheng Cheng, International Bond Issues of the Less Developed Countries: Diagnosis and Prescription 67 (1969).

developing-country borrowers. Created apparently in response to Eastern European hard currency needs[2] fueled initially by surplus United States dollars accumulated overseas, later by surplus Arab funds and greatly spurred by the United States capital controls programs, which have just recently ended, the Euro-dollar market has greatly increased the number of lenders in international money markets; many of the newcomers are American banks hitherto without international experience but which have quickly adapted to the international scene. The increased number of lenders has made the Euro-dollar market increasingly competitive to the point where insufficient demand by borrowers from developed countries has led the more venturesome of the Euro-dollar lenders actively to seek out lending possibilities in developing countries.[3]

It is in this search for new lending markets that the risk premium dilemma described by Keynes re-emerges. Having acquired experience with the risks attendant upon international loans generally, the Euro-dollar lender must attempt to assess, quantify and, if possible, limit the risks (of making a loan to a developing-country borrower) sufficiently to place the risk premium it must charge within the range of the borrower's capacity to repay the loan out of the return derived from its investment. Moreover, it is precisely in this attempt that the international legal profession can best help lenders face the enormous challenge of increasing the flow of capital from the industrialized countries to those less developed. It is the purpose of this article to outline the additional problems that lawyers face when drafting a loan agreement with borrowers operating in a developing country and to make some suggestions that can hopefully result in the lowering of the risk of, and the consequent risk premium on, a developing-country loan, thereby facilitating the flow of capital to developing countries.

Additional considerations include the type of borrower and the nature and purpose of the loan. Whether the borrower is a public or private entity, whether the loan is short or long term, or whether its use is for a specific project or general purpose—these factors will naturally affect the ultimate document reflecting the agreement between the borrower and lender. This article will discuss the influence of all these factors but will not delve into the problems

2. Effros, *The Whys and Wherefores of Eurodollars*, 23 Bus. Law. 619, 637 (1968).

3. Davis, *A Buyer's Market in Eurodollars*, 51 Harv. Bus. Rev. 119 (1973).

encountered in raising funds for a borrower in a developing country by means of a bond offering, a matter that has its own peculiar problems.[4]

II. PROVISIONS OF A BASIC LOAN AGREEMENT—CAPACITY, COVENANTS AND DEFAULT

A. *Parties—Legal Capacity to Act*

Some of the legal problems of international loan agreements are not unlike those of domestic contracts.[5] With regard to the capacity of the parties, there must be a careful examination of such factors as the charter and by-laws of the corporation or international organization, the constitutional and legislative authorization for a governmental borrower, and central government authorization for loans to political subdivisions and other domestic entities. Aid of local counsel in the borrower's country is often advisable in conducting such examinations. For example, a government entity as a potential borrower may have restrictions on its long-term international borrowing capacity, which requires Ministry approval, while its short-term (defined as any period less than one year) borrowing capacity is unrestricted. Contrary to a potential short-term lender's reasonable expectation, even though supported by the borrowing entity's interpretation, that the less-than-one-year exception denotes the time period elapsing between takedown of the loan and its repayment, the matter may not be settled and, indeed, may be placed in doubt by a contradictory view from the competent Ministry that the loan period begins to run from the date the loan agreement is executed. Local counsel is peculiarly in a position to be aware of such problems. Further, if a definitive Ministry interpretation cannot be obtained and the borrower insists on effecting the transaction, based on its interpretation of the loan period, by urging a loan agreement signing more than one year in advance of repayment, the lender can acquiesce only if local counsel determines that any sanction for violating the borrowing limitation falls on the borrower and not the lender.

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4. *See* note 1 *supra*.

5. For a discussion of the practical problems in drafting a purely domestic loan agreement see Simmons, *Drafting of Commercial Bank Loan Agreements*, 28 BUS. LAW. 179 (1972).

