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Imperatives of International Finance

by Joel J. Karp*

Many lenders understandably seek to reduce spiraling legal costs by standardizing loan documents and thereby minimizing or eliminating legal review costs of all but significantly complex transactions. With respect to domestic transactions, the results have largely been successful, or at least not disastrous. Problems arise, however, when lenders use standard documents, developed for purely domestic transactions, in connection with loan transactions with an international flavor.

One need only peruse the trade statistics to realize that bankers and other lenders will increasingly be asked to accommodate this type of transaction in the future. This is especially true where the enactment of enabling legislation authorizing the local implementation of International Banking Facility legislation has led to expansion of loans to foreigners by local banks, or where a favorable atmosphere has led to the opening of banking offices of various types by lenders who may be unfamiliar with international banking practices in our part of the world.

International lending involves many snares for the unwary, especially when a lender is making what it regards as a purely domestic loan to a foreign borrower. Suppose, for example, that a loan fully secured by mortgages on Florida real estate is made to a foreign corporation or nonresident alien individual. The loan is made in Florida, governed by Florida law, and payable in Florida. All loan documents were fully negotiated, executed and delivered in Florida. If a corporation is involved, a certificate of good standing, counsel’s opinion, certified minutes and other assurances can be obtained to verify that the loan is duly and validly authorized and thus a binding obligation of the corporation. Under these circumstances, why is normal domestic documentation not fully adequate? The simple answer is that there are numerous problem areas which either would not be anticipated by local documentation or which could not adequately be dealt with by the general boiler plate clauses normally found in such documentation.

This article is intended as a review of prominent problem areas in-

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1 See Greene, Financing Foreign Government and Official Entities, in Offshore Lending by U.S. Commercial Banks at 222, Fig. 11-2 (F.J. Mathis 2d ed. 1981).

I. Foreign Exchange

Lenders should consider the foreign exchange regulations of a foreign borrower's country prior to making a loan. It is not unusual today for the foreign borrower to reside in a country with a comprehensive system of exchange control. Furthermore, exchange control sometimes is imposed after the loan is made. Under many systems of exchange control, licenses must be obtained for the repayment of any indebtedness incurred by a national of the country involved. No license means no foreign exchange. The Mexican freeze recently reminded U.S. lenders of the dangers of unanticipated exchange control regulations.\(^3\)

Even if the foreign borrower has U.S. operations which might generate revenues for debt service, foreign exchange control regulations often contain provisions requiring repatriation of earnings of foreign investment to the country of origin. Accordingly, the foreign borrower must export all profits from operations to the borrower's country for conversion into local currency. The lender may take an appropriate lien or assignment of available profits for debt service, but the enforceability of a lien or assignment in conflict with foreign exchange control rules is questionable.

The long standing common-law rule has been that the courts of one country will not enforce the revenue laws of another country. Exchange control laws are treated as revenue laws for this purpose.\(^4\) In the United States, however, as in other countries, the common law rule probably has been weakened by judicial decision;\(^5\) in any event, the rule is to some degree superseded by Article VIII, Section 2(b), of the Articles of Agreement of the International Monetary Fund,\(^6\) to which the U.S. is a party. Section 2(b) provides as follows: "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 . . . ."\(^7\) The proper interpretation of the section is a matter of some

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\(^3\) In the case of Mexico, of course, a limited freeze was first imposed which has since been relaxed through the medium of multiple exchange rates. However, Mexico is an excellent example of the need to protect against supervening exchange control. N.Y. Times, Dec. 20, 1982, at D7, col. 1. N.Y. Times, Aug. 13, 1982, at D6, col. 3.


\(^7\) IMF Agreement, supra note 6, 60 Stat. at 1411, 2 U.N.T.S. at 66.
Whether the provision should be given an expansive or narrow interpretation probably will depend upon the special equities involved, rather than upon the result dictated by the interests of consistency. In view of this uncertainty, a prudent lender and careful lender's counsel will want to take adequate precautionary measures.

