THE EXTRATERRITORIALITY OF EXCHANGE CONTROL REGULATIONS UNDER THE IMF ARTICLES OF AGREEMENT*

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INTRODUCTION

Exchange control[1] may be adopted for a variety of purposes. Usually, however, it is used, and designed, to husband foreign exchange resources and to utilize such resources in accordance with some general plan or policy.[2] The objective of this plan or policy will be the protection of exchange resources with the view of maintaining a good balance of payment position. Used in such manner and for such purpose, it is considered the most elaborate form of direct financial intervention by government, aiming to equilibrate the balance of payment by restricting payments and transfers of foreign exchange.[3]

* The article is an edited version of a research paper submitted by the author in fulfillment of the requirements of the Ll.M. program. The author wishes to acknowledge the help of Gail T. Valderrama and Brenda K. Velasco in the preparation of this article for publication.

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[1]Exchange control is not new. It existed even during the pre-mercantilist and mercantilist period in the form of interdictions of gold bullions and the prohibition against the exportation of gold and other precious metals. (*See* generally A. NUSSBAUM, MONEY IN THE LAW, NATIONAL AND INTERNATIONAL (1939) [hereinafter referred to as "NUSSBAUM, MONEY (1939)"]. In fact some form of "registration" of "foreign investments" was in practice as early as 1353, when under Edward III's Statute of Staple "merchant strangers" were permitted to take out of the country the same amount of money they had brought in provided such amount had been put in writing by "searchers." *Id.* The rise of exchange control and its evolution into its present day extent and features can be traced to three landmark periods of this century—World War I, the Great Depression and World War II. Through these periods regulations that started out as war measures developed into traditional measures of national economic policy. *See* INTERNATIONAL MONETARY FUND, FIRST ANNUAL REPORT ON EXCHANGE RESTRICTIONS 17-20 (1950) [hereinafter referred to as "IMF ANNUAL REPORT (1950)"]; *see also*, Notes and Comments, *Foreign Exchange Control in American Courts*, 26 ST. JOHN'S REV. 97, 98-99 (1951). Today exchange control has become a more or less permanent economic panacea of some countries in disburdening their respective economies of demands for scarce foreign exchange. "Measures of state intervention which are directed towards the balancing of the external account have become so widespread and so varied in application, that *we can no longer preserve the polite fiction that they are mere temporary aberrations thrown upon by the war and its aftermath. For good or for ill they have established a large foothold as means to control balance of payments....*" (Emphasis supplied). W. SCAMMELL, INTERNATIONAL MONETARY POLICY 106 (1962) [hereinafter referred to as "SCAMMELL (1962)"]. For a summary of exchange restrictions in member countries of the International Monetary Fund [hereinafter referred to as "IMF"], see the IMF's ANNUAL REPORT ON EXCHANGE RESTRICTIONS, sub nom. ANNUAL REPORT ON EXCHANGE ARRANGEMENTS AND EXCHANGE RESTRICTIONS.

[2]IMF ANNUAL REPORT (1950); R. EDWARDS, JR., INTERNATIONAL MONETARY COLLABORATION 385 (1985).

[3]SCAMMELL (1962), *supra* note 1, at 106.

In its comprehensive form,[4] it will usually have, among others, the following features: it will (i) subject all contracts and transactions giving rise to an obligation to make settlement in foreign currency to license by some monetary authority, usually a central bank,[5] (ii) require the surrender, by citizens and residents, of all foreign currency to the relevant monetary authority either directly or through authorized agent banks or other instrumentality,[6] and (iii) restrict all purchase and sale of foreign exchange to the relevant monetary authority or its authorized agents.[7] And to implement these

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[4]*See* EDWARDS, INTERNATIONAL MONETARY COLLABORATION, *supra* note 2, at 385-89; A. NUSSBAUM, MONEY IN THE LAW 448-61 (1950) [hereinafter referred to as "NUSSBAUM, MONEY (1950)"]; D. VAGTS, TRANSNATIONAL BUSINESS PROBLEMS 30 (1986) [hereinafter referred to as "VAGTS (1986)"]; M. SHUSTER, THE PUBLIC INTERNATIONAL LAW OF MONEY 30-31 (1973) [hereinafter referred to as "SHUSTER (1973)"]. For a more detailed discussion of the features of a comprehensive exchange control, see L. YEAGER, INTERNATIONAL MONETARY RELATIONS 117-31 (1966) [hereinafter referred to as "YEAGER (1966)"].

