Cornell International Law Journal

Volume 20
Issue 2 *Summer 1987*

Article 1

Allied's Flawed Application of the Act of State Doctrine: Impropriety of the Doctrine in International Finance

James M. Wall

ALLIED'S FLAWED APPLICATION OF THE ACT OF STATE DOCTRINE: IMPROPRIETY OF THE DOCTRINE IN INTERNATIONAL FINANCE

INTRODUCTION

In *Allied Bank International v. Banco Credito Agricola de Cartago*,[1] the Second Circuit Court of Appeals reversed the district court's earlier decision,[2] holding that the act of state doctrine did not preclude judicial examination of Costa Rican currency control regulations.[3] While American banks with foreign loans outstanding will applaud the Second Circuit's holding, a close scrutiny of the court's reasoning reveals a decision at least partially flawed. The court's holding turned on its determination that the currency controls were not wholly effective within Costa Rica.[4] To make this determination, the court adopted an inaccurate formula of debt situs incompatible with the act of state doctrine's constitutional underpinnings.[5] Further-

1. 757 F.2d 516 (2d Cir. 1985).

2. The district court held that the act of state doctrine barred judicial examination of the Costa Rican currency controls. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd*, 733 F.2d 23 (2d Cir. 1984), *reh'g granted*, July 3, 1984. Subsequently, the court of appeals held that the Costa Rican currency controls should be given effect as being consistent with U.S. law and policy. The court did not even reach the act of state doctrine. *Allied*, 757 F.2d at 519.

3. In 1981 the Costa Rican government imposed restrictions upon foreign exchange transactions. One of these restrictions was to require approval by the Central Bank of Costa Rica of any foreign exchange transaction on the part of Costa Rican banks. Subsequently, on August 27, 1981, the Central Bank's Board of Directors passed a resolution prohibiting public sector entities from paying any interest or principal on debts to foreign creditors denominated in foreign currency. On November 6, 1981, Costa Rica Executive Decree 13103-H, which prevented any institution in Costa Rica from making payment on an external debt without prior approval of the Central Bank in consultation with the Ministry of Finance, was published. *Allied*, 566 F. Supp. at 1442. In the instant case, the regulations effectively prevented three Costa Rican banks from making payments to Allied, a New York bank, on a past due debt of $4.5 million. *Id.* The three Costa Rican banks were Banco Cartago, Banco Anglo, and Banco Nacional. Banco Cartago had a total unpaid principal balance of about $3.8 million; Banco Anglo had a principal balance of $500,000; and Banco Nacional had a principal balance of about $186,000. *Id.*

4. *Allied*, 757 F.2d at 521. The judiciary created the act of state doctrine to prevent adjudication of a foreign sovereign's acts that occur wholly within that sovereign's territory. The Act states that "[s]ubject to § 429, courts in the United States will refrain from examining the validity of an act of a foreign state taken in its sovereign capacity within the state's own territory." RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 428 (Tent. Draft No. 4, 1983); *see also* Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1963) (defining the act of state doctrine's modern formulation). In *Allied*, the court determined that the currency controls were not wholly effective within Costa Rica by establishing the situs of the Costa Rican debts to be in New York. *Allied*, 757 F.2d at 521. The court was thus able to conclude that the currency controls affected property outside the territorial boundaries of Costa Rica, and, consequently, were not effective acts of state.

5. The *Allied* court used place of payment to locate debt situs. Place of payment, however, fails to accurately measure the effectiveness of a sovereign's actions within its territory, since the court may thus judicially review a sovereign's act that is completely effective within its territory. The separation of powers rationale of the act of state doctrine, which maintains that the courts should refrain from offending a sovereign, is therefore violated. *See* Comment, *Debt Situs and the Act of State Doctrine: A Proposal for a More Flexible Standard*, 49 ALB. L. REV. 647 (1985) [hereinafter Comment, *Debt Situs*]; Comment, *The Act of State Doctrine and Foreign Sovereign Defaults on United States Bank*

more, the court's rigid debt situs theory conflicts with *Banco Nacional de Cuba v. Sabbatino*'s flexible decision-making approach.[6]

Despite these errors, the court reached the most appropriate resolution of the Costa Rican defaults. The Costa Rican currency controls, blocking payment on a valid and binding loan agreement, violated fundamental contract principles and disrupted the normal resolution of international debt problems.[7] Recognition of the Costa Rican currency controls as a legitimate act of state would have set dangerous precedent and created a serious threat to the stability of international commerce.[8]

Simply stated, the *Allied* court reached a sound result notwithstanding a flawed application of the act of state doctrine. This incongruity in the *Allied* decision should consequently focus attention on the doctrine's impropriety in the specific context of foreign loan defaults. In short, this Note concludes that the courts should not allow the act of state doctrine to threaten those mechanisms and legal principles designed to orderly resolve international debt problems. To reach this conclusion, this Note first evaluates the act of state doctrine's theoretical basis and modern formulation. It then analyzes the court's application of the act of state doctrine in *Allied*, as well as surveys the *Allied* litigation as a whole. Finally, it considers the impropriety of the act of state doctrine in the context of international finance.

I. BACKGROUND

A. COMITY, SOVEREIGN IMMUNITY, AND THE ACT OF STATE DOCTRINE

Although the act of state doctrine constitutes the central concern in *Allied*, the court also considered the related principles of comity and sovereign immunity.[9] A complete analysis of *Allied* therefore requires

Loans: A New Focus for A Muddled Doctrine, 133 U. PA. L. REV. 469 (1985) [hereinafter Comment, *A New Focus*].

6. The *Allied* court's focus on the single criterion place of payment, for the application of the act of state doctrine conflicts with the balancing approach advocated by the Supreme Court. *See Sabbatino*, 376 U.S. at 398; *see also* Comment, *Debt Situs*, *supra* note 5.

7. *Allied*, 757 F.2d at 522.

8. In its amicus brief filed at the rehearing, the United States expressed concern that recognition of the Costa Rican currency controls as a legitimate act of state would threaten the certainty of international financial transactions. Brief for the United States as Amicus Curiae at 6-7, Allied Bank Int'l v. Banco Credito Agricola de Cartago, 733 F.2d 23 (2d Cir. 1984), *reh'g granted*, July 3, 1984 [hereinafter Government Brief].

9. There has been a significant amount of commentary that includes analysis of the interrelationships of comity, sovereign immunity, and the act of state doctrine. *See generally* Lengel, *The Duty of Federal Courts to Apply International Law: A Polemical Analysis of the Act of State Doctrine*, 1982 B.Y.U. L. REV. 61; Zaitzeff & Kunz, *The Act of State Doctrine and the Allied Bank Case*, 40 BUS. LAW. 449 (1985); Zimmerman, *Applying an*

an explanation of all three interrelated principles.

1. Comity

The principle of comity is relevant to an analysis of *Allied* for two reasons: (1) comity comprises part of the theoretical foundation of the act of state doctrine;[10] and (2) comity formed the basis for the court of appeals' initial disposition of the Costa Rican currency controls.[11]

The principle of comity, as adopted by the court in the first *Allied* hearing, does not lend itself to a single definition. Indeed, commentators define the principle in a number of different ways.[12] For example, at least one author asserts that comity is the respect nations must accord one another, and that it therefore functions to preserve international law.[13]

In *Hilton v. Guyot*,[14] the Supreme Court adopted a more elaborate definition of comity. The Court stated that comity is "neither a matter of absolute obligation on the one hand, nor of mere courtesy and good will upon the other."[15] According to the Court, comity involves one nation's recognition of another nation's acts, "having due regard both to international duty and convenience, and to the rights of its own citizens."[16]

As an independent judicial doctrine, comity contains several important limitations.[17] For example, comity is accorded to a foreign act only where the laws and public policy of the forum state "and the

---

Amorphous Doctrine Wisely: The Viability of the Act of State Doctrine after the Foreign Sovereign Immunities Act, 18 TEX. INT'L L.J. 547 (1983); Note, *Adjudicating Acts of State in Suits Against Foreign Sovereigns: A Political Question Analysis*, 51 FORDHAM L. REV. 722 (1983) [hereinafter, Note, *Adjudicating Acts of State*]; Comment, *The Act of State Doctrine: A History of Judicial Limitations and Exceptions*, 18 HARV. INT'L L.J. 677 (1977); Note, *Rehabilitation and Exoneration of the Act of State Doctrine*, 12 N.Y.U. J. INT'L L. & POL. 599 (1980); Note, *Limiting the Act of State Doctrine: A Legislative Initiative*, 23 VA. J. INT'L L. 103 (1982) [hereinafter Note, *A Legislative Initiative*].

10. *See supra* note 9.

11. *Allied*, 757 F.2d at 519.

