COMMENTS

FREEZER BURN: UNITED STATES EXTRATERRITORIAL FREEZE ORDERS AND THE CASE FOR EFFICIENT RISK ALLOCATION

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Consider the record of recent American asset freezes¹:

- 1990: Iraq, upon the invasion of Kuwait;
- 1988: Panama, before American intervention;
- 1986: Libya, after a spate of terrorist actions;
- 1979: Iran, after the seizure of American hostages;
- 1975: South Vietnam, after the fall of Saigon.²

The list extends further back,³ and is certain to continue into the

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¹ In the face of "any unusual or extraordinary threats" from abroad to national security, foreign policy, or the economy, the President is endowed with the power to declare a national emergency and to prescribe regulations which will "regulate or prohibit . . . transfers of credit or payments between, by, through, or to any banking institution" if they involve designated foreign countries. International Emergency Economic Powers Act (IEEPA), Title II § 202(b), 50 U.S.C. §§ 1701, 1702 (1977). See generally Abner J. Mikva & Gerald L. Newman, *The Hostage Crisis and the "Hostage Act"*, 49 U. CHI. L. REV. 292, 299-300, 346 n.293 (1982) (discussing the Hostage Act, 22 U.S.C. § 1732 (1976), Citizens in Foreign States Act, 22 U.S.C. § 1731 (1988), and how the Iranian freeze enacted pursuant to IEEPA might have been effected under these acts).

² See Iraqi Sanctions Regulations, 31 C.F.R. §§ 575.201, 575.212(a) (1991) (Iraqi freeze effective 5:00 a.m. e.d.t., August 2, 1990); Panamanian Transactions Regulations, 31 C.F.R. §§ 565.201, 565.301 (1991) (Panamanian freeze effective 4:00 p.m. e.d.t., April 8, 1988); Libyan Sanctions Regulations, 31 C.F.R. §§ 550.201; 550.301 (1991) (Libyan freeze effective 12:01 a.m. e.s.t., February 1, 1986); Iranian Assets Control Regulations, 31 C.F.R. §§ 535.201; 535.208(b) (1991) (Iranian freeze effective 8:10 a.m. e.s.t., November 14, 1979); Foreign Assets Control Regulations, 31 C.F.R. § 500.201(a)(1), (d)(1)-(4) (1991) (freeze orders and schedule of countries including: North Korea, Cambodia, North Vietnam, and South Vietnam).

³ See Cuban Assets Control Regulations, 31 C.F.R. § 515 (1991); Nicaraguan Trade Controls Regulations, 31 C.F.R. § 540.204-.209 (1991) (effective 12:01 a.m. e.d.t., May 7, 1985.); 15 Fed. Reg. 9040 (1950) (China). With residual World War II asset controls, the United States continues to regulate banking transactions between persons within the United States and Albania, Bulgaria, Czechoslovakia, Estonia, Hungary, Latvia, Lithuania, Outer Mongolia, Poland, Romania, Tibet and other

future, but with what alarming regularity and with what detrimental impact on the Eurodollar market⁴ and its participants?

International political crises often throw financial markets into a tailspin, especially one so reliant upon the speed of transactions and liquidity of funds as the Eurodollar market. The turmoil increases and lingers with continued litigation which has as yet been unable to provide clear rules enabling parties to international financial transactions to bargain efficiently and allocate political risk. The problem is especially acute given the vast sums involved.

This Comment will focus on the primary issues arising from the use of executive freeze orders⁵ to block extraterritorial Eurodollar accounts:⁶ the uncertainty of the outcome of litigation and the inefficient allocation of risk. Courts have spurned an economic analysis of risk allocation and have instead manipulated legal doctrines, thus producing variable and inefficient outcomes in cases arising from Eurodollar transactions.⁷ Consequently, the United States government has been slow to acknowledge and internalize the costs of imposing its will overseas: increased transaction costs in the Eurodollar market and removal of capital from American banks and branches. To find a framework providing a clear rule of risk allocation, this Comment will address the essential question and its corollary: (1) who should bear the risk of an extraterritorial freeze order, the depository institution or the target country depositor?; and (2) what are the consequences and ramifications of such an allocation decision?

The discussion will in turn consider freezes, defenses asserted by bank branches impaired by them, an alternative economic analysis, and the ramifications of such a risk allocation analysis. The first section will provide background on Eurodollar transactions necessary for analysis of the issues which arise in a freeze. The second section will discuss the process of imposing an executive freeze order and its scope. The third section will critique the standard legal analyses used in evaluating international deposit

nations. See 31 C.F.R. § 505.10 (schedule of countries). Changes in American policy following the upheavals in Central and Eastern Europe remain to be seen.

⁴ See *infra* notes 19-31 and accompanying text.

⁵ See *infra* notes 49-65 and accompanying text.

⁶ See *infra* notes 8-18 and accompanying text.

⁷ Although extraterritorial freezes have spawned litigation in many countries, this Comment will be concerned only with American and English decisions, due both to the close relationship between these countries and London's preeminence as a Eurocurrency center. See *infra* note 25 and accompanying text.

disputes. The fourth section will propose an efficient rule of risk allocation derived from economic analysis, focusing on interest rate differentials between domestic dollar and Eurodollar accounts. Lastly, the fifth section will address the consequences of the rule in foreign policy terms, evaluating the benefits and disadvantages of extraterritorial freeze orders.

I. AN INTRODUCTION TO THE EURODOLLAR MARKET

To discuss the issues involved, it will be useful to outline some basic aspects of the Eurodollar market: (1) What are Eurodollars and how are they created? (2) Why is the Eurodollar market significant? (3) How is the typical Eurodollar transaction effected? and (4) What are the risks involved in dealing in Eurodollars?

A. Eurodollars Defined and Created

A Eurodollar is a deposit liability⁸ denominated in dollars of a banking office located outside the United States,⁹ whether or not in Europe.¹⁰ Eurodollars are a subset of Eurocurrency deposits, those liabilities of banks generally, denominated in any currency,¹¹

⁸ The depositor's claim on a bank is a liability to the bank; the bank's subsequent loan to a borrower is an asset to the bank.

⁹ See Milton Friedman, *The Eurodollar Market: Some First Principles*, in THE EURODOLLAR 273, 275 (Herbert V. Prochnow ed., 1970); THOMAS MAYER ET AL., MONEY, BANKING AND THE ECONOMY 522 (1984); MARCIA STIGUM, THE MONEY MARKET 129 (rev. ed. 1983) [hereinafter STIGUM, MONEY MARKET].

Contrary to intuitive expectations, Eurodollar deposits may be carried within the United States, but only by domestic branches of foreign banks' international banking facilities (IBFs). This dispensation was created in an effort to bring more foreign banking to the United States; such banks might be "constructively" considered outside the United States. See *id.* at 188-91; International Banking Act of 1978, § 3103, Pub. L. No. 95-369, 92 STAT. 607 (1990) (establishing IBFs); HENRY S. TERRELL & RODNEY H. MILLS, INTERNATIONAL BANKING FACILITIES AND THE EURODOLLAR MARKET 7-9 (1983) (noting that IBFs expand the geographical scope of Eurocurrency markets, increasing the opportunity for unregulated banking transactions without greatly increasing foreign investment in the U.S.); see also MARCIA STIGUM, AFTER THE TRADE: DEALER AND CLEARING BANK OPERATIONS IN MONEY MARKET AND GOVERNMENT SECURITIES 16 (1988) [hereinafter STIGUM, AFTER THE TRADE] (explaining that dollars deposited in IBFs are also Eurodollars).

¹⁰ The term "Eurodollar" is generally recognized to encompass all dollar deposits outside the United States, including those in Asia (e.g., Singapore), the Caribbean (e.g., Nassau), and the Middle East (e.g., Bahrain). See STIGUM, MONEY MARKET, *supra* note 9, at 130 n.2.

¹¹ Actually, not just any currency is a likely candidate. At least two characteristics are crucial: (1) it must be "safe" enough to be internationally acceptable; and (2) it must be easily convertible into other major currencies at exchange rates not subject

outside the jurisdiction of that currency.¹² Eurodollar deposits may be fully liquid, or of a longer duration, negotiable or non-negotiable.¹³

The creation of a Eurodollar deposit may be illustrated best by a streamlined example:¹⁴ IBM Corporation decides to transfer \$1 million out of its account at Chase Manhattan Bank in New York and deposit the funds with Barclays Bank in London, to take advantage of the higher interest rate offered on Eurodollar accounts.¹⁵ In transferring the payment obligation on IBM's demand deposit to Barclays from Chase, a Eurodollar deposit is created which substitutes for an equivalent demand deposit in the United States.¹⁶ Barclays will then utilize these funds to grant a loan to a borrower, or else place the \$1 million in the Eurodollar interbank market.¹⁷ Eurodollar deposits are thus "linked" to

to violent or unpredictable changes or controls. See W.P. HOGAN & I.F. PEARCE, *THE INCREDIBLE EURODOLLAR* 2 (1982). Others have added requirements, including that the currency-issuing country: (1) runs a current account surplus (*i.e.*, is a net exporter); (2) is willing to enable the development of markets for the export of capital; and (3) does not suffer from heavy inflation. See DAVID F. LOMAX & P.T.G. GUTMAN, *THE EUROMARKETS AND INTERNATIONAL FINANCIAL POLICIES* 230 (1981).

¹² See ARIE L. MELNIK & STEVEN E. PLAUT, *THE SHORT-TERM EURO CREDIT MARKET* 4-5 (New York University Salomon Center Monograph Series in Finance & Economics ed. 1991).

¹³ See PAUL DAVIDSON, *INTERNATIONAL MONEY AND THE REAL WORLD* 219-20 (1982) (delineating three types of deposits: fully liquid day-Eurodollar deposits; longer term, non-negotiable Eurodeposits; and fixed maturity, negotiable Eurodollar Certificates of Deposit (CDs)).

¹⁴ See GUNTER DUFÉY & IAN H. GIDDY, *THE INTERNATIONAL MONEY MARKET* 14-19 (1978) (outlining the transaction described) [hereinafter DUFÉY & GIDDY, *INTERNATIONAL MONEY MARKET*]. In the interest of simplicity, this example specifically omits changes in the banks' accounts at their respective central banks.

¹⁵ The example operates in the reverse as well, with a foreign account holder creating the Eurodollar demand deposit with funds already in the United States: Iran receives \$1 million in payments for oil at its account at Chase in New York. Iran then decides to transfer the funds to its Eurodollar account at Barclays in London; the funds are maintained as Eurodollars since dollars will later be needed to pay for imports. See Charles J. Scanlon, *Definitions and Mechanics of Eurodollar Transactions*, in *THE EURODOLLAR*, *supra* note 9, at 17, 18-21.

¹⁶ Barclays thus now has a claim on the United States banking system via Chase, although there has been no change in the amount of outstanding dollar liabilities. See DANIEL R. KANE, *THE EURODOLLAR MARKET AND THE YEARS OF CRISIS* 132-33 (1983) (discussing the creation of Eurodollars).

¹⁷ See Scanlon, *supra* note 15, at 17. The interbank market is the market through which banks place deposits with each other at a wholesale interbank rate, such as LIBOR, the London Interbank Offered Rate. See ADRIAN HAMILTON, *THE FINANCIAL REVOLUTION* 58-59, 247 (1986) (defining LIBOR as "the rate of interest offered by banks in the London eurodollar market [, and] . . . the benchmark for a large proportion of international loans and floating-rate issues").

demand deposits in the United States, in that they "represent claims to demand deposit liabilities of a bank in the U.S. which can be mobilized at a specific future date."¹⁸

B. *The Eurodollar Market and Its Growth*

Seemingly as abstract as Eurodollars, the Eurodollar interbank market, alluded to above, is a forum comprising financial institutions (Eurobanks¹⁹) which compete for depositors' dollars and make loans to borrowers, outside the United States.²⁰ Primarily a wholesale market, transactions denominated in sums of \$1 million or more²¹ are effected by bankers²² at an ever-increasing number of financial centers²³ outside the United States,²⁴ preeminently

Many scholars are wary of the "pyramidal" creation of Eurodollars which occurs when one or more intermediary bank places the deposit before the funds are loaned to the ultimate borrower. See KANE, *supra* note 16, at 133, 141.

¹⁸ DAVIDSON, *supra* note 13, at 219 (viewing players in the Eurodollar market as those who "wish to hold or sell (for liquidity purposes) titles to dollar deposits"). See *infra* note 108 for further discussion of Eurodollar deposits as rights to repayment in credits, not cash.

¹⁹ A "Eurobank" is essentially any bank that participates in the interbank market, and has been defined as: "a financial intermediary that simultaneously bids for time deposits and makes loans in a currency, or currencies, other than that of the country in which it is located." DUFY & GIDDY, *INTERNATIONAL MONEY MARKET*, *supra* note 14, at 10 (emphasis omitted).

²⁰ See *id.* at 7 (defining the "international money market . . . as the Eurocurrency market and its linkages with other segments of national markets for credit" (emphasis omitted)). Dufey and Giddy appropriately warn against confusing the Eurodollar market, a "market[] for credit (the use of funds over time)," with a foreign exchange market, which is a "market[] for means of payments (money)." *Id.* at 5.

²¹ See *id.* at 14 n.5 (noting, however, that "London dollar CDs" are available in Eurodollar sums as small as \$5,000 or \$10,000).

²² The metaphysical quality of such interbank transactions has been enhanced by technological advances in communications. As one commentator has noted:

You look at your screen and, when you want to deal on one of the prices quoted, you ring the bank concerned or use the Reuters dealer super-telex to make the deal and to get your confirmation slip from a printer attached to the screen. The interbank settlement systems allow efficient settlement procedures.

HAMILTON, *supra* note 17, at 58-59. The speed, lack of negotiation and reliance on settlement of the transaction illustrated here will become significant features to consider in allocating risk between the parties. See *infra* notes 174-76 and accompanying text.

²³ A range of banking centers has sprung up in recent years. With the "internationalization of credit transactions," the financial center need not actually supply the capital, thus enabling new, smaller candidates to enter the ring. DUFY & GIDDY, *INTERNATIONAL MONEY MARKET*, *supra* note 14, at 36. "Offshore banking" centers generally offer financial services to nonresident borrowers and depositors, and are characterized by an absence of "intrusive and expensive official regulations," including

London.²⁵ The increased creation of Eurodollars and the enormous growth of the Eurodollar market in recent decades²⁶ is largely attributable to United States banking and loan regulations,²⁷ international monetary shocks,²⁸ technological advanc-

taxes and restrictions on portfolio management. *Id.* at 37.

²⁴ In addition to the mainstays, London and Luxembourg, growing financial centers even as early as 1981 included Asia (most notably Singapore, Hong Kong, and the Philippines), and the Arabian Gulf (including Saudi Arabia, the United Arab Emirates, Bahrain, and Kuwait). Offshore banking exists in the Bahamas, the Cayman Islands, and Panama. See LOMAX & GUTMAN, *supra* note 11 at 191-211. Panama was considered especially attractive because the dollar is legal tender in that country, and there were no exchange controls. See DUFEY & GIDDY, INTERNATIONAL MONEY MARKET, *supra* note 14, at 45-46 (also adding the British Virgin Islands, Grenada, Curacao and Caracas, Venezuela to the list of offshore banking centers). Panama's allure as an offshore banking center helps to explain the United States' decision to freeze the assets at branches of American banks there. See *supra* note 2; *infra* note 64.

²⁵ London has long been considered the center of Euromarket activities. See MELNIK & PLAUT, *supra* note 12, at 3; Scanlon, *supra* note 15, at 22 ("Since the beginning, London has been the major center for trading in Eurodollars."). London's preeminence was a factor in the decisions in the Libyan Arab Foreign Bank litigation, discussed *infra* notes 79-92 and accompanying text.

²⁶ See STIGUM, MONEY MARKET, *supra* note 9, at 142 (tabulating the growth in the gross size of the Eurocurrency market from \$315 billion in 1973 to \$1.86 trillion in 1981, with Eurodollars constituting 74% and 78%, respectively, of all Eurocurrency liabilities). As of December 1988, the Eurocurrency market was estimated at \$4.62 trillion, with Eurodollars still comprising about three quarters of the market. See JULIAN WALMSLEY, GLOBAL INVESTING: EURO BONDS AND ALTERNATIVES 4-6 (1991).

²⁷ In the 1960s, a combination of loan regulations designed to reduce the United States' balance of payments imbalance coerced commercial banks into bidding for funds abroad. See ANDREW CROCKETT, INTERNATIONAL MONEY: ISSUES AND ANALYSIS 178-80 (1977) (citing the impact of the 1964 Interest Equalization Tax on foreign deposits in the United States, the 1965 voluntary program of restraint on lending to nonresidents, and controls on direct investment abroad, as factors which hampered the capacity of American banks to compete for international business).

United States banking regulations also increased the cost of funds in the United States. See *id.* at 176-77 (noting that statutorily mandated below-market interest rates under Regulation Q in periods of tight credit in the 1960s forced banks to turn to the Eurodollar market, and that reserve requirements raised the cost of funds in the United States). See *infra* notes 189-190 and accompanying text. Further, bank merger laws prevented domestic growth of the banking industry, forcing it to expand overseas. See LOMAX & GUTMAN, *supra* note 11, at 29 (describing the limitations on domestic expansion of American banks).

²⁸ Realizing that the dollar was undervalued and that adjustments would soon be made, European central banks absorbed Eurodollars in dramatic amounts immediately prior to the 1971 decision to shift from gold-fixed to floating exchange rates. See GEOFFREY BELL, THE EURO-DOLLAR MARKET AND THE INTERNATIONAL FINANCIAL SYSTEM 90-92 (1973).

In the 1970s, international markets weathered another shock as the OPEC crisis resulted in a transfer of an additional \$150 billion annually to the Cartel's accounts. See HAMILTON, *supra* note 17, at 22-23.

es,²⁹ opportunities for diversification and higher interest rates,³⁰ and convenience to customers.³¹

A Simple Eurodollar Transaction and Clearing House Settlement

A Eurodollar transaction, requiring the transfer of funds from IBM's new account at Barclays to Citicorp's London branch, to pay a European servicer, British Airways (BA), for example,³² warrants illustration, as the mechanism has been pivotal to the defense of non-payment of frozen assets.³³ When IBM asks Barclays to pay out to BA, Barclays will telex its correspondent bank in the United States,³⁴ Manufacturers Hanover Trust (MHT) and request the transfer of dollars from its account in favor of BA's account at Citicorp/London. MHT will then submit instructions to the

²⁹ One commentator has noted that technological advances in communications have made international transactions easier, and thus more prevalent, by "reduc[ing] the economic distance between the banking offices and their customers." ROBERT Z. ALIBER, *THE INTERNATIONAL MONEY GAME* 255-56 (5th ed. rev. 1987). Another noted that advanced communications have "created an entirely new system of world finance based on the incredibly rapid flow of information round the world . . . [C]ommunications now enable and ensure that money moves anywhere around the globe in answer to the latest information or misinformation." HAMILTON, *supra* note 17, at 30 (quoting Walter Wristo).