"Modern day exchange control operates through a system of government licenses which juridically represent lawful exemptions from statutory prohibitions. The effects reach far beyond the monetary field proper. For instance, since an importer needs foreign exchange for payment, and since any remittance abroad, as well as the procurement of foreign exchange, requires licenses, exchange control leads to control of import trade; and the importer will receive licenses only where sufficient foreign exchange is available and is placed at his disposal by the government. Similarly, exchange control entails government regulation of export trade because the exporter must deliver the foreign exchange received to the authorities who will also see to it that he will not, by underbilling or otherwise, divert parts of it to himself. Even internal trade, and especially banking, will be affected in many ways. Enforcement of exchange control may encroach upon the privacy of the mail, and generally upon personal liberty. All these require a tremendous machinery. At the same time exchange control must continually adapt itself to shifting conditions and find new means to meet the tricks of evader. Thus exchange controls, wherever they exist are in constant flux with a tendency to intensify. Basic statutes are relatively terse, leaving wide leeway to the administration." NUSSBAUM, MONEY (1950), *supra* note 4, at 448.

[5]*E.g.*, "No contract shall be entered into by any resident involving payment or outward remittance of foreign exchange, unless specifically authorized by the Central Bank [of the Philippines].... No transaction shall be made by any resident where the foreign exchange is paid, retained, delivered or transferred abroad while the corresponding [Philippine] pesos are paid for, or received in the Philippines, unless specifically authorized by the Central Bank...." CB CIRC. NO. 1028, AS AMENDED (1984) [hereinafter referred to as "CB CIRCULAR 1028"], SECTION 31.

[6]*E.g.*, "All foreign exchange earned or acquired by residents shall be sold to an Authorized Agent Bank (AAB) for [Philippine] pesos within three (3) business days from the date of their receipt in the Philippines. If received abroad, a resident shall cause the inward remittance in full value within fifteen (15) calendar days from the date ownership accrues, and the sale for pesos with an AAB within three (3) business days from receipt in the Philippines." CB CIRCULAR 1028, SECTION 1.

"No person or resident shall open and maintain foreign exchange deposit accounts abroad involving outward remittance of foreign exchange unless otherwise permitted by law or Central Bank regulations." CB CIRCULAR 1028, SECTION 32.

[7]*E.g.*, "It shall be unlawful for any person to sell foreign exchange to unauthorized persons. No person shall engage in the purchase of foreign exchange except [Authorized Agent Bank]s." CB CIRCULAR 1028, SECTION 2.

"It shall be unlawful for any person to buy foreign exchange for pesos unless authorized by the Central Bank as foreign exchange agent in accordance with this Circular." CB CIRCULAR 1028, SECTION 33.

"Only commercial banks are, by virtue of their incorporation and license, considered as [Authorized Agent Bank]s of the Central Bank. They may deal in foreign exchange for [Philippine] pesos from the general public, subject to the provisions of this Circular and other specific Central Bank rules and regulations on foreign exchange positions [and] external trade transactions." CB CIRCULAR 1028, SECTION 4(a).

controls effectively, it will usually complement these features with an elaborate system of reporting and verification to keep track of foreign currency receipts and disbursements and to ensure that foreign currencies are not channeled to, or obtained from unofficial sources, and will normally provide sanctions for violations.[8]

In a limited form, it may range from requiring notification of contracts and transactions which give rise to liabilities requiring settlement in foreign exchange to the relevant monetary authority, or involve the intervention by the relevant monetary authority in the foreign exchange market, by periodically buying and selling foreign currencies, whenever necessary to adjust the local currency's exchange rate.[9] It may also be used to control certain specified assets within a country in order to protect its national security. Examples of these are the United States' freezing orders against Germany during the war[10] and the more recent asset control regulations of the United States against Iranian assets.[11] In fact, it is not unusual to find some statute or law that authorizes the imposition of exchange control measures upon the happening of certain specified events or circumstances.[12] Even in this limited form it should be expected that sanctions will be imposed for violations of exchange control measures.

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[8] *E.g*, "All residents who regularly earn, acquire, or receive foreign exchange locally or from abroad shall submit reports of each earnings, acquisitions or receipts from operations and other sources, and foreign exchange disbursements to the Central Bank... in the prescribed form... within ten (10) calendar days following the end of every month." CB CIRCULAR 1028, SECTION 18.

"Verification of the foregoing reports against books of accounts and other related records shall be made by the [Foreign Exchange Department] I of the Central Bank." CB CIRCULAR, 1028 SECTION 19.

"Any person who shall engage in the trading or purchase and sale of foreign currency in violation of existing laws or rules and regulations of the Central Bank shall be guilty of a crime of blackmarketing of foreign exchange and shall suffer the penalty of *reclusion temporal* [minimum of twelve (12) years and maximum of twenty (20) years and a fine of not less than Fifty Thousand [Philippines] pesos (P50,000.00)]. If the offender is a naturalized citizen of the Philippines, conviction of the offense described above shall carry with it the automatic cancellation of his naturalization as citizen of the Philippines and shall, upon service of sentence, immediately be deported. A foreigner who is convicted of the offense of blackmarketing shall, upon service of his sentence, be immediately deported.