B. *Financial Covenants*

International lenders also have a special interest in guiding and assisting developing borrowers in order to protect the viability of the loan from subsequent deleterious events. This interest may be secured in various ways—specific provisions for the application of the loan proceeds and negative covenants certifying that specified actions (*e.g.*, merger or consolidation with other entities) adverse to the lender's interests will not be taken without lender consent. It may also be important (as in domestic transactions) to protect loan viability by requiring the borrower to adhere to certain overall debt-asset and quick-fixed-asset ratios and to limit capital expenditures in any year by reference to the prior year's net cash flow. Here the lawyer's role as communication specialist comes to the fore since such covenants can be useful only if the communication gap between widely varying accounting standards and practices is bridged.

Even with successful communication, however, it may legitimately be asked what purpose is served by such financial covenants if accounting reports and practices in the country in question are at best erratic and the distant lender cannot adequately verify compliance. The answer lies in the self-enforcing character that such covenants assume with the conscientious borrower who properly understands the operation and need for such covenants. The potential of the self-enforcing covenants has been demonstrated to this writer in another difficult enforcement context—that of license agreements with Eastern European countries.[6]

C. *Default Provisions*

The matter of covenant drafting is closely allied to the problem of dealing with default provisions. Naturally, covenant breach will constitute one event of default, but the peculiar problem of drafting default terms for a loan in a developing country centers around the description of acts of bankruptcy and insolvency. Local law and practice regarding these matters must be checked to determine whether the almost formulaic recital of acts of insolvency and bankruptcy, which customarily appear in loan agreements in developing countries, adequately describes the acts and procedures

6. *See* Schmidt, *Licensing in the Eastern Bloc*, 7 VAND. J. TRANSNAT'L L. 1, 14 (1973).

recognized where the borrower operates. If not, the lender may find it difficult to prove, even to a court in a developed country, that the borrower's action constitutes an event of default.

III. Assurance of Loans—Guaranties and Security

A. *Guaranties*

One of the principal ways a lender can reasonably reduce the risk premium it must charge is by obtaining security of an adequate kind and amount. While viewing resort to a developed country's courts for enforcement of a loan agreement is at best time consuming, a lender is likely to view resort to a developing country's court as a hopeless morass. Hence the preference for security in the form of an asset or for a guarantor with assets accessible in the lender's own (or at least a developed country's) forum. The simplest kind of assurance a borrower can offer is, of course, a third-party guaranty made by a private person, a government or governmental agency, or an international organization such as the World Bank. Third-party covenants and guaranties can take many forms—promises to supply the borrower with funds or foreign exchange, to subordinate claims against the borrower or, in the case of public guarantors, to give the lender tax exemption.

A mere promise to pay on notice of default by the borrower, however, is not much of a guaranty, since the guarantor can normally avail itself of all of the borrower's defenses. An unconditional guaranty, however, may be too vague unless express waivers are constructively inferred under law. Moreover, in negotiating guaranties, a lender should bargain for the right to proceed directly, in case of default, against the guarantor without first proceeding against the borrower. Waivers or the issuance of a promissory note serve this purpose well. A lender should also assure itself of the guarantor's ability to perform any nonfinancial obligations and to obtain sufficient quantities of foreign exchange. It might be mentioned here that stipulation of jurisdiction is especially important in foreign government guaranties since the guarantee is not itself a waiver of immunity, a matter discussed in more detail below.

B. *Security*

If the borrower offers an assignment of revenues as security, it is best to bind the third-party revenue source in a separate agreement to pay the lender upon notice of default. If chattels are to be

pledged as security, they should be easily marketable and removed from the borrower's possession. The few items that satisfy these qualifications include corporate stock, bonds (and other evidence of indebtedness), gold and marketable commodities. Further, it is desirable to have these chattels deposited outside the borrower's country. International lenders may want to consider, if they are available, certain new forms of civil law security without transfer, such as *gage sans possession* or *prenda sin desplazamiento,* which usually involve machinery or commodities.[7]