³⁰ Commentators have noted that the "Euro-dollar market attracts funds because it offers higher rates of interest, greater flexibility of maturities, and a wider range of investment qualities than other short-term capital markets." Oscar L. Altman, *Euro-Dollars*, in *READINGS IN THE EURO-DOLLAR* 1, 3 (Eric B. Chalmers, ed., 1969). The Eurocurrency market generally "offered a range of geographical, country, and institutional risks which catered to the emerging desire of investors to diversify their investments." *INTERNATIONAL BANKING FACILITIES HAVE IMPROVED THE COMPETITIVE POSITION OF BANKS IN THE UNITED STATES* 3-6 (1984) (GAO Report to the Chairman, Board of Governors of the Federal Reserve System) (tracing the development of the market). The Comment will return to the interest rate issue, see *infra* notes 185-209 and accompanying text.

³¹ Since dollars are frequently used to settle international trade contracts, possessing Eurodollars can facilitate payments: "[T]itles to Eurodollar deposits, to the extent that they are readily transferable, have the potential to be utilized as the medium of contractual settlement at least for international contractual obligations." DAVIDSON, *supra* note 13, at 221; see also *Libyan Arab Foreign Bank v. Bankers Trust Co.*, 1 Lloyd's Rep. 259, 276 (Q.B. 1988) (noting that the depositor gained the advantage of "both the speed and efficiency with which current account payments could be made in New York, and the advantage of an account in London bearing interest at Eurodollar rates").

³² The transaction would function similarly were this an interbank transaction, i.e., Barclays loaning Eurodollars to Citicorp overnight.

³³ See *infra* notes 105-14 and accompanying text.

³⁴ The correspondent bank is one with which another bank holds an account, and which will perform business transactions in the United States.

Clearing House Interbank Payment System (CHIPS) to credit dollars from its account, in favor of Citicorp's New York office, the corresponding bank of Citicorp/London.³⁵ At the end of the day, CHIPS nets out all the transactions of the various member banks, and credits Citicorp's New York office, which then telexes its London branch to notify it of the credit received in its favor.³⁶ Citicorp's and Chase's reserve accounts with the Federal Reserve Bank of New York (Fed) are similarly adjusted.³⁷

Although just one of a number of clearing systems³⁸ which settle a mind-boggling variety of international transactions,³⁹ CHIPS is the clearinghouse most significantly related to dollar transfers initiated in international markets.⁴⁰ The clearing system

³⁵ This portion of the example is designed to illustrate that the corresponding bank often is, but need not always be, a head office of an overseas branch, or vice versa.

³⁶ For a diagrammatic approach to CHIPS, see James L. Foorman & Sally A. James, *Balanced Banks Have a CHIP on Both Shoulders*, INT'L FIN. L. REV., July 1987, at 26-29. For a simple discussion of wire transfer systems, see MARTIN MAYER, *THE MONEY BAZAARS: UNDERSTANDING THE BANKING REVOLUTION AROUND US 88-97* (1985).

³⁷ See STIGUM, *AFTER THE TRADE*, *supra* note 9, at 106-07 (summarizing the clearing insofar as Fed funds may be transferred: "Wire transfers are . . . used to effect the large payments and receipts of Fed funds that big banks, domestic and foreign, experience daily as a result of settlement of *CHIPS* . . ."); Friedman, *supra* note 9, at 287-91; Scanlon, *supra* note 15, at 27.

³⁸ Clearing systems around the globe include: Euroclear in New York (established in 1968, with 125 participants); Cedel (Centrale de Livraison de Valuers Mobilières) in Luxembourg (a rival established in 1971), see WALMSLEY, *supra* note 26, at 267-69; and Tokyo dollar clearing (run by Chase Manhattan's Tokyo Branch). See *Libyan Arab Foreign Bank v. Bankers Trust*, 1 Lloyd's Rep. 259, 275 (1988). The existence of clearing systems outside the United States seriously undermines the cover theory, as parties could have intended another system.

Methods of transmission in addition to telexes include: Cashwire; SWIFT (Society of Worldwide Interbank Financial Telecommunications, a computer link between banks); EUCLID (the computer link between Euroclear's operations center and its participants), see WALMSLEY, *supra* note 26, at 267-71 (discussing the securities clearing, functioning alongside currency clearing, and diagrammatically detailing the timing of a transaction's progression through the system); and Fedwire (a link between Fed banks and insured depository institutions), see STIGUM, *AFTER THE TRADE*, *supra* note 9, at 105-10 (noting Fedwire's capacity in 1988 to complete ten to fifteen transactions per minute).

³⁹ The list of instruments is exhaustive; suffice it to say that in addition to Eurocurrencies, the clearing systems handle transactions involving Eurobonds, bonds, securities, futures, options and swaps. See WALMSLEY, *supra* note 26, at 275-83 (discussing the trend toward "dematerializing" securities, and settlement of transactions through clearing systems in Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States); see also BANK FOR INTERNATIONAL SETTLEMENTS, *RECENT INNOVATIONS IN INTERNATIONAL BANKING* 149-55 (1986) (discussing integration of global securities markets and markets for new financial instruments).

⁴⁰ See, e.g., STIGUM, *AFTER THE TRADE*, *supra* note 9, at 107 ("[M]ost Eurodollar

allows the netting of debits and credits of participant banks, and through them, as illustrated above, of participants' correspondent institutions, so that Eurodollar transactions can occur at high volumes daily.⁴¹

D. Risk, Very Briefly

International transactions are subject to two types of risk, political and credit, and parties pay each other to assume these risks. Credit risk is the risk of default: the risk "that the borrower will not be able to pay interest on his loan and repay the principal when it becomes due."⁴² Political risk, the risk of foreign governmental action, has been defined as "the risk incurred by lenders and/or investors that the repatriation of their loan and/or investment in a particular country . . . is restricted by that country for political reasons only."⁴³

Eurodollars are potentially subject to the inimical acts of three different governments:⁴⁴ (1) the currency-issuing country (the

transactions—each day, these amount to a huge sum—are settled through CHIPS.").

⁴¹ Mayer notes the intangible and fast-clearing mechanism: "And the actual payments and receipts that the Clearing House certifies when the CHIPS computer blips its goodnight are (like Fedwire payments and receipts) transfers of the reserve balances of the settling banks." MAYER, *supra* note 36, at 92 (also suggesting the future possibility of multilateral settlements as an innovation on the debtor/creditor recording system).

⁴² THOMAS E. KRAYENBUEHL, COUNTRY RISK: ASSESSMENT AND MONITORING 11 (1985). Foorman and James note that CHIPS participants are exposed to the credit risk of their counterparties and their counterparties' settling participants, in what is termed, "intraday exposure." Foorman & James, *supra* note 36, at 27. Though brief, such exposure in the aggregate is staggeringly large. As of 1987, for example, daily volume rose on peak days to highs of \$800 billion, and in 1986 aggregate daylight overdrafts exceeded \$100 billion. *See id.* at 27-28. The authors do not, however, consider the inherent political risk, which would no doubt add to the perception of intraday exposure. Yet they do note that binding rules reduce the risk when both parties are participants in a single system, *see id.* at 29, underscoring the need for a single rule for Eurodollar transactions as well.

⁴³ KRAYENBUEHL, *supra* note 42, at 3. Sovereign risk has been considered the risk associated with a loan to or guaranteed by a foreign state, and the possibility that "it might prove impossible to secure redress through legal action." *Id.* at 4. Country risk, composed of political risk and transfer risk, is the possibility that a foreign sovereign might impose controls on funds as part of economic policy. *See id.* at 3. *See generally* Jote Kassa, *A Safety Net for the Eurodollar Market?*: Wells Fargo Asia Ltd. v. Citibank, 65 N.Y.U. L. REV. 126, 126 n.4 (1990) (discussing political versus sovereign risk); Anthony F. Marra, *The Overseas Private Investment Corporation*, in 2 INTERNATIONAL FINANCIAL LAW 165, 168-72 (Robert S. Rendell ed., 2d ed. 1983) (discussing types of OPIC insurance, including limited coverage available for overseas bank branches).

⁴⁴ Dufey and Giddy have noted this part of multiple-sovereign risk scenario in

country in whose currency the deposit is denominated); (2) the host country (where the branch is located); and (3) the bank chartering country (where the head office is incorporated).⁴⁵ Indeed, the case law reveals that just such risks have materialized, prompting litigation arising from such actions as revolution followed by expropriation of bank branches⁴⁶ or accounts,⁴⁷ exchange

anticipation of the cover theory and Bretton Woods defenses:

Since all Eurocurrency transactions must be cleared through bank balances in the country whose currency is used to denominate the external claims, the [London offshore] depositor ultimately receives payment in the U.S. He could be deprived of his funds at maturity by an action of either the British or the U.S. authorities, whereas a domestic deposit would be affected only by actions of the U.S. government. Since, from a regulatory point of view, all Eurodollar transactions are international transactions, they are all subject to the risk of intervention by at least two governments.

Gunter Dufey & Ian H. Giddy, *The Unique Risks of Eurodollars*, J. COM. BANK LENDING, June 1978, at 50, 53 [hereinafter Dufey & Giddy, *Unique Risks*]. Dufey and Giddy assume that the currency issuing country would have some sort of ultimate control over deposits denominated in that currency, not so much because of the location of the clearing house, but because of the ultimate transfers between accounts of corresponding banks with a central bank.

⁴⁵ Professor Herring has termed the forums as follows: the "currency jurisdiction," the "residential jurisdiction," and "the chartering jurisdiction." See Richard J. Herring, *Who Bears the Risk of Controls on Eurodollar Deposits? Some Recent Developments* 3 (International Banking Center Working paper No. 29, 1988) [hereinafter Herring, *Who Bears the Risk?*]. This third type of political risk has not often figured heavily in Eurodollar deposit disputes, but in fact reveals some of the overlap between credit and political risk; depositors would require a higher rate of return to place their money with such banks in part because the bank might become insolvent (credit risk) due to political upheaval in the home country, even without an expropriation.

⁴⁶ See, e.g., *Ngoc Quang Trinh v. Citibank, N.A.*, 850 F.2d 1164, 1172 (6th Cir. 1988) (holding bank liable for repayment of deposit, despite force majeure waiver clause, when bank closed Saigon office immediately prior to fall of South Vietnamese government), *cert. denied*, 110 S. Ct. 2602 (1990); *Garcia v. Chase Manhattan Bank, N.A.*, 735 F.2d 645, 646, 651 (2d Cir. 1984) (holding bank liable after Cuban revolution for payment of CDs issued from its Vedado branch because bank officials had assured plaintiffs that "they could be repaid by presenting the certificate at any Chase branch worldwide"); *Vishipco Line v. Chase Manhattan Bank, N.A.*, 660 F.2d 854, 863 (2d Cir. 1981) (holding that new Vietnamese government's expropriation of branch did not relieve head office of its liability to depositor), *cert. denied*, 459 U.S. 976 (1982). But see *Perez v. Chase Manhattan Bank, N.A.*, 463 N.E.2d 5, 11 (N.Y.) (holding expropriation of accounts by Castro government relieved bank of obligation to CD holder), *cert. denied*, 469 U.S. 966 (1984).

Sometimes a statute of limitations will bar the action. See *Tat Ba v. Chase Manhattan Bank, N.A.*, 616 F. Supp. 10, 14-15 (S.D.N.Y. 1984) (dismissing action to recover funds deposited in Saigon branches of Chase and Citibank because of New York statute of limitations), *aff'd* 762 F.2d 991 (2d Cir. 1985); *Ngoc Dung Thi Tran v. Citibank, N.A.*, 586 F. Supp. 203, 205 (S.D.N.Y. 1983) (holding that Citibank had breached its contract with depositor in closing Saigon branch, but that action was time-barred). But see *Edelmann v. Chase Manhattan Bank, N.A.*, 668 F. Supp. 99, 102

controls,⁴⁸ and of course, freeze orders, extraterritorial or domestic.

II. THE EXTRATERRITORIAL REACH OF EXECUTIVE FREEZE ORDERS AND THEIR LEGAL REPERCUSSIONS

Given the extent of the Eurodollar market, it is clear why any disruption in its smooth flow causes great worry in financial sectors: the amounts involved are gargantuan, the liquidity relies on swift, electronically-effected transactions, and the risk exposure is omnipresent. American freeze orders are about as welcome as the plague.

Nonetheless, the United States has long used freeze orders as a foreign policy tool in response to aggression;⁴⁹ a glance through the federal regulations noted above would easily supplement a brief lesson in adversarial American foreign relations.⁵⁰ Although some of the regulations have lasted for decades,⁵¹ the recent freezes

(D.P.R. 1987) (finding claim for collection on certificates issued before Cuban revolution time-barred), *rev'd*, 861 F.2d 1291, 1305 (1st Cir. 1988) (holding bank liable because the bank's actions had effectively amounted to a "separate guarantee that the deposit [would] be paid despite government expropriation of the deposit").

⁴⁷ See, e.g., *Trujillo v. Bank of Nova Scotia*, 273 N.Y.S.2d 700, 704 (1966) (holding bank's obligation to depositor, the deposed dictator's brother, extinguished upon confiscation of the account and payment to Dominican Republic National Treasury), *aff'd*, 289 N.Y.S.2d 389, *cert. denied*, 393 U.S. 982 (1968).

⁴⁸ See, e.g., *Wells Fargo Asia Ltd. v. Citibank, N.A.* 660 F. Supp. 946, 947 (S.D.N.Y. 1987) (resolving dispute over CDs deposited at Citibank's Manila branch and obligation of bank after imposition of foreign exchange controls by new Aquino government), *remanded by* 847 F.2d 837 (2d Cir. 1988), *on remand* 695 F. Supp. 1450, *aff'd*, 852 F.2d 657 (2d Cir. 1988), *vacated*, 495 U.S. 660 (1990), *aff'd on remand* 936 F.2d 723 (2d Cir. 1991), *petition for cert. filed*, 60 U.S.L.W. 3360 (U.S. Oct. 24, 1991) (No. 91-689); see also *Callejo v. Bancomer, S.A.*, 764 F.2d 1101, 1126 (5th Cir. 1985) (affirming district court's dismissal of breach of contract claim against bank by purchasers of CDs when bank refused to repay in dollars, rather than in pesos as required by Mexican exchange control regulations); *Braka v. Bancomer, S.A.*, 589 F. Supp. 1465, 1471 (S.D.N.Y. 1984) (holding suit barred by act of state doctrine), *aff'd*, 762 F.2d 222 (2d Cir. 1985); *Braka v. Multibanco Comermex, S.A.*, 589 F. Supp. 802, 804 (S.D.N.Y. 1984) (same); see also *infra* note 149 (discussing exchange controls).

⁴⁹ The United States blocked German assets during World War II, and enacted subsequent asset and trade embargoes against the People's Republic of China. See 15 Fed. Reg. 9040 (1950) (codified as amended, after China's removal from the schedule of foreign countries subject to prohibitions, at 31 C.F.R. § 500.201 (1991)); see also 45 Fed. Reg. 7224 (1980) (unblocking Chinese assets). See generally Mitchell A. Silk & Lester Ross, *Transnational Deposits, Government Succession, Frozen Assets and the Taiwan Relations Act: National Bank of Pakistan v. The International Commercial Bank of China*, 8 INT'L TAX & BUS. LAW. 1, 7-8 (1990) (discussing the case history and the blocking and unblocking of assets of the People's Republic of China).

⁵⁰ See *supra* notes 2-3.

⁵¹ Such duration raises the question of freeze versus confiscation. Cuban assets

against Iran, Libya, and Iraq have had the most significant effects on the Eurodollar market.

A. Yelling Freeze!

The President⁵² possesses broad power to impose an immediate economic freeze under the International Emergency Economic Powers Act (IEEPA).⁵³ Executive orders directed at freezing

have remained blocked since the sixties. See 31 C.F.R. § 515.201(d) (1991). Yet, despite challenges in the United States, such freezes have not been deemed "takings" under the Fifth Amendment. See Alexander F. Cohen & Joseph Ravitch, Comment, *Economic Sanctions, Domestic Deprivations and the Just Compensation Clause: Enforcing the Fifth Amendment in the Foreign Affairs Context*, 13 YALE J. INT'L L. 146, 163, 164 & n.89 (1988) (citing *Tole S.A. v. Miller*, 530 F. Supp. 999, 1005 (S.D.N.Y. 1981) (holding asset freeze is not a taking within the meaning of the Fifth Amendment)). The authors discuss *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 318 (1987) (finding that the Fifth Amendment may require compensation for temporary takings due to regulation), and note that courts have treated the "temporary deprivation of the use of property" as a "form of regulation." Cohen & Ravitch, *supra*, at 163. On logical and public policy grounds, denial of compensation for frozen assets is legitimate: "The very purpose of an assets freeze would be undermined by a judicial grant of compensation, which would render an important economic weapon useless." *Id.* at 164.

⁵² Although IEEPA directs the President to discuss the impending action with Congress "in every possible instance," he is not required to consult it in advance. International Emergency Economic Powers Act, 50 U.S.C. § 1703(a), (b) (1988). The President is required to keep Congress apprised of actions only once they have been taken. *Id.* § 1703(b). See also Richard Pregent, *Presidential Authority to Displace Customary International Law*, 129 MIL. L. REV. 77, 91-93, 104-06 (1990) (discussing the President's foreign affairs powers under other acts as well).

⁵³ 50 U.S.C. § 1701 (1988). See *supra* note 1. Other means of freezing assets both within the United States and extraterritorially are available, but cannot be as swiftly implemented as a freeze pursuant to IEEPA.

