Commission decided to request the General Assembly of the United Nations to recommend the use of provisions in future conventions or revised conventions that would give effect to one of the alternative techniques advanced by the Working Group. The alternatives are reproduced in Appendix A under the headings of Sample Price Index and Sample Amendment Procedure for Limit of Liability.

The provision on a "sample price index" takes no position on what would be a suitable index. The decision of the Commission suggests that the negotiators of a future convention or amendment should consider "the nature of the intended price index and the institution to be charged with its preparation, revision and calculation." It is proposed also that there should be a margin of tolerance within which adjustments should not be made because of changes in the index. The emergence in treaty practice of provisions for special meetings to consider the adaptation of treaties in present conditions has been noted elsewhere.[43]

The report of UNCITRAL recognizes that some states will not ratify a convention that contains a provision on indexing. The recommendation of a price index is without precedent so far in treaty practice.[44] The greater likelihood is that provisions will be adopted along the lines of those in the COTIF for the revision of limits expressed in SDRs.

Currencies

Surveillance Over Exchange Rate Policies

Review of Surveillance

Under the Articles, the Fund must oversee the international monetary system in order to ensure its effective operation and must also oversee the compliance of each member with its obligations regarding exchange arrangements.[45] In order to fulfill these functions, the Fund must exercise firm surveillance over the exchange rate policies of members and must adopt specific principles for the guidance of all members with respect to these policies. Members, when requested by the Fund, must consult with it on their exchange rate policies.[46] The Fund had adopted two decisions in 1977 and 1979 in which it set forth the principles for guidance and the procedures for surveillance.[47] The Fund has reviewed these matters, and on April 9, 1982 adopted the decision set forth in Appendix B.

The decision adopts no new principles. It approves the continuation of existing procedures for surveillance, in which the procedures for consultation with members are the main element, in the light of the Managing Director's summing up of the discussion by the Executive Board that preceded the decision. The Managing Director is Chairman of the Executive Board.[48]

The summing up notes the view of a number of Executive Directors that the Fund's function of surveillance could be made more effective. Greater effectiveness, the Managing Director states, depends on the full cooperation of members. This cooperation should take place on three distinct levels.

(a) A common view or understanding should be reached on the analytical framework within which exchange rate issues and requirements can be discussed. Several Executive Directors had mentioned, among the matters on which a better assessment was required, the role of exchange rates in the adjustment process and the adequacy or appropriateness of different exchange rate regimes as well as the adjustment of those regimes when necessary. (The Articles give each member freedom to choose its exchange arrangements, except for the maintenance of the value of its currency in terms of gold[49] and the imposition of multiple currency practices or discriminatory currency arrangements.[50] The Fund can grant approval of the second and third of these practices but not the first.) The Managing Director notes also the suggestion that the Fund needed a better understanding of the functioning of the European Monetary System (EMS), the currency intervention that it entailed, and the relationship between EMS members and other countries.[51]

(b) Members should agree to discuss with the Fund, and in the Fund, the aspects of the policies they choose that have or can have an adverse impact on other countries. (The phrase "in the Fund" can be read to mean that discussions are held not only within the institution but also at the headquarters of the Fund, according to established procedures, and not solely in the field with a mission consisting of members of the staff of the Fund. Discussion "in the Fund" gives Executive Directors an opportunity to express the views of members when the Fund is considering which of a member's policies are having, or could have, adverse effects on fellow members.)

(c) It was important for members to cooperate "by taking seriously into account, in their national process of decision-making," the views

expressed and conclusions reached by the Executive Board under (a) and (b) above. Seven of the numerous other topics in the Managing Director's summing up are noted in sections (i) to (vii) that follow. These sections contain important clarifications of both the constitutional law of the Fund and its practice under the law.

(i) A number of Executive Directors[52] held the view that in the exercise of surveillance there remained some asymmetry between members that use the Fund's resources and those that do not, or between small countries and major industrial countries. The Managing Director stressed the Fund's efforts to treat members on a uniform basis, but an evenhanded approach did not mean that consultations with members could be perfectly symmetrical, because the situations of members were not symmetrical. A country that is dependent on the use of the Fund's resources is more likely to be the object of active surveillance by the Fund than one not in need of financial assistance, but that fact induced special efforts by the Fund to achieve an evenhanded treatment among categories of members when making its appraisals and recommendations.[53]

(ii) It was agreed that for surveillance to be really effective, it had not only to be exercised in relation to members individually but had also to be looked at in a multilateral context. The Fund's exercise on the World Economic Outlook[54] (conducted by the Executive Board and by the Interim Committee of the Board of Governors on the International Monetary System) was a helpful method of integrating individual judgments or assessments into a more collective framework.

An idea that had been mentioned in connection with a multilateral context was the possibility of holding, within the framework of the Fund, informal discussions with or on the industrial countries as a group or with those whose currencies are included in the SDR basket. The phrase "with or on" can be read to contemplate alternative procedures. Under one procedure, but not necessarily under the other, the discussions could be held collectively with those members that constituted the special group, perhaps under a special procedure. The mention of informal discussions suggests a special procedure. Under the alternative, the Executive Board could discuss the position of all members of the group simultaneously.

(iii) The paragraphs on the role of the Managing Director in surveillance deserve special attention. The two basic decisions of the Fund on the principles and procedures of surveillance have already allotted central

functions to the Managing Director. The document under discussion gives further definition to a creative role for him:

> [T]he Managing Director must...formulate proposals to the Executive Board about how surveillance or adjustment should be conducted. At this level, he must not serve simply as a conduit for the views of the membership—which are often divergent—but must exercise some independence in synthesizing these views and making proposals that, in his view, will best serve the membership as a whole. It is understood, of course, that such proposals must be expressed in a way that does not impinge on the sovereign right of members to make policy.[55]

(iv) The Managing Director responded also to the request of a number of Executive Directors for clarification of the role of Executive Directors in the consultation process and their role, and perhaps that of the Executive Board itself, in the briefing stage before a mission begins the consultative process. The Managing Director stated that the role of the Executive Board is clearly defined by the Articles, which provide that the Managing Director and the staff conduct the ordinary business of the Fund under the direction of the Executive Board.[56] The ordinary business includes consultation missions. The Executive Board, he continued, has the power and the responsibility to adopt policies and to establish procedures for the conduct of consultations and negotiations with members, but the conduct of the consultations and negotiations themselves is the responsibility of the Managing Director and staff.[57]

The Managing Director described the role of the individual Executive Director as follows:

> The individual Executive Director plays a different but very important role in the consultation process. He is obviously responsible for presenting and explaining the views of his countries during Board discussions; but there are also many ways in which he can play a particularly useful intermediary role at an earlier stage by helping the staff mission to understand the policies and views of his countries and vice versa....[58]

This statement is one of the few authoritative examinations of the role of individual Executive Directors, although the subject has been raised from time to time in connection with some particular feature of the Fund's activities.[59] The Articles are silent on this subject, partly because of the novel position of Executive Directors as officers of the Fund[60] appointed or elected by members, but officers who, unlike the Managing Director and staff, do not "owe their duty entirely to the Fund and to no other

authority" in the discharge of their official functions.[61] How an Executive Director achieves a balance between his relationship to the Fund and to members of his constituency is left to the Executive Director himself.

(v) The Managing Director declared that there was "general agreement"[62] that reports by the staff should continue to cover trade issues in supporting the efforts of the CONTRACTING PARTIES to the General Agreement on Tariffs and Trade (GATT), but without ignoring the respective jurisdictions of the two organizations. The Annual Report of the Fund for 1982[63] explains that the role of consultations under Article IV is not confined to relationships between the Fund and members. Consultations, and especially the reports resulting from them, have an important function in the Fund's relations with other international organizations, such as the GATT, the International Bank for Reconstruction and Development (World Bank), and the Organization for Economic Cooperation and Development (OECD).[64] For members, too, consultation reports can be useful in the conduct of their external relations.[65]

(vi) The last paragraph in the Managing Director's statement deals with the information that members must supply to the Fund. The Articles have always declared that the Fund may require members to provide it with such information as the Fund deems necessary for the effective discharge of its duties.[66] The Second Amendment declares, in addition, that each member must provide the Fund with the information necessary for the Fund's surveillance of the member's exchange rate policies.[67] Furthermore, each member must notify the Fund promptly of any changes in its exchange rate arrangements.[68]

In his summing up, the Managing Director emphasized the importance of timely and comprehensive information. The normal period for the provision of information about changes in exchange arrangements should be no more than three days after the date of a change.

The comprehensive information to be supplied should include information by members about their intervention policies if members maintain flexible exchange rate regimes, as well as information by other members about developments in their pegged or managed arrangements. The Fund is to be kept up to date on policies conducted by members or actions taken by them affecting their exchange arrangements. In clarifying the need for full information and the obligation to supply it, the summing up should dispose of reluctance to provide certain kinds of information. The Fund must receive details of the composite of currencies to which a member

pegs its currency or which the member treats as a set of indicators for the adjustment of the external value of its currency. Between 1975 and 1981, there had been a marked shift in pegging from single currencies to composites,[69] and the statement reflects this development. The statement also reflects the view that the obligation to supply information is the same for all categories of members in the classification of exchange arrangements.[70]

(vii) Aspects of the summing up that appear to be concerned solely with procedure or taxonomy may have normative implications. For example, the section that deals with the frequency of consultations could affect the period for which restrictions, multiple currency practices, or discriminatory currency arrangements are approved if the Fund were to grant approval until the next consultation.[71] The Fund's current practice, however, is to grant approval for periods of approximately one year, although the decision of March 20, 1981 on multiple currency practices, which is discussed elsewhere in this pamphlet, makes this practice subject to the caveat of "the cycle of consultations under Article IV."[72] The classification of exchange arrangements affects the kind of information that members may be required to provide.[73]

Versailles Communiqué

The Heads of State and Government of Canada, France, the Federal Republic of Germany, Italy, Japan, the United Kingdom, and the United States, who met at Versailles on June 4–6, 1982, issued a communiqué in which they announced their dedication to an increase in growth and employment, in the expectation that this progress should help to bring about more stable exchange rates. They recognized that intensified economic and monetary cooperation was essential. They would work, therefore, toward a constructive and orderly evolution of the international monetary system by a closer cooperation among the authorities representing the currencies of North America, Japan, and the European Community in pursuing medium-term economic and monetary objectives. In this respect, the Seven announced that they had committed themselves to the undertakings contained in the statement attached to the communiqué.[74] The attachment, which is reproduced in Appendix C of this pamphlet, reiterated elements of Article IV and the Fund's principles for the guidance of the exchange rate policies of members, but paragraph 3

advanced an idea that had been adumbrated by the Managing Director in his summing up on surveillance:

> We are ready to strengthen our cooperation with the IMF in its work of surveillance; and to develop this on a multilateral basis taking into account particularly the currencies constituting the SDR.

The Fund's Interim Committee responded to this declaration in the communiqué it issued on September 4, 1982:

> In the view of the Committee, full cooperation by all members was essential for the success of the Fund's efforts to promote increased international stability. In this connection, the Committee was pleased to note the policy declaration relating to the Fund's surveillance responsibilities and its efforts to foster stability that was included in the Statement on International Monetary Undertakings issued at the Versailles Summit Meeting of last June.[75]

The Managing Director, in presenting the Thirty-Seventh Annual Report of the Executive Board to the Board of Governors at the 1982 Annual Meeting in Toronto, welcomed the Versailles statement on surveillance:

> [T]he statements of policy relating to Fund surveillance that resulted from the summit at Versailles last June are encouraging. On that occasion, the major industrial countries stated an intention to strengthen their cooperation with the Fund in its surveillance work and to develop this on a multilateral basis. It is of great importance, not only for these countries themselves, but also for the rest of the world, that this commitment be carried out effectively. It is now up to the major industrial countries to take the necessary action. The Fund, for its part, will, of course, assist these countries in bringing about the desired closer convergence of their economic policies.[76]

In his concluding remarks, the Managing Director announced that "the process of enhanced economic and monetary cooperation that was agreed upon at Versailles has already begun."[77]

Multiple Currency Practices

Jurisdictional Issues Under Second Amendment

Under Article VIII, Section 3, a member may not engage in or permit any of its fiscal agencies to engage in multiple currency practices without the approval of the Fund, unless the practice is authorized by the Articles. The provision favors a unified exchange system on the hypothesis that it contributes to the most efficient allocation of domestic resources,

adjustment of the balance of payments, and the expansion and balanced growth of international trade.[78] The Fund has always understood the necessity for approval to mean approval before a practice is instituted. The necessity for approval has not been rescinded by the words "other arrangements of a member's choice" that a member can apply under Article IV, Section 2(*b*)(iii), even though Article VIII, Section 3 provides that approval is not required for multiple currency practices that are authorized by the Articles. If that view were not adopted, members would be able by unilateral action to negate the obligation imposed on members by Article VIII, Section 3 and render it wholly ineffectual. An interpretation of the Articles must give effect to all relevant provisions.

Moreover, the "choice" of exchange arrangements that a member may make under Article IV must be "consistent with the purposes of the Fund and the obligations of Section 1" of Article IV. Under Section 1, a member undertakes to "avoid manipulating exchange rates...in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." Multiple currency practices continue to be subject to approval by the Fund because they could be inconsistent with this undertaking. Finally, although multiple currency practices may be justifiable as temporary expedients, in essence they are incompatible with the purpose of the Fund "[t]o assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade."[79]

It has never been suggested that a member's freedom to choose exchange arrangements under Article IV of the Second Amendment authorizes the imposition of multiple currency practices without the Fund's approval. The question whether Article XIV, Section 2 permits some members to adapt or introduce multiple currency practices without the need for approval by the Fund was posed under the original Articles. Article XIV, Section 2 establishes transitional arrangements to which members may have recourse before undertaking to perform in full the obligations set forth in Article VIII, Sections 2, 3, and 4. A member availing itself of the transitional arrangements may "maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which it became a member."[80] Usually, multiple currency practices that establish exchange rates for transactions of this character are also

restrictions of the kind referred to in this formulation. The Fund held, under the substantially similar provision of the original Articles, that a member availing itself of the transitional arrangements had to obtain the approval of the Fund under Article VIII, Section 3 for the introduction of a multiple currency practice, because Article XIV, Section 2 did not authorize the introduction of restrictions.[81] Article XIV, Section 2, however, did authorize the maintenance or adaptation of multiple currency practices, and it was the authority to adapt under the transitional arrangements that gave rise to the question of the necessity for the Fund's approval. The Fund held that approval was necessary even for adaptations of multiple currency practices because all the provisions of the Articles on exchange rates had to be observed.