The taking of a mortgage on foreign real estate requires careful examination of the law of the situs governing mortgages, real estate and rights of aliens. Of course, the deed must be drafted and recorded according to local law. A primary question is whether aliens can own land. The inability to do so, however, does not exclude land as security, for various arrangements can usually be validly established under local law, which enables the alien lender to receive the proceeds from the sale of land without ever holding title to it. It is also noteworthy that in some less developed countries (Indonesia is a good example) there may be no satisfactory means of recording a mortgage. Since certain countries, particularly civil law jurisdictions, may require recordation of the mortgage in local currency, lenders must covenant to protect themselves against depreciation of the local currency;[8] a revaluation clause, if legal, is one possibility. Depreciation may affect other covenants, such as insurance, and the parties may wish to plan to meet this contingency. In many civil law jurisdictions a mortgage includes movable property on the premises. While broadening the lender's security, this may greatly inconvenience the operations of the mortgagor and the parties may wish to plan accordingly.[9]

IV. CHOICE OF LAW AND FORUM

A. *Choice of Law*

The parties' choice of law and forum can significantly affect the

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7. G. DELAUME, LEGAL ASPECTS OF INTERNATIONAL LENDING AND ECONOMIC DEVELOPMENT FINANCING 239-40 (1967).

8. *See, e.g.,* CIV. C. art. 1477 (1830), *as amended,* Madrid, Instituto de Cultura Hispanica, 1959) (Bol.); CIV. C. art. 2455 (1887), *as amended,* 6 ed. Bogotá, Editorial Temis, 1969) (Colom.).

9. *See,* G. DELAUME, *supra* note 7, at 246-47.

lender's view of the risk and value of agreement covenants and events of default, as well as guaranties and security. The understandable attitude of international lenders can be condensed in the forthright credo: "one judge, one law, preferably my own." Unfortunately, the determination of the law and forum governing international loans is not as straightforward.

It is always advisable to stipulate expressly the law governing international loan agreements. For loans made by private persons or domestic public lending agencies, the usual practice is to stipulate the law of the lender's country; for bond issues, the law of the market of issue is usually specified. These practices are also common in loans concluded by international entities such as sovereign governments and international organizations (like the World Bank). Recognizing that their ultimate remedy was not in the lender's country, some international organizations have elected not to submit their loan agreements to the law of the borrower's country, and have prepared their documents so as to be valid under the law of that country.[10] Regardless of this stipulation of applicable law, it is advisable to conform the provisions of the loan agreement to both the lender's and borrower's laws. This will insure that in case of a controversy, which may have to be litigated in the borrower's country, the lender has the greatest likelihood to prevail. In the alternative, international law may be invoked by the lender arguing that no domestic law shall frustrate the expressed terms of the international loan agreement. The World Bank, for example, includes in its Loan Regulations the statement that: "The rights and obligations of the Bank and the Borrower under the Loan Agreement and the Bonds shall be valid and enforceable in accordance with their terms notwithstanding the law of any state, or political subdivision to the contrary . . . ."[11]

If there is no stipulation of applicable law in an international loan made by a private person, courts may be expected to apply the law of the lender or, in the case of bonds, the law of the market. This is rather important since foreign governments, for reasons of prestige, may not wish to specify applicable law in case of default

10. *Id.* at 80-81.

11. INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, LOAN REGULATIONS NO. 3 APPLICABLE TO LOANS MADE BY THE BANK TO MEMBER GOVERNMENTS, art. VII, § 7.01 (1961).

in their public debenture issues. If the loan is to be guaranteed by a third-party, the same law should be stipulated as that governing the principal debt.

It should be stressed that the stipulation of applicable law is not a substitute for precise expression of the intent of the parties about what constitutes performance and breach, lender's remedies and borrower's defenses since the law itself is subject to change. A special problem is that of statutes of limitations for bonds or government debts, which vary from country to country. It should be noted that civil law countries view this question as a substantive issue controlled by the law governing the cause of action; common law jurisdictions view the question as a procedural issue governed by the law of the forum. Hence, there may be instances when it is preferable from a lender's point of view *not* to specify the applicable statute of limitations.