12. *See* Comment, *Foreign Sovereign Immunity and the Act of State: The Need for A Commercial Act Exception to the Commercial Act Exception*, 17 U.S.F. L. REV. 763, 764 (1983). The author quotes Brownlie defining international comity as a species of accommodation unrelated to, but distinguishable from, morality. He lists four other definitions of comity cited by Brownlie. *See id.; see also* I. BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 31 (3d ed. 1979).

13. Comment, *supra* note 12, at 765.

14. 159 U.S. 113 (1895).

15. *Id.* at 163-64.

16. *Id.* at 164.

17. In *Hilton*, the Supreme Court made clear that comity is not an absolute requirement. The Court indicated that the recognition of another nation's laws is conditioned on the judiciary's international duty and its regard for the rights of its own citizens. *Id.* at 163-64; *see infra* notes 18-19.

rights of its residents are not violated."[18] Furthermore, comity cannot be used to resolve conflicts between foreign and domestic laws "when courts are forced to choose between a domestic law which is designed to protect domestic interests, and a foreign law which is calculated to thwart the implementation of the domestic law in order to protect foreign interests allegedly threatened by the objectives of domestic law."[19]

As mentioned, the principle of comity also comprises at least part of the theoretical basis for the act of state doctrine.[20] In *Oetjen v. Central Leather Co.*,[21] the Supreme Court found that the doctrine's initial articulation in *Underhill v. Hernandez*[22] rested "upon the highest considerations of international comity and expediency."[23] Citing *Oetjen*, scholars argue that one purpose of the act of state doctrine is the preservation of international comity.[24] By preventing inappropriate judicial review of a foreign sovereign's actions, the act of state doctrine effectively recognizes those actions. The doctrine thus operates as an extension of the principle of comity.

Yet the act of state doctrine differs from comity in several important respects.[25] Perhaps the most important difference is that the act of state doctrine will mandate the recognition of a foreign sovereign's law.[26] Comity, on the other hand, only allows for the voluntary recognition of a foreign sovereign's law.[27]

2. *Sovereign Immunity*

If comity constitutes one part of the act of state doctrine's theoretical basis, sovereign immunity qualifies as another.[28] Sovereign immunity therefore provides further insight into the act of state doctrine. In addition, the district court in *Allied* directly addressed issues of sovereign immunity.[29]

---

18. Cornfeld v. Investors Overseas Services, Ltd., 471 F. Supp. 1255, 1259 (S.D.N.Y.) (citing *Hilton*, 159 U.S. at 202-03), *aff'd mem.*, 614 F.2d 1286 (2d Cir. 1979).

19. Laker Airways v. Sabena, Belgian World Airlines, 731 F.2d 909, 948 (D.C. Cir. 1984).

20. *See supra* note 9.

21. 246 U.S. 297 (1917) (applying the act of state doctrine to preserve international comity in a Mexican expropriation case).

22. 168 U.S. 250 (1897).

23. *Oetjen*, 246 U.S. at 303-04. In *Oetjen*, the Court stated that "to permit the validity of the acts of the sovereign to be reexamined and perhaps condemned by the courts of another would very certainly imperil the amicable relations between governments and vex the peace of nations." *Id.* at 304.

24. *See* Comment, *supra* note 12.

25. *See* Zaitzeff & Kunz, *supra* note 9, at 450-51.

26. *Id.* at 451.

27. *Id.*

28. *See supra* note 9.

29. The district court that first decided the *Allied* case held that the execution of the Costa Rican promissory notes was a "commercial activity" within the meaning of the For-

By definition, the principle of sovereign immunity "precludes [a] litigant from asserting an otherwise meritorious cause of action against a sovereign or a party with sovereign attributes unless [the] sovereign consents to suit."[30] The Supreme Court established this principle in *The Schooner Exchange v. M'Faddon*, a case in which the Supreme Court granted immunity from seizure to vessels of a foreign national.[31] According to the Court:

> The jurisdiction of the nation within its own territory is necessarily exclusive and absolute. It is susceptible of no limitation not imposed by itself. Any restriction upon it, deriving validity from an external source, would imply a diminution of its sovereignty to the extent of the restriction, and an investment of that sovereignty to the same extent that power which could impose such restriction.[32]

In the context of foreign affairs, sovereign immunity prevents the law of one country from infringing upon the rights of another country.[33] The Foreign Sovereign Immunities Act of 1976[34] (FSIA) currently defines the United States' understanding of international sovereign immunity. FSIA codifies a restrictive theory of sovereign immunity. Under this theory, a court may grant immunity for public acts but not for private acts.[35] In simpler terms, FSIA generally grants immunity subject to a number of statutory exceptions.[36] The most commonly used exceptions involve either a specific waiver of

---

eign Sovereign Immunities Act and therefore not entitled to per se protection under sovereign immunity. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440, 1443 (S.D.N.Y. 1983).

30. BLACK'S LAW DICTIONARY 1252 (5th ed. 1979).

31. The Schooner Exchange v. M'Faddon, 11 U.S. (7 Cranch) 116 (1812).

32. *Id.* at 136.

33. *See* Comment, *supra* note 12, at 765 n.9. The author writes that the doctrine of sovereign immunity was viewed as a fundamental attribute of the foreign sovereign. Challenges to the concept of sovereign immunity were viewed as calling into question the right of the foreign sovereign to exist. *Id.* at 765.

34. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1602-1611 (1982) [hereinafter FSIA].

35. The State Department adopted restrictive immunity in 1952 in the "Tate Letter." The letter outlined the State Department's position adopting restrictive immunity. *See* C. EBENROTH, BANKING ON THE ACT OF STATE: INTERNATIONAL LENDING AND THE ACT OF STATE DOCTRINE 16 n.7 (1985).

36. FSIA clearly adopts the policy of restrictive immunity. Section 1602 states:

> The Congress finds that the determination by United States courts of the claims of foreign states to immunity from the jurisdiction of such courts would serve the interests of justice and would protect the rights of both foreign states and litigants in United States courts. Under international law, states are not immune from the jurisdiction of foreign courts insofar as their commercial activities are concerned .... Claims of foreign states to immunity should henceforth be decided by courts of the United States and of the States in conformity with the principles set forth in this chapter.

28 U.S.C. § 1602 (1982).

Section 1604 states:

> Subject to existing international agreements to which the United States is a party at the time of enactment of this Act, a foreign state shall be immune from jurisdiction

immunity by the sovereign or some commercial activity on the part of the sovereign.[37] With regard to the latter exception, immunity fails to extend to a sovereign's commercial activity because, theoretically, the activity represents a private act.

The act of state doctrine contains an exception that is, in some respects, analogous to FSIA's "commercial exception." The Supreme Court first developed this exception in *Alfred Dunhill of London, Inc. v. Republic of Cuba*.[38] In *Dunhill*, the Court stated that the act of state doctrine should not extend to the repudiation of a foreign sovereign's purely commercial obligation.[39] The Court argued that the act of state doctrine should not bar adjudication of commercial disputes. Under the Court's rationale, adjudication of a commercial dispute does not intrude into foreign policy matters because the foreign sovereign's actions are of a private nature.[40]

The existence of parallel exceptions in the act of state doctrine and the doctrine of sovereign immunity comes as no surprise. Admittedly, sovereign immunity under FSIA is a legal principle independent of the act of state doctrine. Yet it also functions as part of the act of state doctrine's theoretical substratum.[41] In *Underhill v. Hernandez*,[42] the first U.S. articulation of the act of state doctrine, sovereign immunity formed the Supreme Court's critical concern. In *Underhill*, the Court held that the tortious acts of a Venezuelan revolutionary government, committed against an American citizen in Venezuela, were "not properly the subject of adjudication in the courts of another government."[43] Emphasizing the sovereignty issue, Chief Justice Fuller wrote:

> Every sovereign State is bound to respect the independence of every other sovereign State and the courts of one country will not sit in judgment on the acts

---

of the courts of the United States and of the States except as provided in sections 1605 to 1607 of this chapter.

Id. § 1604 (1982).

37. Statutory exceptions include waiver of immunity by the foreign state, explicitly or by implication; commercial activities; appropriation of property in violation of international law; disputes over immovable property situated in the United States; and certain actions for personal injury or death. 28 U.S.C. § 1605 (1982). The statute also limits the liability of foreign states. *Id.* § 1606.

Foreign states are not immune from counterclaims arising from "the same transaction or occurence" that is the subject matter of a claim initiated in United States courts by the foreign state. *Id.* § 1607.

38. 425 U.S. 682 (1976) (only four Justices in *Dunhill* approved the existence of a "commercial exception" to the act of state doctrine).

39. *Id.* at 695.

40. *Id.* at 697-99.