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"Administrative sanctions... shall be imposed upon banking institutions, their directors and officers for violation of this Circular." CB CIRCULAR 1028, SECTION 67.

See generally, YEAGER (1966), *supra* note 4.

[9] SHUSTER (1973), *supra* note 4, at 30.

[10] *See generally* Fruetel, *Exchange Control, Freezing Orders and the Conflict of Law*, 56 HARV. L. REV. 30 (1942) [hereinafter referred to as "Fruetel (1942)"].

[11] *See* 2 J. GOLD, THE FUND AGREEMENT IN THE COURTS 360-427 (1982) [hereinafter referred to as "GOLD, COURTS II"]; Edwards, Jr., *Extraterritorial Application of the U.S. Iranian Asset Control Legislation*, 75 AM. J. INT'L L. 870 (1981) [hereinafter referred to as "Edwards, Iran"].

[12] *E.g.*, International Emergency Economic Powers Act, Sections 202 and 203, 50 U.S.C. Secs 1701 and 1702 (1972).

Due to the intrusive effect of exchange control on contracts and transactions, in particular, contracts and transactions that give rise to obligations requiring settlement in foreign currencies, the question of its extraterritorial effect has been litigated all over the world, and has inspired a tremendous amount of literature.

The first part of this paper will examine the treatment received by foreign exchange control regulations from the courts of certain countries in the context of their respective conflict of law rules, in particular the various principles relied upon by courts in justifying their refusal to recognize the effect of foreign exchange control regulations upon contracts and transactions litigated before them. This discussion is necessary in order to appreciate better the impact and effect of Article VIII, Section 2(b) of the IMF Articles of Agreement ("Fund Agreement") on the choice of law principles of IMF member countries.

The second part will deal with the policy and rule of Article VIII, Section 2(b), discussing the impact of this provision on the choice of law rules of IMF member countries, as applied to foreign exchange control regulations, and the conflicting interpretations that have been put forward by courts and commentators with regard to such provision. As these matters are treated and analyzed, the writer will also state what he believes to be the better interpretation of Article VIII, Section 2(b) in the light of the relevant history, objectives and other provisions of the Fund Agreement.

The second part will not, however, attempt to embark on a comprehensive comparative analysis of the interpretations received by Article VIII, Section 2(b) from the courts of all IMF member countries. It will focus primarily on the United States, Great Britain and West Germany, IMF member countries whose court decisions have been selected to represent the different interpretations of Article VIII, Section 2(b).

The third part will contain the conclusions of the writer regarding the vitality of Article VIII, Section 2(b). It will also discuss in passing a recent threat to its effectiveness, at least within the United States, in view of certain dicta in the recent case of *Callejo* v. *Bancomer.*[13]

I. EXCHANGE CONTROL REGULATIONS AND THE CONFLICT OF LAWS

Conflict of laws (or private international law) is a branch of the domestic law of a country which deals with cases having a foreign element.[14] In contradistinction to public international law which is, at least, in theory, the same everywhere, the rules of conflict of laws (or private international law) are

[13] 764 F. 2d 1101, 1118-1119 (5th Cir. 1985).

[14] 1 DICEY & MORRIS, THE CONFLICT OF LAWS (1980) [hereinafter referred to as "DICEY & MORRIS I"].

different from country to country.[15] Accordingly, the rules of conflicts are not universally the same[16] While the rules of conflict of laws are not international in character but merely domestic or national, certain of such rules may assume an international character when embodied in an international convention or agreement.[17] "The rules of private international law may be common to several states and may be established by international convention or customs, and in the latter case may possess the character of true international law governing the relations between states. But apart from this it has to be considered that these rules form part of municipal law."[18] As will be discussed later, the view has been expressed that Article VIII, Section 2(b) of the Fund Agreement is essentially an international conflict rule binding on all (subject to some qualification)[19] IMF member countries.

Foreign exchange control regulations, especially exchange restrictions, have not been viewed with favor by most courts. Despite the diversity in conflict of law principles obtaining in different countries, courts have generally refused to recognize the effects of such regulations.[20] On the basis of court decisions that have been reported and discussed in the various books and articles written on the subject[21] it appears that the court's refusal to recognize the effects of foreign exchange control regulations have been based, generally, on (i) the territoriality principle, (ii) ordre public, or public policy,[22] and (iii) control of the governing law of the contract.[23]

The foregoing observation should not, however, be taken to imply that the three "lines of defense" which courts have usually used as legal bases for refusing to recognize the effects of foreign exchange control regulations are exclusive of each other. They are not. It is not unusual to find conflict rules

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[15]*Id.*

[16]J. SALONGA, PRIVATE INTERNATIONAL LAW (1981) [hereinafter referred to as 'SALONGA (1981)"].