B. *Choice of Forum*

A similar dichotomy exists with regard to the choice of forum. In civil law countries, lenders often do not specify forum since the nationality of the lender gives local courts jurisdiction.[12] In common law countries, lenders prefer to specify their nonexclusive forum choice and also reserve the right to sue in foreign courts. A stipulation of exclusive forum constitutes a waiver by the parties of other jurisdictional rights and also binds successors and assigns, a point which the Supreme Court in *The Bremen v. Zapata Off-Shore Co.*[13] case appears to have definitely made a part of United States law. But a stipulation cannot extend the jurisdiction of a court beyond its own subject-matter jurisdiction. For example, in loan agreements, which provided for the settlement of controversies before the International Court of Justice in The Hague, the jurisdictional stipulation was frustrated and of no effect since the International Court only has jurisdiction in controversies between sovereign nations.

Jurisdictional stipulations in loans between international parties vest jurisdiction that would otherwise be lacking. The effectiveness of such clauses in loans from private parties to international parties depends on whether the accompanying waiver of

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12. *See* C. Civ. arts. 14, 15 (ed. Petits Codes Dalloz, 1971-72) (Fr.).
13. 407 U.S. 1 (1972).

immunity is revocable, as it is in the United Kingdom.[14] In the United States the question of revocability of waiver is enmeshed in the still uncertain law of sovereign immunity. American lenders, in addition to specifying jurisdiction, often have international borrowers "irrevocably" waive immunity and further characterize the loan as private and commercial as opposed to governmental or public.

V. ARBITRATION

International lending organizations, such as the World Bank, have been the most receptive to the use of arbitration clauses in their loan agreements. This may be because the international legal character of their transactions does not provide a convenient judicial forum. Moreover, the complex economic and technical nature of their loans may also lend themselves better to arbitration by experts than to determination by courts.[15] Generally speaking, however, arbitration clauses have not been a common feature of international loan agreements. In loans to governmental entities, considerations of prestige and mutual trust may militate against arbitration clauses. Furthermore, governmental regulations sometimes restrict or forbid arbitration provisions, particularly in public or government contracts, and thereby cast doubt on the validity or enforceability of arbitration clauses. In loans between private entities, lenders often (rightly) believe courts to be more effective than arbitration in conclusively and speedily resolving differences. After all, from a lender's viewpoint there is little in need of arbitration; the only issue is whether an event of default occurred and, if so, a speedy and effective judgment for the amount of the loan should be obtained.

Notwithstanding the preference of most lenders to leave the settlement of controversies to the courts, the shortcomings of reliance upon courts of law should be obvious, particularly if the borrower has no assets within the jurisdiction of the forum. To facilitate the use of arbitration in international contract disputes, the World Bank has sponsored the creation of the International Centre for Settlement of Investment Disputes (ICSID). Under the definitive

14. *See* Duff Dev. Co. v. Government of Kelatan, [1924] A.C. 797; Kahan v. Pakistan Fed. [1951] 2 K.B. 1003.

15. DELAUME, *supra* note 7, at 180.

regulations and rules, which came into effect in 1968, contracting states and their nationals may bring requests for conciliation or arbitration to the ICSID whose comprehensive rules prescribe procedures for selection of arbitrators, apportionment of costs, the proceeding itself and the rendering of the award. It should be emphasized that the ICSID rules are not intended to restrict the rights of the parties to agree on their own rules; rather, they will apply only when the parties have not agreed on their own rules.[16] That the ICSID has not yet been accepted and employed on a broad scale can be attributed to the prevalence of those factors militating against arbitration already discussed.

The major problem of recognition and enforcement of foreign arbitral awards is the subject of a 1958 United Nations Convention. Reluctance to enter arbitration agreements has been due, in no small part, to a winning party's need to initiate a judicial proceeding to enforce a foreign award, with judicial recognition and enforcement a matter of grave uncertainty. The 1958 United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards[17] provides that courts of a contracting country will not take jurisdiction of a matter that the parties have previously agreed to submit to arbitration and that each contracting state will recognize such arbitral awards as binding and enforceable in its jurisdiction once the petitioner has complied with several formal requirements. There are a few exceptions, most notably when domestic law does not permit arbitration of the particular subject matter and when recognition or enforcement of the award would be contrary to a nation's public policy.

