

MEMORANDUM

TO: United States Congress

DATE: May 30, 2003

RE: Legal Confirmation of China's Financial Obligations to U.S. Bondholders

This Memorandum addresses the question of whether the payment by the People's Republic of China in 1979 to the United States of \$80.5 million related to property expropriated by China between 1949 - 1979 resolved China's payment obligations to United States holders of defaulted full faith and credit bonds of the Chinese Government issued prior to October 1, 1949, including the 5% Reorganization Gold Loan of 1913 Bearer Bonds.

The answer is "No". No American holder of Chinese Government full faith and credit bonds issued prior to October 1, 1949 (including the 5% Reorganization Gold Loan of 1913 Bearer Bonds) received, or was eligible to receive, any of the proceeds of the 1979 payment by China. The rightful payment claims of American bondholders have not been addressed or resolved.

Scope of the 1979 U.S. – China Agreement

On May 11, 1979, the United States and the People's Republic of China entered into an Agreement Concerning the Settlement of Claims (the "1979 US – China Agreement"). The 1979 US – China Agreement, by its terms, settled the "claims of the United States and its nationals against the PRC arising from any nationalization, expropriation, intervention, and other taking of, or special measures directed against, property of nationals of the United States on or after October 1, 1949 and prior to the date of this Agreement".

However, American holders of Chinese bonds that had gone into default prior to October 1, 1949 were not eligible to receive any of the 1979 Chinese Government payment made to the United States. The United States Foreign Claims Settlement Commission had already ruled in 1970 and 1971 that the date of a "taking" of a defaulted Chinese Government bond was the date the bond first went into default.¹ All the Chinese Government Bonds held by American bondholders affiliated with the American Bondholders Foundation first went into default before October 1, 1949 (and have since remained continuously in default). Most bonds held by those associated with the

¹ Carl Marks & Co., Inc., Foreign Claims Settlement Commission, Claim No. CN-0420; Decision No. CN-472, March 11, 1971.

American Bondholders Foundation went into default in 1939. The U. S. Foreign Claims Settlement Commission reaffirmed this ruling in October 1979². *In the Matter of the Claim of Welthy Kiang Chen*, Claim No. CN-2-015, Decision No. CN-2-066, entered as a Proposed Decision on October 17, 1979 and reaffirmed as the Final Decision of the Commission, April 1, 1981, the U.S. Foreign Claims Settlement Commission held that:

“The Commission has consistently held that in the absence of a positive action by the foreign government affecting the right to payment, a bondholder’s right is “taken” by the debtor foreign government on the day when it refuses to pay the obligation for the first time, in other words, when the foreign government first defaults upon its obligations.”

U.S. Foreign Claims Settlement Commission, when reaffirming in April 1981 its 1979 decision in the *Chen* matter, determined that there was no record that “the Government of the PRC has affirmatively repudiated the [defaulted bonds]. The setting up of a takeover committee does not do so;nor does the freezing of U.S. assets in China affect or imply a repudiation of such bonds and notes.”

The State Department of the United States in a December 11, 1979 letter to the Chairman of the U. S. House of Representatives Subcommittee on Trade of the Committee on Ways and Means acknowledged that defaulted Chinese bonds owned by Americans were outside the scope of the 1979 U.S.- China Agreement between the United States and China and referred United States claimants to the Foreign Bondholders Protective Council. “Because the PRC has not repudiated the [defaulted] bondsa valid claim under the principles of international law has not arisen. In our view, the appropriate channel for seeking compensation remains the Foreign Bondholders Protective Council”³.

According to the records of the U.S. based Foreign Bondholders Protective Council⁴ (FBPC), it was well known at the time of the 1979 U.S.– China Agreement and during its immediate aftermath that the claims of American owners of defaulted Chinese Government bonds

².. The Commission was authorized by Congress in 1966 to receive and determine the validity of claims “against the Chinese Communist regime...for losses resulting from the nationalization, expropriation, intervention, or other taking of, or special measures directed against, property...owned...by nationals of the United States...” 22 United States Code Sec. 1643.