Court-ordered freezes arising from the investigative and litigation process are often directly related to causes of action, rather than precipitated by them, and are imposed to prevent further harm to the plaintiff, rather than for use as a political bargaining chip by a third party. See, e.g., *Republic of Philippines v. Marcos*, 862 F.2d 1355, 1364 (9th Cir. 1988) (reh'g en banc) (upholding preliminary injunction freezing less than \$10 million in assets of the former Philippine president and his wife), *cert. denied*, 490 U.S. 1035 (1989); *United States v. Noriega*, 746 F. Supp. 1541, 1542 (S.D. Fla. 1990) (disallowing freeze of assets by Government without showing that assets were connected to illegal activity); *Republic of Panama v. Republic Nat'l Bank of New York*, 681 F. Supp. 1066, 1072-73 (S.D.N.Y. 1988) (granting injunction to Panama under Edge Act, 12 U.S.C. § 632 (1988), which prevents transfer of funds without prior State Department certification of recognized foreign government officials). Section 5(b) of the Trading With the Enemy Act (TWEA), chp. 106, 40 Stat. 415 (codified as amended at 50 U.S.C. 5(b) (1988)), has provided a means of blocking assets in many ways analogous to IEEPA, but was amended in 1977 to restrict prospectively the President's authority to times of war. The scope of TWEA is similarly broad, covering the "acquisition holding, withholding, use, transfer, withdrawal . . . or dealing in, or exercising any right, power, or privilege with respect

offending nations' assets delegate authority to the Treasury Department to issue regulations to enforce the orders. These regulations prohibit all transactions with the target nation without prior authorization in the form of a license from the Treasury Department's Office of Foreign Asset Control (OFAC).⁵⁴ Of such executive power,⁵⁵ one participant in the financial negotiations during the Iranian crisis noted that, "[b]y a stroke of his pen, the President of the United States had immobilized over \$5 billion in deposits in other countries and kept them immobilized for 14 months."⁵⁶

B. Blocking Target Countries' Assets

The language of the Iranian freeze⁵⁷ mandated the blocking of assets with American entities' subsidiaries, not merely branches, overseas.⁵⁸ After experience with litigation during that freeze,⁵⁹ the Treasury tailored the Libyan and Iraqi regulations more narrowly, referring to "U.S. Persons,"⁶⁰ and restricting only those

to, or transactions involving" the enemy's property. *Id.* § 5(b)(1)(B). Ultimate responsibility to control assets rests with the OFAC, as under IEEPA. *See* 7 Fed. Reg. 1409 (1942) (delegating the President's authority to the Secretary of the Treasury); 32 Fed. Reg. 3472 (1967) (redelegating the Secretary's authority to the Director, OFAC). For case law, see, e.g., *Tran Qui Than v. Regan*, 658 F.2d 1296, 1299 n.5 (9th Cir. 1981) (finding Treasury validly blocked funds in the United States of a Vietnamese bank that had not been fully dissolved before the blocking regulations became applicable to South Vietnam), *cert. denied*, 459 U.S. 1069 (1982).

⁵⁴ *See* 31 C.F.R. § 500.801-802 (1991) (regarding licensing procedures and applications to unblock assets).

⁵⁵ Presidential power to freeze the Iranian assets under IEEPA withstood constitutional challenge in *Dames & Moore v. Regan*, 453 U.S. 654, 674 (1981). *See* Richard S. Simmons, *The Iranian Hostage Crisis: Its Impact on International Financial Law*, in 1 INTERNATIONAL FINANCIAL LAW 189, 194-96 (Robert S. Rendell ed., 2d ed. 1983) (concise discussion of the legality of asset controls).

⁵⁶ Robert Carswell, *Economic Sanctions and the Iran Experience*, 60 FOREIGN AFF. 247, 249 (1981).

⁵⁷ The Iranian regulations restricted transactions of business entities "whosoever organized or doing business," as long as they were, or were controlled by persons "subject to the jurisdiction of the United States." 31 C.F.R. §§ 535.329(d), 535.201 (1991).

⁵⁸ *See* Henry Weisburg, *Unilateral Economic Sanctions and the Risks of Extraterritorial Application: The Libyan Example*, 19 N.Y.U. J. INT'L L. & POL. 993, 1000 n.39 (1987) (noting that the Iranian asset freeze caught about half a billion dollars in French subsidiaries of United States banks alone).

⁵⁹ *See infra* notes 66-76 and accompanying text.

⁶⁰ 31 C.F.R. §§ 550.201-210 (Libya), 575.201-212 (Iraq) (1991). "Person" means "an individual, partnership, association, corporation or other organization." *See id.* §§ 550.306, 535.308, 575.314 (defining "Person" in the Libyan, Iranian, and Iraqi

business entities⁶¹ which were "juridical person[s] organized under the laws of the United States, or any person in the United States."⁶²

This slight narrowing of the freeze's coverage reflects the Treasury and State Departments' growing sophistication and sensitivity⁶³ with regard to the blockages.⁶⁴ Even in engineering the Iranian freeze, the Treasury specifically confined the freeze to dollar-denominated accounts with American bank branches, rather than all dollar accounts.⁶⁵ Such a revision in the language of the regulations seems to signal an acknowledgment by policymakers of the costs of a freeze, an issue to be discussed further below.

C. Legal Responses

In two of the three freeze situations to be examined, target country depositors have sued the depositary institution for return of their Eurodollar deposits, action interdicted by American orders. Although courts have couched their decisions in contract terms,

regulations, respectively).

⁶¹ *Id.* § 550.320 (explicitly defining banking institutions to include the principal, agent, home office, branch, or correspondent of a bank).

⁶² *See, e.g., id.* § 550.308 (defining "United States person").

⁶³ Showing additional concern for equity and banking practices, the regulations have authorized the transfer of funds blocked in a demand deposit account to a blocked interest-bearing account, as long as the funds are transferred to a blocked account of a United States financial institution located within the United States. *See id.* § 575.503. This regulation seems to have enabled the investment facilities considered in *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust Co.* discussed *infra* notes 84-86 and accompanying text.

⁶⁴ One curious aberration in the pattern is the Panamanian freeze. In blocking assets of the "Noriega/Solis regime" the Treasury used the term "U.S. person," 31 C.F.R. § 565.307 (1991), which broadly applied to "juridical person[s]" organized under United States law, but nonetheless, "intended to express a geographical limitation," and included only those overseas branches operating in Panama. *Id.* § 565.405. The Treasury may have calculated that a broader freeze would likely catch few assets, not meriting the international community's opposition. But a freeze confined to Panama would have great effect given its role as an offshore banking center, especially for drug cartels. *See supra* note 24. Such a freeze would be enforceable through American intervention. This type of extraterritorial freeze quite rightly elicits the worst criticism of American imperialism. Other regulations, in contrast, have not even purported to apply the freeze to the target country (e.g., Iran, Libya, Iraq), as it would have been in vain. Interestingly, the Panama regulations also provided for the continued functioning of clearing transactions by authorizing payments to the Federal Reserve Bank of New York. *See id.* §§ 565.202, 565.203, 565.314 (defining interbank clearing payments); *see also supra* note 37 and accompanying text.

⁶⁵ *See infra* notes 69-70 and accompanying text.

purporting to interpret laconic, telexed communications and account arrangements, at base lurks the question of whether a foreign court will allow the extraterritorial extension of a United States freeze.

1. Iran: Moot Court

As was to be expected, the post-revolutionary Iranian government responded to the vast immobilization of its assets⁶⁶ by filing suit. Although by their language previous freezes had purported to block overseas assets as well,⁶⁷ the Iranian freeze⁶⁸ was the first to capture significant funds.⁶⁹ With \$5.6 billion in deposits with foreign branches of United States banks,⁷⁰ Bank Markazi—the

⁶⁶ At first the American freeze order blocked deposits abroad denominated in currencies other than the dollar. See Carswell, *supra* note 56, at 250-51. These assets were unblocked via license, however, after foreign countries objected to such an extensive American extraterritorial reach, and since the amounts were considered rather small. See John E. Hoffman, Jr. & Ian H. Giddy, *Lessons from the Iranian Experience: National Currencies as International Money*, 3 J. COMP. CORP. L. & SEC. REG. 271, 281-82 (1981) (comments from the Conference on the Internationalization of the Capital Markets).

⁶⁷ See *supra* notes 1-2 and accompanying text. IEEPA's broad language allows controls over all transfers to and from all banks in the event of a national emergency.

⁶⁸ On November 14, 1979, ten days after United States citizens were seized at the United States Embassy in Teheran, President Carter declared a national emergency pursuant to IEEPA and froze all assets of the Iranian government under the control of the United States. See Carswell, *supra* note 56, at 247-48; see also Robert Carswell & Richard J. Davis, *The Economic and Financial Pressures: Freeze and Sanctions*, in AMERICAN HOSTAGES IN IRAN 173 (Paul H. Kreisberg ed., 1985) [hereinafter Carswell & Davis, *Financial Pressures*] (discussing freeze of Iranian assets and the negotiation of a settlement unblocking them).

⁶⁹ Carswell has noted that while the funds were frozen overseas, they were not to be confiscated: "[I]t seemed quite unlikely that [the U.K.] would permit up to six billion dollars to be removed from the books of bank offices in the U.K. and confiscated solely on the basis of legislation enacted in the United States, with the implications that might have for sanctity of contract and equal protection of the law in the U.K." Carswell, *supra* note 56, at 251.

⁷⁰ By all accounts, the order froze much more than had been anticipated. See, e.g., Carswell & Davis, *Financial Pressures*, *supra* note 68, at 177 (noting that the Iranian assets frozen were "grossly underestimated at around \$6 billion"); Richard W. Edwards, Jr., *Extraterritorial Application of the U.S. Iranian Assets Control Regulations*, 75 AM. J. INT'L L. 870, 873 n.16 (1981) (noting that the total of funds held with overseas branches and subsidiaries of United States banks transferred pursuant to agreement and orders exceeded \$5.5 billion); John E. Hoffman, Jr., *The Iranian Assets Litigation*, in PRIVATE INVESTORS ABROAD: PROBLEMS AND SOLUTIONS 329, 341-42 (Martha L. Landwehr ed., 1980) (finding early estimates put the aggregate amount at between \$7 and \$8 billion). The extraterritorial reach of the block was considered crucial to its effectiveness, since according to a Treasury Department census, deposits and securities held by foreign branches of U.S. banks constituted about \$5.6 billion of the

Central Bank of Iran—sued for repayment of its deposits in England,⁷¹ France,⁷² and Germany.⁷³

Although a variety of defenses and analyses were proposed, they were never fully tested in the English litigation since the suits were rendered moot by the Declaration of Algiers,⁷⁴ which orchestrated the exchange of the American hostages for the release of Iranian assets.⁷⁵ The United States Justice Department specifically conducted "holding actions" in various forums to delay disposition of the cases because from a diplomatic standpoint, "any court ruling had the potential of changing the basis of the negotiation either by encouraging Iran that it might ultimately prevail in court or by tying up Iran's assets so thoroughly as to preclude a settlement"⁷⁶ In contrast, under a different administration and circumstances, litigation resulting from the Libyan freeze proceeded to its conclusion.

total \$12 billion affected. See Carswell, *supra* note 56, at 252, 255 (the total included \$800 million in interest).

⁷¹ Bank Markazi's suits against the branches of six U.S. banks were consolidated for trial. The banks included: Bank of America National Trust & Savings Association, Bankers Trust Co., Chase Manhattan Bank N.A., Citibank N.A., Irving Trust Co., and Manufacturers Hanover Trust Co. See Edwards, *supra* note 70, at 876.

⁷² In litigation in France against Bank of America and Citibank, Bank Markazi failed to gain summary dispositions, and experts' reports on issues, though requested, were never submitted to the Tribunal de Grande Instance. See *id.* at 876-81; Hoffman, *supra* note 70, at 356-59. Note, however, that the experts' report in one French case came out in favor of the banks that argued a defense to payment based on the cover theory, discussed in text *infra* accompanying notes 105-14. See also John E. Hoffman, Jr. & Brigid Carroll, *Set-off By U.S. Lender Banks Against Off-Shore Deposits*, in SOVEREIGN LENDING: MANAGING LEGAL RISK 211, 212 n.4 (Michael Gruson & Ralph Reisner eds., 1984) (discussing the French court's appointment of an expert committee to consider the legal effect of the freeze).

⁷³ The Iranian government sued to vacate judicial attachments on its property and interests in property obtained by American banks, oil service companies, and contractors; since it involved court-ordered freezes, the German litigation will not be discussed here. See Hoffman, *supra* note 70, at 359.

⁷⁴ See Carswell, *supra* note 56, at 252.

⁷⁵ For a detailed and exciting account of the negotiations, see Roberts B. Owen, *The Final Negotiation and Release in Algiers*, in AMERICAN HOSTAGES IN IRAN, *supra* note 68, at 297, 319-20 (detailing the precise determination of the amounts to be transferred to an escrow account upon release of the hostages).

⁷⁶ See Robert Carswell & Richard J. Davis, *Crafting the Financial Settlement*, in AMERICAN HOSTAGES IN IRAN, *supra* note 68, at 201, 215-16.

2. Libya: Development of Precedent

Following a spate of terrorist attacks,⁷⁷ President Reagan issued executive orders⁷⁸ freezing assets of the Government of Libya. The Libyan Arab Foreign Bank (LAFB)⁷⁹ sued on breach of contract for the return of its deposits at overseas branches of American banks. First in *Libyan Arab Foreign Bank v. Bankers Trust Co.*⁸⁰ and then *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust Co.*,⁸¹ British courts found in favor of the depositor and required repayment by the debtor banks.

The hybrid character and operation of the "managed" or Automatic Fund Transfer (AFT) arrangements, which necessitated that LAFB have accounts in both New York and London, lay at the heart of the litigation, and thus warrants some description. In *Bankers Trust*, LAFB had a current account in New York (non-interest-bearing) and a call account in London (interest-bearing), such that if the balance in New York exceeded a fixed "peg" of \$500,000, any excess as of 2:00 p.m. (e.s.t.) would be transferred in \$100,000 increments to the London account, and vice versa, if the New York balance fell below the peg.⁸² Similarly, though on a smaller scale, in *Manufacturers Hanover*, LAFB had an AFT arrangement with a peg of \$250,000 and transfers in increments of \$10,000 between a non-interest-bearing account in New York and an

⁷⁷ See John Tagliabue, *Airport Terrorists Kill 13 and Wound 113 at Israeli Counters in Rome and Vienna*, N.Y. TIMES, Dec. 28, 1985, at A1 (reporting attacks on the Vienna and Rome airports on December 27, 1985 attributed to Libyan terrorists); see also Weisburg, *supra* note 58, at 993 (discussing the terrorist buildup to the Libyan freeze, including a TWA hijacking and killing of an American serviceman passenger, the *Achille Lauro* hijacking and killing of Leon Klinghoffer).

⁷⁸ See Exec. Order No. 12,544, 3 C.F.R. § 183 (1987), reprinted in 50 U.S.C.A. § 1701 app. at 269 (West Supp. 1988); see also Exec. Order No. 12,543, 3 C.F.R. § 181 (1991) (earlier order prohibiting United States citizens from trading with and travelling to Libya).

⁷⁹ The Libyan Arab Foreign Bank is a corporation engaged in offshore banking, and wholly owned by the Central Bank of Libya. See *Libyan Arab Foreign Bank v. Bankers Trust Co.*, 1 Lloyd's Rep. 259, 261 (Q.B. 1988).

⁸⁰ *Id.*

⁸¹ 1 Lloyd's Rep. 608 (Q.B. 1989) (relying on *Bankers Trust*).

⁸² See *Bankers Trust*, 1 Lloyd's Rep. at 263-64. Although the London Bankers Trust and Manufacturers Hanover Trust branches' corresponding banks in the United States were head offices of the same bank, such need not necessarily be the case; a branch might use an American bank, with which it has no corporate relationship, as a correspondent. Such a situation would underscore the notion that funds are actually paid out to different accounts, potentially at different banks, in the simple Eurodollar transaction.

interest-bearing account in London.⁸³ The only substantial difference in the facts of the two cases is that after the imposition of the freeze order by the President, LAFB, seeking to put its funds in an interest-bearing account, instructed Manufacturers Hanover to transfer its excess funds not to London, but to another account in the United States.⁸⁴ LAFB subsequently requested a further revision of the arrangement to invest the excesses in one-month time deposits in an International Banking Facility (IBF),⁸⁵ which would pay LAFB a more favorable rate.⁸⁶

The cases focused on the basic issue of whether an American bank branch could be excused from repayment of a deposit denominated in dollars when a freeze order in the United States prohibited the repayment. Justice Staughton noted that under generally established principles of contract law, performance of a contract is excused if the requisite action would be illegal in the designated place. Bankers Trust argued in defense that use of CHIPS⁸⁷ in New York was an implied term of the contract, since a payment in London of such magnitude, \$131 million, would necessitate use of that interbank clearing facility and the New York account. Finding no such implied term⁸⁸ and rejecting the impossibility defense, the court found that Bankers Trust could still repay its debt in London by other means⁸⁹ and was thus obligated to do so.⁹⁰ In *Manufacturers Hanover*, Justice Hirst, relying on Justice Staughton's opinion, similarly found that there was no implied term in the deposit agreements requiring that withdrawals from the London account could only be made through the New York

⁸³ See *Manufacturers Hanover Trust*, 1 Lloyd's Rep. at 611.

⁸⁴ This arrangement constituted an Automatic Investment Facility (AIF). See *id.* at 612.

⁸⁵ See *supra* note 9.

⁸⁶ See *Manufacturers Hanover Trust*, 1 Lloyd's Rep. at 611-12.

⁸⁷ See *infra* notes 105-14 and accompanying text.

⁸⁸ See *Bankers Trust*, 1 Lloyd's Rep. at 277-80 (finding that neither usage nor course of dealing dictated the use of New York clearing as an implied term).

⁸⁹ Justice Staughton suggested other means of repaying the obligation without running afoul of the freeze order, including: (i) in-house transfer in London; (ii) correspondent bank transfer; (iii) banker's payment; (iv) other clearing systems outside the United States; (v) cash-dollar bills; and (vi) cash-sterling. See *Bankers Trust*, 1 Lloyd's Rep. at 280-82. Curiously, Justice Staughton accepted Bankers Trust's arguments regarding the nonviability of London dollar clearing as a repayment option, noting that "the introduction of a very large sum by one participant into the clearing system would impose an excessive credit risk." *Id.* at 275. It would seem that the Justice was most concerned with the stability of the London financial market, placing it ahead of the interests of the depositor plaintiff.

⁹⁰ See *id.* at 284.

account.⁹¹ The apparent result of the *Bankers Trust* and subsequent *Manufacturers Hanover* litigation, reached without actually ruling on the question, is that the English judiciary will not necessarily uphold or enforce an assertion of an extraterritorial freeze pursuant to an Executive Order of an American President. It is important to note that the Treasury granted a license to Bankers Trust to enable it, without color of illegality, to transfer funds to the Libyans after Justice Staughton delivered his opinion.⁹² The United States' ostensible acquiescence in the English decision has left open the question of the United States' view of its ability to freeze dollars in American banks overseas. The subsequent freeze against Iraq revived similar issues, with the significant distinction that host countries with money centers have acted in unison under the United Nations' resolution against Iraq.

3. Iraq: Lack of a Forum

That the United States would freeze Iraqi assets could have been considered a foregone conclusion once Iraqi forces invaded Kuwait on August 2, 1990.⁹³ Already familiar with the protocols,⁹⁴ banks

⁹¹ See *Manufacturers Hanover Trust*, 1 Lloyd's Rep. at 625. Hirst further determined that the AFT arrangement, just as Justice Staughton had considered the Bankers Trust managed account, was "properly to be regarded as an instruction equivalent to a mandate, which was terminable unilaterally."

⁹² See Corinne R. Rutzke, *The Libyan Asset Freeze and its Application to Foreign Government Deposits in Overseas Branches of United States Banks*: *Libyan Arab Foreign Bank v. Bankers Trust Co.*, 3 AM. U. J. INT'L L. & POL'Y 241, 282 & n.291 (citing John Marcom Jr. & Rose Gutfield, *Bankers Trust Cleared by U.S. to Repay Libya*, WALL ST. J., Oct. 13, 1987, at 41 (reporting that the Treasury Department issued a license permitting Bankers Trust to repay \$320.1 million)).