The most obvious relevant provision on exchange rates before the Second Amendment was Article IV, Section 4(*a*), under which each member undertook to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations. Although the language of Article I(iii), which defines a purpose of the Fund in similar language, has not been deleted or modified by the Second Amendment, the former Article IV, Section 4(*a*) has been excised from the Articles. The provision has been abrogated because the stability that members now undertake to achieve is the stability of underlying conditions and not the stability of exchange rates. The stability of exchange rates, in the opinion of many members, had led to exchange rigidity and eventually to instability. The present theory is that if the stability of underlying conditions is achieved, a stable system of exchange rates will emerge. Notwithstanding the change in the concept of stability introduced by the Second Amendment, the same basic legal principle that the effect of all relevant provisions of the Articles must be respected still applies. Therefore, the broad obligation of each member to collaborate to ensure the existence of orderly exchange arrangements and a stable system of exchange rates, and the more specific obligation to refrain from manipulating exchange rates to gain an unfair competitive advantage over other members,[82] preclude the right of members to "adapt" (change) multiple currency practices without the approval of the Fund. Approval is necessary so that the Fund can be satisfied that the adaptation is required by "changing circumstances" in accordance with Article XIV, Section 2 and is consistent with the provisions of Article IV.

The two jurisdictional issues that have been discussed have not led to any change in the law relating to multiple currency practices as it existed before the Second Amendment, but fundamental changes have occurred in two other aspects of the law as a result of the present Articles. These aspects are the responsibility of members for exchange rates and the definition of multiple currency practices.

Responsibility of Members

Article VIII, Section 3 provides now, and provided before the Second Amendment, that no member shall engage in, or permit any of its fiscal agencies referred to in Article V, Section 1, to engage in multiple currency practices that are not authorized by the Articles or approved by the Fund. The fiscal agencies of a member have always been defined as its treasury, central bank, stabilization fund, or other similar fiscal agency.[83] Multiple currency practices, therefore, have resulted from the conduct of a member or of its fiscal agencies. Before the Second Amendment, however, multiple currency practices might exist even though the member or its fiscal agencies had not taken positive action to produce multiple rates of exchange. A member might be held to be engaging in multiple currency practices if it or its fiscal agencies tolerated the emergence of exchange rates within the member's territories. In short, a member might be engaging in multiple currency practices as the result of either action or inaction. Multiple currency practices might emerge, without the impetus of positive action by a member or its fiscal agencies, because of action by commercial banks or exchange dealers in imposing charges or commissions that were deemed to be part of an effective exchange rate and that resulted in what was deemed to be a multiplicity of exchange rates. Domestic law was not decisive when the Fund examined the question whether multiple currency practices existed. The charges and commissions might be consistent with domestic law, but a member might be responsible for multiple currency practices if there was a black market in its territories that was tolerated even though it was not legal.

A member was held accountable for multiple currency practices as the result of inaction by itself or by its fiscal agencies because the member had an absolute duty to prevent exchange transactions from taking place in its teritories at exchange rates that differed from the parity between the two currencies exchanged in the transactions by more than the margins

prescribed by the Articles.[84] The parity was the ratio between the par values of the currencies established in accordance with the Articles by the members issuing the currencies. Par values have been abolished by the Second Amendment, and members are no longer required to take measures to ensure that the exchange rates for exchange transactions in their territories remain within margins.

The Fund has examined its law and policy on multiple currency practices in the new conditions created by the Second Amendment, and on March 21, 1981 the Fund adopted the decision that is reproduced in Appendix D.[85] The decision purports to be confined to the Fund's policy, but the decision obviously assumes certain legal conclusions, without which the policy could not have been formulated. In fact, paragraph 1 of the decision is more a statement of law than of policy. The decision also states that the Fund will be "guided by the approach" in the conclusions that are set forth. This language is intended to permit flexibility and adaptability. Elasticity is advisable in the present international monetary system, in which conditions are changeable and legal obligations are less precise than in the past.

One of the fundamental legal postulates on which the decision rests is that members are responsible for exchange rates as multiple currency practices only if the rates result from "official action" or from "action by a member or its fiscal agencies." Language of this kind appears in almost every sentence of paragraph 1 of the decision. Official action is not defined. The concept could give rise to difficulty, particularly in view of the diverse ways in which members organize their constitutional and financial functions. For this reason, the decision states that when difficulties of interpretation and application arise in specific cases, "particularly concerning the nature of official actions," the staff of the Fund will present the relevant information to the Executive Board for its determination. Direct and overt action by a member or by its fiscal agencies, such as the imposition of exchange taxes or the institution of dual exchange rates, is not likely to create difficulty in recognizing that official action has been taken. Difficulty might arise if the action of a member or its fiscal agencies was not overt or was indirect because it was in the form of guidance or influence or in some other way that was less than peremptory.

Toleration is not the equivalent of official action, but a member's responsibility for multiple currency practices is not limited to those that

result from the actions of its fiscal agencies. Article VIII, Section 3 provides that a member shall not engage in multiple currency practices and shall not permit any of its fiscal agencies to engage in such practices. The word "member" is intended to be a broader expression than "fiscal agencies." It is less likely, but not at all inconceivable, that, in some economic structures, official action relating to exchange rates might be taken by an agency that was not fiscal. For example, an agency that has duties in the field of trade may perform accessory functions in connection with exchange. The provision assumes that an agency is not to be deemed "fiscal" simply because it engages in multiple currency practices.

An agency, whether fiscal or not, can "engage" in multiple currency practices without participating in exchange transactions. A central bank, for example, will be engaging in a multiple currency practice if exchange transactions that in all other respects fall within the decision are entered into by authorized exchange dealers as instrumentalities of the central bank. Moreover, a multiple currency practice may exist even though no agency of a member participates, directly or through instrumentalities, in exchange transactions. The Fund will conclude that there is a multiple currency practice if a member's agency applies regulations that impose a multiplicity of exchange rates for exchange transactions in which the agency is not involved in any other way. Article VIII, Section 3 prohibits members and their fiscal agencies from engaging in "practices," which may or may not be "transactions."

It follows from the emphasis on official action that if diverse exchange rates exist solely as the result of the commercial costs and risks of exchange transactions, however extreme the diversity may be, the Fund's jurisdiction under Article VIII, Section 3 will not be involved.

Definition of Multiple Currency Practices

The Articles have never included a definition of multiple currency practices. The interpretation and application of the concept have been left to the Fund as the administrator of the Articles. The Fund has never attempted to formulate a comprehensive definiton and has preferred to act pragmatically. It has decided whether a multiple currency practice existed in the circumstances of a particular case or, at most, it has decided that a category of exchange practices comes within the concept. An extensive "jurisprudence" developed over the years, but no attempt was made to synthesize it into anything resembling a *vade mecum.*

Before the Second Amendment, the parities between members' currencies that resulted from par values, and the margins around parities prescribed by the Articles for exchange transactions, had a fundamental function in the Fund's determination that multiple currency practices within the meaning of the Articles were in force. For example, if all exchange rates were within the prescribed margins, the Fund did not regard any practices that diversified the rates as multiple currency practices. If one exchange rate was within the margins but another rate was forced outside them, the practice was considered a multiple currency practice. To constitute a multiple currency practice, there need be no more than one buying rate or one selling rate outside the margins. An underlying idea in the Fund's approach was that multiple currency practices existed if there were two or more exchange rates, of which at least one was outside the margins, that were independent of each other because of nonmarket forces and that applied to different transactions.

The new decision (reproduced in Appendix D) is based on the same underlying idea in distinguishing between market and nonmarket forces, but margins for exchange rates are not prescribed by the Articles and have no role. Indeed, Article VIII, Section 3 makes it clear that multiple currency practices may exist even if all exchange rates are within margins for exchange transactions that a member is observing, or even if the rates are within margins prescribed by or under Schedule C should that schedule be called into operation.[86]

The Executive Board, in specifying what exchange rates will be considered independent of each other and therefore multiple currency practices, has been influenced by the two decisions it adopted on central rates and wider margins for operation in the period that succeeded the breakdown of the par value system and preceded the Second Amendment.[87] Those decisions recognized that multiple currency practices resulted either from (a) the character of the spread between the buying and the selling rate of exchange for a member's currency in its exchange market, or from (b) the character of the difference between the rates for a member's currency in exchange for other members' currencies in the member's principal exchange market and exchange rates between these other currencies in their principal exchange markets. The character of the spread or of the difference that the new decision treats as a multiple currency practice has been derived by study of the normal practice of exchange markets that are free from official action relating to the

quotation of exchange rates. The spirit of the decision can be said to be that a member should not have more than limited authority to interfere with the normal working of the exchange market without the approval of the Fund.

Spreads are the subject of paragraph 1(a) of the new decision. It establishes three propositions:

(i) The first proposition is that an exchange spread of whatever breadth does not give rise to a multiple currency practice if official action is not involved. The evidence of the markets is that normally spreads that are influenced solely by commercial considerations are not broad and do not create inequities among members. The proposition frees the Fund from the necessity to determine the reasonableness of commercial costs or of other practices.

(ii) A multiple currency practice exists if an action by a member or by its fiscal agencies results, by virtue of that action considered in isolation from other influences on exchange rates, in a spread of more than 2 percent between the buying and the selling rates for the member's currency in exchange for another member's currency. This proposition relates to spot exchange transactions, and, although it is not made explicit, the proposition probably relates to exchange transactions that take place within the territories of the member in which the spread occurs. The reason for the latter qualification is that a member has unquestioned jurisdiction to take official action on exchange rates only within its own territories. For this reason, the original Articles, which imposed on a member the obligation to take appropriate measures to ensure that exchange rates for its currency did not go beyond the prescribed margins, were explicit in declaring that this obligation related only to exchange transactions within the member's territories.[88] The territory within which an exchange transaction takes place may be debatable in some circumstances, but the Fund has not established criteria for settling this question.

Some illustrations may help to clarify propositions (i) and (ii) above. A spread of 1.5 percent exists between the buying and the selling rates quoted by the commercial banks for their domestic currency in exchange for a foreign currency. The spread is determined by the banks solely on the basis of commercial considerations and without the influence of official action. The member imposes a 1 percent exchange tax, and the spread becomes 2.5 percent. The effect is not to produce a multiple currency practice. If, however, the exchange tax is 2.5 percent, the tax

itself produces a multiple currency practice. Assume a spread of 2.5 percent without official action. The spread does not constitute a multiple currency practice, and even a broader spread of 4.5 percent as the result of an exchange tax of 2 percent does not become a multiple currency practice.

(iii) Deviations between the rates for spot exchange transactions and rates for other exchange transactions will not be considered multiple currency practices if the deviations represent the additional costs and exchange risks of the other exchange transactions. Nothing is said in the decision about the extent to which, if at all, official action can contribute to deviations without constituting multiple currency practices.

A quantitative limit for official action in relation to spot exchange transactions only has been specified because these exchange transactions represent the largest proportion of total exchange transactions, and because normally exchange rates for other exchange transactions are based on the rates for spot transactions. The evidence of practice in the markets shows that a spread of 2 percent for official action gives ample discretion to monetary authorities, and at the same time makes it unnecessary for the Fund to become concerned with such matters as small exchange taxes and minor stamp duties that do not threaten to create disorderly exchange markets.

Differences between exchange rates for currencies in a member's and other members' markets are the subject of paragraph 1(b) of the new decision. Action by a member or its fiscal agencies that results in midpoint spot rates for other members' currencies in exchange for the member's currency in a relationship that differs by more than 1 percent from what would be the midpoint spot rates derived from the spot rates for the exchange of the currencies of the other members in their principal markets constitutes a multiple currency practice. If the practice persists for more than a week, the approval of the Fund must be sought.

The decision refers to the exchange rates that are the subject of the differentials covered by paragraph 1(b) as "cross rates." This term and the substance of paragraph 1(b) must be understood by taking account of the practice of major exchange markets, in which the overwhelming proportion of exchange transactions is in U.S. dollars. In the absence of official action, the principal markets in which the U.S. dollar is the main traded currency would establish a consistent pattern of exchange rates in those markets and in all other markets connected with them. At any one

moment, the exchange rate between currencies A and B would be derived from the rate of exchange for currency A against the U.S. dollar in A's market and the rate of exchange for currency B against the U.S. dollar in B's market, and the rates of exchange in both markets would be in concord with each other. There would be concord among exchange rates for all currencies in all markets whatever the relationships (cross rates) that were the subject of comparison. Deviations from this concord constitute "broken cross rates."

Two kinds of practice may introduce discord. It may be produced, first, by official action in a market. Second, even in the absence of official action, concord will not prevail because the spreads between buying and selling rates are not the same in all markets. Moreover, it has been seen that spreads can be wide without creating a multiple currency practice even if there is no official action or only limited official action (up to 2 percent) to broaden spreads. In the absence of official action, concord would be achieved only if spreads were the same in all markets.

The decision adopts safeguards against the dangers of both discordant practices. One safeguard is the limit of 2 percent on official action to produce spreads without the need for the Fund's approval, as explained earlier. The limit exercises a restraint on the degree of discord that can be introduced freely by a member.

A second safeguard is that a member is deemed to be applying a multiple currency practice if the midpoint rates for the exchange of its currency and other members' currencies in its principal market differ by more than 1 percent from the midpoint rates that would be derived from the midpoint rates for the exchange of these other currencies in their principal markets.[89] Midpoint rates are considered because the spread between buying and selling rates is not the same in all markets. The difference of more than 1 percent must result from official action in order to justify the finding that there is a multiple currency practice because of broken cross rates. The differences must be no more than 1 percent, because broken cross rates are necessarily disadvantageous to one or more members in comparison with other members. The practices that are considered broken cross rates are discriminatory currency arrangements as well as multiple currency practices under the Articles. The Fund has been strongly opposed to discriminatory currency arrangements for many years.

The fluidity of conditions in exchange markets and the variability of exchange rates create difficulties in limiting discord among exchange relationships. The difficulties would be met to some extent if a member were to base the relationships between quotations of other members' currencies against its own currency on the midpoint rates of these currencies in their principal markets, but even this practice might not ensure concord because of differences in time and in administrative procedures. Even if members quote exchange rates daily, cross rates may be broken because of changes in exchange rates in other markets. Exchange rates have been volatile in the markets of major currencies. The decision gives a member reasonable leeway for the adaptation of its quotations without the necessity for seeking the approval of the Fund. To constitute a multiple currency practice, a difference in cross rates must persist for longer than a week. The period of a week should give members adequate opportunity to adjust their quotations to developments in exchange rates abroad. Under normal market conditions, differences of even less than 1 percent in midpoint exchange rates would induce arbitrage by operators in the exchange markets, which would eliminate the differences.