Various contractual protections may be required to avoid resorting to the courts to resolve these issues. The commitment and loan documents, for example, should call for adequate licenses or other clearances in advance of disbursement of loan proceeds to the borrower. If the licenses cannot be obtained within the time allotted for consumating the transaction, or if the cost involved in obtaining the clearances is considered prohibitive, the solution may involve structuring the transaction in compliance with applicable exchange control rules, but without time-consuming or expensive special clearances. Under former English exchange controls, for example, general licenses or exemptions (in effect regulations) were issued by the Bank of England approving certain transactions without requiring a special license. Thus, subject to choice of law problems, a promissory note payable at a New York or Miami bank (in U.S. dollars or a neutral currency) out of foreign funds normally maintained abroad, or secured by an irrevocable, confirmed, non-documentary letter of credit issued by a neutral bank, may be enforceable against supervening exchange control regulations.

II. Taxation

A. Shifting the Burden

Frequently, the borrower's country of residence imposes a withholding tax on interest paid by nationals to foreign lenders. Surprisingly, lenders sometimes overlook this problem. A U.S. citizen borrowing abroad is normally obliged to withhold tax in similar circumstances. There are, however, numerous exceptions to this general rule. For example, neither an individual U.S. citizen residing abroad, nor a U.S. corporation that realizes substantially all of its income as non-U.S. source

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10 See infra text accompanying note 28.
11 See Weston Banking Corp. v. Turkiye Garanti Bankasi, A.S., 57 N.Y.2d 315, 442 N.E.2d 1195, 456 N.Y.S.2d 684 (1982); J. Zeevi & Sons v. Grindley's Bank (Uganda), 37 N.Y.2d 220, 333 N.E.2d 168, 371 N.Y.S.2d 892 (1975) (although here the exchange control regulations involved were discriminatory and contrary to public policy and the Court's overall decision may have been influenced by this finding).
income, is required to withhold tax.\textsuperscript{13} Once again, careful planning is necessary.

In general, the payment of foreign income tax does not present a major problem to U.S. taxpayers, because such payments may be credited against the U.S. income tax due.\textsuperscript{14} In a lending business, however, the loss of the tax dollars for any period of time can have a significant effect upon the net rate of return on the loan even if the tax dollars ultimately are fully recovered through foreign tax credits. Moreover, limitations on the availability of the credit may prevent the foreign taxes from ever being adequately recovered.\textsuperscript{15}

A prudent lender or his counsel should include a tax clause under which the lender shifts the burden of the income tax to the borrower. These clauses take numerous forms. For example, a lender could use what is referred to as a tax indemnification clause. Additional interest or gross-up clauses are also used. Often these clauses are combined. A tax indemnification clause is a clause under which the borrower indemnifies the lender against any taxes that may be imposed on interest or other payments under the loan agreement. An additional interest or gross-up clause requires the borrower to pay the lender additional interest sufficient to make the net amount paid after retention of tax equal to the amount of interest originally due under the loan agreement. Under a gross-up clause, the borrower, in effect, ends up paying interest on interest. Since each payment of additional interest involves a payment of additional income, the amount of tax due pyramids. In the United States, for example, with a thirty percent (30\%) withholding rate, a gross-up clause would result in an effective tax to the borrower of approximately forty-three percent (43\%).

In certain countries, such as Venezuela, tax indemnification and similar clauses are unlawful.\textsuperscript{16} Thus, the inclusion of such clauses in the documentation could expose both lender and borrower to fines and other penalties. In these circumstances, it is not unusual for the lender to insist upon an increase in the contract rate of interest so that the net amount of interest paid to the lender equals the amount of interest that would otherwise have been due but for the tax. A gross-up by contract or effect of law is obviously a very expensive solution from the borrower’s point of view and may be legally precluded by usury or similar laws if the grossed-up interest exceeds the legal rate.

It is worthy of mention that often a clause is used in documentation which provides simply that all interest shall be paid net of all withholding or other taxes or, even more simply, without diminution by any with-

\textsuperscript{15} I.R.C. § 904 (1976).
holding or other taxes. While simplicity in drafting is often a virtue, it is sometimes, as in this case, a snare. As indicated earlier, in some countries such a clause may be contrary to public policy and therefore void; worse still, it may constitute an offense resulting in significant civil or administrative penalties.