⁹³ See Youssef M. Ibrahim, *The Iraqi Invasion: A New Gulf Alignment*, N.Y. TIMES, August 3, 1990, at A1; see also Glenn Frankel, *Iraq's Pre-Invasion Scramble for Funds Has Cushioned Impact of Sanctions*, WASH. POST., Nov. 9, 1990, at A29, A35 (noting that the invasion "triggered sanctions that effectively froze most of Iraq's \$4 billion in foreign holdings and cut off oil exports").

⁹⁴ See Danforth Newcomb, *Old Tools for a New Job: U.S. Sanctions Against Iraq*, reprinted in THE IMPACT OF THE FREEZE OF KUWAITI AND IRAQI ASSETS ON FINANCIAL INSTITUTIONS AND FINANCIAL TRANSACTIONS 25, 26 (Barry R. Campbell & Danforth Newcomb eds., 1990) [hereinafter KUWAITI FREEZE IMPACT] (noting that perhaps because of banks' familiarity with freeze protocols based on prior experience, the Treasury and OFAC have "focus[ed] on the specific disputes created by freezing Kuwaiti and Iraqi assets and hav[er] issued general licenses to resolve these disputes first, leaving the formal regulations for later"). The familiarity of banks with the freeze regulations, and their ability to use prior examples as guides, though expedient, is also a sad commentary on the regularity with which the United States has imposed monetary sanctions.

implemented the Iraqi freeze order, which followed the same pattern as the previous ones, with the exception that Kuwaiti assets were frozen as a protective measure as well.⁹⁵ The United Nations sanctions⁹⁶ and vast European and Asian cooperation⁹⁷ also distinguish this freeze from those previously discussed. What litigation may arise, if any, remains to be seen, as many money center countries have acted in accord with the United Nations' resolution, effectively precluding suit since repayment of deposits would be illegal.⁹⁸

III. INTERNATIONAL LAW AND JURISDICTION TO PRESCRIBE: LEGAL DOCTRINES ALONE CANNOT ALLOCATE RISK

In both Libyan cases, although the courts heard testimony from market experts, finance professors, and jurists to determine the status of deposits, they nonetheless rejected practical economic arguments in favor of attenuated legal theories. In a classic example, responding to Dr. Marcia Stigum's testimony that "[d]ollars deposited and dollars lent in wholesale Eurodollar transactions never leave the United States," Justice Staughton noted: "That statement no doubt makes sense to an economist. For

⁹⁵ See 31 C.F.R. Pt. 570 (1991) (OFAC administering Kuwaiti Assets Control Regulations as protective freeze); 31 C.F.R. Pt. 575 (1991) (Iraqi Sanctions Regulations).

⁹⁶ President Bush modified the first set of Executive Orders placing a trade embargo on Iraq and blocking both Iraqi and Kuwaiti assets, with a second set to comply with the United Nations' resolution. See Exec. Order No. 12,722, 55 Fed. Reg. 31,803 (1990) (Iraq); Exec. Order No. 12,724, 55 Fed. Reg. 33,089 (1990) (Iraq, second order); Exec. Order No. 12,723, 55 Fed. Reg. 31, 805 (1990) (Kuwait); S.C. Res. 660, U.N. Doc. S/RES/660 (Aug. 2, 1990) (U.N. resolution condemning the Iraqi invasion and calling for its immediate and unconditional withdrawal); see also George K. Walker, *The Crisis Over Kuwait, August 1990-February 1991*, 1991 DUKE J. COMP. & INT'L L. 25, 34-40 (discussing the U.N. Security Council's actions and the issuance of the President's executive orders).

⁹⁷ See generally, KUWAITI FREEZE IMPACT, *supra* note 94 (outlining and reprinting materials on sanctions imposed by countries including the United States, Canada, France, Germany, Italy, Japan, Switzerland, and the United Kingdom); *Sanctions*, INT'L FIN. L. REV., Sept. 1990, at 11-15 (1990) (special section outlining participant countries' freezes during Gulf crisis).

⁹⁸ See Jillian A. Gross, *Iraqi-Kuwaiti Sanctions and Choice of Law in the Eurodollar Market*, 22 L. & POL'Y INT'L BUS. 471, 524-25 (1991) (foreseeing litigation because of a mismatch between the U.K. and U.S. sanctions against Iraq, posing the issue of repayment in the United States on Iraqi claims on U.K. banks); see also, George N. Grammas, *Multilateral Responses to the Iraqi Invasion of Kuwait: Economic Sanctions and Emerging Proliferation Controls*, 15 MD. J. INT'L L. & TRADE 1, 12-20 (1991) (discussing in particular restrictions on the proliferation of nuclear, biological, and chemical weaponry, and missile technology).

a lawyer it is meaningless."⁹⁹ Given the manner in which Eurodollars are created and transactions are effected and the enormity of the market, however, such staunch disregard of economists' analyses could be devastating. In attempting to divine parties' contractual intentions from telexes, or to derive the arguably equitable outcomes of the disputes, courts have haphazardly applied ill-adapted doctrines rather than observe and heed the functioning of efficient capital markets.¹⁰⁰

*A. Prescribing Law Extraterritorially: Territoriality,
Nationality and Interests*

The primary analyses courts have applied may be classified according to three strands recognized in defining a sovereign power's jurisdiction to prescribe law extraterritorially,¹⁰¹ as articulated by the Restatement (Third) of the Foreign Relations Law of the United States:¹⁰² territoriality, nationality, and a balance of interests or effects.¹⁰³ These three principles have provided the underpinnings for analysis of extraterritorial freeze orders and defenses to payment by branches against target countries' claims.

⁹⁹ *Libyan Arab Foreign Bank v. Bankers Trust Co.*, 1 Lloyd's Rep. 259, 272 (Q.B. 1988).

¹⁰⁰ Revealing his general distaste for economic arguments, Justice Staughton criticized F.A. Mann, an expert on British banking law, on one particularly market-oriented point, writing: "I am reluctant to disagree with such a great authority on money in English law, but feel bound to do so. [This] . . . is one passage which appears to me to be an indication of economic rather than legal reasoning." *Id.* at 279; see also Peter S. Smedresman & Andreas S. Lowenfeld, *Eurodollars, Multinational Banks, and National Laws*, 64 N.Y.U. L. REV. 733, 761 (1989) (noting particularly this decision-making process, and calling Staughton's opinion "unsatisfying").

¹⁰¹ These bases serve in other areas to determine the scope of U.S. litigation. See, e.g., *EEOC v. Arabian Am. Oil Co.*, 111 S. Ct. 1227, 1230-36 (1991) (territoriality: holding that Title VII does not apply to United States employers of United States citizens outside the United States); *Laker Airways v. Sabena, Belgian World Airlines*, 731 F.2d 909, 935-36 (1984) (effects: finding reasonable the exercise of prescriptive jurisdiction finding significant territorial effects in antitrust case); *Mannington Mills, Inc. v. Congoleum Corp.*, 595 F.2d 1287, 1292 (3rd Cir. 1979) (nationality: with regard to antitrust legislation, "Congress in prescribing standards of conduct for American citizens may project the impact of its laws beyond the territorial boundaries of the United States" (quoting *Steele v. Bulova Watch Co.*, 344 U.S. 280, 282 (1952) (antitrust))); *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597 (9th Cir. 1976) (interests: balancing test used in antitrust case).

¹⁰² See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 401 (1987) (providing a general framework for considering a state's jurisdiction to prescribe, adjudicate, and enforce law).

¹⁰³ See *id.* § 402; see also *id.* § 414 & reporters' notes 3, 6, 7 & 9 (regarding jurisdiction with respect to activities of foreign branches and subsidiaries).

Yet criticisms of theories aligned with these basic strands¹⁰⁴—the cover theory based on territoriality, the separate entity doctrine rooted in nationality, and the act of state doctrine with its host of analyses relying on a balancing of interests or effects—reveal that these doctrines as applied in deposit dispute cases, especially in the event of a freeze, are flawed.

1. Territoriality: The Cover Theory and Debt Situs

In both the Iranian and Libyan freeze cases, foreign branches of American banks based their defenses to depositors' claims on the "cover account theory."¹⁰⁵ Under this theory, dollar-denominated accounts with foreign banking offices were considered merely credits¹⁰⁶ representing dollar amounts kept in the United States.¹⁰⁷ The foreign branches asserted that they were excused from payment, since dollar transactions overseas would necessarily require clearing in the United States, according to a claimed implied

¹⁰⁴ Territoriality and nationality as bases of jurisdiction to prescribe law are not useful on theoretical grounds, according to some critics who invoke an image of the state not as "natural, bounded, and enclosed, but as constructed, boundless, and open, a constellation of authoritative behaviors, or authoritative exercises of jurisdiction over individuals, events, and property[. . .] [an] ever-changing snapshot emerging from these jurisdictional assertions." Note, *Constructing the State Extraterritorially: Jurisdictional Discourse, the National Interest, and Transnational Norms*, 103 HARV. L. REV. 1273, 1295-96 (1990). The inadequacies of these theories legitimately to provide bases for jurisdiction in deposit disputes is due to their firm lodging in concrete requirements.

¹⁰⁵ See Carswell, *supra* note 56, at 250; see also Carswell & Davis, *Financial Pressures*, *supra* note 68, at 179 n.8 (explaining that, under this theory, "any (even non-U.S.) bank holding an Iranian dollar account overseas would be deemed to be holding a corresponding amount in the United States"). This nomenclature derives from the use of "cover" or clearing accounts maintained by foreign banks with their corresponding banks in the United States to facilitate payments. See *supra* notes 18 & 31 and accompanying text.

¹⁰⁶ F.A. Mann, the English jurist, has suggested a distinction between "monetary obligations" and credits, and has considered bank accounts, especially extraordinarily large ones, as the latter, since banks have no expectations of payment or discharge of debts "other than through the medium of a credit to an account with another bank." F.A. MANN, *THE LEGAL ASPECT OF MONEY* 63, 194 (4th ed. 1982). One might compare such credits to commodity options: the average investor with a long position in corn has no desire actually to take delivery of the bushels of corn for which she has a contract, but rather expects to trade the option at a profit prior to the delivery date; the only difference is that corn must ultimately be used rather than continually traded or it rots—not so with money.

¹⁰⁷ Stigum has noted: "The first important point to make about Eurodollars is that regardless of where they are deposited—London, Singapore, Tokyo, or Bahrain—they never leave the United States. Also, they never leave the United States regardless of where they are lent" STIGUM, *MONEY MARKET*, *supra* note 9, at 130-32.

term of managed account agreements. Performance would thus be in violation of United States asset control regulations.¹⁰⁸

The cornerstone of the cover theory defense is territoriality: the brief Eurodollar U-turn through CHIPS, as previously illustrated, necessary to clear a transaction in New York,¹⁰⁹ was considered sufficient territorial basis to endow the United States with prescriptive jurisdiction.¹¹⁰ However, as the existence and development of other clearing systems outside the United States demonstrate,¹¹¹ an argument based on the location of the clearing function has limited use. Moreover, interbank clearing systems are significant¹¹² not because use of them, perhaps required by an implied contractual term, would provide an esoteric basis for debt situs (territorial location)¹¹³ and territorial jurisdiction, but rather because of the necessary liquidity they provide to the Eurodollar market.¹¹⁴

¹⁰⁸ Although it can never be impossible to perform monetary obligations, since shifting the location or means of payment in contingent circumstances can enable repayment in another place, Mann concludes that discharge of bank accounts as *credits* "may become impossible." MANN, *supra* note 106, at 66 n.19, 194. He has observed that, "as economists have said, the Eurodollar market is a mere account market rather than a money market;" i.e., players in the Eurodollar market never expect to receive or pay out in cash. *Id.* at 194. Of course, the primary problem with Mann's analysis is that the British courts have not accepted it, despite its accuracy insofar as bankers understand their own industry. See *Libyan Arab Foreign Bank v. Bankers Trust Co.*, 1 Lloyd's Rep. 259, 280 (Q.B. 1988) (Staughton, J.) ("I have not accepted the argument which Professor Goode refers to, that it is well understood that [Eurodollar] deposits cannot be withdrawn in cash.").

¹⁰⁹ See *supra* notes 32-41 and accompanying text.

¹¹⁰ But compare the treatment of similar arguments in securities fraud decisions where actions in the United States have been relatively more extensive. Merely preparatory actions taken within the United States have been considered insufficient to grant the United States jurisdiction. See, e.g., *IIT v. Vencap, Ltd.*, 519 F.2d 1001, 1018 (2d Cir. 1975) (holding that engagement in "mere preparatory" activities such as exchange by American attorneys of a purchase agreement for an overseas transaction and minor drafting do not constitute conduct in the United States sufficient to confer jurisdiction in a fraud action). But see *Civil Aeronautics Bd. v. Deutsche Lufthansa Aktiengesellschaft*, 591 F.2d 951 (D.C. Cir. 1979) (holding confirmation in United States of flights sufficient basis for Civil Aeronautics Board to subpoena documents extraterritorially pursuant to investigation).

¹¹¹ See *supra* note 38.

¹¹² See STIGUM, *AFTER THE TRADE*, *supra* note 9 (entire work discussing significance of clearing operations).

¹¹³ See *infra* notes 133-41 and accompanying text.

¹¹⁴ See STIGUM, *AFTER THE TRADE*, *supra* note 9, at 121-50 (discussing clearing systems for wireable securities). As increasingly more transactions are effected by wire, general clearing facilities will become more significant, and situs of formerly "tangible" assets will become difficult to determine as well.

2. Nationality: the Separate Entity Doctrine

Based on conceptions of nationality as expressed in the Restatement, the United States could claim jurisdiction to prescribe law affecting American corporate citizens.¹¹⁵ Under the separate entity doctrine, courts have sometimes treated branches as separate entities, and have refrained from imposing one banking office's liability upon another.¹¹⁶ The rationale for this doctrine derived from the fear of a bank's double liability if a depositor were to be paid at one branch and again at another, before notice could be received at the first.¹¹⁷ Under the ultimate liability doctrine, the obverse of the separate entity doctrine, the home office of a bank may be liable for obligations undertaken by a branch.¹¹⁸ This

¹¹⁵ See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW § 414 and Reporters' Note 1; see also JAMES V. HOUPPT & MICHAEL G. MARTINSON, FOREIGN SUBSIDIARIES OF U.S. BANKING ORGANIZATIONS 1-2 (1982) (discussing banks' preferences for branch organization overseas rather than separately incorporated subsidiaries); Paul N. Filzer, *The Continued Viability of the Act of State Doctrine in Foreign Branch Bank Expropriation Cases*, 3 AM. U. J. INT'L L. & POL'Y 99, 102-07 (1988) (discussing the expansion of the multinational corporation, and the predominant choice of branches as the form of overseas banking facility).

¹¹⁶ See Ethan W. Johnson, Comment, *Reducing Liability of American Banks for Expropriated Foreign Branch Deposits*, 34 EMORY L.J. 201, 214 n.100 (1985) (discussing garnishment and attachment cases holding home offices' and branches' funds to be separate); Edmund W. Sim, Note, *Throwing a Monkey Wrench Into the Wheels of International Finance: Wells Fargo Asia Ltd. v. Citibank, N.A.*, 11 MICH. J. INT'L L. 1039, 1049, 1050 & n.72 (1991) (discussing the separate entity doctrine, and citing *Pan-American Bank & Trust Co. v. National City Bank*, 6 F.2d 762, 767 (2d Cir. 1925) ("[T]he branch is not a mere 'teller's window'; it is a separate entity."), *cert. denied*, 269 U.S. 554 (1929)). See generally Shawn E. Flatt, Case Comment, *Citibank, N.A. v. Wells Fargo Asia Ltd.: A Threat to U.S. International Banking?*, 1991 DUKE J. COMP. & INT'L L. 241, 251-59 (discussing the single and separate entity doctrines at both the New York state and federal levels).

¹¹⁷ See *Cronan v. Schilling*, 100 N.Y.S.2d 474, 476 (Sup. Ct.), *aff'd*, 126 N.Y.S.2d 192 (1950) (espousing the separate entity doctrine because, "[u]nless each branch . . . is treated as a separate entity . . . , no branch could safely pay a check drawn by a depositor without checking with all other branches and the main office"); *Chrzanoska v. Corn Exchange Bank*, 173 A.D. 285, 290-91 (1916), *aff'd*, 122 N.E. 877 (1919) (holding that bank need not honor check written on another branch because allowing a depositor to demand repayment at any office "would produce endless confusion"); see also *Harris v. Balk*, 198 U.S. 215, 226 (1905) ("It ought to be and it is the object of the courts to prevent the payment of any debt twice over."), *overruled on other grounds by Shaffer v. Heitner*, 432 U.S. 186 (1977).

¹¹⁸ See Patrick Heininger, *Liability of U.S. Banks for Deposits Placed in Their Foreign Branches*, 11 L. & POL'Y INT'L BUS. 903, 924-25 (1979). The controlling decision in this area continues to be *Sokoloff v. National City Bank*, 224 N.Y.S. 102 (Sup.Ct. 1927) (holding that the home office of the Russian branch of an American bank which had wrongfully failed to pay out a depositor in the wake of the Russian Revolution could be held liable), *aff'd mem.*, 227 N.Y.S. 907, *aff'd*, 164 N.E. 745

theory of liability has also given rise to a concept of "springing debt," in which a debt may be demanded and repaid at any branch.¹¹⁹

The potential for a court's result-oriented, fact-intensive adoption of one of the competing doctrines of bank corporate relationships is highlighted in a freeze situation. The depositor and depository institution would argue the reverse¹²⁰ of their standard positions in a freeze scenario (the bank invoking ultimate liability, the depositor claiming the separate entity doctrine),¹²¹ easily allowing a court to choose the doctrine most suited to its desired results.¹²² Moreover, the separate entity theory has lost its equity

(1928); see also H. Thomas Byron III, *A Conflict of Laws Model for Foreign Branch Deposit Cases*, 58 U. CHI. L. REV. 671, 672 (1991) (discussing the "ultimate liability doctrine" deriving from banking cases in the 1920s).

¹¹⁹ See *Vishipco Line v. Chase Manhattan Bank, N.A.*, 660 F.2d 854, 862 (2d Cir. 1981) (adopting the argument that if a branch is closed, the "situs of the debt represented by the deposit would spring back and cling to the home office" (quoting Heining, *supra* note 118, at 975)), *cert. denied*, 459 U.S. 976 (1982); see also *Garcia v. Chase Manhattan Bank, N.A.*, 735 F.2d 645, 651 (2d Cir. 1984) (holding nationalization of bank branch by Cuban government insufficient to extinguish bank's obligation to pay CD where bank officers offered reassurances that debtors could demand repayment in dollars at any branch). This basic rule derives from *Harris v. Balk*, 198 U.S. at 215 (holding that power to enforce payment of a debt depends on jurisdiction over the debtor).