Relevance of Other Provisions

The new decision on multiple currency practices is inspired by the attitude that interference with the freedom of exchange markets to determine exchange rates should be kept within reasonable bounds. If differential exchange rates were to develop in a member's exchange market that do not amount to multiple currency practices under Article VIII, Section 3, for example, because they do not result from official action by the member or its fiscal agencies, the Fund might still consider it necessary to express concern under other provisions of the Articles. Article IV, Section 1 requires a member to collaborate with the Fund and other members "to assure orderly exchange arrangements and to promote a stable system of exchange rates." The Fund would be able to call on a member to collaborate under this provision by consulting with the Fund in order to determine the cause of certain conditions in the member's exchange market. If the Fund were to conclude that these conditions were not consistent with a stable system of exchange rates, the Fund could require the member to correct the situation in the exchange market.

Policy on Multiple Currency Practices

The new decision on multiple currency practices sets forth a number of propositions of mixed policy and law that the Fund will observe in exercising its authority over multiple currency practices and discriminatory currency arrangements. It will become apparent from the propositions as discussed below that the Fund's practice has not been changed substantially by the disappearance of the par value system.

1. The policy on the exercise of the Fund's jurisdiction as established by a decision of June 1, 1960[90] "remains broadly appropriate." In accordance with that decision, the Fund will be prepared to approve multiple currency practices introduced or maintained by a member for balance of payments reasons if (i) the member represents, and the Fund is satisfied, that the measures are temporary and are being applied while the member is endeavoring to eliminate its balance of payments problems, and if (ii) the multiple currency practices do not give the member an unfair competitive advantage over other members and (iii) do not discriminate among them.

2. The Fund will "continue to be very reluctant" to approve the maintenance of broken cross rates. The new decision determines what are broken cross rates.

3. The Fund reaffirms its decision of June 26, 1957[91] on complex multiple currency practices and will not approve these practices unless the member is making reasonable progress toward simplification and ultimate elimination of the system or is taking measures or adopting programs that seem likely to result in such progress.

4. While urging members to apply alternative policies not connected with the exchange system, in accordance with the decision of June 1, 1960,[92] the Fund will be prepared to grant temporary approval of multiple currency practices introduced or maintained principally for reasons other than the balance of payments, provided that the practices do not materially impede adjustment of the member's balance of payments, do not harm the interests of other members, and do not discriminate among members.

This proposition is based on the legal principle, which is in conformity with a decision of the Fund on payments and transfers for current international transactions,[93] that the Fund's jurisdiction over the measures that need approval under Article VIII does not depend on the motive that induces a member to apply the measures. The proposition stated in the preceding paragraph refers to multiple currency practices that are

introduced or maintained "principally" for reasons not connected with the balance of payments. The adverb recognizes that there may be more than one motive for the application of measures.[94]

The Fund's jurisdiction over exchange measures does not depend on the motive for measures because no such limitation is to be found in the provisions of the Articles. One justification for the absence of a limitation is that the measures subject to Section 2 or Section 3 of Article VIII may affect balances of payments whatever may be the motive or motives for the measures. The effect may be on the balance of payments of the member that resorts to the measures or on the balances of payments of other members.

The Fund's jurisdiction over measures that are in force for reasons principally unconnected with the balance of payments avoids a gap in international economic jurisdiction and enables the Fund to ascertain that a member is not relying on multiple currency practices in order to avoid its obligations under other treaties. Multiple currency practices can have effects similar to those produced by measures directly applicable to trade that are within the province of the GATT. A member may find that, under its law and administration, multiple currency practices can be introduced more easily than trade measures. The GATT itself seeks to inhibit contracting parties to that Agreement from relying on exchange measures that frustrate the intent of the GATT:

> Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.[95]

Multiple currency practices introduced or maintained for reasons unrelated to the balance of payments are not invariably, or even most often, designed as alternatives to measures that would fall under the jurisdiction of the CONTRACTING PARTIES to the GATT. For example, multiple currency practices may be designed for domestic fiscal objectives. These practices resemble taxes or subsidies in their effects and again may be adopted in lieu of fiscal legislation.

The proposition under discussion enables the Fund to take account of the feasibility of measures that would be alternatives to multiple currency practices applied for reasons mainly unrelated to the balance of payments. The Fund is also able to consider the relationship of such multiple currency practices to a member's obligations under the GATT. If, having taken account of these matters, the Fund decides to approve the multiple

currency practices, it will do so only if the conditions stated in this proposition are satisfied. Furthermore, the Fund will give its approval for no more than a limited ("temporary") period.

5. To assist the Fund in deciding whether or not to approve a multiple currency practice, the reasons underlying the practice and its effects will be analyzed in reports on consultations under Article IV or in other papers prepared by the staff on exchange systems. Approval will be granted for periods of approximately one year, so that the practices can be kept under review by the Executive Board.

Consequences of Unapproved Multiple Currency Practices

The Fund's approval or nonapproval of multiple currency practices can produce consequences within the Fund and outside it. Nonapproval is a term that applies to two situations: the Fund's refusal to approve a multiple currency practice that a member has submitted to the Fund for approval and the failure of a member to submit a multiple currency practice for approval.[96] In both situations, the multiple currency practice can be said to be unapproved. Some of the consequences of unapproved multiple currency practices are as follows.

1. A member is in breach of its obligations under the Articles if it maintains, introduces, or adapts a multiple currency practice that is not authorized by the Articles or approved by the Fund. It follows that the Fund may declare the member ineligible to use the Fund's resources or may react in other ways in accordance with the Articles. The word "sanctions" is frequently used for these responses of the Fund, but it is not wholly appropriate because some of the same responses may be available to the Fund in certain circumstances when a member is not in breach of obligations.[97]

2. An unapproved multiple currency practice may result automatically in a member's inability to use the Fund's resources. The model form of stand-by arrangement or extended arrangement adopted by the Fund on April 29, 1981[98] provides that a member for which an arrangement has been approved will not be able to make purchases beyond the first credit tranche under a stand-by arrangement or in any circumstances under an extended arrangement if the member

> (i) imposes [or intensifies[99]] restrictions on payments and transfers for current international transactions, or

(ii) introduces [or modifies[100]] multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII,[101] or

(iv) imposes [or intensifies] import restrictions for balance of payments reasons.

If a member is unable to use the Fund's resources because the member is not observing the performance criteria listed above, the right to purchase resources revives only after the Fund and the member consult and understandings are reached on the circumstances in which purchases can be resumed.[102]

These provisions do not confine the interruption of a member's right to make purchases under a stand-by or extended arrangement because of the imposition or intensification of multiple currency practices to those cases in which the Fund has not approved these practices. If, however, the Fund approves the practices, and there are no other departures from performance criteria, it is improbable that the Fund would prolong the interruption of rights under an arrangement.[103]

The automatic effect of the imposition or intensification of multiple currency practices as discussed above affects access to the Fund's resources only under a stand-by or extended arrangement. A member's right to use the Fund's resources under provisions or policies not involving a stand-by or extended arrangement is not interrupted automatically because of the imposition or intensification of multiple currency practices. The member's right under these provisions or policies is not automatically affected even if its right to make purchases is interrupted under an arrangement. In order to interrupt a member's right to make purchases that were in accordance with these provisions or policies, the Fund would have to take a decision under another provision of the Articles to limit the member's use of the Fund's resources or to declare it ineligible to use them.[104]

3. Agreements under which official or private entities undertake to lend to a member sometimes provide that the member will be able to borrow under the agreement only if it is in a position to use the Fund's resources under a stand-by or extended arrangement.[105] An effect of an unapproved multiple currency practice may be that the member will be unable to borrow under agreements that are tied to a stand-by or extended arrangement.

4. The Fund's Compensatory Financing Facility is designed to assist members, particularly the exporters of primary products, that have encountered difficulties because of temporary shortfalls in the proceeds of exports. A member that suffers this kind of difficulty can expect the Fund to comply with requests for transactions under the policy if

(a) the shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member: and

(b) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.[106]

Purchases under the policy may amount to 100 percent of a member's quota, but requests for purchases that would increase transactions outstanding under the policy beyond 50 percent of quota are met "only if the Fund is satisfied that the member has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties."[107] Similar conditions apply under the Fund's decision on the compensatory financing of fluctuations in the cost of cereal imports.[108] Total outstanding purchases under the combined effect of the two decisions may amount to 125 percent of quota.

The conditions relating to willingness to cooperate and actual cooperation are intentionally vague and require the Fund to exercise judgment according to the circumstances of each request. Codification to govern or guide judgment has been avoided. It is conceivable that the circumstances taken into account may include a member's attitude to multiple currency practices, particularly if it persists in applying them without the Fund's approval. No decision has been taken, however, that the existence of such practices is conclusive or even presumptive evidence of unwillingness to cooperate or of actual noncooperation.

5. The first sentence of the much-litigated Article VIII, Section 2(*b*) provides that

> 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....[109]

If a member's regulations prescribing a multiple currency practice that has been authorized by the Articles or approved by the Fund were deemed to be exchange control regulations, an exchange contract that was contrary to

them would be unenforceable in the courts of other members. This legal consequence would not follow under the Articles if the multiple currency practice was inconsistent with the Articles because it was not authorized or approved. The court's attitude to the regulations would be determined by its private international law without reference to Article VIII, Section 2(*b*).[110]

The Fund has refrained from taking a decision on the question whether a rate of exchange confined exclusively to capital transactions is subject to the jurisdiction of the Fund under Article VIII, Section 3. The problem is whether Article VI, Section 3, which authorizes members to control capital transfers, has overriding effect notwithstanding Article VIII, Section 3, or whether Article VIII, Section 3 has overriding effect notwithstanding Article VI, Section 3. The staff has concluded that the practice in question is indeed a multiple currency practice and subject to Article VIII, Section 3,[111] but the new decision on multiple currency practices continues to avoid a solution. The problem remains in limbo because of the enormous importance members attach to the power to control capital transfers and their effect on the domestic monetary situation.

As a result, a difficulty could arise for courts under Article VIII, Section 2(*b*). The provision applies to exchange control regulations whether they affect payments and transfers for current international transactions or capital transfers,[112] but the regulations must be authorized by the Articles or approved by the Fund. No difficulty would arise if Article VIII, Section 3 did not embrace capital transfers, because regulations controlling capital transfers would be authorized by the Articles (i.e., by Article VI, Section 3). Article VIII, Section 2(*b*) would apply. If, however, Article VIII, Section 3 does apply, the regulations would be neither authorized by the Articles nor approved by the Fund, and the court would not be required by Article VIII, Section 2(*b*) to treat contracts contrary to the regulations as unenforceable. The courts would find it necessary to choose between these alternative interpretations with no present guidance other than the opinion of the staff of the Fund.

The likelihood that the courts will have to face this predicament is less than might be assumed because regulations imposing a multiple currency practice on capital transfers are rarely confined with rigor to those transfers. The regulations usually affect payments and transfers for some current international transactions as well. The Executive Board has relied

on this circumstance to justify its reluctance to decide the jurisdictional issue. A member may find it difficult for administrative reasons to preserve a strict separation between payments and transfers for capital and for current transactions. In addition, the definition of payments and transfers for current international transactions is a broad one under the Articles.[113] It includes some payments and transfers that economists would classify as capital transfers. In some cases in which the two categories of payments and transfers have been involved, the Fund has avoided decision of the jurisdictional issue by means of a formula under which the Fund gives such approval as may be necessary under the Articles. Such a formulation relieves courts of the need to decide the jurisdictional issue for themselves.

6. If a member applies multiple currency practices, its own courts may find it necessary to decide which rate of exchange is appropriate as the basis for a judgment. The question of the validity of rates of exchange under domestic law has arisen in some proceedings, and this issue has led to the question of validity under the Articles.[114]

7. The Fund's classification of a practice as a multiple currency practice and the Fund's attitude to it may have consequences under treaties other than the Articles. The most obvious treaty under which there may be consequences is the GATT. For example, an Interpretative Note to Article VI of the GATT, which deals with antidumping and countervailing duties, explains that multiple currency practices in certain circumstances can constitute a subsidy to exports that may be met by countervailing duties or can constitute a form of dumping by means of a partial depreciation that may be met by an antidumping duty.[115] Multiple currency practices under the law of the GATT are said to be practices by governments or practices sanctioned by governments.[116] One expert, in discussing a contracting party's export subsidies under Article XVI of the GATT, has written that "approval by the IMF excludes the possibility of a challenge under Article XVI."[117] This conclusion is based on an Interpretative Note to Article XVI, which declares that nothing in Section B of Article XVI "shall preclude the use by a contracting party of multiple rates of exchange in accordance with the Articles of Agreement of the International Monetary Fund."[118]

In these matters, the legal position as discussed above probably has not been changed by the Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and

Trade (Relating to Subsidies and Countervailing Measures), which was negotiated in the Tokyo Round of the Multilateral Trade Negotiations. The illustrative list of export subsidies annexed to the new Agreement includes "(b) Currency retention schemes or any similar practices which involve a bonus on exports." A currency retention scheme usually results in a multiple currency practice. "Any similar practices" could be interpreted broadly to encompass other forms of multiple currency practice.[119]

Article VIII of the GATT prohibits the imposition of certain fees and charges on or in connection with importation or exportation unless they are limited in amount to the approximate cost of services rendered and do not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes. An Interpretative Note to Article VIII of the GATT explains that, while the use of exchange taxes or fees as a device for implementing multiple currency practices is condemned, if multiple currency practices resulting from exchange fees are being used for balance of payments purposes with the approval of the Fund the practices are exempt from this condemnation.[120]

Article VIII of the GATT deals with valuation for customs purposes and prescribes as the basis for valuation the par value established under the Articles of the Fund or the rate of exchange recognized by the Fund. The CONTRACTING PARTIES were authorized, in agreement with the Fund, to formulate rules for the translation by contracting parties of any foreign currency in respect of which multiple rates of exchange are maintained consistently with the Articles of the Fund.[121] The abrogation of the par value system necessitated the re-examination of the problem of valuation. The re-examination was undertaken as part of the Tokyo Round of the Multilateral Trade Negotiations, which led to the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade. This Agreement has been discussed in Pamphlet No. 36 (1981).[122]

Discriminatory Currency Arrangements

Discrimination Under the Articles

A theme of the Fund's new decision on multiple currency practices is the undesirability of discrimination in the form of broken cross rates. The possibility that cross rates may be broken has increased since the demise of the par value system and the floating of major currencies. This

development is more likely among currencies that are pegged to one or more currencies or to a basket of currencies. Members' fiscal agencies that quote exchange rates may deliberately employ the practice for reasons of policy. But broken cross rates may result because of changing exchange rates in the principal markets abroad with a lagged response by a member in changing its quotations to conform with the changes.