The results of such a clause in the United States may be bizarre, as in the case of an inbound loan by a foreign lender to a U.S. borrower. Notwithstanding the clause, the borrower faced with an obligation to withhold U.S. income tax may do so without incurring additional cost. This is because of a little-known section of the Internal Revenue Code, apparently never judicially construed from this point of view: "Every person required to deduct and withhold tax under this chapter . . . is hereby indemnified against claims and demands of any person for the amount of any payments made in accordance with the provisions of this chapter." Thus, borrowers under this type of withholding clause have an argument that the U.S. has indemnified them from the contractual consequences of withholding, notwithstanding the language of the obligation. It may also be arguable that a tax indemnification clause is similarly vulnerable, although the situation in both cases becomes exceedingly complex if U.S. law does not govern the loan. Accordingly, the safest type of tax clause, at least from a U.S. viewpoint, is an additional interest or gross-up clause, even though, as indicated earlier, such clauses are expensive and may be ineffective or illegal in other countries.

B. Elimination of the Tax

A more congenial solution requires sophisticated tax planning aimed at the elimination of the tax altogether. It has been normally effective in the past to legally eliminate tax, and the cost often may be passed back to the borrower. While a detailed discussion of the various structures employed is beyond the scope of this article, a brief review may be helpful.

In Eurodollar financing, a familiar mechanism to obtain relief from withholding tax involves the use of an international finance subsidiary ("IFS"). An IFS is a company established in a tax haven country, such as the Netherlands Antilles. The U.S. borrower creates the IFS.

17 Such a clause might read as follows: "Payments of interest and any other amounts due under this Note shall be made without deduction, retention or withholding of any income taxes or withholding tax in lieu thereof or any other tax or similar imposed by [County of Borrower] or agency or subdivision thereof having authority to tax."


19 "[A] Eurodollar is most generally defined as a U.S. dollar account held in a bank (including a branch of a U.S. bank) located outside of the U.S." Bee, Syndication, in OFFSHORE LENDING BY U.S. COMMERCIAL BANKS 178 (J.F. Mathis 2d ed. 1981). It should be noted that today international lending is not limited to Eurodollars. Transactions are carried out in all manner of Eurocurrencies and in Asian currencies to give account to new financial centers in the Far East.
The IFS, in turn, borrows from the foreign lender and reloans the proceeds to subsidiaries or affiliates of the U.S. parent company. The U.S. parent company is commercially required to guarantee payment of interest and principal on the foreign borrowings of the IFS. This somewhat complex structure works when there is (i) a tax treaty between the U.S. and the tax haven corporate domicile of the IFS that exempts U.S. source interest payments from U.S. income and withholding tax; (ii) a favorable tax regime in the corporate domicile that reduces (or with the aid of the U.S. foreign tax credit, eliminates) the local tax burden; and (iii) the absence of withholding or income tax in the place of corporate domicile on the interest payments by the IFS to the foreign lender.

Recent Internal Revenue Service audits, however, have disallowed IFS financing as a sham. Because of this, and because of treaty renegotiation designed to preclude so-called "treaty shopping" (third party use of tax treaties), the continued viability of the IFS and similar structures is questionable. Moreover, if the United States adopts a universal tax withholding and refund system in the next two years, these devices may not be desirable even if exemption is ultimately available, because the borrower loses the use of his money pending refund. The "address system," under which claims for withholding tax exemption showing an address in the treaty country may be filed with the withholding agent in order to avoid withholding of tax at the source, is currently in operation. While the danger of moving to a refund system has receded, implementation remains a possibility.

In order to facilitate international lending transactions, the U.S. Treasury, now in line with certain other countries, officially favors an elimination of withholding tax on certain types of interest. Proposed exempting legislation does not extend tax exemption to interest received by a bank on a post-enactment extension of credit made pursuant to a loan agreement entered into in the ordinary course of its banking

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21 See Discussing Draft of Proposed Article 16 of the U.S. Model Income Tax Treaty, 1 Tax Treaties (CCH) ¶ 152A (April 1982).