¹²⁰ In the event of an exchange control or expropriation, the depositor would argue in favor of ultimate liability, since she could then demand repayment at any office. But the bank would advocate the separate entity doctrine, in an effort to sever its ties with the misbefallen branch, and bar the depositor's claims. In a freeze, however, the roles are reversed with the bank arguing for the ultimate liability doctrine, (claiming regulations affecting the head office necessarily extend to the branch), and the depositor invoking the separate entity doctrine (to preclude extension of the freeze to her branch).

An exception to the separate entity doctrine, however, specifically prevents its application in the event of expropriation. See, e.g., *Bluebird Undergarment Corp. v. Gomez*, 139 Misc. 742, 744 (N.Y. City Ct. 1931) ("Not only are branch banks separate entities, but deposits made in a branch bank are payable then and there only *except*, if the branch be closed, . . . then demand will lie against the parent bank.") (citations omitted).

¹²¹ In analogous circumstances involving set-offs, one observer noted the problem arising from banks' consideration of a foreign borrower government's various agencies as separate entities to facilitate the extension of multiple loans, in contrast with banks' eagerness to view the agencies as parts of a whole, to enable set-offs of losses against deposits at the bank in the event of a freeze or other impediment to repayment. See M.S. Mendelsohn, *Iran Hostage Deal Leaves Unsettled Issues of International Contract Law*, AM. BANKER, Feb. 3, 1981, at 1, 15 ("But it is clearly impossible to have this argument both ways—to claim that a government and its agencies are separate entities for purposes of building up loans, while also claiming that they are a single entity for the purpose of clawing back loans.").

¹²² The separate entity doctrine, however, seems to be on shaky ground. See, e.g.,

justification because the speed of electronic transactions has dramatically reduced the threat of a bank's double payment at different branches due to a time lag in record-keeping.¹²³

3. Interests / Effects Balancing Tests

The third basis of jurisdiction to prescribe law derives from a balance of forums' interests and often includes notions of reasonableness¹²⁴ or comity.¹²⁵ But such balancing tests, while purportedly solicitous of states' interests, are especially prone to tipping the scales in favor of the jurisdiction in which the action is brought.

First Nat'l Bank v. Banco Nacional de Cuba, 658 F.2d 895, 900 (2d Cir. 1981) (rejecting separate entity doctrine where bank branches which had issued letters of credit were expropriated after Cuban revolution), *cert. denied*, 459 U.S. 1091 (1982).

¹²³ In *Digitrex, Inc. v. Johnson*, 491 F. Supp. 66 (S.D.N.Y. 1980), the court took stock of changes in banking technology and rejected the separate entity doctrine, since most large commercial banks,

use[] highspeed computers with central indexing capabilities to keep track of its depositors' checking accounts. The employment of these computers, together with other sophisticated communications equipment, has enabled the Bank to monitor checking accounts *from its main office* . . . Under these circumstances, service of a restraining notice at the Bank's main office promotes, rather than endangers, the orderly transaction of banking business.

Id. at 68 (quoting counsel for Manufacturers Hanover). In *Digitrex*, the court changed the rule of law based on changed practicalities in the banking system. Similar enlightenment would be useful with regard to freeze orders of Eurodollars. *See also* Byron, *supra* note 118, at 675 ("The separate entity doctrine developed in response to the difficulty of interbranch communication before the days of instant telecommunication and global computer networks.").

¹²⁴ Section 403 of the Restatement provides a laundry list of elements to consider in determining whether the exercise of jurisdiction by any sovereign over a person or activity is "reasonable," including:¹²⁴

- (a) the link of the activity to the territory. . .
- (b) the connections, such as nationality, residence, or economic activity. . .
- (c) the character of the activity to be regulated, the importance of regulation to the regulating state, . . .
- (d) the existence of justified expectations. . . [and]
- (e) the importance of the regulation to the international political, legal, or economic system

RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW § 403(2) (1987).

¹²⁵ *See, e.g.,* Joel R. Paul, *Comity in International Law*, 32 HARV. INT'L L.J. 1 (1991) (discussing at length comity in international law).

a. *The Act of State Doctrine and Its Tests*

The act of state doctrine has provided yet another mode of analysis of risk allocation in international deposit disputes, often acting as a choice of law rule by allowing a court to uphold or ignore a foreign government's act.¹²⁶ As initially and broadly articulated, the doctrine held that "the courts of one country will not sit in judgment on the acts of the government of another done within its own territory."¹²⁷

Refinements on the principle have restricted its application to acts perpetrated by a sovereign within its own territory.¹²⁸ If American branches abroad could have established that the deposits frozen were located within the United States, they might have argued that a freeze was an act of state. Since the operation of the doctrine has relied on a factual or legal determination of the location of an act or property, and because the location of debt is not immediately evident in the case of freezes of funds (which may or may not be said to "spring back" to the head office),¹²⁹ the door remains open to politically-based conclusions of law or fact.¹³⁰ Idiosyncratic applications¹³¹ of the doctrine based on

¹²⁶ The literature in this area is voluminous; this Comment discusses the doctrine only in that it may be viewed as a defense to repayment based on the location of the debt or debtor, and as a key for choice of law, despite objections that the doctrine does not operate that way. See Michael Gruson, *The Act of State Doctrine in Contract Cases as a Conflict-of-Laws Rule*, 1988 U. ILL. L. REV. 519, 529-38 (arguing that the act of state doctrine functions as a choice of law rule in contract cases and cases involving the expropriation of tangible property). But see Clyde Crockett, *The Relationship Between the Act of State Doctrine and the Conflict of Laws and Choice-of-Law Rules*, 10 N.Y.L. SCH. J. INT'L & COMP. L. 309 (1989) (arguing that the act of state doctrine does not act as a choice of law rule); see also F.A. MANN, *FOREIGN AFFAIRS IN ENGLISH COURTS* 164-82 (1986) (discussing the doctrine of the foreign act of state, and stating in reaction to an American case invoking the act of state doctrine to avoid embarrassment to a foreign sovereign: "In England there is, or ought to be, no room for an attitude which implies subservience to the imaginary idiosyncracies of foreign States.").

¹²⁷ *Underhill v. Hernandez*, 168 U.S. 250, 252 (1897). The doctrine also encompasses a separation of powers rationale, that foreign policy determinations are more appropriately concluded by the executive branch.

¹²⁸ See *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 428 (1964) ("[W]e 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 . . .").

¹²⁹ See *supra* note 119 and accompanying text.

¹³⁰ Qualifications on the doctrine have been well-warranted in certain egregious situations. In considering some of the cases in United States courts as a result of World War II, one scholar has aptly written, "American courts found themselves hoist by their own Act of State petard in cases arising from the World War II Nazi confiscations of Jewish property under the infamous Nuremberg Laws . . ." EUGENE

interests arguments reveal that it has been invoked conveniently at best and inconsistently at worst.¹³² A range of tests devised to determine whether or not the doctrine applies have only added to the lack of consistency in decisions, some of which will be discussed here.

i. Discarding Situs: Location of the Debt

A prerequisite determination under the act of state doctrine has been the location of the debt at issue.¹³³ Academics,¹³⁴ critics,¹³⁵ and members of the judiciary¹³⁶ have long criticized the

F. MOONEY, FOREIGN SEIZURES: SABBATINO AND THE ACT OF STATE DOCTRINE 66 (1967); see also MOONEY *supra* at 70-72. Of course the State Department's *Bernstein* letter practice and later the Hickenlooper Amendment enabled public policy exceptions to the Act of State doctrine. See *Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 210 F.2d 375, 376 (2d Cir. 1954) (following letter from State Department, court held that act of state doctrine did not apply to expropriation of Jewish citizens' property by German government during World War II); see also Hickenlooper Amendment, 22 U.S.C. 2370(e)(2) (1990) (precluding invocation of the act of state doctrine with respect to confiscations or takings in violation of international law).

¹³¹ Two other exceptions to the doctrine, the treaty and commercial activity exceptions, exist as well. See, e.g., *Callejo v. Bancomer, S.A.*, 764 F.2d 1101, 1114-19 (5th Cir. 1985) (expounding the two exceptions in exchange control cases).

¹³² Compare *Perez v. Chase Manhattan Bank, N.A.*, 463 N.E.2d 5, 11 (N.Y. 1984) (holding act of state doctrine precluded court's inquiry into confiscation of bank branch during Cuban revolution), *cert. denied*, 469 U.S. 966 (1984) with *Garcia v. Chase Manhattan Bank, N.A.*, 735 F.2d 645, 651 (2d Cir. 1984) (holding acts of Cuban government in confiscating bank did not warrant application of the act of state doctrine). See also Joseph B. Frumkin, *Act of State Doctrine and Foreign Sovereign Defaults on United States Bank Loans: A New Focus for a Muddled Doctrine*, 133 U. PA. L. REV. 469, 471-85, 472 n.16 (1985) (analyzing the doctrine and its exceptions to show that the legislative, executive, and judicial branches are uncomfortable with a rule which denies plaintiffs a forum, and that there is a common misunderstanding by the courts of the purpose behind the doctrine); John L. Warden, *Choice of Law and Act of State Questions in International Banking Transactions*, in PRIVATE INVESTORS ABROAD—PROBLEMS AND SOLUTIONS IN INTERNATIONAL BUSINESS IN 1984, at 281, 308 (1984) (noting that Second Circuit decisions have created "unjustifiable uncertainty as to . . . the contingent liabilities of United States banks for foreign deposits").

¹³³ Location of the debt has frequently been construed as moving with the debtor. See *Harris v. Balk*, 198 U.S. 215, 222 (1905), *overruled on other grounds by Shaffer v. Heitner*, 432 U.S. 186 (1977).

¹³⁴ One economist has noted, "The determination of 'situs' is . . . a powerful way of hacking through the tangled undergrowth of legal complexity; but it succeeds at a cost of some violence to the reality of international financial transactions." Herring, *Who Bears the Risk?*, *supra* note 45, at 11.

¹³⁵ One jurist, for example, has questioned the assumption that debt, really only a claim to property, need be assigned a situs like tangible property, given that it produces different expectations:

legal fiction of "situs", especially as it has been ascribed to debt merely in order to apply one forum's law,¹³⁷ without tackling the economic and policy issues which should inform the decision to allocate liability.¹³⁸ Yet even while recognizing that determining

[T]here appears to be no necessity why title to intangible property should be governed by the same choice of law rule as tangible property. The *situs* of a debt is not there for all to see and expect in quite the same way as is the place where one would find a piano or a painting.

P.J. Rogerson, *The Situs of Debts in the Conflict of Laws—Illogical, Unnecessary and Misleading*, 49 CAMBRIDGE L.J. 441, 454, 458-59 (1990) (favoring a view of debt as a contractual right); see also, *Wells Fargo Asia Ltd. v. Citibank, N.A.*, 852 F.2d 657, 660 (2d Cir. 1988) ("[T]he rule being that debts as such have no *locus* or *situs*, but accompany the creditor everywhere, and authorize a demand upon the debtor everywhere." (quoting *Harris v. Balk*, 198 U.S. at 225)), *vacated and remanded*, 495 U.S. 660, *on remand*, 936 F.2d 723 (1991), *petition for cert. filed* Oct. 24, 1991 (No. 91-689).

¹³⁶ Discussing confiscations even in the late 1950s, one Swedish member of the judiciary wrote:

[A] serious objection to the territoriality doctrine is that debts and industrial and literary property rights like trademarks and patents can have no *situs* in the strict sense of that word. It is only a legal fiction to say that such intangibles have a *situs*, and the purpose of the fiction is merely to enable a court to apply . . . the *lex rei sitae* as if the intangible were a tangible, situated at the place in question *Instead of asking for the situs of the debt, we should ask for the rules according to which confiscations of debts and other intangibles have to be adjudged*

Lars A.E. Hjermer, *The General Approach to Foreign Confiscations*, in SELECTED READINGS ON PROTECTION BY LAW OF PRIVATE FOREIGN INVESTMENTS 523, 553 (George W. Ray, Jr. & Andrew R. Cecil eds., 1964) (emphasis added). Hjermer has written more recently as the Vice Chairman of the International Chamber of Commerce's Commercial Practices Commission, drafting portions of INTERNATIONAL CHAMBER OF COMMERCE, FORCE MAJEURE AND HARDSHIP (1985).

¹³⁷ Taken to its logical conclusion, the fiction has given rise to multiple *situs*es, each for different purposes, and even potentially, for different desired results:

The *situs* of intangible property is about as intangible a concept as is known to the law. The *situs* may be in one place for *ad valorem* tax purposes; it may be in another place for venue purposes, i.e., garnishment; it may be in more than one place for tax purposes in certain circumstances; it may be in still a different place when the need for establishing its true *situs* is to determine whether an overriding national concern, like the application of the Act of State Doctrine is involved.

Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706, 714-15 (5th Cir.), *cert. denied*, 393 U.S. 924 (1968) (references and citations omitted).

¹³⁸ Note that the use of the word "situs" with regard to accounts has the misleading effect of reifying the property interest and reducing it to a thing as to which one can adjudicate based on similarly concrete notions. See, e.g., *Libyan Arab Foreign Bank v. Bankers Trust Co.*, 1 Lloyd's Rep. 259, 276 (Q.B. 1988). Considering Eurodollars in their most concrete terms, Justice Staughton preposterously suggested that Bankers Trust might pay the \$131 million in cash, since it was unwilling to keep sufficient dollars on hand: "[Dollar bills] could be obtained from a Federal Reserve

situs in modern financial markets with advanced telecommunications is often ludicrous, professors¹³⁹ and judges have nonetheless fallen back on situs as a solution. Justice Hirst, for example, easily designated situs in London to fit the policy his court required in *Manufacturers Hanover Trust*,¹⁴⁰ that of preserving the integrity of the City of London.¹⁴¹ The fictive location of the debt designates the applicable law, and thus the risk allocation rule; but such interest-oriented situs analysis fails to provide the consistency necessary for an efficient global financial community.

ii. Expectations: Incidents of the Debt Analysis

An "incidents of the debt" analysis entails the evaluation of various aspects of the deposit agreement to arrive at the situs of the debt, which will act as a key to the applicable law and assignment of liability.¹⁴² Considering such elements as jurisdiction over the

Bank and sent to London by aeroplane, although several different shipments would be made to reduce the risk. The operation would take some time—up to seven days." *Id.* He noted that the bank would want to charge for the service, and would likely suspend interest payments in transit. A more inefficient manner of accomplishing international financial transactions would be difficult to devise.

¹³⁹ As Smedresman and Lowenfeld concede, it is indeed "surprising—and . . . certainly ironic—after sixty pages of discussion of currencies without a country and of credits issued, transferred and extinguished by entries on linked computer terminals, to put forward a rule based on territoriality . . ." Smedresman & Lowenfeld, *supra* note 100, at 799-800.

¹⁴⁰ Justice Hirst wrote:

In the age of the computer it may not be strictly accurate to speak of the branch where the account is kept. Banks no longer have books in which they write entries; they have terminals by which they give instructions; and the computer itself with its magnetic tape, floppy disc or some other device may be physically located elsewhere. Nevertheless it should not be difficult to decide where an account is kept for this purpose, and is not in the present case At all events I have no doubt that the London account was at all material times "kept" in London.

Libyan Arab Foreign Bank v. Manufacturers Hanover Trust Co., 2 Lloyd's Rep. 494, 499 (Q.B. 1988) (Hirst, J.), *aff'd*, 1 Lloyd's Rep. 609 (Q.B. 1989).

¹⁴¹ See *id.* at 504 (Hirst, J.) ("[I]t is of the utmost importance to the reputation of the City of London as a banking and financial centre that customers of a London-based bank should be able to recover without difficulty debts admittedly owed by the bank."), *aff'd*, 1 Lloyd's Rep. 609 (Q.B. 1989).

¹⁴² See Margaret E. Tahyar, *The Act of State Doctrine: Resolving Debt Situs Confusion*, 86 COLUM. L. REV. 594, 611-13 (1986). These factors are strongly reminiscent of elements of the "center of gravity" test, which requires the forum court to determine which state has the most significant relationship to the subject matter of the dispute, by considering contact with the forum, such as place of contracting and negotiation, place of performance and place of business of the parties. See Filzer, *supra* note 115, at 137-38. These elements also run parallel to the Restatement's "reasonableness"

debtor, place of payment, intent as to governing law, and denomination of the currency, courts may determine whether the "foreign sovereign ha[d] reasonable expectations of dominion over a debt."¹⁴³ But the "incidents of the debt" analysis is also an interests balancing test in disguise, which merely reduces the liability problem to a series of discrete factors and seemingly grants paramount importance to the foreign sovereign's expectations.¹⁴⁴ In applying competing policy arguments,¹⁴⁵ courts in different countries or jurisdictions may easily arrive at diverse conclusions.¹⁴⁶

criteria. See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW § 403 (1987).

¹⁴³ Tahyar, *supra* note 142, at 616; see also *Perez v. Chase Manhattan Bank, N.A.*, 463 N.E.2d 5, 8 (1984) ("[A] debt is located within a foreign State when that State has the power to enforce or collect it."), *cert. denied*, 469 U.S. 966 (1984). See generally Kenneth L. Miller, *Debt Situs and the Act of State Doctrine: A Proposal for a More Flexible Standard*, 49 ALB. L. REV. 647, 675-80 (1985) (suggesting that equitable results would more likely result were the act of state doctrine invoked along a continuum of the foreign sovereign's expectations of dominion).

¹⁴⁴ Tahyar has written: "If the relationship of the debt to the foreign nation is such that the foreign sovereign could reasonably expect deference to its attempt to change the obligation, then the situs of the debt must be within that foreign sovereign's territory, and the act of state doctrine should apply." Tahyar, *supra* note 142, at 610 (emphasis added). Tahyar smuggles in a test balancing sovereigns' interests by injecting a notion of reasonable expectations, which may very well be different depending on the forum. See also Stuart H. Coleman, Note, *Act of State Doctrine Held Inapplicable to Foreign Seizures When the Property at the Time of the Expropriation Is Located Within the United States: United Bank Ltd. v. Cosmic Int'l, Inc.*, 9 INT'L L. & POL. 515 (1977) (discussing the expectation of dominion).

¹⁴⁵ One critic has argued: "Even within this general system of reasonableness, however, areas can exist where issues are so important to states that they are unlikely to concede that their individual interests are subordinate to interests of another state." Robert B. Thompson, *United States Jurisdiction Over Foreign Subsidiaries: Corporate and International Law Aspects*, 15 LAW & POL'Y INT'L BUS. 319, 399-400 (1983) (Thompson further noted that "[c]ontrol over foreign subsidiaries is usually invoked in such a situation . . . In focusing on the real conflict between two states, the use of the device of the corporate entity to hide the interests of one side should be avoided").