41. *See* Note, *Adjudicating Acts of State*, *supra* note 9, at 723. The author writes: "The act of state doctrine developed as a corollary to the doctrine of sovereign immunity and then assumed a life of its own." *Id. See generally supra* note 9.

42. 168 U.S. 250 (1897).

43. *Id.* at 254.

> of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.[44]

Despite the overlap, sovereign immunity, as codified by the Foreign Sovereign Immunities Act, differs significantly from the act of state doctrine.[45] The principal difference lies in the doctrines' divergent applications. A court applies sovereign immunity at the jurisdictional level.[46] If the court finds that a foreign sovereign enjoys immunity, it will dismiss the suit for want of subject matter jurisdiction.[47] By contrast, the act of state doctrine only applies to the merits of a case.[48] For example, a foreign sovereign would not use the act of state doctrine to defeat jurisdiction. Rather, the sovereign would invoke the act of state doctrine as a complete defense of its actions.[49]

Difficulties still arise where sovereign immunity and the act of state doctrine overlap. Much of the trouble stems from *Dunhill*'s[50] recognition of a commercial exception to the act of state doctrine.[51] The *Dunhill* exception fails to work in tandem with FSIA's commercial exception.[52] For example, a court, such as the district court in

---

44. *Id.* at 252.

45. *See generally* C. EBENROTH, *supra* note 35. Ebenroth provides a good treatment of the act of state doctrine and the Foreign Sovereign Immunities Act.

46. FSIA, *supra* note 34, § 1604. Section 1604 specifically provides for the immunity of a foreign state from jurisdiction. *See also* Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 520 (2d Cir. 1985).

47. *See* Frankel v. Banco Nacionel de Mexico, No. 82 Civ. 6457 (S.D.N.Y. May 31, 1983). *Frankel* involved Mexican currency controls. The court ultimately determined that the currency controls were governmental acts and not commercial acts, and that sovereign immunity barred adjudication. The court dismissed the suit for lack of subject matter jurisdiction. *See also* C. EBENROTH, *supra* note 35, at 31-38.

48. *See* Allied Bank Int'l v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd*, 733 F.2d 23 (2d Cir. 1984), *reh'g granted*, July 3, 1984. The district court granted subject matter jurisdiction on the grounds that the litigation fell within the commercial activities exception of FSIA. However, the court denied the plaintiff's motion for summary judgment on the theory that the act of state doctrine constituted a legitimate defense. The Costa Rican banks had challenged subject matter jurisdiction by asserting sovereign immunity; alternatively, they raised the defense of the act of state doctrine. The court stated: "[T]he defense of the act of state doctrine is a meritorious one and in view thereof Allied's motion for summary judgment must be denied." *Id.* at 1442.

49. *Id.* A finding that the act of state doctrine is applicable would confer presumptive validity on the foreign sovereign's actions. The court in *Allied* stated, "The act of state doctrine operates to confer presumptive validity on certain acts of a foreign sovereign by rendering non-justiciable claims that challenge such acts. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 520 (2d Cir. 1985).

50. Alfred Dunhill of London Inc. v. Republic of Cuba, 425 U.S. 682 (1976).

51. *See supra* notes 38-40 and accompanying text. *See generally* McCormick, *The Commercial Activity Exception to Foreign Sovereign Immunity and the Act of State Doctrine*, 16 LAW & POL'Y INT'L BUS. 477 (1984); Note, International Association of Machinists v. OPEC: *The Ninth Circuit Breathes New Life into the Act of State Doctrine in Commercial Settings*, 16 GEO. WASH. J. INT'L L. & ECON. 427 (1982); Comment, IAM v. OPEP: *Commercial Activity—One Factor in a Balancing Approach to the Act of State Doctrine*, 14 LAW & POL'Y INT'L BUS. 215 (1982).

52. *See* C. EBENROTH, *supra* note 35, at 26-38.

Allied, may conclude that a sovereign's action (e.g., the execution of a promissory note) constitutes a commercial activity beyond the protection of sovereign immunity.[53] Yet a court may further conclude that subsequent actions taken by the sovereign (e.g., currency controls) do not constitute a commercial activity and consequently are nonreviewable as acts of state.[54] The two actions are separate and discrete; yet, they inhere to a common commercial transaction and therefore are closely interrelated. Logic and consistency of decision would seemingly compel the court's recognition of a commercial exception to the act of state doctrine when the court recognizes a commercial exception to sovereign immunity. Otherwise, as *Allied* illustrates, the act of state doctrine undercuts its closely related counterpart, sovereign immunity, because the court grants jurisdiction only to deny relief.

3. *The Act of State Doctrine*

The earliest articulation of the act of state doctrine stemmed from considerations of sovereign immunity and comity.[55] Subsequent case law continued to emphasize both legal principles.[56] The law also recognized "conflict of laws principles" as a third element in the act of state doctrine's theoretical framework.[57] Until the 1964 decision, *Banco Nacional de Cuba v. Sabbatino*, sovereign immunity, comity,

53. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440, 1443 (S.D.N.Y. 1983), *aff'd*, 733 F.2d 23 (2d Cir. 1984), *reh'g granted*, July 3, 1984.

54. *Id.* at 1443-44.

55. *See supra* notes 9, 21-23, 42-44 and accompanying text.

56. C. EBENROTH, *supra* note 35, at 18.

57. *Id.* The Supreme Court clearly delineated the act of state doctrine as a "special conflict of laws rule" in the Mexican expropriation case, Ricaud v. American Metal Co., 246 U.S. 304, 309 (1918). The Supreme Court recognized, at an early stage, that the act of state doctrine operates as a mandatory choice of law or "super-conflict of laws" rule that modifies ordinary conflict rules including comity, when the conduct of a foreign sovereign is at issue. Under such circumstances, the act of state doctrine requires a United States court to select the law of the sovereign whose actions are at issue and confer on those actions a presumptive validity over that sovereign's law. The court cannot decline application of the sovereign's law on the grounds that it is repugnant to domestic public policy. *See* Note, *A Legislative Initiative*, *supra* note 9, at 107; *see also* Collinson, Sabbatino: *The Treatment of International Law in United States Courts*, 3 COLUM. J. TRANSNAT'L L. 27 (1964); Gilbert & Bradford, *The Act of State Doctrine:* Dunhill *and Other* Sabbatino *Progeny*, 9 SW. U. L. REV. 1 (1977); Henkin, *Act of State Today: Recollections in Tranquility*, 6 COLUM. J. TRANSNAT'L L. 175 (1967); Kirgis, *Act of State Exceptions and Choice of Law*, 44 U. COLO. L. REV. 173 (1972); Leigh & Sandler, Dunhill: *Toward A Reconsideration of* Sabbatino, 16 VA. J. INT'L L. 685 (1976). Henkin writes:

> Act of state is a special rule modifying the ordinary rules of conflict of laws. If there were no act of state doctrine,a domestic court in a case like Sabbatino would decide it on "conflicts" principles. It would first decide what law "governed" the issues. If under accepted choice of law principles the foreign law should govern, the court could still refuse to apply that law if it were found to be contrary to the public policy of the forum. The act of state doctrine, however, says that the foreign "law"(i.e. the act of state) must govern . . . .

Henkin, *supra* at 178.

and conflict of laws principles formed the theoretical basis for the act of state doctrine.[58] In *Sabbatino*, however, the Supreme Court reformulated the act of state doctrine, giving the doctrine "constitutional" underpinnings.[59]

Sabbatino, like the majority of act of state decisions at the time, involved foreign expropriation of American property.[60] The defendant, an American commodity broker, contracted with a Cuban corporation, largely owned by American investors, to buy Cuban sugar. In response to U.S. reduction of the Cuban sugar quota, the Cuban government expropriated the corporation's property and rights. The Cuban government permitted the ship carrying the sugar to leave Cuban waters only after the broker entered into a new contract with a bank, an instrumentality of the Cuban government. Upon delivery of the sugar, the broker accepted the bills of lading, received payment for the sugar from its customer, and then refused to deliver the proceeds to the Cuban agent. The Cuban instrumentality subsequently instituted an action to recover the proceeds. The district court granted summary judgment against the plaintiff on the grounds that the Cuban expropriation decree violated international law. The Second Circuit Court of Appeals affirmed.[61]

The Supreme Court reversed, holding that the act of state doctrine barred judicial scrutiny of the Cuban expropriation decree. The Court concluded:

> [R]ather than laying down or reaffirming an inflexible and an all encompassing rule in this case, we decide only that the Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government, extant and recognized by this country at the time of suit, in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates customary international law.[62]

Critics have exhaustively examined the Court's holding above.[63] This Note focuses on four areas of particular interest:[64] (1) the Court's theoretical justification for the act of state doctrine; (2) its analysis of the act of state doctrine and international law; (3) its emphasis on a flexible case-by-case approach to the act of state doctrine; and (4) its specific inclusion of a territorial limitation to the act of state doctrine.