22 See Tax Equity and Fiscal Responsibility Act of 1982, §§ 342 Pub. L. No. 91-248, 1982 U.S. Code Cong. & Ad. News (96 Stat.) 635 which provides as follows: Withholding of Tax on Nonresident Aliens and Foreign Corporations—Not later than 2 years after the date of the enactment of this Act [September 3, 1982], the Secretary of the Treasury or his delegate shall prescribe regulations establishing certification procedures, refund procedures, or other procedures which ensure that any benefit of any treaty relating to withholding of tax under sections 1441 and 1442 of the Internal Revenue Code of 1954 is available only to persons entitled to such benefit.


business.\textsuperscript{25}

With proper planning, current conditions for lawful elimination of foreign withholding and similar taxes remain generally favorable for U.S. lenders making foreign loans. As noted earlier, certain countries grant exemption from tax for interest paid on international loans. Careful attention, however, must be paid to any formal pre-conditions that may exist locally. Additionally, exemption from tax may not be terribly meaningful if the borrower's country utilizes a refund system rather than a system involving exemption at the source.

When foreign tax problems exist, U.S. lenders extending credit internationally may still have recourse to IFS and similar structures. The winds of tax reform, however, are rising internationally and the continued viability of these structures in other countries is questionable.\textsuperscript{26} Accordingly, this is an area in which lender and his counsel must be especially sensitive to new developments and constantly searching for new solutions to old problems.

C. Other Taxes

While income taxes are normally of primary consideration, they are not the only types of taxes which may be applicable to an international lending transaction. For example, documentary or registration taxes may apply in one or more of the countries involved in a particular international loan transaction. In some cases, these duties may be extremely high and the penalty for nonpayment significant. Stamp or registration duties are especially prevalent in South America and therefore should be of particular concern to lenders doing business with persons, firms, and corporations domiciled in that area. Careful planning often can avoid these duties, at least at the inception of a loan transaction. Although the tax may be avoided at the outset, however, it may have to be paid later if suit is commenced on the transaction in the country where the borrower resides or where the collateral is located. The documentation should contain some provision to guard against this contingency.

III. Foreign Investment Controls

Foreign investment controls present problems sometimes overlooked in foreign lending. These controls are designed to restrict or discourage, and always to monitor, the level of foreign investment in a particular country. The applicability of such controls to equity investments is apparent. What is often overlooked is that these laws sometimes restrict

\textsuperscript{25} I.R.C. §§ 31, 275, 6042, 6044, 6049 (1976); I.R.C. §§ 6682, 7205 (Supp. V 1981); I.R.C. §§ 3451, 3456 (West Supp. 1983) providing for domestic withholding tax on dividends and interest. There are numerous exemption provisions including exemptions for certain foreign lenders. However, there are also complex administrative provisions relating to claims for exemption.

\textsuperscript{26} See, e.g., Board of Inland Revenue, Taxation of International Business (1982).
borrowing abroad as well. For example, the regulations issued by SIEX (Superindendencia de Inversiones Extranjeros) in Venezuela require registration of all foreign credits.\(^\text{27}\) Failure to register could render the promissory notes representing the loan unenforceable in the jurisdiction of the borrower's residence or elsewhere depending upon choice of law, characterization of law (for example, an unenforceable revenue or penal law), and other issues.

Even if the law of the borrower's jurisdiction is not the governing law of the loan because of a contractual stipulation that some other law should govern, the courts of the governing law jurisdiction may, by reason of local public policy or supervening treaty obligation, feel bound to refer to the strong economic policies of the borrower's jurisdiction as reflected in its foreign investment control laws.\(^\text{28}\) They may, of course, take a contrary view. Therefore, it is better to consider these problems in advance and come to some protective conclusions than to leave the matter to the uncertainties of international litigation and the vagaries of the applicable rules.

The United States, in general, places no restrictions on the making of loans by foreign lenders to U.S. borrowers, unless, of course, the transaction is a subterfuge to evade restrictions on foreign ownership in national defense related or otherwise sensitive industries or enterprises.\(^\text{29}\) Nevertheless, a recent specter which has raised its head could become a significant barrier to international lending if the restrictions involved are ever applied stringently. The President of the United States, acting in a state of economic emergency, declared under the International Emergency Economic Powers Act,\(^\text{30}\) can block (but not vest) all U.S. properties, including loans receivable owed by U.S. persons to nationals of designated foreign countries. This power was most recently used to seize all deposits and other property of the Iranian Government and its agencies in the United States as a result of the Iranian hostage seizure. The effect of blockage is not to discharge the debts of U.S. borrowers, but to


\(^{28}\) See Note, Effectiveness of Choice-of-Law Clauses in Contract Conflicts of Law: Party Autonomy or Objective Determination? 82 COLUM. L. REV. 1659 (1982) for the U.S. interstate viewpoint not necessarily applicable to international loans. England, France and other foreign countries appear to be prepared to give greater latitude to the parties in terms of contractual choice of law than are certain of our states, most notably New York in similar circumstances. However, Federal law seems to favor party autonomy in international contracts, at least where no overriding state interests are involved. See The Breman v. Zapata Offshore Co., 407 U.S. 1 (1972). See generally WOOD, supra note 16, at § 1.04.