¹⁴⁶ See Jonathan M. Clark, Jr., Note, *The Resolution of Act of State Disputes Involving Indefinitely Situated Property*, 25 VA. J. INT'L L. 901, 928 (1985) ("The 'law and policy' analysis is inherently subjective and unpredictable since it depends on the court's assessment of the myriad laws and policies of the United States that a foreign decree might conceivably implicate.").

iii. Meaningful Relief

Attempts to assign liability according to a "substantially effective" analysis, that is, whether a foreign government's acts within its own borders are such that "United States courts will be unable to grant meaningful relief," also miss the point.¹⁴⁷ Such analysis places the remedy before consideration of the forum's jurisdiction to prescribe law, making it impossible for parties to plan based on an expected result. Recall that the Treasury granted a license permitting payment in the Libyan cases;¹⁴⁸ had it not done so, the branches might have been unable to pay out. Such an outcome would have left bankers with even less of a consistent course to follow.

b. IMF Approval: A Partisan Policeman

Other theories focusing on countries' interests as mediated by International Monetary Fund (IMF) approval of either "exchange controls"¹⁴⁹ or "exchange contracts"¹⁵⁰ provide defenses of freeze orders. According to Article VIII, section 2(a) of the Articles of Agreement of the International Monetary Fund (Fund Agree-

¹⁴⁷ See Frumkin, *supra* note 132, at 492-96. This analysis seems particularly results-oriented, putting the remedy-enforcement "cart" before the prescriptive jurisdiction "horse," without resolving any issues of whether the court ought to be able to grant meaningful relief based on legal and equitable notions. See also Karen L. Goldthwaite, Comment, *Recent Approaches to Situs of Debt in Act of State Decisions*, 1 CONN. J. INT'L L. 151, 181 (1985-86) (discussing the "fait accompli" test, and noting that "predeterminations of the outcome by reclassification of the *res* really represents an avoidance of analysis").

¹⁴⁸ See *supra* note 92; see also *Vishipco Line v. Chase Manhattan Bank, N.A.*, 660 F.2d 854, 865 n.6 (2d Cir. 1981) (noting that plaintiff's assets were issued a license before judgment, but only by the Federal Reserve Bank), *cert. denied*, 459 U.S. 976 (1982).

¹⁴⁹ Exchange controls are government-imposed regulations on a country's own banking industry restricting the conversion of currencies. These restrictions are usually imposed in order to prevent the flight of capital.

The exchange control theory was once litigated in the United States. In *Libra Bank, Ltd. v. Banco Nacional De Costa Rica*, the Costa Rican national bank defaulted on a \$40 million loan. After the court determined that the exchange controls imposed by that government did not operate as a defense to payment based on the act of state doctrine, since the situs of the debt was considered outside Costa Rica, the defendant sought to reargue the case claiming that the controls were actually "exchange contracts." See *Libra Bank, Ltd. v. Banco Nacional De Costa Rica*, 570 F. Supp. 870, 884-85 (S.D.N.Y. 1983); see also William W. Park, *Legal Policy Conflicts in International Banking*, 50 OHIO ST. L.J. 1067, 1082 (1989) (discussing the IMF Articles of Agreement with respect to the *Libra Bank* decision).

¹⁵⁰ Exchange contracts generally are contracts to trade currencies.

ment), member states¹⁵¹ may restrict capital movements, including payments out of bank accounts for current transactions, on grounds of national security, but must inform the IMF immediately.¹⁵² If the IMF does not formally object within thirty days, then the control regulation is considered approved.¹⁵³ During the Iranian freeze, for example, the IMF's Executive Board was notified of the United States' actions and did not formally object.¹⁵⁴ The regulations thus fell within the provisions of section 2(a),¹⁵⁵ and might have provided a valid defense had the Iranian litigation in the United Kingdom been completed.¹⁵⁶ Along a parallel, though a much more disputed vein of argument, the blocked accounts might be considered "exchange contracts"¹⁵⁷ involving United States currency under section 2(b),¹⁵⁸ since some foreign exchange would become involved in any repayment of deposits.¹⁵⁹

¹⁵¹ Regarding the effect on members of non-membership of other nations, see JOSEPH GOLD, *THE FUND AND NON-MEMBER STATES; SOME LEGAL EFFECTS* (1966) (claiming that restrictions on member states' dealings with non-members effectively regulates the actions of non-members from within, so that only non-members dealings amongst themselves are not regulated).

¹⁵² Article VIII, section 2(a) provides: "(a) Subject to [provisions requiring notification and approval], no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions." Articles of Agreement of the International Monetary Fund, December 27, 1945, *amended* July 28, 1969, *reprinted in* JOSEPH GOLD, *VOTING AND DECISIONS IN THE INTERNATIONAL MONETARY FUND* app. IX, 270 (1972) [hereinafter *FUND AGREEMENT*].

¹⁵³ See Edwards, *supra* note 70, at 874.

¹⁵⁴ *Id.* at 875.

¹⁵⁵ *Id.*

¹⁵⁶ Extensive discussion of this issue in cases before the Iran-United States Claims Tribunal can be found in 3 JOSEPH GOLD, *THE FUND AGREEMENT IN THE COURTS* 79-87 (1986).

¹⁵⁷ There are two competing interpretations of "exchange contracts." One holds that a true exchange contract is designed to "exchange the currency of one country for the currency of another"; the other designates as exchange contracts, all contracts which "prejudice exchange resources of a member state." Patrick Balfour, *Extraterritorial Recognition of Exchange control Regulations—The English Viewpoint*, in *THE LAW OF INTERNATIONAL TRADE FINANCE* 125, 129 (Norbert Horn ed., 1989).

¹⁵⁸ Article VIII, section 2(b) provides in pertinent part: "(b) Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member." *FUND AGREEMENT*, *supra* note 152, at 270.

¹⁵⁹ See Rutzke, *supra* note 92, at 245. The paradigm of abuse is the situation in which the price of an export contract is inflated, with the seller generally providing a kickback to the buyer in the desired currency outside the jurisdiction of the currency controls. See also Werner F. Ebke, *Article VIII, Section 2(b), International Monetary Cooperation, and the Courts*, in *FESTSCHRIFT IN HONOR OF SIR JOSEPH GOLD*

Yet the IMF as an international governing body can hardly be relied upon to police members as powerful as the United States, let alone non-member money centers. According to one "politically realistic" observer, "the IMF is a creature of its members who are sovereign governments. In particular, it is a creature of its major members, the major countries who collectively have the ability to manage the system for good or for ill."¹⁶⁰ Thus, defense of an American action based on IMF approval, or definition of a contract in terms of the Fund Agreement is inconclusive.

B. Summary

Having examined the common arguments used in international financial litigation and their ramifications in freeze situations, one can agree with Noyes Leech, who has effectively summarized the complaints against most of these analyses: "Unfortunately, these legal concepts and doctrines [e.g., contract law, debt situs, act of state doctrine] lack scientific precision, have been incompletely developed, and are understood in differing ways by different lawyers, and no better understood by lay people, bankers and judges."¹⁶¹

IV. THE LEGAL-ECONOMIC NEXUS

To attack once more the essential questions—to whom and on what grounds should a legal system allocate the risk of a freeze—one now can turn away from previously proposed and unavailing theories, and approach the problem instead using economic analysis.

Since the primary focus of negotiation and litigation in international bank deposit transactions is the assignment of both credit and political risk,¹⁶² the following discussion considers the

63, 73-84 (Werner F. Ebke & Joseph J. Norton eds., 1990) (discussing the narrow American and English, and broader German interpretations of the term "exchange contract," and public policy considerations inherent in the notion of "monetary transactions in disguise" as commercial transactions).

¹⁶⁰ *International Financial Conditions: Hearings Before the Subcomm. on International Finance of the Senate Comm. on Banking, Housing and Urban Affairs*, 96th Cong., 1st Sess. 262 (1979) [hereinafter *International Financial Conditions Hearings*] (testimony of Benjamin J. Cohen).

¹⁶¹ Noyes Leech, *International Banking: Effects of Nationalizations and Exchange Controls*, 8 J. COMP. BUS. & CAP. MARKET L. 123, 123-24 (1986).

¹⁶² Note that the difference between political and credit risk is not entirely distinct, nor can it be. See Smedresman & Lowenfeld, *supra* note 100, at 746-61.

transaction costs which arise when political risks are not clearly or efficiently allocated. Although it may seem odd to consider the United States politically risky, to the depositor on shaky foreign relations ground, it is just that.¹⁶³

A. Coase and Perfect Markets

The Coase theorem postulates that from an efficiency perspective, the initial allocation of legal entitlements does not matter as long as the parties, themselves best situated to evaluate their own preferences, can bargain to obtain the cost-effective outcome: the party to suffer the loss will bribe the least-cost risk-avoider to take the precautions necessary to prevent the reduction in value.¹⁶⁴ However, such a result will necessarily ensue only in a perfect market: one in which there are low or nonexistent transaction costs (and a small number of parties to the bargaining); information is available equally to all parties; and the assignment of the liability or entitlement is clear and freely alienable.¹⁶⁵

In many ways, the Eurodollar market, like other financial markets, approximates a perfectly competitive system, and would therefore be conducive to efficient outcomes, were it not for two primary obstacles: (1) regulatory interference, especially unexpected restraints on liquidity¹⁶⁶ such as executive freeze orders, and

¹⁶³ One recent handbook even warns of the potential effects of United States freezes both within and outside its borders:

Persons accustomed to restrictions on foreign transactions in their own currency may be surprised to find how little regulation of this type is in force in the United States. They should not, however, be lulled into assuming that international transactions into and out of the U.S. are not well regulated. Concerns of foreign policy and national security . . . influence the U.S. regulatory system.

. . . .

Additionally, one must always bear in mind the broad reach of some U.S. laws, notably the extra-territorial application of complex or restrictive statutes such as the anti-trust laws

Erica L. Gut, *United States of America*, in *THE GUIDE TO FOREIGN EXCHANGE REGULATIONS* 319, 319 (P. Bentley & R. Crossan eds., 4th ed. 1990).

¹⁶⁴ See R. H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 30-34 (1960) (expounding the theorem, using the now-famous crop versus train and spark-prevention device); see also Robert D. Cooter, *Economic Theories of Legal Liability*, 5 J. ECON. PERSP., Summer 1991, at 11, 16-21 (discussing the Coase theorem and other legal theories of liability with respect to their efficiency).

¹⁶⁵ See ROBERT L. RABIN, *PERSPECTIVES ON TORT LAW* 168 (3d ed. 1990).

¹⁶⁶ See PAUL F. SMITH, *MONEY AND FINANCIAL INTERMEDIATION* 258-59 (1978) (noting that investors must be able freely to liquidate assets or raise funds in money markets, and that "[a]ny barriers to the movement of funds among markets will create

(2) an unclear rule of law, as evidenced by extensive and expensive litigation. These exogenous elements distance the markets from a state of perfect competition by introducing political risk and uncertainty.

1. Uncertainty Breeds Murky Legal Rules

The current system needs, but lacks, consistent legal rules which would enable depositors and banks to anticipate and plan for contingencies.¹⁶⁷ As one commentary has noted: "Unpredictability (not to mention the prospect of confiscation and double liability) is anathema to a banker."¹⁶⁸ Unfortunately, different results have been derived from such factors as the interpretations of contracts and potentially implicit terms; boilerplate disclaimers; the currency at issue; the manner in which the deposit was made and by whom; the nature of the political disruption; and the target of the asset impediment.¹⁶⁹ Though a depositor might well assert that she has

differentials that reflect the imperfections in the adjustment process").

¹⁶⁷ Justice Hirst recognized the mandate for a standard rule: "I am very conscious of the need, wherever possible, for consistency of decision in commercial and banking matters such as the present" *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust*, 2 Lloyd's Rep. 494, 502 (Q.B. 1988), *aff'd*, 1 Lloyd's Rep. 608 (Q.B. 1989); *see also* Leech, *supra* note 161, at 141 (concluding that "[b]ecause of [legal doctrines'] uncertain content and application, litigation may lead to results the parties would not have contemplated had transactions been fully negotiated and their terms clarified The uncertainties of the search for those expectations [of parties] in commercial practices and understandings would have been avoided.").

¹⁶⁸ Francis D. Logan & Mark A. Kantor, *Deposits at Expropriated Foreign Branches of U.S. Banks*, 1982 U. ILL. L. REV. 333, 354.

¹⁶⁹ *See* Ngoc Quang Trinh v. Citibank, N.A., 850 F.2d 1164, 1166 (6th Cir. 1988) (refusing to honor deposit agreement waiver absolving bank of "any loss or damage suffered or incurred by any depositor resulting from government orders, laws . . . or from any other cause beyond its control" when branch closed prior to fall of South Vietnamese government), *cert. denied*, 110 S. Ct. 2602 (1990); *Vishipco Line v. Chase Manhattan Bank, N.A.*, 660 F.2d 854, 866 (2d Cir. 1981) (holding bank liable to depositors on CD after having closed bank branch in Saigon before coup), *cert. denied*, 459 U.S. 976 (1982); *Trujillo v. Bank of Nova Scotia*, 273 N.Y.S.2d 700 (1966) (extinguishing bank's obligation under New York Banking Law § 204-a(3)(a) upon confiscation of depositor's accounts by Dominican government); *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust*, 1 Lloyd's Rep. 608, 614-19 (Q.B. 1989) (finding two contracts with two accounts using AFTs, and the applicability of two sovereigns' laws, based in part on stamped legend on documents); *Libyan Arab Foreign Bank v. Bankers Trust Co.*, 1 Lloyd's Rep. 259, 280 (Q.B. 1988) (finding no implied term of deposit agreement that transfers be through CHIPS); *see also* Garcia v. Chase Manhattan Bank, N.A., 735 F.2d 645, 648-49 (2d Cir. 1984) (finding that actions of Cuban government did not cancel bank's debt to depositor, because of bank officers' assurances to depositors). *But see* Perez v. Chase Manhattan Bank, N.A., 463 N.E.2d 5 (N.Y.) (holding that confiscation of branch by Cuban government

"money in the bank," she can no longer claim with certainty that she is entitled to retrieve it in a particular form or forum.¹⁷⁰

2. Transaction Costs of Uncertainty

United States regulatory interference, coupled with the inability of courts to assign political risk consistently raises transaction costs in the international banking system at all three stages: in the creation of the contract, during its performance, and in the resolution of any alleged breach.

a. Preliminary Negotiation

Because of the uncertainty of outcomes, the parties must explicitly determine their responsibilities for political risk *ex ante*, bearing the cost of increased negotiation. In an analogous vein, one observer predicted that after the Iranian freeze, "contracts governing international loans will become even longer. Some of them already run to 300 pages and more, partly because word processors make it possible to incorporate ever more contingency clauses as fast as lawyers can dream them up."¹⁷¹ To induce greater consistency, one proposal has urged courts to treat the parties' own privately bargained assignments of liability with greater deference:¹⁷² "When it appears either that the bank may be forced to withdraw from the market, or that the customer must find other safeguards for his savings, the parties will come together to work out a solution. Foreseeing these problems . . . courts should provide an incentive to bargain in advance."¹⁷³ Even if private bargaining could produce efficient results in situations with valid

extinguished debt to depositor), *cert. denied*, 469 U.S. 966 (1984).

¹⁷⁰ See Smedresman & Lowenfeld, *supra* note 100, at 787 (discussing chart of recent deposit claim cases, and concluding that "in sum, no clear rule emerges, nor any reliable basis for prediction").

¹⁷¹ Mendelsohn, *supra* note 121, at 1, 15. Note, however, that a depositor cannot contractually assign subjection to government regulation, since such a contract would be in violation of the public policy of the blockage; the interest premium paid is advance compensation for this risk.

¹⁷² Not unlike the IMF, international commercial and banking organizations which promulgate codes and provide arbitration lack binding authority, providing only persuasive evidence in subsequent courtroom battles. See, e.g., W. LAURENCE CRAIG ET AL., INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION xxi-xxii (2d ed. 1990) (noting that "parties to an ICC arbitration would affirm only that they were honor bound to carry out the award of the arbitrators"). Concerning the IMF, see *supra* notes 150-60 and accompanying text regarding the IMF.

¹⁷³ Johnson, *supra* note 116, at 246.

express disclaimers,¹⁷⁴ sophisticated parties,¹⁷⁵ and an absence of political pressure,¹⁷⁶ the time-sensitive, wire-mediated Eurodollar market is still not conducive to bargaining during each trade over much more than price.

b. *Managed Accounts and Similar Arrangements*

The United States' political risk after the Iranian and Libyan freezes in particular, as seen from the viewpoint of depositors on tenuous foreign relations ground with the United States, signalled loudly that "unguarded" investment in dollars would be ill-advised.¹⁷⁷ Managed account arrangements may be seen as transaction costs¹⁷⁸ incurred in attempts to protect against the uncertainty of legal results and the risk of political regulation, without compromising depositors' returns from Eurodollars, or credit security from American banks.¹⁷⁹

¹⁷⁴ Cf. *Ngoc Quang Trinh v. Citibank, N.A.*, 850 F.2d 1164, 1166, 1172 (6th Cir. 1988) (holding that Citibank's disclaimer in a deposit contract was not sufficient to relieve the home office of the branch's debt when the branch closed before being expropriated), *cert. denied*, 110 S. Ct. 2602 (1990).

¹⁷⁵ Most participants in the Eurodollar market, if they are dealing in increments of \$1 million or more, must be considered sophisticated. Thus, the potential for the standard adhesion contract problem is dissipated.

¹⁷⁶ Johnson suggests that in many cases the parties are sufficiently sophisticated that no problems of coercive bargaining or contracts of adhesion arise. See Johnson, *supra* note 116, at 247 (citing *Vishipco Line v. Chase Manhattan Bank, N.A.*, 660 F.2d 854, 856-57 (2d Cir. 1981) (depositors were ten shipping companies) and *Garcia v. Chase Manhattan Bank, N.A.*, 735 F.2d 645, 646 (depositor was Cuban senator and owner of many successful businesses)). Timing is crucial as well, since bargaining in the face of impending violence or freeze might later be considered coercive.

¹⁷⁷ See Gross, *supra* note 98, at 471, (citing *Libyan Arab Foreign Bank v. Bankers Trust, Co.*, 1 Lloyd's Rep. 259 (Q.B. 1988)).

¹⁷⁸ Banks profited from the arrangement. Bankers Trust received remuneration in the form of the benefit of an interest-free balance of between \$500,000 and \$599,999, the "peg" amount plus the \$100,000 increment, plus retained interest on excess credit after 2:00 p.m. (e.s.t.) on business as well as non-working days. See *Bankers Trust*, 1 Lloyd's Rep. at 264.