The United States did not accede to this convention until 1970, and it did not become effective in the United States until February 1, 1971. It is hoped that more nations will ratify the convention (the United States was only the 37th nation to ratify the convention[18]), since ratification by less developed countries may encourage lenders to make greater use of arbitration clauses, whether through the ICSID or otherwise, and since this increased protection for international lenders will certainly increase the availability of foreign capital to the less developed nations.

16. *ICSID R. & Rules* 140 (Washington, D.C., 1968).

17. Multilateral Convention on the Recognition and Enforcement of Arbitral Awards, Dec. 29, 1970, *opened for signature* June 10, 1958, [1970] 21 U.S.T. 2518, T.I.A.S. No. 6997, 330 U.N.T.S. 38.

18. *Id.*

VI. SOVEREIGN IMMUNITY

A. *Two Theories—Absolute and Restrictive*

The problem of sovereign immunity is particularly significant in transactions involving less developed nations, since in these countries, the government or governmental agencies are more likely to be the borrowers or guarantors of loans of international capital. In countries adhering to the absolute theory of sovereign immunity, such as the United Kingdom, plaintiffs are barred from pursuing all claims in court against foreign governments or foreign governmental agencies on the grounds that the court lacks jurisdiction. In countries adhering to the restrictive theory of sovereign immunity, including the United States, a foreign sovereign is granted immunity from suits arising from its public acts (*jure imperii*) but not from those arising from its private acts (*jure gestionis*).[19]

B. *Restrictive Theory of Sovereign Immunity*

1. *Immunity from Suit.*—Under the restrictive theory of sovereign immunity, whether foreign government borrowing is a public or private act would seem to depend on the circumstances and purposes of the loan. If, for example, a national bank guaranteed the payment of a commercial loan by a domestic corporation, it could be argued that the bank acted in a private commercial capacity and was not entitled to immunity from suit with respect to such a private act. The inclusion in loan agreements of consent to jurisdiction and an "irrevocable" waiver of immunity, and characterization of the loan as private and commercial, as opposed to governmental and public, are not necessarily binding, but are useful as expressions of the intent of the parties. A second ground for denial of sovereign immunity may arise when the borrowing entity has an identity distinct from the foreign sovereign. For example, there exists a line of cases, almost exclusively New York State and Southern District of New York cases, holding on various rationales that a foreign public corporate instrumentality, even if wholly and directly owned by a foreign government, may be denied immunity from suit if it has an identity distinct from, and may sue or be sued distinct from, its governmental shareholder.[20]

19. National City Bank v. Republic of China, 348 U.S. 356 (1955); Victory Transp. Inc. v. Comisaria General, 336 F.2d 354 (2d Cir. 1964), *cert. denied*, 381 U.S. 934 (1965).

20. United States v. Deutsches Kalisyndikat Gesellschaft, 31 F.2d 199 (2d Cir.

2. *Immunity from Execution of Foreign Judgments.*—Even for those states possessing restrictive rules of sovereign immunity, an area of great difficulty remains in attempting to secure execution of a judgment that has been obtained against a foreign state. While legal authorities are not in complete agreement, a distinction has long been recognized between immunity from jurisdiction and immunity from execution.[21] Under this distinction a foreign entity, which has waived (or been found to lack) sovereign immunity from judicial proceedings, may still invoke immunity from execution against its property even when execution is based on the judgment resulting from those proceedings.

C. *Sovereign Immunity—The United States Position*

1. *Current Rationale.*—The current ground for sovereign immunity peculiar to the United States Constitutional system is the deference of the courts to the foreign policy requirements of the United States as expressed by the Executive Branch. United States courts will normally defer to the suggestion of the Department of State that immunity be accorded; only when the Department of State makes no suggestion to the court will the courts make their own determination of entitlement to immunity.