---

58. *See supra* notes 9, 21-23, 41-44, 57 and accompanying text.

59. Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 423 (1963).

60. *Id.* at 403.

61. *Id.* at 401-08.

62. *Id.* at 428.

63. *See supra* notes 5, 9, 35, 51.

64. The complexity of the Court's opinion offers innumerable lines of analysis. Such analysis, however, is beyond the scope of this Note.

a. The Act of State Doctrine's Theoretical Justification

Sabbatino is most significant for its reformulation of the act of state doctrine's theoretical basis.[65] While recognizing "historic notions of sovereign authority" as the accepted rationale for the act of state doctrine, the Court in *Sabbatino* concluded that these notions "do not dictate its existence."[66] Instead, the Court grounded the act of state doctrine squarely in the constitutional theory of separation of powers.[67]

According to the Court in *Sabbatino*, the fundamental purpose of the act of state doctrine is to preserve the separation of power between the judiciary and executive in the area of international relations:

> The act of state doctrine . . . . arises out of the basic relationships between branches of government in a system of separation of powers.
>
> . . . .
>
> . . . its continuing vitality depends on its capacity to reflect the proper distribution of functions between the judicial and political branches of government on matters bearing on foreign affairs.[68]

Ideally, proper application of the act of state doctrine limits the judiciary's role in international matters. Arguably, this is the case when a United States court declines to review the actions of a foreign sovereign effective within the sovereign's territory.

A careful analysis of *Sabbatino* reveals three closely intertwined reasons for limiting judicial review under such circumstances: (1) judicial review would offend the foreign nation; (2) judicial review would consequently interfere with executive efforts to resolve the dispute; and (3) judicial review, in any event, would not lead to practical relief for the plaintiff. Stated simply, a court runs the risk of offending a foreign sovereign when it passes judgment on acts of the sovereign that are effective within its territory. The court's judgment could complicate executive involvement and lead to the disruption of diplomatic relations.

Judicial intrusion of this kind into foreign affairs is antithetical to the courts' traditional position. As one commentator noted, "[S]ince the 1930's, the judiciary in this country has consistently held that the conduct of foreign policy is vested solely in the executive branch."[69] This position is explicitly echoed in *Sabbatino*: "If the political

---

65. *See Sabbatino*, 376 U.S. at 421.
66. *Id.*
67. *Id.* at 423.
68. *Id.* at 423, 427-28.
69. Lengel, *supra* note 9, at 91.

> Chief Justice John Marshall, while a member of the House of Representatives, said, "The President is the sole Organ of the nation in its external relations and its sole representative with foreign nations." This position, prevalent in Justice Harlan's opinion in *Sabbatino*, is followed by the Court today.

Id.

branches are unwilling to exercise their ample powers to effect compensation, this reflects a judgment of the national interest which the judiciary would be ill advised to undermine indirectly."[70]

The Court in *Sabbatino* further emphasized the impropriety of judicial involvement when an effective taking by a foreign sovereign precludes the court's ability to grant practical relief.[71] By precluding judicial review under such circumstances, the act of state doctrine saves the court the time and trouble of reaching a decision that has no practical value.

Unfortunately, the *Allied* court's application of the act of state doctrine does not square with the doctrine's constitutional underpinnings. The *Allied* formulation of debt situs does not effectuate the act state doctrine's separation of powers rationale.

b. The Act of State Doctrine and International Law

The court in *Sabbatino* concluded that the act of state doctrine should delimit the proper roles of the judiciary and executive in international relations. In doing so, the Supreme Court diminished without eliminating the judiciary's power to adjudicate international disputes. The Court in *Sabbatino* explained "that the greater degree of codification or consensus concerning a particular area of international law, the more appropriate it is for the judiciary to render decisions regarding it, since the courts can then focus on the application of an agreed principle to circumstances of fact . . . ."[72] The Court's holding also indicated that United States courts are to apply international law of a sufficiently specific nature, i.e., "a treaty or other unambiguous agreement regarding controlling legal principles."[73] The Court qualified this position, though, noting that "customary international law" is not dispositive.[74]

70. *Sabbatino*, 376 U.S. at 436. "Piecemeal dispositions of this sort involving the probability of affront to another state could seriously interfere with negotiations being carried on by the Executive Branch and might prevent or render less favorable the terms of an agreement that could otherwise be reached." *Id.* at 432.

71. *Id.* at 435. The Court stated, "When one considers the variety of means possessed by this country to make secure foreign investment, the persuasive or coercive effect of judicial invalidation of acts of expropriation dwindles in comparison." *Id.*

72. *Id.* at 428.

73. *Id.*

74. *See id.* The Court states that the act of state doctrine may bar judicial inquiry into the validity of a taking effective within a foreign sovereign's territory "even if the complaint alleges that the taking violates customary international law." *Id.*

In a strong dissent, Justice White took issue with the majority's remarks on customary international law. Arguing from case law and general policy, White held that the act of state doctrine should not preclude judicial review of a foreign state's actions when there has been a clear violation of international law. *See id.* at 439-72. Congress likewise took issue with the Supreme Court's reluctance to apply customary international law. *See* Foreign Assistance Act of 1964, Pub. L. No. 88-633, § 301(d)(4), 78 Stat. 1009 (1964) (current version at 22 U.S.C. § 2370(e)(2) (1976) (amending the Foreign Assistance Act of 1961)).

The Court's willingness to apply "hard" international law relies on the premise that the presence of such law eliminates the risk that the judiciary will offend a foreign sovereign and consequently become entangled in foreign affairs. Where hard international law exists, a foreign sovereign in violation of that law would have little or no expectation that its actions could evade judicial condemnation. Clearly delineated rules of international law would put the sovereign on notice that its actions could not escape judicial scrutiny.

c. The Act of State Doctrine and Flexibility of Decision Making

Application of the act of state doctrine involves an intricate balancing process.[75] A court must determine whether and to what extent judicial review of a foreign sovereign's actions will harm United States foreign policy.[76] As the Supreme Court implied in *Sabbatino*, such a determination will necessarily vary from case to case: "It is also evident that some aspects of international law touch more sharply on national nerves than do others; the less important the implications of an issue are for our foreign relations, the weaker the justification for exclusivity in the political branches."[77] Against this duty to refrain from setting foreign policy, a court must weigh its apparent duty to apply controlling principles of international law,[78] determining in turn whether the codification of that law is sufficient to compel its application.[79]

As the Supreme Court concluded in *Sabbatino*, a case-by-case approach best accomplishes this balancing process.[80] Failure to adopt

---

In the "Hickenlooper Amendment" to the Foreign Assistance Act of 1964, Congress proposed to "reverse in part the recent decision of the Supreme Court in Banco National de Cuba v. Sabbatino." *See* S. REP. NO. 1188, pt. 1, 88th Cong., 2d Sess. 24, *reprinted in* 1964 U.S. CODE CONG. & ADMIN. NEWS 3829, 3852. The Amendment's statement of purpose claims that its effect is "to achieve a reversal of presumptions." The statement continues:

> Under the Sabbatino decision, the courts would presume that any adjudication as to the lawfulness under international law of the act of a foreign state would embarrass the conduct of foreign policy unless the President says it would not. Under the amendment, the Court would presume that it may proceed with an adjudication . . . unless the President states officially that such an adjudication . . . would embarrass the conduct of foreign policy.

Id. The Hickenlooper Amendment has been narrowed by subsequent judicial decisions. *See* French v. Banco Nacional de Cuba, 22 N.Y.2d 46, 242 N.E.2d 704, 295 N.Y.S.2d 433 (1968); Banco Nacional de Cuba v. First National City Bank of New York, 431 F.2d 394 (2d Cir.) *remanded* 400 U.S. 1019 (1970), *aff'd*, 441 F.2d 530 (2d Cir. 1971), *rev'd on other grounds*, 406 U.S. 759 (1972).

75. *See* Comment, *Debt Situs*, *supra* note 5; Comment, *A New Focus*, *supra* note 5; *see also infra* notes 76-79 and accompanying text.

76. *See, e.g.*, *Sabbatino*, 376 U.S. at 428.

77. *Id.*

78. *Id.* at 428, 439-72. *See generally* Lengel, *supra* note 9.

79. *Sabbatino*, 376 U.S. at 428.