¹⁷⁹ See *Bankers Trust*, 1 Lloyd's Rep. at 263-67. After the first shock of the Iranian freeze, OPEC and other Arab countries went to great lengths to arrange managed accounts to reduce their United States political risk exposure. A managed account should not be confused with the standard relationship between foreign branch and corresponding bank necessary to create Eurodollars.

c. Litigation

Uncertainty has fostered increased litigation and its associated costs.¹⁸⁰ The *Citibank, N.A. v. Wells Fargo Asia Ltd.* decisions supply a notorious example of a single case generating exorbitant costs, without producing a governing rule for international deposit disputes.¹⁸¹ Litigation costs incurred in court battles do not cancel out the windfall a party may receive when a court decides in its favor; the opposing party incurs parallel costs, without the benefit of a favorable decision.¹⁸² High litigation costs are a

¹⁸⁰ Given uncertainty, the mistaken view that increasing expenses can insure a favorable outcome may even result in irrational overpayment: "Randomness . . . brings with it more litigation More randomness also means that the litigants are more likely to disagree about the likely outcome of a case They won't find a mutually beneficial compromise. Differences in opinion don't only make for horse races; they also make for litigation." Leo Herzel & Leo Katz, *Smith v. Van Gorkom: The Business of Judging Business Judgment*, 41 BUS. LAW. 1187, 1191 (1986).

¹⁸¹ The issue whether Citibank was required to pay a CD issued by its Manila branch to Wells Fargo Asia Ltd. after the Central Bank of the Philippines imposed exchange controls came first before the District Court for the Southern District of New York. *See Wells Fargo Asia Ltd. v. Citibank, N.A.*, 612 F.Supp. 351 (S.D.N.Y. 1985) (denying summary judgment). Recovery was subsequently allowed. *See Wells Fargo Asia Ltd. v. Citibank, N.A.*, 660 F. Supp. 946 (S.D.N.Y. 1987). Appeal was taken (unpublished opinion, 847 F.2d 837 (2d Cir. 1988), and the Court of Appeals subsequently remanded for supplemental findings. *See Wells Fargo Ltd. v. Citibank, N.A.*, 695 F. Supp. 1450 (S.D.N.Y. 1988). It also ruled. *See Wells Fargo Asia Ltd. v. Citibank, N.A.*, 852 F.2d 657 (2d Cir. 1988) (*aff'g* judgment below). The Supreme Court granted certiorari, ruled that the district court's findings had not been clearly erroneous, and remanded the case to the appellate court to determine the applicable law, and whether repayment might be required in New York. *See Citibank, N.A. v. Wells Fargo Asia Ltd.*, 110 S. Ct. 2034 (1990). The Second Circuit ruled on remand. *See Wells Fargo Asia Ltd. v. Citibank, N.A.*, 936 F.2d 723 (2d Cir. 1991). The Supreme Court expressly avoided declaring a federal common law rule regarding bank deposits.

After the Supreme Court provided what many consider to have been a less than insightful decision on this crucial and complex issue, Chief Justice Rehnquist wrote, "[O]ne may fairly inquire as to why certiorari was granted. The opinion decides no novel or undecided question of federal law I do not believe that granting plenary review in a case such as this is a wise use of our limited judicial resources." *Wells Fargo*, 110 S. Ct. at 2034, 2042-43 (Rehnquist, C.J., concurring). Considering litigation and court costs today, it is regrettable that the Supreme Court squandered the opportunity to set a rule of law governing such circumstances.

Ultimately Judge Kearse, writing for the Second Circuit, found that Citibank was required to repay Wells Fargo out of its worldwide assets. *See Wells Fargo Asia Ltd. v. Citibank, N.A.*, 936 F.2d 723, 725, 728 (2d Cir. 1991). But the saga continues. *See Wells Fargo*, 60 U.S.L.W. 3360 (U.S. Oct. 24, 1991) (No. 91-689) (filing petition for certiorari).

¹⁸² In the Libyan cases, the depositors got the windfall benefit of repayment of their deposits despite risk premiums already paid to them by the bank to cover just such contingencies. Attempts to recharacterize their litigation costs as appropriate

symptom of an inefficient system without predictable rules; they are not appropriate payments to achieve a particular outcome.

B. *Finding an Efficient Rule: Calabresi*

Given the uncertainty of courts' assignments of liability and the potential for American political action, the rule of risk allocation which most closely tracks the adjustment parties would have made under the Coase theorem, will provide the most efficient outcome. Using Calabresi's guidelines,¹⁸³ an efficient method of risk allocation will attempt to make a good initial guess of the least-cost risk avoider, cause parties to internalize their costs, and assign risk to the party best able to make corrections through the market.¹⁸⁴ As will be explained below, an evaluation of Eurodollar and domestic interest rate differentials points towards the efficient allocation of risk to the debtor in a freeze crisis, as will be explained below.

1. The Risk-Return Tradeoff

Higher returns induce depositors to make riskier deposits, given the basic premise that an individual's utility function may be plotted as a tradeoff between risk and the rate of return.¹⁸⁵

risk avoidance payments which eliminate any windfall neglects that: (1) payment of attorneys' fees alone does not insure a favorable outcome (and bribing judges is illegal); and (2) the opposing party must pay analogous fees, thus preserving a net gain to the winner in the amount of her windfall.

¹⁸³ See GUIDO CALABRESI, *THE COSTS OF ACCIDENTS* 140-73 (1970). Calabresi has noted that total deterrence of accident-causing activities is not necessarily desirable; rather the market, relying on prices to reflect the true costs of activities should serve to effect "general deterrence," allowing society to substitute safer, less expensive activities. *Id.* at 68-69. A clear analogy may be drawn to the United States' decision to engage in freezes, once it has weighed its costs in comparison to other alternatives, such as diplomatic negotiation or trade embargoes.

¹⁸⁴ See *id.* at 144-45, 150-52.

¹⁸⁵ See, e.g., SMITH, *supra* note 166, at 102-06 (discussing risk aversion as a barrier to investment).

a. *Sources of Interest Rate Differentials:*¹⁸⁶ *Cost and Risk*

Because of reduced costs and increased risk,¹⁸⁷ Eurodollar deposits command a higher return than deposits in the United States.¹⁸⁸ The cost components derive from regulations designed to reduce credit risk, such as reserve requirements and deposit insurance, from which funds payable only at foreign branches are excused under Regulations D¹⁸⁹ and Q¹⁹⁰ respectively. Considering the flip side of the coin, Eurodollar returns are higher because of greater perceived risks.¹⁹¹ Credit risk of overseas branches

¹⁸⁶ As an analogue to the Efficient Capital Markets Hypothesis, which suggests that all relevant information is reflected in the market price of a stock, one might similarly argue that interest rates reflect basic cost and risk information as perceived by the market. See, e.g., Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 3-5 (1978) (discussing the theory and its weak, semi-strong, and strong incarnations); see also STIGUM, MONEY MARKET, *supra* note 9, at 592-95 (discussing the existence of an active arbitrage market).

¹⁸⁷ Cost and risk are the preeminent, but not the only, reasons for the interest rate differential. Investors will also pay a premium for secrecy, as is evidenced by the continued attractiveness of Swiss and other monetary (and tax) havens. See generally INGO WALTER, THE SECRET MONEY MARKET 8 (1990) (discussing what the author terms a "secrecy seeker's surplus," and suggesting that an investor may be willing to accept higher costs imposed in the form of lower interest rates on deposits in return for a guarantee of confidentiality).

¹⁸⁸ See M. Ann Hannigan, *United States Home Bank Liability for Foreign Branch Deposits*, 1989 U. ILL. L. REV. 735, 738 ("[B]y using foreign branches, American banks can loan out a larger percentage of their capital reserves at higher interest rates, and, at the same time, offer a higher rate of interest to depositors.").

¹⁸⁹ 12 C.F.R. § 204.1(c)(5) (1991) (Regulation D, stating in pertinent part that the reserve requirement provisions "do not apply to any deposit that is payable only at an office located outside the United States"); *id.* § 204.2(t) (1991) (clarifying the term deposit, "as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States"); see also, MAYER ET AL., *supra* note 9, at 527 ("Reserve requirements are an implicit tax on deposits.").

¹⁹⁰ 12 C.F.R. § 217.1(c)(2) (1991) (Regulation Q, excluding foreign deposits from interest rate limits); Lawrence L. Kreicher, *Eurodollar Arbitrage*, FED. RESERVE BANK N.Y. Q. REV., Summer 1982, at 10, 13 (noting that the basic FDIC assessment has typically been 1/12 of one percent of total deposits); see also MAYER ET AL., *supra* note 9, at 527.

¹⁹¹ Since one of the functions of money is to serve as a "medium for storing value through time," the investor must be assured that the chosen investment and currency will withstand risks over that period. See J. Carter Murphy, *International Moneys: Official and Private*, in Festschrift in Honor of Sir Joseph Gold, *supra* note 159, at 237, 239; see also Edward J. Frydl, *The Eurodollar Conundrum*, FED. RESERVE BANK N.Y. Q. REV., Spring 1982, at 11, 12 (noting the potential for arbitrage between foreign and domestic markets based on these discrepancies).

stems from their lack of both insurance on Eurodollar deposits and direct access to the Federal Reserve discount window.¹⁹² But since central banks of the largest participants have agreed to bail out branches of their own Eurocurrency market members¹⁹³ should the threat of insolvency arise,¹⁹⁴ credit risk premiums provide only a means of comparing banks, not comparing Eurodollar and dollar deposits.¹⁹⁵

b. *Political Risk: Bribing Depositors to Assume Risk
in the Eurodollar Market*

Parties bargain over political risk,¹⁹⁶ as they do over credit risk, by "tiering." Banks "pay up" more or less, offering premiums commensurate with depositors' perceptions of risk.¹⁹⁷ The practi-

¹⁹² Banks in dire straits frequently borrow from the Fed discount window at reduced rates. The head office, however, will generally assume responsibility for the credit failures of a branch. See Kassa, *supra* note 43, at 137-38 (noting that "[b]ecause banks consider themselves at fault for a branch's failure to pay due to insolvency or financial mismanagement, they consider the head office or parent bank to be liable to a depositor for such 'credit risk,' in contrast to liability for 'sovereign risk'").

¹⁹³ See STIGUM, MONEY MARKETS, *supra* note 9, at 176 (noting that central banks could rescue their respective countries' banks "either from their own reserves or by obtaining dollars through swaps from the Fed").

¹⁹⁴ Professor Herring has demonstrated the devastating results of liquidity and credit shocks on the fragile interbank payment system. See RICHARD J. HERRING, PRESSURES ON THE PLUMBING OF THE INTERNATIONAL FINANCIAL SYSTEM: THE THREAT OF SYSTEMIC RISK 13 (International Banking Center Working Paper) (1991) (unpublished manuscript, on file with the author) (citing David B. Humphrey, *Payments Finality and Risk of Settlement Failure*, in TECHNOLOGY AND THE REGULATION OF FINANCIAL MARKETS, SECURITIES, FUTURES, AND BANKING 97 (Anthony Saunders & Lawrence J. White eds., 1986) (study simulating the application of the "unwind rule" in the event of the failure of a major CHIPS settling institution, and warning that such a rule could easily "transform idiosyncratic credit risk into systemic risk")); see also STIGUM, MONEY MARKET, *supra* note 9, at 175. Banks have been particularly fearful due to failures and scandals. See *id.* at 146-47, 177-81 (discussing both the Herstatt failure, which prompted the G10 to issue the Basel Concordat in 1974, promising to provide temporary support to banks in international markets experiencing liquidity problems; and the later Banco Ambrosiano scandal).

¹⁹⁵ The aphorism that a bank is "too big to fail" aptly denotes that branches' credit needs will be adequately served by the home office. The following quip seems to say it all: "If you owe your bank a hundred pounds, you have a problem; but if you owe a million, it has." William W. Park, *When the Borrower and the Banker Are At Odds: The Interaction of Judge and Arbitrator in Trans-Border Finance*, 65 TUL. L. REV. 1323, 1323 (1991) (quoting John Maynard Keynes).

¹⁹⁶ Branches in certain world regions must typically pay higher returns. See STIGUM, MONEY MARKET, *supra* note 9, at 578-79 ("[i]nvestors perceive some political risk associated with Mideast banks," and noting that different time zones may also have an effect on deposit rates, as do liquidity and maturity).

¹⁹⁷ See STIGUM, MONEY MARKET, *supra* note 9, at 578-79; see also Kassa, *supra* note

cal realities of the investors' evaluation of risk must have an indelible effect on a court's determination of depositors' and banks' liability for that risk.¹⁹⁸ By investing in Eurodollars in London, for example, depositors are compensated with higher returns for the risk that action may be taken¹⁹⁹ by the currency-issuing country (United States), bank-chartering country (also United States) and host country (England).²⁰⁰ The depository institution and the depositor thus acquiesce in the market interest rate as the price of their contract, and seem to have accounted for political risk by assigning it to the depositor. In the Eurodollar market, then, the allocation of risk by the judicial system to the debtor branch bestows a windfall on the depositor. Under such a rule, the depositor, Libyan Arab Foreign Bank, for example, reaps the benefits of higher Eurodollar returns and assured repayment, while being protected from the political risk of the currency-issuing and bank-chartering country, the United States,²⁰¹ at no cost.

Criticisms of this interest rate differential analysis stem from comparisons of "snapshots" of interest rates which are not, however, dispositive. In *Citibank v. Wells Fargo Asia Ltd.*, after the Philippine Central Bank imposed exchange controls on foreign currency,²⁰²

43, at 169-70.

¹⁹⁸ Two commentators have noted, "[A]t times interest rate differentials have considerably exceeded those related to pure cost considerations, because nonbank depositors have wished to hold their wealth in the United States or because banks have wished to expand liabilities at their non-U.S. offices." TERRELL & MILLS, *supra* note 9, at 9.

¹⁹⁹ See *supra* notes 42-48 and accompanying text.

²⁰⁰ One expert witness for Citibank testified that he found it "inconceivable" that a sophisticated international bank depositor would claim ignorance of . . . the rules of the game, the most pertinent of which is that a consideration for the higher interest rate earned by a Eurodollar deposit is the depositor's agreement to assume a 'sovereign risk.'" *Wells Fargo Asia Ltd. v. Citibank, N.A.*, 612 F. Supp. 351, 353 (D.C.N.Y. 1985); 660 F. Supp. 946 (S.D.N.Y. 1987); 847 F.2d 837 (2d Cir. 1988), *remanded for supplemental findings*, 695 F. Supp. 1450 (S.D.N.Y. 1988); 852 F.2d 657 (2d Cir. 1988); *remanded*, 110 S.Ct. 2034, 1990; *on remand*, 936 F.2d 723 (2d Cir. 1991); *petition for cert. filed*, 60 U.S.L.W. 3360 (U.S. Oct. 24, 1991) (No. 91-689).

²⁰¹ This results because the depositor is considered the risk-bearer, but is relieved of the burden by the court. See, e.g., *Ngoc Quang Trinh v. Citibank, N.A.*, 850 F.2d 1164, 1176 (6th Cir. 1988) (Brown, J., dissenting) (noting that particularly during periods when interest rate caps were in effect, the Fed "encouraged" and "permitted foreign branches [of United States banks] to offer unusually attractive interest rates in exchange for the depositors' acceptance of the risk of political upheaval"), *cert. denied*, 110 S. Ct. 2602 (1990).

²⁰² See *Citibank, N.A. v. Wells Fargo Asia Ltd.*, 110 S. Ct. 2034, 2038 (1990) (quoting the control providing: "'Any remittance of foreign exchange for repayment of principal on all foreign obligations due to foreign banks and/or financial

defendant Citibank refused to use its worldwide assets to repay certificates of deposit (CDs) purchased previously by the plaintiff, Wells Fargo. Citibank argued that the CDs were payable only in Manila, given the higher return offered on them, claiming it was only able to pay a rate of interest higher than that offered within the United States due to the lower cost of offshore funds,²⁰³ which are exempted from Regulation D.²⁰⁴

In rejecting Citibank's arguments and concluding that the bank was not necessarily relieved of its obligation,²⁰⁵ the Supreme Court placed great emphasis on interest rates, but compared only (1) returns offered in London and Manila, not Manila and New York, and (2) returns at the time of deposit, regardless of expectations regarding the relative rates over time. That the rates offered on June 10, 1983 (the day the CD was purchased) in London and Manila were the same²⁰⁶ says nothing of the premium paid in any event over dollar deposits in the United States.²⁰⁷ Moreover, the

institutions . . . shall be submitted to the Central Bank [of the Philippines]" (alteration in original) (citation omitted)); see also Smedresman & Lowenfeld, *supra* note 100, at 763 (reproducing in pertinent part the Central Bank of the Philippines, Memorandum to Authorized Agent Banks (MAAB No. 47)).

²⁰³ See *Wells Fargo*, 110 S. Ct. at 2041. The Brown dissent in *Trinh* similarly cites the Federal Reserve Board, which "expressly warned banks that the reserve and interest exemptions would no longer apply to deposits in foreign branches if banks 'entered into agreements . . . with depositors that in effect guarantee payment of such deposits in the United States if the foreign branch is precluded from making payment.'" *Trinh*, 850 F.2d at 1177.

²⁰⁴ See 12 C.F.R. § 204.1(c)(5) (Regulation D, stating in pertinent part that the reserve requirement provisions "do not apply to any deposit that is payable only at an office located outside the United States."); *id.* § 204.2(t) (1991) (clarifying the clause: a deposit, "as to which the depositor is entitled, under the agreement with the institution, to demand payment only outside the United States"); see also Regulation Q, *id.* § 217.1(c)(2) (excluding foreign branch deposits from domestic interest rate limitations).

²⁰⁵ See *Wells Fargo*, 110 S. Ct. at 2041. The Court rejected Citibank's argument, "that higher rates [offered for Eurodollar deposits] reflected the depositor's assumption . . . that actions by the foreign government having legal control over the foreign branch and its assets would render the branch unable to repay the deposit." *Id.* (citations omitted).

²⁰⁶ The Supreme Court found:

[T]he identical interest rates being offered for Eurodollars deposits in both Manila and London at the time the deposits were made [June 10, 1983], despite the conceded differences in sovereign risk between the two locations, reflected an understanding that the home office of a bank was liable for repayment in the event that its foreign branch was unable to repay for any reason, including restrictions imposed by a foreign government.

Id. (citations omitted).

²⁰⁷ Professor Herring has suggested that equivalent interest rates between branch

interest rates offered in London and Manila did diverge between August 1983, when the opposition leader Benigno Aquino was assassinated,²⁰⁸ and October 15, 1983, when the Central Bank of the Philippines imposed foreign currency controls, specifically to prevent the flight of capital.²⁰⁹

*c. Asymmetrical Information: The Depositor as the
Least-Cost Risk Avoider*

Assigning risk to the depositor is the cost-efficient outcome because the depositor is also better able than the branch to evaluate, monitor, and control risk exposure through diversification. In the Iranian crisis, American hostages had been seized ten days before the freeze order was issued.²¹⁰ Similarly, a series of terrorist acts had been perpetrated against the United States before the Libyan freeze was imposed.²¹¹ Only in the Iraqi-Kuwaiti situation was there a shorter lag time, with the order issued overnight²¹² (but the connection between the foreign government and the offensive action was all the more explicit). Given the close alliance between certain governments and violent political groups, it is reasonable to expect the communication of at least some information which would enable the depositor to withdraw funds from American banks, thus avoiding the risk of a freeze.²¹³

offices does not disprove the contention that parties expect the depositor to bear political (what he terms "sovereign") risk:

[I]t is clear that market expectations regarding the allocation of sovereign risk in the residential jurisdiction cannot be inferred from a comparison of interest rates on Eurodollar deposits between safe and risky centers That Eurodollar interest rates are the same in Frankfurt and Manila is not necessarily inconsistent with the hypothesis that market participants expect depositors will bear sovereign risk in the residential jurisdiction.