Article VIII, Section 3 prohibits both discriminatory currency arrangements and multiple currency practices. Restrictions on the making of payments and transfers for current international transactions are prohibited by Article VIII, Section 2. The three categories must be regarded as distinguishable from each other, according to established principles of the interpretation of treaties, but over the years it has been rare to find that a discriminatory currency arrangement was not at the same time a multiple currency practice or a prohibited restriction as well. Sometimes, a single measure has fallen into all three categories.

The Fund has understood that the category of discriminatory currency arrangements was made the subject of a specific prohibition in order to emphasize the exceptional undesirability of measures of this character even if they fall into other categories as well. The Fund, therefore, has adopted decisions that express its opposition to discriminatory currency arrangements[123] even though it has authority under the Articles to approve them. The distaste for discriminatory currency arrangements probably influenced the Fund to forbear from invoking the so-called scarce currency clause,[124] under which the Fund can authorize members to discriminate against transactions in a currency declared scarce by the Fund, although there are other explanations of the dormancy of the clause.[125]

It may seem surprising that, notwithstanding the Fund's distaste for discriminatory currency arrangements, no attempt has been made to define them. The suspicion that a definition might be too rigid in a world of changing problems and of practices to deal with them may help to explain the absence of a definition. The Fund has not adopted precise definitions for the other two categories of measures prohibited by Sections 2(*a*) and 3 of Article VIII. The greater frequency of these measures, however, has led the Fund to adopt a "guiding principle" by which to determine whether a measure is a restriction on the making of payments and transfers for current international transactions.[126] The "guiding principle" has become over time a much firmer rule than is suggested by

the tentativeness of the adjective. On multiple currency practices, the Fund was content in the past to proceed from case to case without arriving at a comprehensive concept that rationalized the substantial jurisprudence. The Second Amendment made it necessary to have a more systematic approach to multiple currency practices. This approach also is said to be for the guidance of the Fund, but the Fund's conclusions are likely to become firm principles unless the conclusions are indeed shown to be unsatisfactory in some way. The Fund's active practice in relation to the other two categories of prohibited measures and the more systematic analysis of them, even though comprehensive definitions did not emerge, may have reduced the need to arrive at a unified and compact definition of discriminatory currency arrangements.

When, in 1959, it seemed that a number of European members were likely to undertake to perform the convertibility obligations of Article VIII, Sections 2, 3, and 4, the staff of the Fund prepared an analysis of discriminatory currency arrangements in which the following propositions were derived from the decisions and practice of the Fund:

(1) A discriminatory currency arrangement is an arrangement that involves discrimination against one or more members.

(2) A member is entitled to adopt restrictions on exchange transactions with nonmembers or with persons in their territories. This freedom does not justify restrictions that prejudice the interests of a member and are contrary to the purposes of the Fund.[127]

(3) The essence of discrimination is the absence of equal treatment for all members, with the result that some are treated less favorably than others, either because disadvantage is imposed or advantage conferred on some members as compared with others.

(4) The discrimination relates to currency. It is necessary, therefore, to decide whether, in the circumstances of a case, the unequal treatment of one or more members is so related to currency that it constitutes a discriminatory "currency" arrangement.

(5) The word "arrangement" does not mean that only bilateral agreements can be considered discriminatory currency arrangements, even though there is no doubt that the negotiators of the original Articles were opposed to bilateral payments agreements in particular. A bilateral or multilateral agreement may constitute a discriminatory currency arrangement, but even a member's unilateral action may constitute such

an arrangement. Broken cross rates applied by a member are an example of a discriminatory currency arrangement of a unilateral character.

(6) If the Fund finds that a bilateral or multilateral agreement would be a discriminatory currency arrangement, both or all contracting parties must seek the approval of the Fund.

(7) The prohibition of discriminatory currency arrangements and the Fund's jurisdiction over them do not depend on the motive that influences a member to engage in such an arrangement. The prohibition and the Fund's jurisdiction are not limited to situations in which a member's motive is related to the member's present or prospective balance of payments.

(8) A member is entitled to engage in a discriminatory currency arrangement that is confined to capital transfers.

To these propositions of a legal character there should be added the recent affirmation of policy that

(9) The Fund "will continue to be very reluctant" to approve the maintenance of broken cross rates of exchange.[128]

Discrimination Under Treaty of Rome

A case decided by the Court of Justice of the European Communities on October 28, 1980[129] raised the question whether discrimination was being practiced in contravention of the Treaty of Rome. The interest of the case for the present purpose is the suggestion that not every difference in the treatment of currencies should be classified as a discrimination prohibited by the treaty. Furthermore, in order to conclude that a measure is or is not a prohibited discrimination, a careful examination must be made of all relevant facts, and the practical effect of the measure will be decisive.

The issue arose under Article 7 of the Treaty of Rome, which declares that

> [w]ithin the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.

The Articles of the Fund are understood to prohibit the unequal treatment of members of the Fund (see proposition 3 above), while the Treaty of Rome prohibits the unequal treatment of nationals of member states of the Community. The difference is not important in the present discussion, because discrimination against a member under the Articles can take the

form of discrimination against the member's residents. Another parallel between the two treaties is that, in the court's opinion, prohibited discrimination against the nationals of another member state of the Community can be overt or covert. The actual effect and not the formulation of a practice was the test by which to decide whether the practice was discriminatory. In the case before the court, a discrimination formulated in terms of currency was considered a covert discrimination against nationals. The Fund also administers Article VIII, Sections 2 and 3 in relation to all three categories of prohibited measures by considering the effects of a member's practices and not the language of the law or regulations under which the practices are applied. But a law or regulation expressed as a discrimination puts the Fund on notice that a discriminatory currency arrangement may be in force.

The issue in the case arose in circumstances in which a French creditor instituted summary proceedings in a court of the Federal Republic of Germany for a debt denominated in French francs alleged to be owed by a German resident of the Federal Republic. Summary proceedings gave a creditor certain advantages. German law had been changed in 1976 to make the summary proceedings unavailable for the recovery of a debt expressed in foreign currency when owed by a German resident, although the procedure is available if the claim expressed in foreign currency is against a nonresident. This exceptional provision for debts expressed in foreign currency when owed by nonresidents had been made because the Government of the Federal Republic thought that the terms of a convention required this concession. The German court held that the amended law was discriminatory and in violation of Article 7 of the Treaty of Rome.

The Commission argued before the Court of Justice of the Communities that there was no discrimination because creditors, whether resident in the Federal Republic or in other Community countries, were in the same position in relation to debts expressed in German currency or in relation to debts expressed in foreign currency. The Attorney General disagreed with this argument because in practice German creditors were more likely to invoice their claims in German currency while creditors in other Community countries were more likely to invoice their claims in their own national currencies.[130] The probable effect of the 1976 amendment, therefore, was that German creditors would have the benefit of the summary procedure whether the debtors were resident or not resident in

Germany, because the debts owed to them would be denominated in German currency, while foreign creditors would not have the benefit of the procedure because the debts owed to them by German residents would be expressed in the creditor's currency. It was true that debts owed by nonresidents and expressed in foreign currency could be recovered under the summary procedure, but the creditors were not likely to resort to German procedures in such circumstances.

The Court of Justice noted that the 1976 amendment had been adopted to simplify and facilitate computerization, in effect by confining the summary procedure to debts in German currency against residents of the Federal Republic. Provision had been made, however, for the procedure to apply to debts in foreign currency owed by nonresidents, even though the debts were handled manually. It followed, therefore, that the need for computerization could not be considered a decisive justification for excluding from the summary procedure debts expressed in foreign currency against residents of the Federal Republic.

This reaction did not dispose of the issue. The Court of Justice held that the limitation on the availability of the summary procedure was not a prohibited discrimination. Contracting parties are free to select the currency in which debts are denominated, and ordinary legal procedures for the recovery of debts, in contrast to the special procedures, are available under the law of the Federal Republic to creditors resident in other states of the Community whatever is the currency in which debts are expressed.

Some Effects of Variable Exchange Rates

The variability of exchange rates after the disappearance of the par value system has had numerous effects on international and national law. A study has been made of some of the influences of variability on the drafting of new or amended treaties and on the administration of treaties.[131] Units of account are now a common feature not only of treaties but also of contracts entered into by private parties. The law on the tax treatment of foreign exchange gains and losses has been influenced by current conditions, although inadequately according to some experts.[132] Formerly, the law in some jurisdictions rested on the assumption that exchange rates were stable and that traders did not need to take measures to protect themselves against loss, while now exchange rates are floating,

and sophisticated and substantial forward exchange and Eurodollar markets have emerged.[133] The question has been raised of the effect of fluctuations in the exchange value of the U.S. dollar on margins between fair value and the U.S. price of imported goods under antidumping legislation of the United States. One correlation, among others, that has been detected is between the initiation of new investigations of alleged dumping under the legislation and a declining exchange value of the U.S. dollar.[134]

Some new developments that have occurred as a result of the variability of exchange rates will be considered under the following headings:

Units of Account
Judgments in Foreign Currencies
Judgments and the Articles
Accounting for Variable Exchange Rates
Allocation of Exchange Risks
Normal Protection Against Exchange Risks
Adaptations to Variability

Units of Account

The growing use of units of account by official and private entities is a consequence of the instability of the exchange value of currencies.[135] Some developments in the use of the SDR as a unit of account not noted in earlier pamphlets in this series have been discussed under the heading **SDR as Unit of Account** in an earlier section of this pamphlet. The European Currency Unit (ECU) is increasingly important as a unit of account and as a means of payment in capital and money market transactions, even though the second and permanent stage of the European Monetary System (EMS) has been postponed and even though some effort to extend uses of or to improve the ECU proper during the period of postponement has not succeeded.

The delay in the further development of the EMS or the ECU proper has not discouraged various members of the European Community from adapting their law or regulations to promote the use by private entities of the ECU as a unit of account and as a means of payment. In France, for example, the Ministry of Economics and Finance has advised French banks that, with a view to the expansion of their participation in international financial operations denominated in ECUs, the Ministry had

no objection, notwithstanding the rule prohibiting franc loans to nonresidents, to the grant of franc loans by French banks to nonresidents when the loans constituted the franc portion of ECU-denominated loans. Each bank had to ensure that the total of the franc "portions" of ECU-denominated loans it granted to nonresidents under this authorization did not exceed the total of nonresidents' franc deposits appearing in the bank's liabilities. Subsequently, as a further action to facilitate a larger role for French banks in operations denominated in ECUs on the international market, it was decided that these operations would be bracketed, for the purposes of exchange control regulations, with operations in foreign currency. One of the consequences is that banks may manage their assets and liabilities denominated in ECUs under the same conditions as their assets and liabilities in foreign exchange, without having to observe the former special provision with respect to the French franc portion. Another consequence of these official actions is that French banks may grant loans and advances in ECUs to residents on the same terms as loans and advances denominated in foreign currency; and residents may contract loans denominated in ECUs directly with foreign banks on the same terms as loans in foreign currency.

A similar development has occurred in Italy, where measures have been taken to give the ECU equal status with foreign currencies under exchange control regulations.[136] These and other actions to assimilate ECUs to foreign currencies are not matched by comparable actions to promote the use of the SDR as a unit of account within the Community, even though, under the Second Amendment, members of the Fund have undertaken to make the SDR "the principal reserve asset in the international monetary system."[137]

It has been reported that the leading commercial banks involved in ECU transactions are seeking a central bank, or other monetary authority, to carry out clearing operations and to act as lender of last resort. The banks wish to be able to assure depositors who may be interested in making deposits in ECUs that there would be an adequate supply of ECU-denominated assets to satisfy the depositors' claims.[138]

The ECU may be preferred to the SDR by some European entities because the ECU is composed of European currencies only, and because most of the currencies are allowed to fluctuate only within limits consistent with the exchange rate and intervention arrangements of the EMS. Another motive has been the symbolic quality of the ECU as an

achievement of European solidarity. But not all uses of the ECU have been confined to transactions in which all parties were European.

The Fund has prescribed operations in which settlements of financial obligations between members may be made with SDRs (that is to say, SDRs proper) if the obligations are denominated, inter alia, in a unit of account that is composed of currencies and is applied under an intergovernmental agreement.[139] The ECU is a unit of account that meets these criteria. The Fund's Annual Report for 1982 mentions that a transfer of SDRs took place between the central banks of two members of the Fund that participate in the EMS, under the Fund's prescription of settlement obligations. The transfer was in settlement of a financing operation denominated in ECUs that fell due under the operating procedures of the EMS.[140] For the purpose of this and similar settlements, a representative rate for the ECU in terms of the SDR had to be established.

The Protocol on Clearing and Payments annexed to the Treaty for the Establishment of the Preferential Trade Area for Eastern and Southern African States[141] signed at Lusaka on December 21, 1981 provides for the establishment of a Clearing House for the 18 states[142] on behalf of which the proposed treaty has been negotiated. The objective of the Protocol is to facilitate the expansion of trade among these states by establishing, through the medium of the Clearing House, a more effective machinery for the multilateral settlement of payments. The Clearing and Payments Committee, consisting of Governors of the monetary authorities of member states, after consultation with the Council of Ministers, is to establish a unit of account for the activities of the Clearing House. The unit of account is referred to in the Protocol as the "UAPTA" (unit of account of the Preferential Trade Area). Each monetary authority communicates to the Clearing House the official exchange rate of its currency against its intervention or reference currency, and the Clearing House computes the value of each currency in terms of the UAPTA.[143]

The protocol does not define the unit of account, perhaps because two of the potential members (Angola and Mozambique) are not members of the Fund. The UAPTA, however, could be defined by reference to the SDR.[144]

Judgments in Foreign Currencies

Developments in Miliangos doctrine. The floating of sterling has led directly to the doctrine that English courts can give judgments in foreign

currencies, so that justice can be done to plaintiffs with claims that are payable in foreign currencies.[145] Another, although less powerful, influence has been the floating of other major currencies as well. The House of Lords, in *Miliangos v. George Frank (Textiles) Ltd.*,[146] rejected the former doctrine, which had prevailed for centuries, that judgments could be expressed only in sterling. The House of Lords decided also that the appropriate rate of exchange, if settlement of a claim expressed in a foreign currency is made in sterling, is the rate at the date of payment and not when the claim accrued. The decision and the remarkable effects it has had on judgments vindicating claims expressed in currencies other than sterling even though not rooted in contractual indebtedness have been described in earlier pamphlets in this series.[147]

The *Miliangos* case has had further important effects in English law since Pamphlet No. 36 (1981), the preceding issue in this series dealing with legal developments, was published. For example, under the provisions of English law governing attachment, only "debts" could be attached to satisfy a judgment. Until recently, a sum standing to the credit of a creditor in foreign currency was not regarded as a "debt." If the creditor was not paid, his remedy was not to recover a debt but to recover damages for breach of contract. The reason was that foreign currency was regarded as a commodity or other object and a claim to it was no more a debt than a claim to a foreign cow. Only a sum standing to the credit of a creditor in sterling in a current or deposit account could be attached by a procedure called garnishee proceedings.