2. *Immunity from Suit.*—United States adoption of the restrictive theory of sovereign immunity was the result of a letter from Acting Legal Adviser of the Department of State to the Acting Attorney General on May 19, 1952, asserting that the Department of State would thereafter "follow the restrictive theory of sovereign immunity."[22] The most authoritative discussion of the restrictive theory to date in the United States courts is contained in *Victory Transport Inc. v. Comisaria General.*[23] The court in that case found that there was no satisfactory method for applying the restrictive

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1929); Coale v. Societe Cooperative Suisse des Charbons, Basle, 21 F.2d 180 (2d Cir. 1927); *The Uxmal.*, 40 F. Supp. 258 (D. Mass., 1941); Hannes v. Kingdom of Roumania Monopolies Institute, 20 N.Y.S.2d 825 (App. Div. 1940); Ulen & Co. v. Bank Gospodarstwa Krajowego, 24 N.Y.S.2d 201 (App. Div., 1940); Dunlap v. Banco Central del Ecuador, 41 N.Y.S.2d 650 (Sup. Ct., 1943).

21. Sinclair, *The European Convention on State Immunity*, 22 INT'L & COMP. L.Q. 254, 273 (1973).

22. Letter from Jack B. Tate, Acting Legal Adviser for Dept. of State to Philip B. Perlman, Acting Atty. Gen., May 19, 1952, in 26 DEPT. STATE BULL. 984 (1952).

23. 336 F.2d 354 (2d Cir. 1964).

theory under Supreme Court doctrine but since the restrictive theory had been adopted by the State Department, the courts must follow it. The court then made the following statement:

> The purpose of the restrictive theory of sovereign immunity is to try to accommodate the interest of individuals doing business with foreign governments in having their legal rights determined by the courts, with the interest of foreign governments in being free to perform certain political acts without undergoing the embarrassment or hindrance of defending the propriety of such acts before foreign courts. Sovereign immunity is a derogation from the normal exercise of jurisdiction by the courts and should be accorded only in clear cases. Since the State Department's failure or refusal to suggest immunity is significant, we are disposed to deny a claim of sovereign immunity that has not been "recognized and allowed" by the State Department unless it is plain that the activity in question falls within one of the categories of strictly political or public acts about which sovereigns have traditionally been quite sensitive. Such acts are generally limited to the following categories:
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> (1) internal administrative acts, such as expulsion of an alien.
> (2) legislative acts, such as nationalization.
> (3) acts concerning the armed forces.
> (4) acts concerning diplomatic activity.
> (5) public loans. [footnote omitted]
>
> We do not think that the restrictive theory adopted by the State Department requires sacrificing the interests of private litigants to international comity in other than these limited categories. Should diplomacy require enlargement of these categories, the State Department can file a suggestion of immunity with the court. Should diplomacy require contraction of these categories, the State Department can issue a new or clarifying policy pronouncement.[24]

Although the court included "public loans" within the category of "public acts," it is unclear how broad the term "public loan" is. Does it cover, for example, guaranties of commercial loans or loans made to state commercial trading monopolies?

3. *Immunity from Execution.*—It is clear, however, that the State Department adheres to a policy of absolute immunity from execution for foreign sovereigns. The State Department's position in this area is best presented in its own words from its suggestion

24. 336 F.2d at 360.

of immunity of June 22, 1959, presented in the case of *Stephen v. Zivnostenska Banka, National Corp.*:[25]

> "However, the Department has always recognized a distinction between 'immunity from jurisdiction' and 'immunity from execution.' The Department has maintained the view that in accordance with international law property of a foreign sovereign is immune from execution to satisfy even a judgment obtained in an action against a foreign sovereign where there is no immunity from suit.
>
> . . . .
>
> The Department is of the further view that, where under international law a foreign government is not immune from suit, attachment of its property for the purpose of obtaining jurisdiction is not prohibited. In many cases jurisdiction could probably not be obtained otherwise. But property so attached to obtain jurisdiction over the defendant government cannot be retained to satisfy a judgment ensuing from the suit because in accordance with international law the property of a foreign sovereign is immune from execution even in a case where the foreign sovereign is not immune from suit."[26]