80. The careful weighing of factors inherent to an act of state analysis necessitates a substantial amount of judicial discretion. The only method whereby the courts can fully

a flexible approach prevents a court from adequately considering the unique circumstances that inhere to each act of state situation. A straightforward rule of decision forecloses the careful weighing of factors necessary to determine whether a foreign sovereign's conduct constitutes an act of state. For example, reliance on a rigid rule of decision would prevent a court from completely assessing all the elements that bear on the effectiveness of a sovereign's actions within its territory. Similarly, a court would be unable to accurately determine whether and to what extent adjudication of the conduct in question would harm foreign relations. A court could not even determine whether available principles of international law were sufficiently clear to allow adjudication to proceed.

Recognizing the value of a flexible approach, the Supreme Court expressly refused to formulate the act of state doctrine as a hard and fast rule of decision. It explicitly rejected the option of "laying down or reaffirming an inflexible and all-encompassing rule."[81] In contrast, the *Allied* court's adoption of a rigid theory of debt situs sharply conflicts with the Supreme Court's desire for flexibility of decision making in act of state cases.[82]

d. The Act of State Doctrine's Territorial Limitation

Sabbatino expressly recognized a territorial limitation to the act of state doctrine. According to *Sabbatino*, the act of state doctrine bars judicial examination of a "taking of property within its own territory by a foreign sovereign government . . . ."[83] Conversely, the act of state doctrine does not bar judicial examination of a taking of property that occurs, or is substantially effective, outside the sovereign's territory. Thus, the act of state doctrine only applies to acts effective within the sovereign's territory.

A Second Circuit decision, *Republic of Iraq v. First National City Bank*,[84] illustrates this territorial limitation. In *Republic of Iraq*, both the district court and the court of appeals refused to apply the act of

employ this discretion is through the careful evaluation of the circumstances unique to each alleged act of state.

81. *Sabbatino*, 376 U.S. at 428.

82. The *Allied* court's use of debt situs can only be properly understood in the context of territorial limitation to the act of state doctrine, which confines the application of the doctrine to those acts of a foreign sovereign effective within its territory. In those cases involving intangible assets, the situs of the debt triggers this limitation. That is, where a debt is located determines whether or not the territorial limitation will preclude application of the act of state doctrine. If a debt is located outside the foreign sovereign's territory, the territorial limitation would prevent application of the act of state doctrine: the sovereign's "taking" of the debt is an action effective only outside the sovereign's territory. *See infra* notes 83-106 and accompanying text.

83. *Sabbatino*, 376 U.S. at 428.

84. 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

state doctrine to certain Iraqi ordinances.[85] The ordinances purported to confiscate the U.S. bank accounts of the deceased Iraqi monarch, King Faisal.[86] The court of appeals reasoned that the act of state doctrine did not apply to the ordinances because the affected property lay outside Iraqi borders.[87] After holding that the act of state doctrine did not preclude examination of such extraterritorial takings, the court of appeals concluded that the ordinances were contrary to United States law and policy and should therefore be denied effect.[88]

The court of appeals thus engaged in a three-step analysis, which it also followed in *Allied*.[89] The court asked three questions: (1) whether the taking, the act of the foreign sovereign, was effective within its territory; (2) whether the act of state doctrine consequently precluded judicial review; and (3) if the taking was not effective, whether comity recognized it as consistent with United States law and policy.

While this analysis works easily with tangible assets, it is difficult to apply to a taking of intangible assets. A debt, for example, has no physical attributes that can give it an obvious concrete situs.[90] Rather, a debt's situs is a function of whatever theory of debt situs the court employs. Lack of a concrete situs complicates the determination of whether a purported seizure of a debt is effective within a sovereign's territory.[91] If the court decides the situs is within the sovereign's territory, the sovereign's "taking" is effective and the act of state doctrine precludes judicial review. On the other hand, if the court locates the situs of the debt outside the sovereign's territory, the sovereign's "taking" has extraterritorial effect and the act of state doctrine cannot apply. With regard to intangible assets, application of the act of state doctrine thus hinges on tenuous and malleable determinations of debt situs.

For act of state debt situs analysis, the Second Circuit has generally applied the rule of *Harris v. Balk*:[92] the situs of a debt depends on

85. *Id.* at 50-51.

86. *Id.* at 49-50.

87. *Id.* at 51.

88. *Id.*

89. In the *Allied* rehearing, the court of appeals determined first whether the act of state doctrine precluded judicial examination of the Costa Rican currency controls. The court next determined whether those controls were consistent with United States law and policy, holding that they were not. *See* Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985).

90. *See* Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706, 714 (5th Cir. 1968), *cert. denied*, 393 U.S. 924 (1968) (The court states: "The situs of intangible property is about as intangible a concept as is known to the law.").

91. *See generally* Comment, *Debt Situs*, *supra* note 5; Comment, *A New Focus*, *supra* note 5.

92. 198 U.S. 215 (1905).

jurisdiction over the debtor.[93] *Menendez v. Saks and Co.*[94] was the first case to expressly rely on the *Harris* rule. In *Menendez*, the owners of expropriated Cuban cigar companies sought to recover payments from United States importers for shipments of Cuban cigars.[95] The Cuban government intervened for the purpose of confiscating the accounts receivable.[96] Relying on *Harris*, the Second Circuit Court of Appeals held that the confiscation of the accounts receivable was ineffective and did not constitute an act of state since the situs of the obligation remained with the importers in the United States.[97] The court stated, "For purposes of the act of state doctrine, a debt is not located within a foreign state unless that state has the power to enforce or collect it."[98]

In contrast, a Fifth Circuit decision, *Tabacalera Severiano Jorge S.A. v. Standard Cigar Co.*,[99] treated the issue of debt situs in a manner more consistent with the act of state doctrine's separation of powers rationale. In *Tabacalera*, the Fifth Circuit Court of Appeals held that the Cuban government's efforts to acquire a debt owed to a Cuban corporation were not entitled to protection by the act of state doctrine.[100] Rather than allow esoteric notions of situs to cloud the crucial determination of the effectiveness of the sovereign's actions within its territory, the court simply used a common sense analysis of the effectiveness of the sovereign's actions:

> [W]hen a foreign government performs an act of state which is an accomplished fact, that is when it has the parties and the *res* before it and acts in such a manner as to change the relationship between the parties touching the *res*, it would be an affront to such foreign government for courts of the United States to hold that such act was a nullity.[101]

---

93. In *Harris*, a creditor in Maryland was allowed to garnish a debt owed by a North Carolina resident temporarily in Maryland to a second creditor, who was also a resident of North Carolina. The Supreme Court noted that a debt is intangible, and that the real subject of attachment is the obligation to pay the debt. The obligation of a debtor to pay his debt thus remains unchanged by the movement of the debtor from state to state; therefore, the debt may be enforced wherever the creditor is able to serve process on the debtor. *See Harris*, 198 U.S. at 216-17, 222-23. Although another aspect of *Harris* has been overruled, *see* Shaffer v. Heitner, 433 U.S. 186 (1977), the debt situs holding remains intact.

94. 485 F.2d 1355 (2d Cir. 1973), *rev'd on other grounds sub nom.* Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682 (1976).

95. *Menendez*, 485 F.2d at 1361.

96. *Id.*

97. *Id.* at 1354-65.

98. *Id.* at 1365. *See also* Vishipco Line v. Chase Manhattan Bank, N.A., 660 F.2d 854, 862 (2d Cir. 1981), *cert. denied*, 459 U.S. 976 (1982); United Bank Ltd. v. Cosmic Int'l Inc., 542 F.2d 868, 873 (2d Cir. 1976). *But see* Garcia v. Chase Manhattan Bank, N.A., 735 F.2d 645, 650-51 (2d Cir. 1984) (holding that (1) actions of the Cuban government did not accomplish cancellation of the bank's debt, and (2) the act of state doctrine was not applicable in the action).

99. 392 F.2d 706 (5th Cir. 1968), *cert. denied*, 393 U.S. 924 (1968).

100. *Id.* at 716.

101. *Id.* at 715.

Under the Fifth Circuit approach, a court's particular theory of act of state debt situs must remain consistent with a common sense evaluation of the effectiveness of the sovereign's actions.[102] A court should not adopt a theory of situs that defeats a sovereign's reasonable expectations of dominion over the seized debt.[103] Judicial reliance on a debt situs theory that does not accurately measure either the effectiveness of a sovereign's taking or the reasonableness of the sovereign's expectations only leads to the court's intrusion into foreign affairs.[104] This result is at odds with the act of state doctrine's separation of powers rationale.[105]

Although the Second Circuit Court of Appeals in *Allied* intended to implement the *Tabacalera* "common sense approach,"[106] the court's theory of debt situs failed to accurately measure the effectiveness of Costa Rica's actions. Stated more broadly, the court's focus on a single determinative criterion, place of payment,[107] did not allow for a complete evaluation of those factors logically bearing on the issue of the effectiveness of Costa Rica's actions.