³ Letter of J. Brian Atwood, Assistant Secretary of State for Congressional Relations, dated December 11, 1979 to Hon. Charles A. Vanik, Chairman of the U. S. House of Representatives Subcommittee on Trade of the Committee on Ways and Means

⁴ The Foreign Bondholders Protective Council (FBPC) was formed in 1933 at the request of the United States Secretary of State, the Secretary of the Treasury and the Chairman of the Federal Trade Commission under President Franklin Roosevelt as a private, non-profit corporation to protect the rights and interests of American holders of foreign defaulted bonds. The FBPC has been involved in over 40 settlements between American bondholders and defaulted foreign governments, the most recent being Poland (1975), Hungary (1975), Bulgaria (1978), and Czechoslovakia (1984). The FBPC records are maintained in the Library Archives of Stanford University.

were **NOT** covered by the Agreement. (See, for example, the letters by the President of the Foreign Bondholders Protective Council dated July 11, 1979 to the Chinese Ambassador to the United States and November 27, 1979 to the Chairman of the U.S. Senate Subcommittee on International Trade.)

It was not until after the United States and the Peoples' Republic of China entered into the 1979 U.S. – China Agreement that China officially sought to repudiate its obligation for pre-1949 Chinese government bonds. For more information about China's February 2, 1983 Aide Memoire of the Ministry of Foreign Affairs of the People's Republic of China setting forth China's renunciation of pre-1949 Chinese government foreign debt and especially pre-1912 Chinese government debt, see the August 18, 1983 United States "Statement of Interest to Set Aside Default Judgment against China" filed in the Jackson v. People's Republic of China case, United States District Court for the Northern District of Alabama.

Accordingly, the claims of American owners of Chinese Government full faith and credit bonds which went into default prior to the assumption of control of the Chinese Government by the communist party in October 1949 were excluded from the scope and benefits of the 1979 US – China Agreement and still remain unresolved.

Validity of American Claims and Chinese Discrimination Against American Bondholders

The established and widely recognized government of a nation is liable under international law for the full faith and credit obligations of the established and widely recognized predecessor government of the same nation. (See the Restatement (Third) of the Foreign Relations Law of the United States, Section 712(2) and Creditors Claims in International Law, The International Lawyer, Vol. 34, page 235, Spring, 2000).

China tacitly recognized its liability for the sovereign defaulted debt of predecessor Chinese governments in 1987 when it entered into a treaty with Great Britain that recognized Chinese financial responsibility for Chinese Government bonds issued prior to the 1949 change of governments.⁵ This treaty provided compensation to British citizens and businesses who were holders of Chinese Government bonds issued prior to 1949, including the 5% Reorganization Gold Loan of 1913 Bearer Bonds still owned by a relatively large number of Americans. Unlike the 1979 US - China Agreement, the 1987 China - Great Britain treaty specifically covered claims for bonds issued by the Chinese Government prior to October 1, 1949.

The Chinese Government continues inequitably to discriminate against American bondholders by refusing to respond to American bondholders' plea for a fair settlement of their claims sixteen years after making a settlement with British holders of similar defaulted pre-1949

⁵ Britain reached a settlement in June 1987 with the Chinese Government pursuant to which China paid £23.5 million to Britain in early 1988 for distribution to British bondholders. "China was previously barred from issuing bonds on the London market because of its refusal to honor debts incurred by governments before the 1949 Communist Revolution." New York Times June 8, 1987.

bonds. American bondholders have no recourse to the U.S. Foreign Claims Settlement Commission or to the United States courts. To obtain a fair settlement, American bondholders are dependent upon American political institutions and American public opinion holding China accountable for its wrongful and discriminatory disregard of the American bondholders' rightful claims.

In summary, the claims of American holders of defaulted Chinese Government bonds have never been addressed or honored by the current Chinese Government. American bondholders are entitled under international law to a fair settlement from the Chinese Government.

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