Since case law regarding sovereign immunity from execution is sparse and inconclusive, ultimate court acceptance or rejection of the foregoing State Department view cannot be foretold. Consequently, under existing United States law, American lenders contemplating loans to foreign governmental agencies or to other entities guaranteed by foreign governments must carefully evaluate the risks of such a loan in light of the complex United States attitude towards sovereign immunity.

D. *Draft Bill on Sovereign Immunity*

Fortunately, a joint Department of State-Department of Justice proposal to streamline the United States law of sovereign immunity has been introduced in Congress.[27] The draft bill is entitled: "An act to define the circumstances in which foreign states are immune from the jurisdiction of United States courts and in which execution may not be levied on their assets, and for other purposes . . . ." and is intended to accomplish basically four things:

(1) The task of determining whether a foreign state is enti-

25. 222 N.Y.S.2d 128 (App. Div. 1961).
26. 222 N.Y.S.2d at 133, 134.
27. S. 566, 93d Cong., 1st Sess. (1973); H.R. 3493, 93d Cong., 1st Sess. (1973).

tled to immunity would be transferred wholly to the courts, and the Department of State would no longer express itself on requests for immunity directed to it by the courts or by foreign states.

(2) The restrictive theory of sovereign immunity would be further particularized in statutory form.

(3) Foreign states would no longer be accorded absolute immunity from execution on judgments rendered against them, as is now the case, and their immunity from execution would conform more closely to the restrictive theory of immunity from suit.

(4) The means whereby process may be served on foreign states would be specified.[28]

Of particular interest are the provisions that make irrevocable any waiver of immunity from jurisdiction or execution. While preserving immunity in any case "relating to" public debt, the bill defines "public debt" for this purpose as a debt incurred by the foreign sovereign itself, specifically excluding any case that "relates to" the public debt of a political subdivision or agency or instrumentality of a foreign state. The bill, however, requires some redrafting to eliminate the vagueness that surrounds the contemporary verb "to relate." It should also be noted that the assets in the United States of a foreign central bank will be absolutely immune from attachment and execution under the proposed law.

The chances for passage of this much needed but relatively unknown bill by a preoccupied Congress cannot be determined. The bill is well conceived and deserving of serious consideration. Further, its passage would greatly simplify one important aspect of estimating the risk of international loans and investments and also, by making waivers of immunity irrevocable, simplify the negotiation of international loan agreements.

VII. MONETARY CONSIDERATIONS

In all dealings in foreign currencies, the parties must be concerned with the problem of transferability. Lenders must assure themselves that satisfactory payment will be made despite depre-

28. Letter from William P. Rogers, Secretary of State, and Richard G. Kleindienst, Attorney-General, to the Speaker of the U.S. House of Representatives, January 16, 1973.

ciation of currency or exchange controls. In many cases, lenders will simply seek to have the loan denominated in their own currency. This is the common practice in intergovernmental loans.[29] International lending organizations such as the World Bank, however, are obviously in a special situation since their capital reserves consist of subscription payments. By imposing value maintenance clauses, the risk of depreciation may be shifted to either the international organization's lender-member or borrower. In these days of both United States dollar and gold instability, it may be expected that more international organizations will follow the World Bank practice of shifting the risk to members by obliging them to make additional payment in the event of the depreciation of their currency.