B. *ALLIED BANK INTL. V. BANCO CREDITO AGRICOLA DE CARTAGO*

The *Allied* litigation developed when three Costa Rican banks, wholly owned by the Republic of Costa Rica and subject to direct control by the Central Bank of Costa Rica, defaulted on promissory notes issued by a U.S. banking syndicate for which Allied Bank was the agent.[108] A four and one-half million dollar balance remained on the notes at the time of default.[109] The notes were payable in New York in U.S. dollars.[110]

The banks' defaults were due solely to the Costa Rican government's actions.[111] In July 1981, in response to escalating national eco-

---

102. *See id.*; *Cosmic Int'l*, 542 F.2d at 894.

103. *See generally* Comment, *Debt Situs*, *supra* note 5; Comment, *A New Focus*, *supra* note 5.

104. *See* Libra Bank Ltd. v. Banco National de Costa Rica, 570 F. Supp. 870, 884 (S.D.N.Y. 1983). The court states:

> The underlying notion embodied in the territorial limitation is the considered judgment of the judicial branch that courts will vex our relations with foreign governments only when they act to frustrate the foreign nation's reasonable expectations of dominion. On the other hand, a foreign nation cannot be said to entertain reasonable expectations of dominion over property located in this nation at the time of the attempted confiscation.

Id.

105. *Id.*; *see supra* note 5.

106. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985).

107. *Id.*

108. *Id.* at 518-19.

109. *See supra* note 3.

110. *Allied*, 757 F.2d at 519.

111. *Id.*

nomic problems, Central Bank issued regulations that essentially suspended all external payments, and in November 1981, the government issued an executive decree that conditioned all payments of external debt on express approval from Central Bank. Central Bank subsequently refused to authorize any foreign debt payments in U.S. dollars, thereby precluding payment on the *Allied* notes at issue.[112] In accordance with the provisions of the agreement, Allied accelerated the debt and sued the defaulting banks for the amount of principal and income outstanding.[113]

The district court in *Allied* held that: (1) the execution of the promissory notes was a "commercial activity" within the meaning of FSIA and therefore not per se entitled to protection under sovereign immunity, but (2) where the acts of the Central Bank of Costa Rica, the President, and Finance Minister were acts of state (i.e., acts designed to serve a public, not commercial function), the act of state doctrine would preclude adjudication of the suit.[114] The court correctly distinguished those acts that implicated the jurisdictional concerns of FSIA (the execution of the notes) from those acts that implicated the act of state doctrine (the Costa Rican currency controls). The court made no effort, however, to coordinate the act of state doctrine with the Foreign Sovereign Immunities Act.[115] As mentioned previously, failure to recognize a commercial exception to the act of state doctrine when an exception is granted under FSIA arguably undercuts the effect of FSIA.[116] Under such an approach, a court grants jurisdiction only to deny relief. Finally, the district court did not even consider whether the Costa Rican currency controls were extraterritorial in effect, and therefore beyond the scope of the act of state doctrine.[117]

The decision of the court of appeals, in its first hearing of *Allied*, contained more flaws than the decision of the district court. The court of appeals failed to apply the act of state doctrine[118] and erroneously concluded that comity compelled recognition of the Costa Rican currency controls as valid law.[119]

---

112. *Id.*

113. *Id.*

114. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd*, 733 F.2d 23 (2d Cir. 1984), *reh'g granted*, July 3, 1984.

115. *Id.* at 1443 n.2. "There is an obvious area of overlap between the 'commercial activity' question under the Foreign Sovereign Immunities Act, and certain of the considerations here described in connection with the act of state doctrine." *Id.*

116. *See supra* notes 51-54 and accompanying text.

117. *Allied*, 566 F. Supp. at 1443.

118. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985).

119. *Id.*

The court of appeals' error consisted of two parts: (1) concluding that comity would compel recognition of the Costa Rican controls and (2) concluding that the controls were consistent with United States law and policy. The application of comity is voluntary;[120] comity cannot be used when its application would violate the rights of the residents of the forum state.[121] The court of appeals did not consider the detrimental effects that recognition of the currency controls would have on the U.S. bank, Allied. The court should have denied the controls comity to protect the contractual rights of Allied, a resident of the forum state.[122] Furthermore, the court's conclusion that the currency controls were consistent with United States law and policy was simply incorrect.[123] Indeed, an amicus brief filed by the United States for the rehearing flatly declared that the Costa Rican currency controls were not consistent with United States policy: "The Court's opinion was apparently based upon an incorrect view that the application of Costa Rican law to prevent enforcement of appellant's contract, where Costa Rican law would otherwise not be applicable, was consistent with United States policies and was required by comity."[124]

In the rehearing, the court of appeals reversed its earlier finding that the Costa Rican currency controls were consistent with United States policy.[125] The court held that the Costa Rican government's unilateral attempt to repudiate private commerical obligations was inconsistent with the orderly resolution of international debt problems and contrary to the interests of the United States, a major source of private, international credit. The court concluded that recognition of the Costa Rican directives would run counter to principles of contract law.[126]

Before reaching the issue of the currency controls' consistency with United States policy, the court of appeals correctly considered whether the act of state doctrine even permitted judicial evaluation of the controls.[127] Reversing the decision of the district court, the court

120. *See supra* notes 25-27 and accompanying text.
121. *See supra* note 18 and accompanying text.
122. *See supra* notes 17-19 and accompanying text.
123. *See* Government Brief, *supra* note 8.
A major weakness in the court's decision was its reliance on a one-hundred-year-old bankruptcy case, Canada Southern Railway Co. v. Gebhard, 109 U.S. 527 (1883), to interpret United States law and policy. The court attempted to draw an analogy between an action in bankruptcy and the Costa Rican currency regulations. C. EBENROTH, *supra* note 35, at 53. The analogy fails for a number of reasons. *See* Brief of Plaintiff-Appellant on Rehearing at 22, Allied Bank Int'l v. Banco Credito Agricola de Cartago, 733 F.2d. 23 (2d. Cir. 1984), *reh'g granted*, July 3, 1984. [hereinafter Plaintiff's Brief].
124. *See* Government Brief, *supra* note 8, at 2.
125. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 520 (2d Cir. 1985).
126. *Id.* at 522.
127. *Id.*

of appeals ultimately held that the act of state doctrine did not preclude judicial evaluation of the Costa Rican currency controls.[128] The court made this determination by locating the situs of the Costa Rican debt in New York.[129] In so doing the court was able to conclude that the currency controls were not effective within Costa Rican territory and therefore not within the scope of the act of state doctrine.[130]

The court arrived at New York as the situs of the Costa Rican debt through two separate concepts of debt situs: (1) an "act of state debt situs analysis," and (2) an "ordinary debt situs analysis."[131] The court based its act of state debt situs analysis on the common sense approach of *Tabacalera*.[132] In considering whether Costa Rica had effectively altered the relationship between debtor and creditor, the court, however, departed from *Tabacalera* and focused instead on a single criterion, place of payment of the debt obligation.[133] The court concluded that the currency controls were ineffective in Costa Rica because they "could not wholly extinguish the Costa Rican banks' obligation to timely pay United States dollars to Allied in New York."[134] Under this debt situs analysis, the court merely located place of payment to determine the applicability of the act of state doctrine. Because the place of payment was not within the foreign sovereign's territory, the court considered its purported taking ineffective, i.e., the debt situs was outside the sovereign's territory and the act of state doctrine inapplicable.

In addition to its "act of state debt situs analysis," the court applied an "ordinary debt situs analysis."[135] Factored into this analysis were a number of considerations: "The Costa Rican banks conceded jurisdiction in New York and they agreed to pay the debt in New York City in United States dollars. Allied, the designated syndicate agent, is located in the United States . . . [and] some of the negoti-

128. *Id.*

129. *Id.* at 521-22.

130. *Id.*

The court writes:

> The extraterritorial limitation (of the act of state doctrine) . . . dictates that our decision herein depend on the situs of the property at the time of the purported taking. The property, of course, is Allied's right to receive repayment from the Costa Rican banks in accordance with the agreements. The act of state doctrine is applicable to this dispute only if, when the decrees were promulgated, the situs of the debts was in Costa Rica. Because we conclude that the situs of the property was in the United States, the doctrine is not applicable.

Id. at 521 (footnote omitted).

131. *Id.* at 521-522.

132. *Id.* at 521.

133. *Id.*

134. *Id.*

135. *Id.* at 521-22.

ations between the parties took place in the United States."[136] The court further focused on the U.S. interest in the litigation of maintaining New York's status as one of the foremost commercial centers in the world. The court also noted that "[t]he United States has an interest in ensuring that creditors entitled to payment in the United States . . . under contracts subject to the jurisdiction of the United States courts may assume . . . their rights will be determined in accordance with recognized principles of contract law."[137]

In sum, the court located Costa Rica's debt in New York under both debt situs analyses; consequently, it concluded that the act of state doctrine did not bar judicial examination of the currency controls.[138] After making this necessary determination, the court continued its comity analysis and denied the effect of the controls, finding them contrary to United States law and policy.