In *Choice Investments Ltd. v. Jeromnimon (Midland Bank Ltd, garnishee)*,[148] the English Court of Appeal has decided the question whether the *Miliangos* case has modified the older law. The C. Company obtained a judgment expressed in sterling against J. in respect of a debt in sterling and costs. J. had a credit balance in U.S. dollars in a deposit account with a London bank. Withdrawals were subject to seven days' notice. The company obtained a garnishee order nisi against the bank attaching a sufficient amount of the dollar account to satisfy the judgment. An order nisi directs the bank to pay that amount into court or to the judgment creditor within a stated period unless (nisi) there is a sufficient reason for the bank not to comply. The order nisi is an attachment that enjoins the bank from paying the money to its customer, so that the court can decide whether the garnishee order shall be made absolute, unless the debt is discharged in the meantime. The order is made absolute in the

absence of sufficient reason why it should not be. In this case the bank challenged the legality of the garnishee order nisi.

The Court of Appeal held that the dollar account must be considered a debt owed to the customer J. since the *Miliangos* case, because judgment could be given for the account in U.S. dollars as a debt. The procedure that a bank must follow on receiving a garnishee order nisi is to freeze such an amount of dollars as would realize the amount of the sterling judgment at the buying rate of sterling on the day the bank receives the order.[149] The bank makes the purchase of sterling as soon as reasonably practicable after it receives notice that the order has been made absolute. If, at that date, the dollars are more than enough to satisfy the judgment debt at the rate of exchange for purchasing sterling with dollars at that date, the balance is released to the customer on demand. If the amount realized is not sufficient to satisfy the judgment debt, the full amount realized is paid to the judgment creditor.

The Master of the Rolls stated that the principles of the decision would be adaptable to other circumstances. For example, the judgment creditor might have a judgment in Swiss francs and then find that the judgment debtor has a bank account in U.S. dollars. There was no reason why a garnishee order could not be made to attach the account in an amount sufficient to meet the judgment in Swiss francs.[150]

Ozalid Group (Export) Ltd. v. African Continental Bank Ltd.,[151] decided by the Queen's Bench Division (Commercial Court) of the English High Court on February 27, 1979, provides some important clarifications of the *Miliangos* doctrine. Ozalid, an English company, agreed to sell certain machinery and equipment to a Nigerian concern for a price expressed in U.S. dollars. Payment was to be made by irrevocable letter of credit valid for six months and negotiable through a bank based in London. The seller arranged for a letter of credit to be issued by the defendant, a Nigerian bank with a branch in London. In the circumstances of the case, the defendant should have made payment not later than October 5, 1977, but, without legal justification for delay, did not pay until December 12, 1977. Dollars received by the plaintiff were credited to an account, from which, not later than the last working day of each month, an amount of "excess dollars" determined in accordance with English exchange control regulations had to be sold to an authorized bank for sterling. Dollars were sold under this exchange control instruction on November 1, 1977 and on January 3, 1978. The latter sale included

dollars received from the defendant on December 12, 1977. The U.S. dollar was depreciating against sterling in the period that was relevant.

The court concluded that the defendant must have been aware of the facts, and that the plaintiff's loss was foreseeable. The court held, nevertheless, that it may not have been foreseeable that Ozalid would have delayed sale of the dollars until the latest date for sale, the end of the month of receipt. It was appropriate, therefore, for Ozalid to base its claim on notional sales on October 5, 1977, when the defendant should have paid, and December 12, 1977, when it did pay. The plaintiff was entitled to an amount of sterling that represented the change in the exchange rate between the U.S. dollar and sterling between October 5 and December 12, 1977.

The court noted that because of the *Miliangos* case, which had "revolutionized"[152] the law on claims involving foreign currencies, a plaintiff is entitled to make its claim in foreign currency in circumstances covered by the *Miliangos* doctrine. But the doctrine did not require a plaintiff to make its claim in foreign currency:

> The overriding reason for changing the law was to provide a procedure which would enable the Courts to compensate the claimant in full for the wrong which he had suffered. A change which *required* the plaintiff to claim in foreign currency and to accept sterling at the rate prevailing at the date of judgment could in some circumstances work as great an injustice as the old procedure requiring him to claim in sterling and to adopt the date of breach rate of exchange.[153]

Nevertheless, the court continued, a plaintiff does not have a free choice. In the circumstances of the *Miliangos* case, only a judgment in Swiss francs could compensate the plaintiff. Later cases[154] have decided that it is for the plaintiff to select the currency in which to make his claim and for the plaintiff to prove that an award or judgment in that currency will most truly represent his loss and most fully and exactly compensate him for that loss.[155] The currency of account is a factor of considerable importance but not decisive. (In this case, however, the dollar was both the currency of account and the currency of payment.)

Although the dollar had this double function, the plaintiff's loss was incurred in sterling, and this fact was reasonably foreseeable by the defendant.

> In the light of the foreign exchange regulations of this country, the value of foreign currency to an English company engaged in the export trade must be the amount of sterling which that currency will buy.[156]

It was irrelevant that the plaintiff had accepted the risk of the depreciation of the dollar between the date of the contract and the due date for payment, because the risk was accepted for that period only. The plaintiff's claim was admissible even though the defendant had paid the full dollar amount called for by the contract before the writ making the claim was issued. That payment had to be credited at the rate of exchange on the date of actual payment against the sterling amount that would have been realized on the due date.[157]

The *Ozalid* case makes it clear that the issue between the parties in some circumstances may be the currency in which the plaintiff's loss really was suffered. The pre-*Miliangos* principle of judgment in sterling only was not subject to this uncertainty. The *Miliangos* doctrine is regarded as one that substitutes greater equity for certainty, but some commentators question whether the *Miliangos* doctrine does always produce greater equity.[158]

Another reflection prompted by the *Ozalid* case is that the law sometimes attaches importance to reasonable foreseeability by the parties that the fluctuation of exchange rates may produce loss. Why should there ever be doubt that it is reasonable to foresee that, in present conditions, exchange rates may fluctuate and produce loss for a party? It may have been defensible in the days of the par value system to require a party alleging the reasonable foreseeability of changes in par values, or alleging that a member of the Fund might resort to floating in violation of its obligations under the Articles, to offer proof of foreseeability, but it would be defensible now to assume that exchange rates will fluctuate. The one exception to this assumption might be the case in which the foreign currency in which a claim is expressed is pegged to sterling and pegged, moreover, within narrow margins. In those circumstances, the exchange rate that would be relevant in the proceedings would fluctuate only within the margins. This possible exception is of negligible practical importance if the facts as they stood at mid-1982 persist, because only one currency was pegged to sterling at that time.[159] If the United Kingdom were to join the exchange rate and intervention arrangements of the European Monetary System, further exceptions might be recognized for exchange rates between sterling and the currencies of other members of the European Community that subscribed to these arrangements. But the changes that have occurred in the definition of currencies in terms of the

ECU might deter the recognition, on the basis of the EMS, of exceptions to a presumption in favor of fluctuation.

The English Law Commission,[160] in collaboration with the Scottish Law Commission, in mid-1981 issued, for comment and criticism, its Working Paper No. 80, *Private International Law: Foreign Money Liabilities.*[161] The paper is a detailed and systematic survey and reappraisal of both law and procedure in the whole field of foreign money liabilities. The Commission has reached the provisional conclusion that, in view of the body of decisions that has developed in recent years, legislation is not necessary, at least for the time being, even to deal with aspects that have not yet been determined or with the few relatively minor matters that the Commission thinks have not yet been settled entirely satisfactorily.

The Law Commission endorses both elements of the *Miliangos* doctrine, namely, that the courts can express judgments in a foreign currency when appropriate and that the rate of exchange between sterling and the foreign currency is the one prevailing at the time of payment, which, in the case of execution of a judgment ordered by the court, is, for practical reasons, the date on which the court makes that order. It is interesting to note that, although the floating of currencies, in the sense that they are not maintained in value on the basis of a common denominator, has been the event that brought about the *Miliangos* doctrine, an intimation of the desirability of change was expressed in a dissenting opinion by Lord Denning as early as 1969.[162] The par value system was still in force and effect, but Lord Denning, then Master of the Rolls, was inspired to express his view as a result of the devaluation of sterling.

The provisional conclusions of the Law Commission on the major issues of policy it considered are reproduced in Appendix E.[163]

The leading English scholars on the *Miliangos* doctrine and developments based on it have expressed their doubts about the present state of the law when compared with the law before the *Miliangos* doctrine emerged. Their minor argument is that defendants may be induced to speed up or delay settlements on the basis of their forecasts of exchange rate fluctuations. Their major argument is that the new rules provide less certainty than the old rules, especially in the judicial determination of the currency of judgments, and therefore make parties more uncertain about the terms that they should negotiate or the means of protection against risk

that they should employ.[164] The absence of explicit agreement allocating the risk of fluctuations in exchange rates—which agreement the *Miliangos* doctrine permits—can inflict serious loss on a party.[165]

Miliangos doctrine in other jurisdictions. The effect of the *Miliangos* case in some other jurisdictions was examined in Pamphlet No. 33 (1980).[166] The case is more likely to produce effects in the many jurisdictions in which traditionally English decisions have persuasive influence. These effects may be produced even if the statute law of such a jurisdiction prevents the application of the *Miliangos* doctrine itself.

In Canada, the expression of judgments in a foreign currency is impeded by section 11 of the Currency and Exchange Act:[167]

> All public accounts throughout Canada shall be kept in the currency of Canada; and any statement as to money or money value in any indictment or legal proceeding shall be stated in the currency of Canada.

It has been explained that the rationale of the provision in relation to judgments is that all judgments must be susceptible of execution,[168] although it has been pointed out that there are other justifications for the provision.[169] The sheriff's officers would have difficulty in attempting to execute a judgment expressed in a foreign currency. But an Ontario court, in *Batavia Times Publishing Co. v. Davis*,[170] has said that, were it not for the statutory provision,

> I do not believe that similar problems would arise if a judgment of this Court could be expressed in terms which included a specified sum of foreign currency and provision for the payment of an equivalent amount of Canadian dollars.[171]

The *dictum* quoted above shows sympathy for the *Miliangos* solution even though it was not available for the expression of judgments. The *Miliangos* case, however, has exercised influence on other legal problems in jurisdictions other than England. In the *Batavia Times* case the plaintiff sought enforcement in Ontario of a judgment originally obtained in Pennsylvania and expressed in U.S. dollars. The issue was the date as of which the rate of exchange was to be chosen for translating the U.S. dollars into Canadian dollars.

> Having regard to the economic climate of fluctuating currencies which I know has existed for some time the choice can be very significant to the parties.[172]

The court concluded that the law on the choice of the rate of exchange was judge-made, and that Canadian courts had followed English case-law.

Earlier English cases had applied the rate of exchange at the date of the original judgment. The court thought, however, that it should consider more recent developments in England when proceedings in Canada were based on the original cause of action. The English rule for over three centuries had been that in an action for damages the rate of exchange at the date of a breach of contract or the commission of a tort was the rate to be chosen. This rule had been applied to a debt due in a foreign currency. The *Miliangos* case, however, had "opted for a more realistic approach to modern economic conditions"[173] and had changed the law because fluctuations in exchange rates were normal now and not the exception. In present conditions, fluctuations occurred between the date of breach and the date of judgment as well.

Canadian courts had applied the "breach-day" rule, but that rule had been based on English cases now overruled by the *Miliangos* case. No Canadian case had been cited applying the breach-day rule to actions to enforce foreign judgments. In the absence of such a decision, the court considered itself free to follow the new trend in England. English courts, it was assumed, would probably apply the *Miliangos* doctrine, insofar as it dealt with the choice of exchange rates, to actions to enforce foreign judgments.[174]

The Ontario court considered itself unable to apply the rate of exchange as of the date of payment, because that rate could not be known when judgment was given, and there was no machinery for enforcing it.[175]

> If I could be satisfied that there are no procedural or practical problems and that the *Currency and Exchange Act* either did not apply to judgments or did not prevent a judgment being given for a sum of foreign currency and its equivalent in Canadian dollars, as the English Courts are now doing, I would adopt the effective date of payment as being the date for determining the rate of exchange. Because I am not certain that there are no problems and because I assume that the *Currency and Exchange Act* does not permit judgments to be given as they are now being given in England, I will use the rate of exchange as prevailing at the date of the second judgment herein, the date of my judgment, December 21, 1977, in determining the amount which the defendant here owes to the plaintiff. As I have said above if the parties cannot agree upon what the rate of exchange was on December 21, 1977, I will accept on behalf of the plaintiff a statement of any chartered bank of Canada signed by an officer or manager thereof which sets out the rate of exchange on that date.[176]

In a later case, *Am-Pac Forest Products Inc. v. Phoenix Doors Ltd. et al.*, decided by the Supreme Court of British Columbia on July 12,

1979,[177] damages were claimed for breach of a contract that provided for payment in U.S. dollars. An issue in the case was the date as of which to choose the rate of exchange for translating the U.S. dollar amount into Canadian currency. "In this era of constantly fluctuating exchange rates, this can be a matter of some import."[178] In this case, the Canadian dollar had depreciated substantially against the U.S. dollar between the date when the debt became payable and the date when the case began to be heard.

The court spoke of English law as now conforming to "commercial realities" and referred to the *Batavia Times* case as "a step in the same healthy direction."[179] The British Columbia court, however, distinguished the Ontario decision as one that dealt with the enforcement of a foreign judgment, and held that decisions of the Canadian Supreme Court required application of the breach-day rule in the case before the British Columbia court.

The decision of the Quebec Superior Court (in Bankruptcy) in *Re Canadian Vinyl Industries Inc.*,[180] on April 7, 1978, preceded the decision in the *Batavia Times* case. A creditor, resident in the Federal Republic of Germany, claimed an amount under contracts with a Canadian debtor expressed in deutsche mark in the bankruptcy proceedings of the debtor. The creditor based its claim on the rate of exchange at the date of submission of its proof of claim in the proceedings and reserved the right to adjust the rate when at later dates dividends were paid by the trustee in bankruptcy.