\(^{29}\) There are, however, some restrictions. See, e.g., The Johnson Act, 18 U.S.C. § 955 (1976) which prohibits anyone in the U.S. from making loans to countries (other than both IMF and International Bank for Reconstruction and Development Members) that have defaulted on loans to the U.S. International lenders should also be sensitive to reporting obligations requiring certain reports to the U.S. Treasury under the International Investment Survey Act of 1978, 22 U.S.C. §§ 3101-08 (1976 & Supp. V 1981) as well as Federal Reserve and other similar reporting requirements.

use those debts to pay U.S. persons considered damaged by the acts of the foreign government involved. The foreign loan may, in effect, be expropriated by ultimate bilateral settlement agreements. The fifth amendment aspects of this procedure have yet to be resolved. Nevertheless, foreign lenders may not receive effective protection.

IV. Enforcement Problems

A. International Suit

The special problems involved in the enforcement of international loans may be ameliorated by properly structuring the loan transaction and documents. Many lenders do not adequately consider the possible necessity of international suit because they consider themselves more than adequately secured. They overlook, however, the exposure created by a rapid unforeseen deterioration in the value of the collateral.

Also, lenders, especially international lenders, should be sensitive to the public relations aspects of enforcement. Many borrowers, including foreign borrowers, are sufficiently sensitive to the public relations effect of the commencement of suits against them that they avoid defaulting, if possible. For this reason, international loan documents specifically authorize and facilitate the commencement of suit in international financial centers, such as London, New York, San Francisco or Miami. The theory is that the commencement of suit in these centers will receive sufficient attention to impair the debtor's credit on a worldwide basis. In fact, this device may be the only practical method of compelling payment when national governments or their agencies are the debtors involved.

B. Sovereign Immunity

At one time, sovereign immunity may have been considered a problem applicable only to grandiose intergovernment loans. In today's environment, however, because governments are so deeply involved in commercial matters, and because so many foreign commercial enterprises are government owned or controlled, the issue has become one of everyday concern to international lenders and their counsel.

The efficacy of sovereign immunity and related defenses has been substantially reduced in the United States by the enactment of the Federal Foreign Sovereign Immunities Act of 1976 (FSIA), which, among other things, mandates judicial recognition, on a binding irrevocable basis, of properly drafted waivers of sovereign immunity. Nevertheless,
there are many open questions relating to the proper construction and legal effect of this statute.

One of the principal problems of interpretation involves the resolution of a conflict between a waiver of sovereign immunity in the loan documents, and provisions of foreign constitutional or statutory law that may outlaw such waivers. Provisions exist in the law of Venezuela and Brazil, for example, that cause problems in this area. Other countries, such as Chile, have promulgated detailed rules concerning the conditions and procedures under which sovereign immunity can, in fact, be waived by government or quasi-government agencies involved in commercial activities. It has wisely been suggested that in all cases involving waiver of sovereign immunity in sovereign risk loans, an opinion of the attorney general, or highest state legal officer involved, should be obtained. If that is not possible, the alternative is to obtain the opinion of competent local counsel. Both precautions, however, are probably of limited value.

C. Choice of forum

Regardless of whether sovereign risk is involved, it is always a good practice for lenders to insure that they can control the litigation to the greatest extent possible in the event of default. Borrowers should be required to agree in the operative documents that any judicial action relating to enforcement of the loan may be commenced in the courts of the lender's jurisdiction or, if more favorable and if legally binding, a place of lender's choice. The borrower should be required to designate a local agent for service of process to effectuate this choice.