II. ANALYSIS

The *Allied* court's use of place of payment as the controlling principle in its debt situs analysis conflicts with two important aspects of the act of state doctrine: (1) the doctrine's intended purpose of restricting the judiciary's role in matters of foreign affairs, and (2) the flexible case-by-case approach advocated by the Supreme Court for handling potential act of state situations.[139] Despite its flawed application of the act of state doctrine, the court of appeals reached an appropriate resolution of the Costa Rican defaults. The Costa Rican currency controls, unilaterally terminating a valid loan agreement, violated both relevant international law and basic contract principles.[140] Recognition of the currency controls as a legitimate act of state would have set dangerous precedent and created a serious threat to the stability of international finance.[141]

The *Allied* court's application of the act of state doctrine illustrates the doctrine's impropriety in the context of foreign loan defaults. The courts should not allow the act of state doctrine to threaten or disrupt the workings of those mechanisms and legal principles designed to resolve the growing international debt crisis. In short, the act of state doctrine should not apply to foreign defaults.

---

136. *Id.* at 521.

137. *Id.* at 521-22.

138. *Id.* at 522.

139. *See supra* notes 90-91 and accompanying text.

140. *Allied*, 757 F.2d at 522.

141. *See* Government Brief, *supra* note 8.

A. *ALLIED*'S DEBT SITUS ANALYSIS CONFLICTS WITH ACT OF STATE PRINCIPLES

The *Allied* court's application of the act of state doctrine, which relied on place of payment to determine act of state debt situs, conflicts with the doctrine's separation of powers rationale.[142] Ideally, debt situs and the doctrine's territorial limitation should work together to preclude judicial examination of acts effective within a sovereign's territory and acts that the sovereign had a reasonable expectation of being effective within its territory.[143] By precluding judicial review of such acts, debt situs, as an integral part of the territorial limitation, prevents U.S. courts from offending foreign nations and interfering with executive foreign policy.[144] Simply put, debt situs should prevent the courts from intruding into matters of foreign affairs. Debt situs should ultimately confine the courts to their proper role in the area of international relations.[145] As indicated, *Sabbatino* narrowly circumscribes this role[146] in the absence of clearly delineated and readily applicable principles of international law.[147]

Unfortunately, the *Allied* court's place of payment test does not accurately measure either the effectiveness of a sovereign's actions[148] or reasonableness of a sovereign's expectations of dominion over the debt.[149] Place of payment thus fails to provide the necessary guidance to prevent courts from offending the foreign sovereign whose acts are at issue. To summarize, place of payment cannot properly determine act of state debt situs. Place of payment fails to appropriately locate debt situs because its narrow focus precludes consideration of many factors having a practical bearing on the issues of effectiveness and reasonableness of the expected dominion over the debt.[150] For example, a creditor, debtor, and the assets necessary to pay a debt could all be present within a sovereign's territory, yet a court could deny the effectiveness of a sovereign's purported taking of the debt if the loan agreement specified a place of payment outside the sovereign's territory. Reliance on place of payment, therefore, may lead a court to erroneously conclude that a foreign sovereign's actions are ineffective within its territory even though common sense dictates otherwise.

142. *See supra* notes 5-6, 102-07 and accompanying text.

143. *See* Libra Bank Ltd. v. Banco Nacional de Costa Rica, 570 F. Supp. 870, 844 (S.D.N.Y. 1983).

144. *Id.*

145. *Id.*; *see supra* notes 102-05 and accompanying text.

146. *See supra* notes 69-70 and accompanying text.

147. *See supra* notes 72-74 and accompanying text.

148. *See supra* notes 102-07 and accompanying text.

149. *Id.*

150. *See supra* notes 5-6.

The court's subsequent refusal to apply the act of state doctrine would therefore be incorrect.

The *Allied* decision further illustrates how reliance on place of payment may lead to inaccurate estimates of the effectiveness of a sovereign's actions. The court of appeals stated that the Costa Rican currency controls, which purported to "take" the debt owed Allied, did not "come to complete fruition" within Costa Rica.[151] The court reasoned that the currency controls could not constitute an effective taking within Costa Rican territory because the property they purported to affect was located outside Costa Rica and in New York.[152]

Assuming that place of payment correctly locates debt situs, the court's analysis makes perfect sense. The currency controls cannot be effective within Costa Rica if the object they purport to affect is in New York. From a practical standpoint, though, the court's analysis is far from perfect. The finding of the court that Costa Rica's purported taking did not come to "complete fruition" within Costa Rica glosses over the crucial fact that Costa Rica had withdrawn all of its New York assets ($2.5 million) prior to the rehearing.[153] With nothing to attach, the court of appeals gave Allied an empty victory. The court may have considered the currency controls ineffective, but from Allied's perspective the currency controls most effectively appropriated the Costa Rican debt.

The *Allied* court concluded its opinion by noting that the Costa Rican banks' "inability to pay United States dollars relates only to the potential enforceability of the judgment; it does not determine whether judgment should enter."[154] Such a statement, however, overlooks the obvious. When the Costa Rican banks cannot pay Allied and the court cannot attach any assets to grant practical relief, judgment should not enter because the Costa Rican government has engaged in an effective act of state. Judicial review of Costa Rica's actions would serve no purpose except to offend Costa Rica and involve the court in foreign affairs.

In misjudging the effectiveness of a sovereign's actions, place-of-payment analysis thus undermines the act of state doctrine's separation of powers rationale. It also conflicts with the flexibility of decision-making the Supreme Court believed necessary to the application of the act of state doctrine.[155] In *Sabbatino*, the Supreme Court

151. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 521 (2d Cir. 1985).

152. *Id.*

153. *See* Libra Bank v. Banco Nacional de Costa Rica, 570 F. Supp. 870, 884 (S.D.N.Y. 1983).

154. *Allied*, 757 F.2d at 522.

155. *See supra* notes 6, 75-81, and accompanying text.

expressly refused to formulate the act of state doctrine as a clear cut rule of decision.[156] The Court recognized that proper application of the doctrine would require a careful weighing of a multiplicity of factors.[157] In contrast, the *Allied* court's application of the act of state doctrine relied solely upon place of payment.[158] The *Allied* court's simplistic formula cannot be substituted for the careful analysis and balancing of competing interests that comprise the heart of the act of state doctrine.[159]

The *Allied* court did consider, however, factors other than place of payment in its "ordinary debt situs analysis."[160] A careful reading of the court's opinion indicates that the court clearly distinguished this analysis from its act of state debt situs analysis.[161] Nowhere does the court imply that any factor other than place of payment determined act of state debt situs.[162] In fact, the court deliberately mentioned that "the concept of the situs of debt for act of state purposes differs from the ordinary concept."[163]

Even assuming the court's ordinary debt situs analysis supplemented its act of state debt situs analysis, it is questionable whether the factors stressed would be any more accurate in measuring the effectiveness of a sovereign's actions than place of payment. To illustrate, the court emphasized the interest of the United States "in maintaining New York's status as one of the foremost commercial centers of the world."[164] The court further emphasized that "[t]he United States has an interest in ensuring that creditors entitled to payment in the United States in United States dollars under contracts subject to the jurisdiction of United States courts may assume . . . their rights will be determined in accordance with recognized principles of con-

156. Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 428 (1963).

157. *Id.*

158. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 757 F.2d 516, 521 (2d Cir. 1985).

159. *See* Libra Bank Ltd. v. Banco Nacional de Costa Rica, 570 F. Supp. 870, 884 (S.D.N.Y. 1983). Referring to the debt situs tests set forth in *Harris v. Balk* and *Republic of Iraq*, the court states:

> Yet, the tests fashioned to determine the situs of a debt are rigid and mechanical and can be difficult to apply. More importantly, this inflexible approach, focusing on a somewhat formalistic analysis of the situs of the debt, may not be an accurate measure of the foreign state's reasonable expectations which appears to be the root notion underlying the regulatory purpose of the territorial limitation to the act of state doctrine. This court believes, therefore, that the inapplicability of the act of state doctrine is more clearly seen when the principle of objective reasonableness underlying the territorial limitation is applied directly to the facts of this case.

Id.

160. *Allied*, 757 F.2d at 521.

161. *Id.*

162. *Id.* at 516.

163. *Id.*

164. *Id.*

tract law."[165] Although these interests form a compelling justification for denying effect to the Costa Rican currency controls, they do not necessarily determine the relative effectiveness or ineffectiveness of currency controls within Costa Rica.