Herring, *Who Bears The Risk?*, *supra* note 45, at 10.

²⁰⁸ See, e.g., *Chiller in Manila: Citibank Freezes Deposits*, *FORTUNE*, Feb. 20, 1984, at 7 (quoting senior Citibank official's comment: "Any bank that didn't know it was assuming Philippine sovereign risk by placing its money with us in Manila is naive."); see also Sim, *supra* note 116, at 1044 & nn.26-27 (noting the enormous capital flight which drained the Philippines of foreign exchange, and necessitated the controls after Aquino's assassination).

²⁰⁹ See Smedresman & Lowenfeld, *supra* note 100, at 763.

²¹⁰ See Harold H. Saunders, *The Crisis Begins*, in *AMERICAN HOSTAGES IN IRAN*, *supra* note 68, at 35, 35-36 (detailing the early stages of the hostage crisis).

²¹¹ See *supra* note 77 and accompanying text.

²¹² See Exec. Order No. 12,722, 3 C.F.R. 294 (1991) (blocking transactions with Iraq; filed at 9:44 a.m. (e.s.t.), Aug. 2, 1990, and effective immediately).

²¹³ See Carswell & Davis, *Financial Pressures*, *supra* note 68, at 175-76. The authors note that the decision to implement the Iranian freeze was made shortly after the

Despite such asymmetrical information arguments, some courts have nevertheless held banks liable at their head offices,²¹⁴ invoking banks' "assumption of the risk"²¹⁵ by maintaining branches in "risky" locations, or in the case of a freeze,²¹⁶ by accepting the deposits of creditors whose assets were perhaps likely to be blocked. Forcing banks to assume the risk will result in an efficiency loss, since they are not able to distinguish between depositors in an anonymous Eurodollar market, nor would they be able to compete for funds if they offered lower rates to particularly risk-ridden depositors. One might also argue that a bank should monitor the sources of deposits for its own protection.²¹⁷ But one would still

Acting Foreign and Finance Minister Bani-Sadr announced on November 14, 1979 that Iran would remove its assets from United States banks. Plans to implement the freeze were accelerated after news on November 9 that the head of Iran's central bank, Bank Markazi, was discharged or resigned due to resistance to a plan to withdraw the funds. *Id.* A rule which would force the offending nation to withdraw funds prior to aggression could potentially serve to alert American and other governments of impending violence.

²¹⁴ See, e.g., *Garcia v. Chase Manhattan Bank, N.A.*, 735 F.2d 645, 650 (2d Cir. 1984) (noting that the bank "accepted the risk" of liability for its branch's actions) (quoting *Vishipco Line v. Chase Manhattan Bank, N.A.*, 660 F.2d 854, 863 (2d Cir. 1981), *cert. denied*, 459 U.S. 976 (1982)).

²¹⁵ In *Ngoc Quang Trinh v. Citibank*, the court noted: "By operating a branch office in Vietnam, Citibank indicated to its foreign depositors that it accepted the risk that, in at least some circumstances, it would be liable elsewhere for obligations incurred by its branch." *Ngoc Quang Trinh v. Citibank, N.A.*, 850 F.2d 1164, 1169 (6th Cir. 1988) (citing *Vishipco*, 660 F.2d at 863), *cert. denied*, 110 S. Ct. 2602 (1990).

²¹⁶ See, e.g., *Smedresman & Lowenfeld*, *supra* note 100, at 790:

Cuba in 1958-59, Vietnam in 1974-75, even the Philippines in 1983 were obviously not what a prudent banker would regard as risk-free nations. Even the United States, seen from Tripoli in the 1980s (or Libya, seen from New York) could not be regarded as free from the possibility of sudden changes.

Id.

²¹⁷ Indeed, monitoring deposits for money laundering investigation purposes is required under the Bank Secrecy Act (Currency and Foreign Transactions Reporting Act), Pub. L. No. 91-508, 84 Stat. 1114 (codified as amended at 12 U.S.C. §§ 1730d, 1829b, 1951-1959, 31 U.S.C. §§ 321, 5311-5324, and scattered sections of 15 U.S.C. (1988)). Further regulations impose reporting requirements on banks, even restricting them from notifying any party, including the foreign financial institution or customer involved, of the existence of the monitoring. See, e.g., 31 C.F.R. § 103.25(a) (1991) ("[T]he [Treasury] Secretary may prohibit disclosure of the existence or provisions of [the] reporting requirement to the designated [parties]."). Thus, for a bank to request that a party withdraw deposits, one potential way to reduce risk associated with a freeze-prone depositor would be in contravention of the regulations; refusing funds outright from an otherwise legitimate customer would be commercial folly. See Bruce Zagaris, *Dollar Diplomacy: International Enforcement of Money Movement and Related Matters—A United States Perspective*, 22 GEO. WASH. J. INT'L L. & ECON. 465, 486-94 (1989) (discussing administrative responses through the Treasury and IRS to trace deposits related to criminal activity).

have to concede that it is easier for a national bank/depositor, such as LAFB, to control its liability because it is more closely informed of movements of the government or militant groups.

V. THE ECONOMIC-POLITICAL NEXUS: USING EFFICIENT RISK ALLOCATION TO INTERNALIZE POLITICAL COSTS

In producing the market efficient result, a rule assigning liability to the depositor would have the much needed effect of forcing the United States to internalize the costs of its political actions, without damaging Eurocurrency centers, since depositors would merely shift funds out of American branches and into other accounts in London.²¹⁸ The imposition of a freeze intertwines the financial marketplace with a political one in which parties seek to maximize power rather than profit. Courts must resolve the two simultaneous, parallel "transactions." But as long as foreign courts refuse to enforce American freeze orders, the United States evades the cost of its actions, and continues to impose significant transaction costs on the Eurodollar market in the form of increased negotiation, performance, and litigation fees.

A. *Advantages and Costs of Executive Freeze Orders*

Asset freezes can fulfill a range of foreign policy goals and thus ought not to be entirely eliminated. Freezes may be speedily implemented to: (1) express immediate disapproval of a target's actions; (2) disrupt a military "adventure" by impairing a target's potential;²¹⁹ (3) take action commensurate with other nations' expectations, while avoiding the use of force;²²⁰ and (4) amass funds to satisfy potential settlement claims.²²¹ Once issued, the

²¹⁸ In fact, LAFB sought to do just that after its assets were frozen. See *Libyan Arab Foreign Bank v. Bankers Trust Co.*, 1 Lloyd's Rep. 259, 268 (Q.B. 1988) (seeking payment to its dollar account at U.B.A.F. Bank Limited London).

²¹⁹ See GARY C. HUFBAUER & JEFFREY J. SCHOTT, *ECONOMIC SANCTIONS RECONSIDERED: HISTORY AND CURRENT POLICY* 29 (1985).

²²⁰ For example, seemingly due in part to pressure by Haiti, the Organization of American States, and the ousted President Jean-Bertrand Aristide, President Bush signed an executive order freezing the Haitian government's assets, and forbidding United States citizens from making payments to the new government after the coup led by Brigadier General Raoul Cedras. See *Haiti's Assembly Names Interim President*, 51 FACTS ON FILE, Oct. 754B3, 755A2 (1991).

²²¹ The Office of Foreign Assets Control, Department of the Treasury, conducted a census of potential claims and published it on February 11, 1991 to enable it to monitor losses after the Iraqi invasion and after the commencement of Operation

freeze order can take immediate effect²²² by making financing impossible,²²³ whereas trade embargoes²²⁴ or United Nations sanctions may take much longer. It can be tailored to enable the Treasury and State Department to control closely the flow of funds, for use as a "bargaining chip," redeemable once diplomatic preconditions have been met.²²⁵

Desert Storm on January 16, 1991. See 31 C.F.R. Pt. 575 (1991). One theorist has noted that in suggesting the creation of a claims council and compensation fund under its auspices, the United Nations "may have created the 'mother of all international arbitration battles.'" Stanley J. Glod, *International Claims Arising From Iraq's Invasion of Kuwait*, 25 INT'L LAW. 713, 721 (1991) (author is the Chairman of the United States Foreign Claims Settlement Commission).

²²² Note, however, that a delay in signing the order into effect can nullify the order in practical terms. For example, President Reagan, without any administrative explanation, took five months to sign the executive order freezing assets of Jean-Claude Duvalier, resulting in the failure to apprehend more of his funds. See Elaine Sciolino, *Reagan Orders Assets of the Duvaliers Frozen*, N.Y. TIMES, Mar. 20, 1987, at A5.

²²³ Often such an action will cease nearly all a foreign country's transactions since many international contracts are denominated in dollars. This halts trade. See HUFBAUER & SCHOTT, *supra* note 219, at 27-29; see also *Administration and Enforcement of U.S. Export Control Programs: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 102d Cong., 1st Sess. (1991) (forthcoming, available in LEXIS, Nexis Library, Currnt File) (statement of R. Richard Newcomb, Director, Office of Foreign Assets Control) (noting that the President's orders in the Gulf crisis "interfered with or halted altogether billions of dollars of capital flows. These included foreign exchange contracts, oil payments, repurchase agreements and currency swaps, payments to international banking syndicates, and a wide variety of overnight investment arrangements involving capital markets in different political jurisdictions").

²²⁴ See HUFBAUER & SCHOTT, *supra* note 219, at 59 (noting that there is generally less backlash by American firms in response to trade than financial embargoes). Some trade embargoes purporting to have overseas reach, such as the Siberian Gas Pipeline case, have had drastically negative effects in that United States allies have refused to abide by them. See, e.g., Tom Harris, *The Extraterritorial Application of U.S. Export Controls: A British Perspective*, 19 N.Y.U. J. INT'L L. & POL. 959, 959-61 (1987) (noting that the United Kingdom expressly forbids its own firms to comply with the United States embargo on goods or services for use in the construction of the West Siberian gas pipeline).

²²⁵ See Gross, *supra* note 98, at 473 n.10 (noting Treasury license enabling Bankers Trust to pay after the London litigation was resolved). Analogously, in exchange for the release of a British chemical engineer, the British government unblocked the equivalent of \$125 million in frozen Iraqi funds deposited with London banks in accordance with provisions of the United Nations Security Council. See Paul Lewis, *Iraq Frees Briton as London Unblocks Funds*, N.Y. TIMES, Nov. 24, 1991, at A7. Freezes may also be finely tuned with licenses to act as protective orders. The United States froze Kuwaiti assets as a protective measure just as it froze the assets of the Danish and Norwegian governments in the face of Nazi seizures during World War II. See Exec. Order No. 8389, 3 C.F.R. § 645 (1938) (invoking the Trading With the Enemy Act).

But asset freezes have been imposed before policymakers have thoroughly considered their costs.²²⁶ Externalities, costs a party does not take into account in choosing action, that arise from executive freeze orders include: (1) threats to the American banking system²²⁷, specifically, "reverse diversification,"²²⁸ and declining use of the dollar as a reserve currency;²²⁹ (2) threats to the City of London's preeminence as an off-shore currency center;²³⁰ (3) increased transaction costs to the Eurodollar market;²³¹ and (4) resentment of American assertions of extraterritorial jurisdiction.²³² In contrast to policy-makers' myopia, one banker has noted that, "[t]he first thing that comes to the mind of a banker is . . . whether the action will, over the longer term, impair the position of the United States as an international financial market, . . . and thus also impair the standing of the dollar as an international currency."²³³

²²⁶ Carswell has noted that "[f]oreign policy makers do not always give weight to the . . . cost-effectiveness of the imposition of a unilateral economic sanction by the United States. Rather than work through a rigorous analysis, they justify the imposition of a sanction by some variation of sonorous themes . . ." Carswell, *supra* note 56, at 257.

²²⁷ See *id.* at 262-63 (noting that "there has been a noticeable decline in the proportion of OPEC assets held in the form of direct claims against U.S. banks and their major foreign branches").

²²⁸ One critic has written: "Over the longer term . . . should Washington be seen as developing an addiction to asset freezes . . . significant diversification into other countries' institutions and currencies could yet occur, and that could indeed be costly for the competitiveness of American banks. One can go to the well only so often." BENJAMIN J. COHEN, IN WHOSE INTEREST?: INTERNATIONAL BANKING AND AMERICAN FOREIGN POLICY 171 (1986) (discussing the interdependence of high finance and high politics, and advocating regular, structured dialogue).

²²⁹ See generally BANK FOR INT'L SETTLEMENTS, RECENT INNOVATIONS IN INTERNATIONAL BANKING 157 (1986) (Group of Ten study finding growing use of non-dollar currencies for investment purposes due to deregulation, especially in Japan, Germany, France, and the Netherlands).

²³⁰ See Justice Hirst's expression of concern, *supra* notes 140-41 and accompanying text.

²³¹ See *supra* notes 171-82 and accompanying text.

²³² Unilateral extraterritorial freeze orders, like other American legislation perceived as over-reaching, have not endeared the United States to its allies. See, e.g., William Knighton, *Britain: Blocking and Claw-back*, in ACT OF STATE AND EXTRATERRITORIAL REACH 52, 54-56 (John R. Lacey ed., 1983) (discussing blocking legislation in response to the extraterritorial reach of American antitrust law).

²³³ *International Financial Conditions Hearings*, *supra* note 160, at 195 (statement of Dennis Weatherstone, Vice Chairman of the Board, Morgan Guaranty Trust Co., New York). This sentiment was echoed in testimony of Anthony M. Solomon, Under Secretary of the Treasury for Monetary Affairs, in response to Sen. Adlai E. Stevenson's question whether it was "the policy of the United States to block assets every time a depositor threatens to withdraw a deposit that might have an adverse

B. *Virtues of Uncertainty: the Contrary View*

As a brief digression, consider that in a world with seemingly irrational behavior,²³⁴ such as international acts of terrorism²³⁵ and aggression,²³⁶ the best response may very well be correspondingly irrational behavior through legally inconsistent decisions.²³⁷ Thomas Schelling, one of the earliest theorists (though not a proponent) of the "tactic of cultivating irrationality at the highest level of government" has written: "Another paradox of deterrence is that it does not always help to be, or to be believed to be, fully rational, cool-headed, and in control of one self or one's country."²³⁸ In the face of countries or depositors which, from the United States' point of view, irrationally sponsor terrorist activities²³⁹ while maintaining assets in the United States or denominated in dollars abroad, legally inconsistent treatment, and unexpected imposition of freezes could serve as a valid response and counter-threat to acts of aggression. But over an extended period, rather than as an isolated incident, such treatment will not foster stable international transactions, or the sustained predominance of the dollar in Euromarkets.

effect on American creditors." *Id.* at 17. Costs of the Iranian freeze included short-run instability in financial markets, evidenced by an increase in the price of gold. *See id.* at 66 (testimony of John G. Hermann, Comptroller of the Currency), pressures on interest rates, and the dollar in exchange markets.

²³⁴ *See generally* CLAIRE STERLING, *THE TERROR NETWORK: THE SECRET WAR OF INTERNATIONAL TERRORISM* (1981) (writing about left-wing international terrorism during the 1970s).

²³⁵ Although some would quibble over the difference between "terrorists" and "freedom fighters," terrorist is used here to refer to one who systematically uses violence against civilians to achieve an end, regardless of the political endorsement.

²³⁶ *See, e.g.,* R. G. Frey & Christopher W. Morris, *Violence, Terrorism, and Justice*, in *VIOLENCE, TERRORISM, AND JUSTICE* 10-11 (R. G. Frey & Christopher W. Morris eds., 1991) (discussing terrorism and the rules of justice).

²³⁷ *See* Herzl & Katz, *supra* note 180, at 1191-93 (discussing the irrational component of rational decision-making). Professor Leo Katz has spoken of this option as purposely taking an "irrationality pill."

²³⁸ THOMAS C. SCHELLING, *ARMS AND INFLUENCE* vii, 37 (1966).

²³⁹ The frontispiece of one book on terrorism sums up this view and its counterpart in the comment of a member of Italy's Red Brigades to a reporter: "You think it's absurd that I should go out and shoot a man just because I'm ordered to? That's your bourgeois mentality. Don't you think it's absurd that you're ordered to go out and write an article?" STERLING, *supra* note 234, at viii.

*C. Reigning in Freezes: Consequences of the
Risk Allocation Rule*

The enforcement of freeze orders extraterritorially would drive the threats home, forcing the United States to internalize costs at the expense of the American banking industry. Before imposing another freeze it might then act in a well-considered manner,²⁴⁰ in conjunction with other countries, as during the Persian Gulf Crisis, rather than imposing unilateral extraterritorial freezes.²⁴¹

CONCLUSION

The need for a consistent rule on which parties can rely is paramount for the smooth operation of commercial transactions and the stability of international financial markets. Future crises are bound to arise,²⁴² and legal doctrines previously applied to freeze situations have been unable to provide predictable, rather than interest- and result-oriented, rules. Foreign, and American courts should use an economic analysis to allocate risk between the depositor and depository institution, thus efficiently assigning liability, according to the parties' own market bargaining, to the depositor as the least-cost risk avoider. The United States would

²⁴⁰ One writer has suggested the restriction of IEEPA freezes by: imposing sunset and contract-sanctity provisions, making consultation with Congress mandatory, including criteria, and restricting extraterritorial jurisdiction. See Barry E. Carter, *International Economic Sanctions: Improving the Haphazard U.S. Legal Regime*, 75 CAL. L. REV. 1159, 1274-77 (1987). Though imaginative, such qualifications of the President's powers would reduce the swift efficacy of an appropriately imposed freeze.

²⁴¹ The United States might consider restricting the scope of freezes to accounts definitively kept within its territory, as the United Kingdom did in blocking Argentine accounts held in British banks during the Malvinas affair. See Francis D. Logan & Cynthia C. Lichtenstein, *Political Dams Across Financial Flows*, in PRIVATE INVESTORS ABROAD 13-17 (Janice R. Moss ed., 1986); see also Harris, *supra* note 224, at 971 (citing the OECD's support of a policy encouraging member states to promote cooperation as an alternative to unilateral action).

²⁴² Eugene F. Mooney's early comprehensive study of foreign seizures concludes in part as follows:

The millpond of International law is lost in Academe's
Glade,
Obscured by the fog of the Pedagogue's awe and
jurisprudential shade.
Each generation a Nationalist breeze, in disregard of the
rule,
Breaks through the staid professorial trees and ripples the
murky pool.

MOONEY, *supra* note 130, at 159.

then be forced to recognize the costs of its foreign policy actions and restrict them accordingly.