Whenever possible, an independent institution should be designated as agent for service of process and such designation should be irrevocable. Otherwise, a defaulting borrower may hinder or delay recovery simply by discharging the agent for service of process, although the legal effect of such conduct might be questionable. Also, in the case of sovereign risk loans, the designation of a diplomatic officer should be avoided whenever possible, unless it is clear that service on the agent is not hindered or precluded by considerations of diplomatic immunity. The FSIA contains detailed provisions for service of process in the absence of contractual agreement in the case of sovereign risk loans. The incorporation of alternative provisions for service of process is also advisable in the case of private financing.

There are certain caveats to these procedures of which lender and counsel should be aware. The designation of a forum will generally be

36 WOOD, supra note 16, at § 3.08[3][b].
respected in the United States, provided that the enforcement of such a designation is not unreasonable or unjust and that the choice of forum clause is not invalid on such grounds as fraud or overreaching. Similarly, a forum selection clause will be respected if the clause is reasonable and if the forum selected bears some reasonable relationship to the type of transaction involved, even if it bears no relationship to the facts of the particular controversy.\footnote{The Breman v. Zapata Offshore Co., 407 U.S. 1 (1972). It should be noted that this case involved the designation of the "London Court of Justice" as the proper forum. The designation was upheld even though England had no interest in or contact with the controversy other than by reason of the forum-selection clause. It appears that compelling support to uphold the designation in these circumstances stemmed from the fact that London was a reasonable compromise and had significant contacts with the type of transaction involved. See also Scher v. Alberto-Culver Co., 417 U.S. 506 (1974).} Both of these conditions are normally satisfied in the context of international lending.

The designation of a forum, subject to the applicable norms of jurisdiction and venue, should be nonexclusive. This procedure provides flexibility in enforcement and, where applicable (as in the case of sovereign risk loans), furthers the publicity impact. There are other reasons, however, for providing for a nonexclusive forum. Certain countries, such as the Netherlands, do not enforce judgments of foreign courts in the absence of a treaty obligation to do so.\footnote{Note, Foreign Nation Judgments: Recognition and Enforcement of Foreign Judgments in Florida and the Status of Florida Judgments Abroad, 31 U. Fla. L. Rev. 588, 624 n.243 (1979).} This means, for example, in the case of a secured loan on U.S. property to a Dutch company, a deficiency judgment issued by a U.S. court would not directly be enforced. Accordingly, a new action would have to be commenced in the Netherlands to enforce the judgment there. In the event of an exclusive designation of a U.S. court under a forum selection clause, the recovery of the deficiency might be precluded.

It is advisable, where such waiver will be recognized, that any forum selection clause waive all defenses based on "forum non conveniens." The forum non conveniens doctrine provides that the appropriate place of trial is the jurisdiction where all parties, witnesses, and evidence are located. Decided cases since The Breman v. Zapata Offshore Co.\footnote{407 U.S. 1 (1972).} indicate that mere inconvenience is not enough to overthrow a forum selection clause. Difficult questions of fact can arise, however, if the forum becomes so inconvenient as to constitute a denial of justice.\footnote{Compare Mercury Coal & Coke, Inc. v. Mannesmann Pipe and Steel Corp. 696 F.2d 315 (4th Cir. 1982) with Copperweld Steel Co. v. Demag-Mannesmann-Boehler, 54 F.R.D. 539 (W.D. Pa.), reh. denied, 347 F. Supp. 53 (W.D. Pa. 1972), reh. denied, 354 F. Supp. 571 (W.D. Pa. 1973), aff'd, 578 F.2d 953 (3d Cir. 1978).} Under these circumstances, the effectiveness of waiver of the forum non conveniens defense may be open to question.

It has been suggested that an exclusive forum selection clause may
not be enforceable in U.S. courts. This conclusion rests upon a lower federal court decision which struck a choice of forum clause in a domestic context because it found the lack of an unequivocal agreement to submit to the designated jurisdiction. A recent case by the New York Court of Appeals, however, indicates that this does not present a problem in the case of international loans, at least as far as New York law is concerned.

Another problem area in choice of forum is whether judgments can be recovered in the currency stipulated in the loan agreement, which may be a foreign currency in the forum. If the forum precludes rendition of judgment in any but legal tender of the forum, the issue then becomes at what point the currency of the contract is to be converted into the currency of the forum. This seemingly minor consideration can be absolutely crucial. For instance, in a recent case involving the fall of Saigon to the Communists during the Vietnam war, the plaintiff, although prevailing on the merits, would have recovered nothing if the court followed the rule applied in nondiversity federal cases, that the rate of exchange prevailing on the date of judgment should be applied rather than the rate of exchange prevailing on the date of breach.