B. *ALLIED* REACHED AN APPROPRIATE RESOLUTION OF THE COSTA RICAN DEFAULTS

Despite the flaws in *Allied*'s application of the act of state doctrine, the court nevertheless reached the most correct resolution of the Costa Rican defaults.[166] Had the court recognized the currency controls as a legitimate act of state defense to the loan defaults, the court would have set dangerous precedent and created a serious threat to the stability of international finance.[167]

In its amicus brief, the United States indicates the magnitude of the issues posed by the *Allied* litigation: "The United States has a strong interest in the decision in this case, which involves the legal framework applicable to the payment of billions of dollars of loans contracted by foreign governments and foreign private parties for which New York is the place of payment under the contract."[168] The legal framework the government refers to consists primarily of those mechanisms of debt resolution developed by the International Monetary Fund (IMF).[169] The smooth operation of international finance depends in large measure on the operation of these mechanisms.[170] By unilaterally terminating the valid loan agreement, the Costa Rican government violated the IMF's debt resolution structure. In addition, Costa Rica's actions ran directly counter to the cooperative effort espoused by the IMF as necessary to debt restructuring.[171]

---

165. *Id.* at 521-22.

166. The court of appeals decision to deny the Costa Rican currency controls effect was correct from the perspective of international financiers. Judicial recognition of the currency controls as a legitimate act of state would have jeopardized the existing legal framework for resolution of international debt problems. *See infra* note 181 and accompanying text.

167. *See* Government Brief, *supra* note 8, at 6-7.

168. *Id.* at 2.

169. *Id.* at 7 n.2.

> The system, as we know it today, has been in place for close to 40 years. Countries, confronted with the self-defeating competitive trade and monetary policies of the 1930's established a number of international institutions in the 1940's to promote cooperation in governmental policies to facilitate world trade, investment, and finance. In particular, the International Monetary Fund (IMF), through which countries can coordinate and collaborate in the solution of international monetary problems, has facilitated resolution of countries external financing problems, under internationally agreed rules, since its establishment in 1945.

Id.

170. *Id.* at 6-7.

171. *Id.* at 4-12.

The IMF framework was promulgated as a means to combat a mounting international debt crisis: "In recent years, a substantial number of countries—including Costa Rica—have faced serious external payment difficuties, threatening the international financial and trading systems as a whole."[172] According to the Managing Director of the IMF:

> Not only were the problems facing some debtor countries severe but their prospects for tackling those problems in an orderly way were clouded by the deep recession in the world economy .... It was crucial that the problems be tackled quickly, in a cooperative manner, and in a way that was consistent with the preservation of the liberal trade and payments system.[173]

The Director stressed the need for a coordinated response to international debt problems: "[A] growing realization developed that any workable solution necessitated broad support and that it was in the vital interest of all parties to cooperate . . . all parties would lose—and lose heavily—in the event of . . . proliferation of trade and payment restrictions . . . ."[174]

The international financial community's interdependence necessitated a cooperative strategy. The IMF's strategy involved three elements: "[S]trong adjustment efforts by debtor countries, supportive and cooperative action on the part of the international financiers, and a revitalization of world trade to be achieved by a strengthening of policies by the industrial countries."[175] The implementation of this strategy resulted in economic adjustment programs for debtor nations, which the IMF currently approves and supervises.[176] In response to the debt crisis, the IMF thus developed a process for the resolution of international economic problems: "It is a process that adequately balances the interests of creditors and debtors, public and private . . . ."[177]

The Costa Rican currency controls ran counter to the IMF's system of voluntary cooperation. The controls unilaterally suspended external payments on debts expressly made payable in the United States. Judicial recognition of these controls as inviolate acts of state

---

172. *Id.* at 7-8 n.3.

173. *Id.* at 8 (citing J. de Larosiere, Remarks before the Institute of Foreign Bankers, (May 2, 1984), *reprinted in* 13 IMF Survey 145, 146 (May 21, 1984)).

174. *Id.* at 8 n.4.

175. *Id.* at 9.

176. *Id.*

> This approach has in fact worked well. As of June, 1984, 34 countries had current economic adjustment programs with the IMF. J. de Larosiere, Remarks before the International Monetary Conference, (June 4, 1984), *reprinted in* 13 IMF Survey 178 (June 18, 1984). Rescheduling of official and commercial debt was arranged for a large number of countries. In 1983 alone some 30 countries, including 11 of the 25 largest borrowers, completed or were engaged in debt rescheduling with official or commercial creditors ....

Id. at 9 n.5.

177. *Id.* at 11.

would have jeopardized the IMF's international debt refinancing program. The *Allied* court's allowance of the unilateral termination of debt obligations would have established an easier, preferable alternative to the IMF's cooperative process. Preservation of that process required that the court not recognize the Costa Rican controls as acts of state.

C. THE ACT OF STATE DOCTRINE AND INTERNATIONAL FINANCE

From the perspective of international financiers, the Second Circuit correctly refused to apply the act of state doctrine to the Costa Rican currency controls.[178] Nonetheless, the court of appeals premised its decision on a faulty act of state analysis.[179] The court thus arrived at a proper result through an inadequate application of the act of state doctrine.

Regrettably, the court's flawed application of the act of state doctrine places a desirable result on shaky ground. This unstable situation requires a remedy. The vital importance of *Allied*'s subject matter (i.e., the continuing integrity of the IMF debt resolution framework and, more generally, the continuing stability of international contractual relations)[180] necessitates a more substantial basis for the court's decision.

One approach for achieving the *Allied* result without relying on the court's place-of-payment debt situs analysis would involve a judicial recognition that the act of state doctrine's limited range of applicability does not extend to foreign defaults on United States bank loans.[181] Specifically, the courts should tailor a precise commercial exception to the act of state doctrine specifically for instances of foreign defaults.

A correct application of the act of state doctrine would have created a serious dilemma for the *Allied* court. Adherence to the *Sabbatino* blueprint for separation of powers would have forced the court to conclude that the Costa Rican currency controls were legitimate acts of state.[182] Under a "common sense view," Costa Rica's actions were

178. *See supra* notes 167-77 and accompanying text.

179. *See supra* notes 5-6 and accompanying text.

180. *See generally* Government Brief, *supra* note 8.

181. *See* Plaintiff's Brief, *supra* note 123, at 34-35. With regard to the district court's decision in *Allied*, counsel for the plaintiff writes:

> The District Court, however, mistakenly assumed that simply because a state had acted it faced an act of state question .... The perverse effect of such a reading is to extend the act of state doctrine beyond its limited role by using it as an excuse for selecting a law that was never applicable in the first place.

Id.

182. *See supra* notes 153-54 and accompanying text.

effective within its territory and therefore non-reviewable.[183] Yet strict adherence to the principle that the judiciary must apply sufficiently codified international law would have compelled the court to defer to the IMF debt resolving process.[184] Faced with an "effective taking," *Sabbatino* thus presented two possible courses of action. The court could have compromised international finance through an adherence to the act of state doctrine's separation of powers rationale.[185] Alternatively, the court could have assisted the operation of international finance through an application of relevant international law and deference to the IMF.[186] The act of state doctrine's failure to provide a single coherent result indicates that the doctrine should not apply in the context of foreign defaults.

Rather than apply the act of state doctrine to situations involving foreign defaults, courts should recognize a "commercial exception" specific to foreign defaults.[187] Under such an exception, a court could safely refuse to apply act of state doctrine to restrictive currency controls. The consequent strengthening of international finance would more than justify any potential offense the defaulting nation might suffer. Moreover, a commercial exception unique to foreign defaults would have the added benefit of a coordinated operation of the act of state doctrine and FSIA.[188]

CONCLUSION

The *Allied* court's reliance on place of payment in its act of state doctrine analysis does not square with the doctrine's fundamental precepts. The court's use of place-of-payment analysis conflicts with both the doctrine's separation of powers rationale and the flexibility of decision-making advocated by the Supreme Court in *Sabbatino*. Rather than attempt similar future applications of the act of state doctrine, the Second Circuit should consider the impropriety of the act of state doctrine in the context of international finance. The act of state doctrine should not disrupt the workings of those mechanisms designed to effectively resolve international debt problems.

James M. Wall

183. *Id.*

184. For a good description of the international law relevant to the *Allied* litigation, see Santucci, *Sovereign Debt Resolution Through the International Monetary Fund: An Alternative to the Allied Bank Litigation*, 14 DEN. J. INT'L L. & POL'Y 1 (1985).

185. *See supra* notes 167-77 and accompanying text.

186. *See* Santucci, *supra* note 184.

187. *See supra* notes 38-40 and accompanying text.

188. *See supra* notes 52-54 and accompanying text.