The court held that under the Bankruptcy Act[181] the claims of creditors are to be determined at the time the trustee files with the official receiver the insolvent person's proposal for a compromise with creditors, if the proposal is accepted by the creditors and ratified by the court. This date is relevant for all other purposes under the Act. The court held that the date should apply for determining the rate of exchange also unless there was a compelling reason to depart from it. The court considered this solution equitable because the proposal, if made effective, was a new contract that operated as a novation of the contracts under which claims arose. Under the new contract, dividends were payable at fixed dates, and the creditor could enter into a forward contract for sale, at the rate of exchange at the date of entry into the contract, of the Canadian dollars the creditor would receive from the trustee.

The court was pleased that the Bankruptcy Act relieved the court of the necessity to involve itself with English decisions, in view of the "instability"[182] that resulted from the decision by the House of Lords in the *Miliangos* case to overrule its own earlier decision of 1961.[183]

> Thus a reason, persuasive to me, for applying to its fullest extent—albeit in a somewhat arbitrary and artificial manner—the clear and unambiguous rule set forth in the terms of the above-quoted ss. 42(1) and 95(4) of the Canadian Bankruptcy Act, is the sheer hopelessness of attempting to follow and to apply, on a continuing and current basis, the leading decisions in the law of foreign currency obligations of the highest courts of England (where the bulk of our bankruptcy law comes from, but not thank goodness, ss. 42(1) and 95(4), which are of pure Canadian inspiration).[184]

This rejection of English case-law is too energetic in view of *Re Dynamics Corporation of America*,[185] decided by the Chancery Division of the English High Court in 1975 but not mentioned in *Re Canadian Vinyl Industries Inc.* An English court had ordered the liquidation in England of a corporation incorporated in the State of New York for which a scheme of arrangement had been approved in New York under the Federal Bankruptcy Code of the United States. For the purposes of a scheme of arrangement for the distribution of assets in England, the English court was asked at what rate of exchange the claims denominated in U.S. dollars of creditors outside the United Kingdom should be translated into sterling. "The wind of change," the court declared, "bloweth where it listeth,"[186] and the *Miliangos* case had opened up the theoretical possibility, in bankruptcy or liquidation proceedings, of choosing the rate of exchange on a date not selected in the past. In such proceedings, the principle is that liabilities have to be reduced to a single unit of account as of the same date so as to enable a pari passu distribution of available assets to be made to all claimants. The single unit of account in English proceedings can be nothing but sterling. The exchange rate must be the one at the date on which the bankruptcy or winding up is ordered by the court and not on any other of a number of conceivable dates, such as the dates when claims arose or proofs of claims were admitted.

The court rejected the argument that, on the basis of the *Miliangos* doctrine, the sterling value of dollar claims should be readjusted when dividends were paid. Even if the monetary value of a claim is

unquantified, the creditor must estimate its sterling value when, before the order is made, he submits his proof. Later events, such as changes in exchange rates, cannot be taken into account, even though, when sterling is depreciating, creditors would reap maximum advantage if the exchange rate at the latest conceivable date, which would be when dividends were paid, were feasible.[187]

The principle of the *Dynamics Corporation* case was confirmed by the English Court of Appeal on February 11, 1982 in *Re Lines Bros. Ltd.*[188] The principle was the same in both cases even though in the earlier case the winding up was compulsory while in the later case it was voluntary.

In the later case, a bank had lent an English company an amount of Swiss francs, which were repayable in the same currency on November 5, 1971. Voluntary liquidation was deemed to have begun on September 28, 1971. The liquidators paid dividends in sterling to the creditors whose claims were in currencies other than sterling at the rate of exchange prevailing on September 28, 1971.[189] Sterling began to depreciate against the Swiss franc after that date. All creditors, whether their claims were to payment in sterling or in another currency, were paid in full on the basis of the exchange rates on that date. A substantial amount of assets remained after this distribution, and the liquidators proposed to distribute the residue in partial satisfaction of claims to interest that had accrued after September 28, 1971. The bank protested, arguing that, on the basis of the rates of exchange when dividends had been paid, it had lost more than 40 percent of its claim, while the creditors with sterling claims had received 100 percent of their claims. A creditor with a claim in deutsche mark had received about the same return as the bank with its claim in Swiss francs, but a creditor with a claim in Italian lire had received more or less the whole of its claim because the lira had depreciated at about the same rate as sterling against the Swiss franc and the deutsche mark.

The bank argued that the liquidators should have paid the dividends to it either in Swiss francs or in an amount of sterling equivalent to the value of the proportion of the debt in Swiss francs that was being paid. The amount of sterling should have been calculated at the rate of exchange on the date of payment. If, for example, a dividend represented 10 percent of total claims, the bank was entitled to 10 percent of the total loan of SF 18.5 million, calculated at the rate of exchange on the date of payment of the 10 percent. The bank relied on the *Miliangos* doctrine to support this argument. The Court of Appeal rejected the bank's contention, because, if

accepted, it would destroy the certainty about the distribution of assets that the liquidators' practice ensured for all creditors.

One member of the Court of Appeal described liquidation as a "collective enforcement procedure."[190] A winding-up order (or its equivalent in a voluntary liquidation) was compararable to an order by the court authorizing execution of a judgment expressed in a foreign currency. The amount of the judgment had to be translated into sterling at the rate of exchange on the date of the court's order. The judgment creditor was not able to propose the rate of exchange as of a later date, and the creditors were in the same position after the winding-up order had been made in a liquidation.[191]

The *Dynamics Corporation* and *Lines* cases do not resile from the proposition that under the *Miliangos* doctrine a creditor whose claim is to foreign currency is entitled to that currency and not to the sterling equivalent. The practical necessities of liquidation require the solution that has been adopted in these cases, in the same way that a judgment expressed in foreign currency can be enforced in England only if the currency is translated into sterling when the court authorizes enforcement.

The *Miliangos* doctrine, it has been seen, has had some influence in Canada in enabling one court to conclude that the breach-day rule does not apply to judgments to enforce foreign judgments, although the court chose the rate of exchange at the date of the second judgment and not the rate at the date of payment. In the other Canadian cases that have been discussed, the courts have decided that the breach-day rule still applies to judgments for damages for breach of contract and that a special rule applies to claims in bankruptcy. In one of these other cases the court was vehemently critical of the *Miliangos* doctrine, although on similar facts English courts have reached the same result as in the Canadian case notwithstanding the *Miliangos* doctrine. One author who has examined Canadian jurisprudence has written that apart from a few exceptions

> ...Canadian law is currently governed by the principles which prevailed in England before the legal reform initiated by the *Miliangos* decision. Nevertheless, it is not to be excluded that these principles may be dropped in the near future. The unfair and anachronistic nature of the *breach-date rule* has caused a reaction in some legal quarters which now refuse to support it. The trend emerged among the judiciary in Ontario who recently have questioned its validity. Their decision met with a response that seems to be gaining increasing support. *(Translation)*[192]

The same author believes, "[w]ithout expressing too much optimism," that the *Batavia Times* case "may be regarded as the beginning of a serious attack on the exclusive application of the breach-date rule."[193] He cites other Canadian decisions that have followed the *Batavia Times* case in applying the rate as of the date of judgment, although not as of the date of payment. Not all the decisions he cites have involved the enforcement of foreign judgments. Nor have the decisions been confined to Ontario courts.[194]

The Law Reform Commission of British Columbia is of the opinion that the Canadian Federal authorities should amend Article 11 of the Currency and Exchange Act. In view of the slowness and complexity of such a procedure, the Commission would prefer a bolder solution. It has suggested that provincial laws should make it mandatory for courts to apply the rate of exchange at the date of payment.[195]

Isaac Naylor & Sons Ltd v. New Zealand Co-operative Wool Marketing Association Ltd,[196] decided by the New Zealand Court of Appeal on August 14, 1981, is an example drawn from New Zealand jurisprudence of the effects of the *Miliangos* case in other jurisdictions, even though the courts of those jurisdictions consider themselves unable to express judgments in a foreign currency. The litigation concerned five contracts under which Naylor, an English company, purchased wool from the Co-operative, comprised of New Zealand wool farmers. The wool was to be delivered in the last two quarters of 1974 on shipping instructions given in due time by Naylor. The prices were expressed in sterling. Payment was to be made in cash against documents on arrival of the wool. The practice of the Co-operative, which was known to Naylor, was to have sterling payments converted forthwith into New Zealand currency and remitted to New Zealand. Shipments were delayed until June 1975 at the request of Naylor, subject to reservation by the Co-operative of its rights resulting from the delay. Payments were made at the contract price, but the Co-operative claimed that the delay had caused them various losses, including loss occasioned by the depreciation of sterling against the currency of New Zealand, for all of which the Co-operative claimed damages.

Naylor argued that recovery for exchange losses was ruled out by the principle of nominalism. A debt expressed and payable in a particular currency may be discharged by late payment of the same number of units of the currency as is called for by the contract even if that currency has depreciated during the period of delay. The court pointed out that this

principle did not apply to the present case, which was one not of delay in payment after shipment but of Naylor's delay in giving shipping instructions.

All three members of the court agreed that the principle of nominalism did not apply in this case. One member of the court expressed the opinion that if there had been no international element in the case the principle of nominalism probably would have applied and probably would have prevented the recovery of damages claimed because of depreciation of the New Zealand dollar. The *Miliangos* case, he said, dealt not with the principle of nominalism but with another doctrine, which perhaps had an affinity with nominalism in reflecting the former judicial reluctance to allow changes in the value of money to be taken into account. The principle in issue in the *Miliangos* and later cases was whether English courts could give judgments only in sterling at the rate of exchange on the date of a breach of contract or the commission of a tort when liability had to be measured in a foreign currency. "The achievement of the House of Lords in those cases was to abolish that doctrine in favour of more realistic solutions."[197]

Judgment could be given only in New Zealand currency, but the *Miliangos* line of cases gives

> ...some encouragement for the approach that in contracts made in international trade and resulting in the exchange of currency by one party, there is no special rule against the recovery of exchange losses. On this approach such losses will be recoverable if the criteria ordinarily applied in damages cases in contract are satisfied. As is well known the most important of these is usually foreseeability.[198]

The court held that the loss sustained by reason of the depreciation of sterling against the New Zealand dollar between the latest dates when payments could have been made had shipping instructions been given in accordance with the contracts and the actual dates of payment was foreseeable and therefore not too remote. Judgment was given for that loss. The court regarded the case as one of first impression on this point. The principle of the case on the remoteness of damage is that in current conditions contracting parties, at least if they are experienced traders, must be taken to foresee that exchange rates may fluctuate and that loss attributable to fluctuation may be the result of failure to perform contractual obligations on time. The recovery of damages for this loss in

some circumstances may put a creditor in a position similar to the one that would result from the *Miliangos* doctrine, even though the court can express judgments only in its domestic currency. The effect of forward exchange contracts on the quantum of damages in the case is discussed in a later section of this pamphlet.

The New Zealand case resembles the English *Ozalid* case in the emphasis placed on the reasonable foreseeability of an exchange loss as a specific loss that was suffered because of the delayed payment of currency, foreign to the forum, in which the contract called for payment. In both cases, the defendant had foreseen, or should reasonably have foreseen, that the plaintiff would have exchanged the currency of payment for the currency of the forum. Foreseeability was emphasized because of the rules of both English and New Zealand law relating to damages for breach of contract. The specific character of the loss was emphasized because of difficulties in those systems relating to the recovery of damages for delayed payment of a debt.[199]

Judgments and interest. Pamphlet No. 33 (1980) discussed the conflicting views of English judges on the choice of the appropriate rate of interest on judgments expressed in foreign currencies in cases in which English courts have discretionary authority to grant interest.[200] The English Law Commission has provisionally endorsed the economic argument that there must be consistency between the currency of a judgment and the rate of interest awarded by the court. The inverse relationship that exists between the interest rate in a country and the strength of the external value of the country's currency should be recognized when courts award interest.[201] The Commission's endorsement favors the decision adopted in *Miliangos v. George Frank (Textiles) Ltd. (No. 2).*[202] There is some evidence, however, that the inverse relationship is not inevitable. Economists have been puzzled by the relationship between the exchange rates and the interest rates of some currencies during certain periods.

The authors of a paper submitted to the Law Commission have demonstrated that under certain assumptions foreign creditors would have derived greater benefit if they had pursued claims in sterling from time to time in English courts instead of formulating their claims in a non-sterling currency. The demonstration rests on the assumption that the courts would have awarded the interest rate on sterling.[203] The authors recommend that

plaintiffs should take into account the currency in which interest will be awarded when considering the currency in which to formulate their claims.

These same authors have criticized the *Ozalid* case as one in which the plaintiff received double compensation. Special damages in sterling were awarded to the plaintiff as compensation for the fluctuation in the exchange rate of sterling, the currency in which loss was suffered as the result of delayed payment of a debt expressed in U.S. dollars. The award of interest on the sterling equivalent of the dollar debt for the period of delay was compensation for the same loss.[204] Courts should apply an economic analysis to ensure that the currency of judgment, the rate of exchange for translating a foreign currency, and the award of interest do not result in the overcompensation of plaintiffs.

Judgments and the Articles

Rates of exchange. The Articles do not dictate the date as of which an exchange rate must be chosen in proceedings in the courts of members. In particular, the Articles do not direct that the courts must apply the exchange rate as of the date of breach or the date of payment. If the courts follow the "breach-date" principle, a difference between the exchange rate as of the date of breach and the exchange rate prevailing at the date of payment does not constitute a multiple currency practice. The translation of a foreign currency into the currency of the forum is not an exchange transaction. Multiple currency practices involve exchange transactions, that is, the exchange of one currency for another.

The courts are not fettered by the Articles in their choice of the date as of which an exchange rate is applied, but must the exchange rate of a member's currency as of the date they choose be consistent with the member's obligations under the Articles? A contract may provide for payment in the currency of the forum at the market rate of exchange between that currency and a foreign currency, or at one of various rates of exchange, but the contractual rate may be inconsistent with the issuing member's obligations under the Articles. The Fund may have decided that the exchange rate is inconsistent with the member's obligations under Article IV, or the rate may result from a multiple currency practice that is not authorized by the Articles or approved by the Fund. The question of the appropriate exchange rate may arise when the contract does not

prescribe a rate of exchange. For example, a contract provides for payment in a foreign currency. The forum finds it necessary to select an exchange rate either because the forum cannot give judgment in a foreign currency, or because it can do so, has given judgment in a foreign currency, and is then called on to enforce the judgment, which it can decree only in the domestic currency.

The rate of exchange to be selected by the court should not be affected by the consistency of exchange rates with the issuer's obligations under the Articles. Justice can be done between the parties only by applying the exchange rate that is appropriate in the circumstances of the case, whether or not that rate is consistent with the issuer's obligations. Normally, the appropriate rate of exchange will be one that prevails in the market. The issue of the legality of a member's exchange arrangements or the exchange rates for its currency arises, and is to be settled, between the member and the Fund.