In the United States in general, judgments may be entered only in U.S. currency even though the note or contract at issue in the controversy may call for payment in another currency. As a result of the erosion of a contrary rule, however, the English courts can enter judgment in the currency stipulated in the note or contract at issue. In the U.K., when the note or contract calls for payment in U.K. currency, the plaintiff is both required and authorized to seek recovery only in that currency.

The problem of recovery in the currency of the note or contract can be dealt with by an appropriate choice of forum. More practically, it can and should be dealt with by contract. When the chosen forum requires judgment in local currency, for example, the contract can specify the date at which the currency conversion should be computed. In addi-

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45 It should be noted that generally under U.S. commercial law, an obligation expressed in foreign currency is payable in U.S. dollars at the exchange rate prevailing on the date of payment unless the instrument specifically calls for payment in the foreign currency. U.C.C. § 3-107 (1978).
tion, where lawful, appropriate clauses can be employed to maintain the
value of the chosen currency by providing that if the currency of pay-
ment chosen in the contract depreciates in value relative to a given stan-
dard, then the face amount of the obligation shall be adjusted upward
accordingly. Theoretically, the standard could be the price of gold, the
consumer price index, or some foreign currency or basket of currencies,
including the adjusted basket which constitutes the Special Drawing
Rights of the International Monetary Fund.

The history of such protective provisions in the United States, how-
ever, reflects adversely on their effectiveness in times of crisis or economic
instability. As part of the emergency legislation at the beginning of the
New Deal, Congress invalidated all previously binding obligations to pay
U.S. dollar debts or other contractual liabilities "in gold or a particular
kind of coin or currency" at a fixed rate of exchange.49 The legislation
abrogating the so-called gold clause was finally repealed for new obliga-
tions in October 1977.50 While it appears that the gold clause abroga-
tion was never intended to cover indexed loans, at least one court has
indicated that such loans were covered; in any event indexed loans are
subject to attack under state usury laws.51 Value maintenance clauses
are not very popular commercially because of their complexity and un-
certain legal status.52

D. Choice of Law

One of the most significant choices in any loan agreement is the
choice of law. The centrality of this seemingly innocuous clause has been
alluded to several times already. First, a failure to choose a governing
law may simply delegate the choice to the court. Absent binding criteria,
the choice is based upon a multitude of factors.53 An adroit choice of
governing law can result in certain planning advantages for structuring
the loan. For this reason, the choice of law merits much more than the
perfunctory attention it sometimes receives. The choice of a particular
governing law, however, involves not only the domestic law of the juris-
diction, but its conflict of law rules as well.

The United States and most European courts at least give lip service
to the rule that the parties' choice of governing law will be honored as
long as the chosen forum bears a substantial relationship to the contract
and enforcement of the designation does not offend either the public pol-
icy of the forum or, in certain cases, the law of a state having a greater

50 See Act of October 28, 1977, Pub. L. No. 95-147, § 2(c), 91 Stat. 1227, 1229 (codified at
51 Aztec Properties Inc. v. Union Planters Nat'l Bank, 530 S.W.2d 756 (1975); F.A. MANN,
supra note 8, at 169. Other courts have upheld invalidity under state usury laws. See Annot., 90
52 WOOD, supra note 16, at § 2.06[7].
interest in the resolution of the controversy. Nevertheless, at least one significant lender state, New York, does not follow the rule of party autonomy. In fact, one author has suggested that in the United States, as a practical matter, the exceptions have swallowed the rule. European courts, however, still seem prepared to give wide latitude to party autonomy in this area. In any case, the party autonomy rule should prevail in the area of international lending, where the parties are relatively significant and have, if not equal, at least reasonably comparable bargaining power.

The governing law of an international loan agreement usually is the place chosen to be the principal forum for litigation. The structure of the loan, however, sometimes requires another governing law.