In the private sector, when the borrower has the bargaining power to resist repayment in the lender's currency, lenders have traditionally sought to protect themselves by denominating the loan alternatively in gold or in multiple currencies. In the United States the legality of such currency options when the United States dollar is one of the option currencies is uncertain because of a 1933 Joint Resolution of Congress on the basis of which the Supreme Court declared one such currency option to be against public policy when the United States dollar was one of the option currencies.[30] Mere currency options, while protecting the lender, expose the borrower to the risk of upward revaluation, and for this reason may be unacceptable. Alternatives include denominating a single currency considered stable, but such a currency may be difficult to agree upon. Another possibility is to denominate the loan in a "unit of account" defined in gold and tied to multiple stable currencies, with the provision that the value of the "unit of account" will vary only relative to the most stable of these currrencies; however, unstable gold prices militate against this proposal. The latest canon for denominating international loans appears to be the "unit of account" composed of currencies of designated European countries.

Besides the threat of the depreciation of currency, lenders must include in their planning consideration of the exchange controls of the countries whose currencies are involved since the International

29. DELAUME, *supra* note 7, at 258.
30. Guaranty Trust Co. v. Henwood, 307 U.S. 247 (1939).

Monetary Fund Agreement makes unenforceable all exchange contracts contrary to the exchange controls of any member whose currency is involved.[31] In practice, lenders to countries with exchange controls, which includes almost all developing countries, should obtain specific guaranties from the governmental exchange control authority that transferable foreign exchange will be available to service the loan. It is important to note that mere compliance by the borrower with foreign exchange regulations may not insure the availability of transferable foreign exchange.[32]

VIII. Political Considerations

Political instability is a legitimate concern of international lenders, particularly when the loans are made to developing nations; the possibilities of war, revolution, conquest and dismemberment must all be considered in calculating the risk to the lender. The borrower's involvement in war, however, does not relieve any obligations to service loans. If the lender's country is a belligerent enemy, there will probably be a suspension of obligations due for the duration. Thus, the burden may be on the lender to prove nonenemy belligerent status.[33] In the case of changes of government, the international legal principle of state continuity governs, thereby obligating the new government for the debts of its predecessor. While this principle has a long legal history, there is precedent for its breach, notably in the case of certain Communist revolutions.[34] There is generally less respect for creditors in the case of a change of sovereignty, particularly in a case of dismemberment rather than absorption, even though there is a general principle of succession to local debts.[35] In the case of partition, such as Pakistan has recently experienced, the normal practice would be to negotiate a division of the national debt. Of course there may be substantial delays in payment of obligations in all these cases, if they are paid at all.

31. Articles of Agreement with Other Powers respecting the International Monetary Fund, Dec. 27, 1945, *opened for signature* Dec. 27, 1945, art. VIII, § 2(b), 60 Stat. 1401 (1946), T.I.A.S. No. 1501, 2 U.N.T.S. 39.

32. DELAUME, *supra* note 7, at 302-03.

33. *See* Irving Trust Co. v. Deutsch Atlantische Telegraphengesellschaft, 22 N.Y.S.2d 581 (1940).

34. Russia's public debt was repudiated by the Soviets in 1918.

35. DELAUME, *supra* note 7, at 323-25.

There is no reliable protection for lenders against these risks. The creditor's bargaining position may be strengthened somewhat in the event of debt settlement negotiations by assignments of revenue, pledges of security, or covenants to maintain priority of the loan over other debts. In planning for peaceful transitions, covenants to consult and maintain creditor rights may be helpful, but such covenants may be objectionable as restrictions on sovereignty.

IX. Conclusion

It is to be hoped that the international legal profession will accept the challenge presented to facilitate the flow of capital to the developing areas of the world. This will require meticulous and patient study of the laws and customs of foreign nations, which are often very different from those the United States legal profession is accustomed to. Recent developments in the areas of arbitration and sovereign immunity bode well for the further development of financial relations with Asia, Africa and Latin America. One area of particular potential is the development of innovative new forms of international guaranties for loans to developing countries.

In addition, revived interest in international law in American law schools is another encouraging factor. More and better trained practitioners in the international field can only mean greater awareness and hopefully earlier development of solutions to the immediate problems. This in turn will assure the continued flow of funds to the developing nations, enabling the untold millions living in developing nations to increase their standard of living. This is the challenge of the decades to come.