A comparable issue of the choice of exchange rate arose in England in the case of *Lively Ltd. and Another v. City of Munich*,[205] although on facts that are not typical. Sterling was payable by reference to the exchange rate between that currency and the U.S. dollar on December 1, 1973 in accordance with the terms of the London Agreement of September 1953 on German External Debts. Under the Agreement, the rates were to be determined by "the par values of the currencies concerned in force on the appropriate date as agreed" with the Fund. On the appropriate date in the case, both sterling and the U.S. dollar were floating. The par values of both currencies were still in existence according to the law of the Fund, and market rates were inconsistent with the Articles. The court held, on the following principle, that market rates had to be applied:

> In an issue concerning the applicable rate of exchange between a debtor and creditor under a bond which incorporates art 13 it is in my judgment essential to construe this article in a commercially realistic sense. The present issue is concerned with a rate of exchange applicable to a commercial transaction; it is not concerned with treaty obligations by governments to the IMF or inter se. It does not follow from the fact that par values continued to be used for certain purposes in the latter field that they were "in force" for the purpose of construing these words when art 13(a) is incorporated into a bond. In that context, par values are in my view no longer in force when margins are no longer being maintained in relation to the currencies in question. The fact that par values continue to exist does not necessarily mean that they remain in force.[206]

The facts have been referred to as untypical for the purposes of the present discussion because they involved the interpretation of the London Debt Agreement, and the decision rested on the words "in force" in that Agreement.[297] But the court clearly held that the legality under the Articles of market exchange rates was irrelevant when commercial transactions were involved.

The *Miliangos* case is not a clearer indication of the judicial reaction to exchange rates that are incompatible with the Articles, even though the case involved the choice of a rate of exchange as of a date when the currencies of members were floating inconsistently with the Articles. The Second Amendment had not yet become effective, and par values were still in existence under the law of the Fund. The rate of exchange in the *Miliangos* case was between sterling and the Swiss franc. Switzerland was not a member of the Fund, so that a parity between the two currencies did not exist under the Articles. There is no suggestion, however, in any of the later cases involving exchange rates between the currencies of members that the legality of exchange rates under the Articles must be taken into account when a court selects a rate of exchange.

Only two exceptions might be recognized to the principle that courts adjudicating on the claims of private parties should not take into account the legality of exchange rates under the Articles. One possible exception would be the case in which legality under the Articles is required by the law of the forum as a condition for the recognition of an exchange rate. The exception is no more than possible because there may be no such case. If there were such a case, a court might be faced with the problem that there was no actual rate of exchange that was legal under the Articles. A plaintiff's valid claim should not be unenforceable for this reason. The *Lively* case shows how strongly courts may react against the application of a rate of exchange that is fabricated by some arithmetic exercise but was not in effect on a relevant date.

The other exception involves Article VIII, Section 2(*b*), and is discussed below under the heading *Restrictions*. This exceptional case is more likely to occur.

Restrictions. The Articles, though neutral on the question of the date as of which courts choose an exchange rate, can have an effect on a contracting party's claim to currency foreign to the forum. Suppose that X, a resident of England sues in England to recover U.S. dollars to which he is entitled under a contract with Z, a resident of Patria, a member of the

Fund. The contract is considered by the English courts to be an "exchange contract" within the meaning of the first sentence of Article VIII, Section 2(*b*) of the Articles.[208] Patria has adopted an exchange control regulation forbidding its residents to make payments in U.S. dollars to nonresidents. This restriction is authorized by the Articles or has been approved by the Fund. An English court should declare the contract unenforceable under Artixle VIII, Section 2(*b*). The result would not be an exception to the *Miliangos* doctrine. The result would be dictated by Article VIII, Section 2(*b*).[209] The court should award neither dollars nor sterling.

The provision would apply not because the United Kingdom objects in its own interests to a judgment in dollars on the facts as supposed, but because of the interests of Patria in the choice of currencies of payment made by its residents. Article VIII, Section 2(*b*) imposes an obligation on the United Kingdom to collaborate with Patria in these circumstances.

The section *Rates of Exchange*, above, concludes with the comment that an exception to the neutrality of the Articles on the validity of exchange rates selected by courts can occur as the result of Article VIII, Section 2(*b*). Patria's exchange control regulations may forbid its residents to enter into exchange contracts at other than official rates of exchange.[210] If the exchange control regulations are maintained or imposed consistently with the Articles, courts in the territories of other members must refrain from enforcing exchange contracts if they provide for exchange rates that are not official. At first sight, a case of this kind would involve the question of consistency with the Articles of exchange control regulations and not exchange rates. It is unlikely, however, that a member's exchange control regulations could be considered to be "maintained or imposed consistently with the Articles" if the regulations prescribed that residents were to enter into exchange contracts at specified exchange rates that were not consistent with the Articles.

The obligation to give effect to Patria's law by declaring a contract unenforceable does not invalidate the conclusion of the English Law Commission that the *Miliangos* doctrine is a principle of procedure and not one of substance, so that, if Article VIII, Section 2(*b*) is not involved, foreign law cannot interfere with the application of the *Miliangos* doctrine by an English court.[211]

It must not be thought that the Articles require members to apply—or to reject—the *Miliangos* doctrine. Members have freedom of choice in

relation to this practice. The Articles recognize that international trade is carried on in relatively few currencies.[212] For example, members are required by Article VIII, Section 2(*a*) to obtain the Fund's approval of restrictions on the *making* of payments and transfers for current international transactions. The provision does not extend to restrictions under a member's regulations on the currencies that the member's residents may receive in international payments to them. A member is free to prescribe the currencies that its residents may contract to receive in payments to them, provided that its prescriptions are not discriminatory.[213]

The absence of a multilateral treaty on the *Miliangos* doctrine or on some other solution of the problems to which it is addressed may tend to encourage "forum shopping." The European Convention on Foreign Money Liabilities, which was proposed by the Council of Europe in 1967 but which has not become effective, would have dealt with the problem among contracting parties.[214] The absence of international agreement may also encourage parties to adopt contractual terms entitling a payee to recover, in jurisdictions in which the *Miliangos* doctrine does not apply, a head of damages equivalent to the decline in the exchange rate of the currency of the forum against the contractual currency of payment between the date of judgment and the date of discharge of the judgment debt.[215]

Accounting for Variable Exchange Rates

The observance or nonobservance of recognized accounting practices can produce various legal consequences. The fluctuation of exchange rates has intensified problems of accounting when currencies foreign to the accounting entity are involved. The Financial Accounting Standards Board of the U.S. Financial Accounting Foundation has replaced Financial Accounting Standards Board (FASB) Statement No. 8 (*Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements*)[216] with FASB Statement No. 52 (*Foreign Currency Translation*).[217] The later Statement was published in December 1981 and is to be effective for fiscal years beginning on or after December 15, 1981, although enterprises may decide to follow its recommendations at an earlier date.

The approach of FASB Statement No. 8 was that foreign nonmonetary assets, such as inventories and property, plant, and equipment, should be translated into U.S. dollars at exchange rates prevailing when they were

purchased. Monetary assets and liabilities in foreign currency, such as cash receivables, payables, and debt, were to be translated at current exchange rates. Therefore, if a foreign company's total monetary assets were not equal to its total monetary liabilities, a "gain" or "loss" would occur on a change in exchange rates. According to FASB Statement No. 8, the "gain" or "loss" went into income statements, with frequent effects on them because of variations in exchange rates. Fluctuations in earnings had to be reported even when underlying foreign operations were stable. Many multinational businesses undertook uneconomic practices to reduce their exposure as a result of this form of accounting.

FASB Statement No. 8 was the subject of much criticism. FASB Statement No. 52 recommends, among other changes, that in most cases all assets and liabilities in foreign currency financial statements should be translated at current exchange rates, and that the adjustments produced by these translations should be recorded directly in a separate translation adjustment account in stockholders' equity and not in income. For revenues, expenses, gains, and losses shown in financial statements, the exchange rate at the date when these elements are recongized should be used. Translation at numerous dates might be required by this recommendation and therefore an appropriately weighted average exchange rate for the accounting period may be used. Foreign currency transactions, that is, transactions denominated in a currency other than the accounting entity's functional currency, may produce receivables or payables in a fixed amount of the foreign currency. A change in exchange rate between the functional currency and the foreign currency affects the expected cash flow in the functional currency when the translation is settled. The change is regarded as a gain or loss that normally should be included in determining net income for the period in which the exchange rate changes. Similar accounting should be observed for gains or losses realized on settlement.[218]

Efforts have been made to harmonize the standards recommended by accounting institutes in a number of countries. These institutes influence the standards recommended in other countries.[219]

Accounting at current exchange rates may not be the most convenient technique in all circumstances. The Deutsche Bundesbank, for example, has found that its former procedure has shown changes in its reserves in terms of deutsche mark that have not resulted from any deliberate change of policy. The annual balance sheet has valued the Bundesbank's external

position at the end of the year in accordance with the Bundesbank's obligation to enter its assets at the lowest value shown by various permitted methods of valuation. For example, the balance sheet for 1980 showed dollar holdings at about DM 1.73 = US$1. During the whole of 1981, however, the dollar was continuously well above that rate, reaching a peak in August of DM 2.57 = US$1. The Bank's weekly statements of account were based on the amounts of deutsche mark received or paid on sales or purchases of dollars. During 1981, the Bundesbank made frequent sales of dollars in order to smooth out fluctuations in exchange rates. These sales were shown in the weekly statements as deductions, at the rate at which sales were made, from dollar assets valued on the basis of the principle of lowest value as recorded in the balance sheet for 1980. The effect was to overstate the decline in the value of dollar holdings. When the balance sheet for 1981 was prepared, the principle of the lowest value was followed again, and showed, therefore, a discrepancy on comparison with the last weekly statement. As from the beginning of January 1982, purchases and sales of dollars in the foreign exchange market are not accounted at current exchange rates. The deutsche mark equivalent of changes in dollar holdings in 1982 is calculated at the constant exchange rate on which the annual balance sheet for 1981 is based. Any differences between that exchange rate and current exchange rates are shown in the weekly statements under the heading of "Other liabilities."[220]

Allocation of Exchange Risks

The variability of exchange rates creates problems of the equitable allocation of the advantages and disadvantages that result from changes. Two situations can be distinguished. One situation involves parties to a single transaction. An advantage for one party must represent a disadvantage for the other. The problem is the allocation of the advantage and the correlative disadvantage between the two parties. In the other situation, the parties involved are not parties to a transaction they have entered into with each other, but each is a party to a transaction with a common entity. The parties may have entered into these transactions as part of a common design in which they have joined or there may be no such association among them. The situation is deemed to be one that calls for equal or pari passu treatment of the parties by or on behalf of the common entity. It is not an inherent element in situations of this kind that one party must have an advantage over another party or other parties, and that they must have a

correlative disadvantage. Although the situations are different, the solutions adopted for the allocation of advantages and disadvantages in both situations are designed to give effect to equitable considerations as recognized by the authorities empowered to find a solution.

The *Miliangos* doctrine is meant to provide a solution for circumstances that are an example of the first kind of situation. A choice is made among possible exchange rates in allocating risk between delinquent debtor and aggrieved creditor or between tortfeasor and victim when the creditor or the victim seeks a remedy. The decisions in bankruptcy or liquidation that have been discussed deal with a situation of the second kind. Each creditor has a claim against a common entity, and the problem is to do justice to all creditors. *Re Lines Bros. Ltd.*[221] shows that the circumstances of a case may call also for a determination of what justice requires in a contest between creditors and shareholders. A company's assets may be more than sufficient to pay all creditors on the basis of a particular rate of exchange. The remaining assets may then be claimed by shareholders, but the creditors may seek adjustment of the exchange rate that was the basis for payment to them if that rate was less favorable than the rates of exchange on the dates of payment.

The *Miliangos* doctrine has been established under the influence of the more obvious moral consideration that disadvantage should be assumed by a wrongdoer and not by an innocent claimant. In the bankruptcy and liquidation cases, there is no element of wrongdoing among the creditors on the basis of which to allocate advantage and disadvantage. The solutions found for both situations have not been free from the criticism that the solutions attribute excessive advantage to one party or excessive disadvantage to another.[222]

In Pamphlet No. 33 (1980) there was a discussion of a project then under consideration by the World Bank for equalizing the exchange risks assumed by borrowers from the Bank.[223] The problem was seen to be one that fell within the second category of situations mentioned above. Under the terms of loan agreements negotiated by the World Bank, a borrower is required to make repayments in the various currencies it has received under its agreement. It is impossible for the Bank to make disbursements to all borrowers in the same currencies or in equal proportions of the same currencies, with the result that borrowers formerly assumed different exchange risks if measured by a common denominator such as the U.S. dollar. Loans negotiated on or after July 1, 1980 are subject to an

arrangement called the Currency Pooling System that is designed, in terms of a single unit of account, to equalize among all borrowers the risks of fluctuations in the exchange rates of the currencies they borrow.[224]

All currencies disbursed and outstanding under loans subject to the System are deemed to be pooled. The outstanding principal amount under each loan is expressed at all times as a share in the pool arrived at by dividing this amount by the aggregate value of the pool. The value of the pool and of each share is recalculated daily by reference to the U.S. dollar as the unit of account. The effect is to prorate all currencies disbursed and outstanding among all loans subject to the System according to their shares in the pool. The System does not eliminate exchange risks for borrowers: it provides that all borrowers assume the same risk, namely, the risk of fluctuations in the exchange rates of all disbursed currencies against the U.S. dollar.

The World Bank enters into new loan agreements on the basis of the new System, but it has also given borrowers that had not drawn the full amount of loans outstanding on July 1, 1980 the option to bring the undisbursed amount into the System. If a borrower exercises the option, the original agreement is amended.

Some circumstances may combine the two situations that have been distinguished earlier in this section. For example, when a member of the Fund is designated by the Fund to receive SDRs from another member and provide a freely usable currency in return for the SDRs, the transaction must be carried out on the basis of the principle of "equal value."[225] One aspect of this principle is that the transferor of the SDRs must receive the same value whatever member the Fund designates as transferee and whatever currency the designated transferee provides. The equal value principle is addressed to a situation of the first kind because it ensures that a transferee of SDRs will not be able to act to its own advantage and to the disadvantage of the transferor by providing a currency that has depreciated in the market at an exchange rate unfavorable to the transferor. The principle is addressed to a situation of the second kind because, if the transferee of SDRs provides the same currency on the same value date to two or more transferors, they will all receive value at the same exchange rate.[226]

Application of the equal value principle requires the use of a single unit of account. It is the SDR.[227] In the English bankruptcy and liquidation

cases, the single unit of account is sterling whatever the currencies might be that the creditors had been entitled to receive.