The consequences of choice of law decisions can be remarkable. For instance, consider the following hypothetical: a foreign lender has agreed to make a high risk, high interest loan to a Florida borrower, secured by Florida real estate. The interest rate required to make the loan attractive exceeds the applicable Florida usury rate of 25% per annum. The loan is to be made by a Netherlands affiliate. There is no general limit on the interest which may be charged by a Dutch lender of the type involved with respect to international loans. To conform with Netherlands exchange control requirements applicable to this transaction, however, the Netherlands exchange affiliate must borrow the funds outside of the Netherlands in order to reloan them to the Florida borrower. Under Florida law, a Florida borrower can pay interest exceeding the Florida usury rate on a loan secured by Florida land as long as the governing law of the loan is not Florida and the chosen law bears a normal commercial relationship to the transaction. Dutch law will validate the transaction. The Dutch courts, however, may not apply Dutch law if there is a mandatory rule of law in another country which might have applied under general Netherlands conflicts principles and which is violated by the transaction. If such a mandatory rule exists in the country where the Dutch affiliate is obtaining the funds to reloan, then Dutch law may not apply. In that event, the loan might be usurious unless the Florida court can find another law validating the loan. Although this

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54 In New York, although the choice of the parties is not necessarily binding it is said to have great weight. See Haag v. Barnes, 9 N.Y.2d 554, 560, 175 N.E.2d 441, 444, 216 N.Y.S.2d 65, 69 (1961).
55 See Note, supra note 28 at 1660-77.
56 WOOD, supra note 16, at § 1.04.
57 The Breman v. Zapata Offshore Co., 407 U.S. 1, 12 (1972). However, as a matter of international law, the law of the place of payment may prevail over the law of the contract on specific issues such as the abrogation of gold clauses and the like. See generally F.A. MANN, supra note 8, at 295-304.
scenario may be complicated, it is commonly encountered in contemporary international lending.

The choice of law clause may, in effect, be negated if the forum selected for enforcement requires that foreign law be proved as a fact and the circumstances or procedures for doing so prove cumbersome. In the absence of proof of foreign law, certain courts in the past have either assumed that foreign law and the law of the forum were identical or dismissed the claim for failure to prove an essential fact.59 The U.S. federal courts are now vested with discretion to apply foreign law even if not requested to do so by the parties.60 The application of those rules, however, interjects elements of uncertainty into the enforcement process, which in the case of international loans should be as sure and swift as possible.

The problem may be avoided by stipulating the source of the governing law and the method of proof in the loan agreement. While this method may be considered unusual, it should be honored and will thus expedite this often overlooked and sometimes difficult problem. The stipulation method also assists in extrajudicial interpretation and renders more permanent the parties' original understanding concerning technical points that were assumed rather than objectified in the loan agreement.

E. Certain Procedural Considerations

The procedural aspects of enforcement should also be considered in analyzing forum and governing law choices. In certain Latin American countries, for example, expedited or executive enforcement is available for obligations evidenced by a promissory note. In the United States, such summary procedures generally (New York is a notable exception) are not available.61 In fact, summary procedures for seizure of collateral upon default of an obligation to pay money, involving no right to a hearing prior to seizure, are in violation of the fourteenth amendment to the U.S. Constitution.62

Furthermore, the most common kinds of loan arrangements in certain countries can present major unanticipated procedural and substantive problems in other countries. Thus, installment notes, which are extremely common in U.S commercial and financial practice, may be denied executive or summary enforcement in other countries. Indeed, in certain civil law countries following the Geneva Uniform Law on Bills of Exchange and Notes (1930), notes payable by installments are consid-

60 FED. R. CIV. P. 44.1.
61 Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes, June 7, 1930, art. 33, 143 L.N.T.S. 257. See Wood, supra note 16, at § 10.06[3][a].
V. Conclusion

This article outlines some of the general problem areas involved in the technical side of international lending. Obviously, specialized loans have special problems which can be even more significant than those general problems discussed. Additionally, since international lending is such a dynamic area, economic and political developments are rapidly creating new issues and problems. The purpose of this article is merely to point out some of the general problem areas and to suggest sensitivity to other problem areas not discussed in detail. Those who feel that these problems are relevant only to major international loans should note that issues such as taxation relate to the profitability, and therefore desirability, of any loan. Furthermore, one loss can eliminate all credit for a multitude of good loans. Failure to take account of the numerous technical problems in the international lending area is advisable only for the loan officer whose international customers always pay regardless of governmental constraint and, indeed, regardless of ability.

63 Wood, supra note 16, at § 10.06[3][a].