Normal Protection Against Exchange Risks

Courts are working their way toward an idea of normal protection against exchange risks that a party should arrange. The party's legal position may be affected if it does not arrange this protection.

It has been seen that in *Re Canadian Vinyl Industries Inc.*[228] the Quebec court rejected the contention that the Canadian dollar value of the claim of a German creditor in deutsche mark, calculated at the rate of exchange when proof of the claim was submitted in bankruptcy proceedings, should be recalculated at the dates when dividends were paid by the trustee in bankruptcy. Part of the rationale of the decision was the normal practice cited by the court, according to which a Canadian debtor who has to make a future payment to a German creditor of the deutsche mark equivalent of a debt expressed in Canadian dollars can arrange with his bank a forward purchase of deutsche mark within a defined period at the exchange rate prevailing when the contract is made. Similarly, a German creditor who is to receive a future payment of Canadian dollars from a Canadian debtor can arrange with his bank a future sale of the Canadian dollars for deutsche mark at the exchange rate prevailing when the contract is made. The point of this rationale was that parties could protect themselves and know where they stood with respect to exchange rates. Creditors submitting proofs in bankruptcy could protect themselves against exchange risks at the date of the filing of the proposal in bankruptcy.[229] Under the proposal, each creditor knew the amount of the dividend it would receive and when payment would be made. Considerations of certainty provided no overriding justification for the court to modify the choice of exchange rate.

In *Isaac Naylor & Sons Ltd. v. New Zealand Co-operative Wool Marketing Association Ltd.*,[230] the New Zealand court considered the effect of forward exchange contracts on a claim to damages for the purchaser's failure to perform according to the terms of the contract to purchase wool. Naylor argued that it expected the Co-operative to cover itself with forward exchange contracts and to roll them over when they expired in the event of delays, as did Naylor and other firms in the trade. Therefore, any loss suffered by the Co-operative was too remote to justify

the recovery of damages. The Co-operative had entered into forward exchange contracts for some deliveries and for part of the period before payment, but the Co-operative argued that these contracts were *res inter alios* and irrelevant to the proceedings. They were like contracts of insurance, which traditionally are disregarded in assessing damages. This argument of the Co-operative did not succeed. Forward exchange contracts, it was held, are not contracts of insurance, because they do not provide for the payment of sums on the happening of uncertain events. The obligation of the bank to buy at the specified rate if required by the Co-operative to do so was the same whether or not exchange rates fluctuated, and was independent of any breach of contract by Naylor. Nevertheless, the effect of forward exchange contracts should not be disregarded on principle:

> If the floating currencies of recent times have led to developments in the law regarding exchange variations in the interests of realism and justice, I think that the Courts should be consistent and not shut their eyes to covering contracts of this kind. But whether the result of any particular case is affected by taking them into account will depend on the facts. Here, for reasons to be given, I do not think they make any difference.[231]

One reason was that it was not enough for Naylor to allege that it had expected the Co-operative to protect itself. The criterion was whether a reasonable man in the position of the Co-operative was so likely to take those steps that its failure to take them could be treated as the acceptance of risk. Naylor had not offered evidence of how common the practice of buying and selling forward exchange was at the material time among exporters and importers in the wool trade. The Co-operative could not be denied damages on the ground that there was an implied term that it must protect itself by forward exchange contracts in the event of delays or on the ground that its losses were too remote a consequence of the delays because of its failure to protect itself by forward exchange contracts.[232]

Naylor also argued that most of the Co-operative's loss was attributable to the forward exchange contracts the Co-operative had entered into and not to Naylor's breach of contract. Naylor contended that the damages should be equivalent to the sum by which the total New Zealand dollars the Co-operative had received under forward exchange contracts was less than the total it would have received under forward exchange contracts had there been no delays. A member of the court who dealt with this contention distinguished between the periods before and after the due date

for payment. For the period before the due date, the amount that would have been received under forward exchange contracts was not the criterion because, although the bank is bound to buy currency at a fixed rate, the customer is not bound to sell. The customer might refrain from selling because the market exchange rate was more favorable to him than the rate prescribed by the forward exchange contract. It was wrong to assume, therefore, that the Co-operative, by entering into forward exchange contracts, had committed itself to accept the exchange rate it would have received under forward exchange contracts had shipment not been delayed. Losses because of unfavorable exchange rates under forward exchange contracts during the period after breach could not be calculated because none of the contracts or rollovers ran precisely from the due date of payment. No evidence had been given of the difference in exchange rates prevailing on the due date compared with the actual date of payment.[233]

The decision was affected by considerations of evidence on a vital aspect of the case. The decision leaves open the issue whether there is a duty to mitigate damages by negotiating forward exchange contracts and also the issue of the effect of these contracts when entered into on claims for damages for breach of contract resulting from fluctuations in exchange rates.

A case decided by the Court of Justice of the European Communities on March 5, 1980[234] took cognizance of the effect of the normal practice of insuring against risk. Monetary compensatory amounts are a remedy for the effect on agricultural prices of imbalances that develop among the currencies of members of the European Community. The exchange rates applied in the framework of the common agricultural policy to the uniform prices fixed in national currency do not correspond to the exchange rates of the currencies in the market. The purpose of the system of monetary compensatory amounts is to neutralize the consequences for the common agricultural policy of developments that reduce correspondence between the exchange rates used in that policy and exchange rates in the market. A monetary compensatory amount is fixed for the currency of each member so as to compensate for these differences in exchange rates. The monetary compensatory amount payable in the case of exportation from a member with a currency that has appreciated above the specified margin of fluctuation to a member with a currency that has depreciated below that margin is composed of two elements: one granted by the exporting state

when the goods are exported and the other granted by the importing state when the goods are imported. Under Community law, the exporting state may agree to pay the monetary compensatory amount payable by the importing state. Payment of this amount by the exporting state is subject to the condition that proof is offered that customs import formalities have been completed and that duties and equivalent levies have been charged.

The United Kingdom and the Federal Republic of Germany entered into an agreement of the kind referred to. An English company contracted to buy butter from a German company. The cargo was shipped but did not arrive because the vessel was lost. The customs authorities of the Federal Republic of Germany paid to the exporter the monetary compensatory amount payable on exportation but refused to pay the amount payable on importation because no proof was offered that customs formalities had been completed and duty charged. The exporter argued that there was a general principle of *force majeure* under Community law, and that in accordance with this principle the exporting company was discharged from the necessity of providing proof. If the further amount were not paid, the exporter would suffer as a result of fluctuations in exchange rate.

The Court held that the system of monetary compensatory amounts was introduced in order to remedy a monetary situation that threatened the Community's policy on prices for agricultural products. The system of monetary compensatory amounts was not conceived to give individual traders security against all risks that flow from fluctuations in exchange rates or to indemnify them for all loss suffered as a result of these fluctuations. There was no general principle of *force majeure* as alleged by the exporter and no reason to apply it in order to indemnify the exporter for a loss that normally constituted one of the commercial risks that traders assume by taking out suitable insurance.

In the discussion of multiple currency practices, it was noted that the Fund has decided that deviations between the rates for spot exchange transactions and the rates for other exchange transactions, which would include transactions under forward exchange contracts, will not be considered multiple currency practices if the deviations represent no more than the additional costs and risks of the other exchange transactions. Nothing has been said about official action in relation to deviations. The original Articles authorized the Fund to establish margins for other exchange transactions, including forward exchange transactions,[235] but the Fund never took action under this power. The Articles prescribe

margins for spot exchange transactions only, without empowering the Fund to establish margins for other exchange transactions, under the par value system that can be called into operation under Schedule C.[236]

Adaptations to Variability

The prospect of changes in exchange rates is responsible for provisions in legal instruments that govern the adaptation of features of the instrument, particularly financial features. A number of treaties or proposed treaties, including but not confined to buffer stock agreements, provide special procedures for considering the adaptation of financial prescriptions if changes in exchange rates threaten to undermine the purposes of the treaty. These provisions have been examined elsewhere.[237] The Sixth International Tin Agreement, which entered into force provisionally on July 1, 1982, contains provisions of this kind. The Executive Chairman may convene, or any member may request him to convene, an immediate session of the Council to review the floor and ceiling prices if the Chairman or the member that has made the request considers that changes in exchange rates make a review necessary. Detailed provisions regulate the situation pending the session of the Council and for various periods after it does meet, according to various hypotheses about the Council's reaction.[238] The provisions of the COTIF on the summoning of sessions of the Revision Commission have been discussed in the section *International Conventions* under the general heading **SDRs** in this pamphlet.

Another technique, however, is the prescription by law of a formula for the automatic adaptation of financial provisions. The construction of a formula that will be satisfactory to all interests may be a complex undertaking. An example of such an effort is the proposal by the United States Federal Maritime Commission of requirements for filing currency adjustment factors (CAFs) reflecting changes in the exchange rates for tariff currencies by all common carriers by water and conferences of such carriers engaged in the foreign commerce of the United States.[239] The Commission seeks an effective system that will be reasonable and fair for carriers, conferences, and shippers. CAFs would enable adjustments in existing tariffs to be made more promptly than the substitution of changed

tariffs because these changes must be preceded by statutory periods of notice.[240]

CAFs are a reaction to sharp and unforeseen fluctuations in the value of the U.S. dollar measured against the currencies of other major countries, because fluctuations can create substantial losses for carriers engaged in the foreign commerce of the United States. The dollar value of revenues is fixed in tariffs but the foreign currencies in which carriers may incur commitments and expenses are not. If the U.S. dollar depreciates against the foreign currencies, the dollar revenue becomes less adequate for the purchase of the necessary foreign currencies.

The Federal Maritime Commission has developed proposed rules under which no adjustments to tariff rates to take account of fluctuations in exchange rates would be allowed except in accordance with the rules if they become effective. Carriers and conferences would be able to file tariff schedules that would include a base level for their tariff currency (usually the U.S. dollar) in relation to each trade currency selected for the purpose of cargo carried to or from all the ports of a foreign country.[241] Adjustments in the form of surcharges or discounts could be made effective on the first market date of a month in accordance with the following formula:

> No CAFs shall be imposed in any month unless currency values exceed a 2 percent minimum deviation from the base. The schedules are to be constructed on a 50 percent factor of the nominal change in the value of the selected trade currencies in relation to the tariff currency. Unless this 50 percent result equals or exceeds a 2 percent currency change at intervals of 2 percent at the beginning of a month, there shall be no currency adjustment or change in the adjustment. The schedules may be updated at any time based upon the exchange value of the trade currencies prevailing at the time of such filings. The first CAF adjustment under a new schedule cannot be imposed prior to the first market day of a month following the effective date of the revised currency clause.[242]

The element of 50 percent appears in this formula because of the assumption that carriers or conferences incur part of their commitments or expenses in U.S. dollars, and these outgoings should not affect the calculations that are designed to take account of changes in the exchange rates of other currencies against the dollar. The dollar portion would be fixed at 50 percent for reasons of simplicity. The alternative would have to be a detailed accounting.

Comments, of a legal or other character, in support of or in opposition to the proposed rules have been addressed to the Commission. Commentators have criticized the construction and effects of the formula for adjustments. Some comments are of general interest because they illustrate problems that are thought to arise in formulating automatic responses to fluctuations in exchange rates. One problem noted by commentators was that a carrier or conference that filed a schedule in accordance with the rules would be bound to impose a surcharge or discount on the basis of exchange rates on a single date. The exchange rates on that day might be unrepresentative, but adjustments would be in force for a whole month. A counterproposal has been made in favor of averaging exchange rates if carriers or conferences preferred this practice.[243]

The concept of two-currency trade and the requirement based on it that each non-U.S. currency must be treated separately have been criticized as inconsistent with trade between the United States and Europe, in which vessels call at ports in a number of countries and incur expenses in the currencies of all these countries. If CAFs were calculated on the basis of a single currency, a shipper or consignee might divert cargo from normal ports of call, with disruptive consequences for these ports, solely because of considerations relating to CAFs.

The proposed rules as they stand might permit a number of separate CAFs in a single trade, each of which would be based on a separate currency, if a number of trade currencies were involved. The proposals have been criticized, however, because they do not provide for a weighting of these currencies, based on the actual use of them, with the result that there might be overcompensation. The present practice of certain conferences is to employ a weighted basket of currencies in applying CAFs. A single CAF based on such a weighted basket has been suggested in place of the Federal Maritime Commission's proposal.

The Australia/Eastern U.S.A. Shipping Conference has argued that it should be exempted from the proposed rules if they become effective because the Conference is already subject to the system of CAFs that is required by Australian law. According to the Conference, the objectives of that system are similar to those of the rules proposed by the Federal Maritime Commission, but there are differences in both substance and procedure that would create complications. Under Australian practice, the CAFs are reviewed every three months on the basis of the average spot

buying and selling rates for U.S. dollars ruling on the twenty-fifth day of July, October, January, and April as announced by the Reserve Bank of Australia. Review does not mean that there is an automatic adjustment of CAFs. The calculations are not based on a 50 percent factor, and different margins of variation are employed for the adjustment of CAFs. Adjustments take effect with more delay than under the proposed rules of the Federal Maritime Commission. CAFs become part of scheduled freight rates on December 1 each year.

The differences between the proposal of the Federal Maritime Commission and the Australian system are an aspect of a much broader phenomenon. Widely differing CAF systems have emerged throughout the world. The application of CAFs is governed by the place of acceptance of the goods into the custody of a shipping line as shown in the bill of lading. The place of acceptance is normally, but not invariably, the loading area. Shippers in particular have been disturbed by the large disparities in the amounts of CAFs and the differences in procedure for revising them. Efforts have been made by conferences and shipping councils to arrive at a solution of widespread application.

An expert[244] has raised two questions. First, should CAFs be applied differentially area by area if circumstances warrant this treatment or should CAFs be averaged across loading areas? Second, would it be preferable to use the SDR or some other unit of account as the tariff currency instead of the common use of the U.S. dollar for this purpose? The expert opposes averaging CAFs because of the substantial differences in the strength of economies and currencies. To some extent CAFs have been partial averages because most of them have been calculated according to a basket of currencies of varied strength, so that extremes of adjustment have been avoided.

This expert opposes the use of the SDR because its composition—which consisted of 16 currencies when he wrote—was most unlikely to reflect the costs and income of most conferences. In addition, the SDR would be equivalent to applying a single average CAF. Moreover, the SDR is subject to as much fluctuation as CAFs, and indeed more fluctuation because of its daily reflection of exchange rates. These reactions are not the only indication that the special considerations of a trade may affect the acceptability of the SDR as a unit of account in commerce.[245]