[17]*E.g.*, Warsaw Convention of 1919, as amended at the Hague in 1955 and as supplemented by the Guadalajara Convention in 1961, on the carriage of persons and goods by aircraft, and the Geneva Convention on Bills of Exchange. *Id.*, at 10.

[18]Serbian Loan Cases, 2 HUDSON WORLD REPORTS 371 (PCIJ, 1929).

[19]This qualification refers to the question of whether Article VIII, Section 2(b) is a rule applicable only among IMF member countries *inter se*, and accordingly, does not require IMF member countries to recognize the effect of national exchange control regulations of nonmember countries. This question will be discussed in Part II.

[20]*See* NUSSBAUM, MONEY (1950), *supra* note 4 at 462; 465.

[21]Writings on exchange control regulations are numerous and abound in IMF member countries.

[22]Ordre public and public policy are not exactly the same in their conceptual contents. For a detailed and enlightening discussion on their conceptual differences, see Husserl, *Public Policy and Ordre Public*, 25 VA. L. REV. 37 (1938).

[23]*See* NUSSBAUM, MONEY (1950), *supra* note 4, at 487-488; *see also* M. WOLFF, PRIVATE INTERNATIONAL LAW 473 (1950) [hereinafter referred to as "WOLFF (1950)"]; Van Campenhout, Comment, United States: International Monetary Fund Agreement and Foreign Exchange Control Regulations [Perutz v. Bohemian Bank in Liquidation (110 N.E. 2d 6, 304 N.Y. 553 [1953])], 2 AM. J. COMPL. L. 389, 390 (1953).

which will take these "lines of defense" as part of a multi-step choice of law analysis. For example, the Philippines regards these three grounds as exceptions to the application of a foreign law. Thus, under Philippine law, a foreign law will not be applied if it is administrative or fiscal in character, or if it, or its effect, is contrary to public policy, public order, good customs or public morals.[24]

The above-mentioned categorization of the legal bases used by courts to justify their refusal to recognize the effects of foreign exchange control regulations has been impelled only by the desire to move away from what can most often be a convoluted process of conflicts analysis, in order to be able to appreciate clearly the impact of Article VIII, Section 2(b) on these conflict of law principles.

A. Territoriality

Under the principle of territorial supremacy, courts may refuse to enforce any claim which, in their view, is a manifestation of a foreign state's sovereign authority.[25] Thus, they may refuse to enforce, or recognize the effects of, foreign public or administrative or political law on the ground that such laws constitute the manifestation of a foreign state's sovereign prerogatives, and hence, are strictly territorial in effect.[26] Some courts have characterized foreign exchange restrictions as public or administrative law or as being "political" in character, and on this basis have refused to give effect to foreign exchange control regulations. French and German courts have led the way in this approach.

French courts have held that foreign exchange control regulations are "restrictions administrative."[27] The French doctrine stems from Article 3 of the French Civil Code which states that "les lois de police et de surete obligent tous ceux qui habitent le territoie."[28] From this principle, French courts have drawn the proposition that foreign "les lois de police et de surete" are strictly territorial in effect.[29]

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[24]*See* SALONGA (1981), *supra* note 16, at 91.

[25]*See* DICEY & MORRIS I, *supra* note 14, at 90. *See also* Laker Airways Ltd. v. Sabena Belgian World Airlines, 731 F. 2d 909 (D.C. Cir. 1984) (as a matter of customary international law a nation's law has no effect beyond the nation's territory).

[26]Laker Airways Ltd. v. Sabena Belgian World Airlines, 731 F. 2d 909 (D.C. Cir. 1984). As to the character of foreign exchange control regulations, American courts have also viewed them as an exercise of sovereign authority. *See* Callejo v. Bancomer, S.A., 764 F.2d 1101 (5th Cir. 1985) ("the power to issue exchange control regulations is paradigmatically sovereign in nature"); Braka v. Bancomer, S.N.C., 762 F.2d 222 (2d Cir. 1985) (action taken by the Mexican government for the purpose of saving its national economy from the brink of disaster is an exercise of sovereign power).

[27]*See* Fruetel (1942), *supra* note 10, at 45.

[28]*Id.*

[29]*Ibid.* This proposition has been criticized by Professor Arthur Nussbaum for being "cryptic and confusing." Professor Nussbaum found it particularly inept in reference to exchange control regulations which, according to him, explicitly purport, by their very nature, to affect debtors residing abroad and assets of debtors that are situated abroad. *See* NUSSBAUM, MONEY (1939), *supra* note 1, at 487. *Accord:* F.A. MANN, THE LEGAL ASPECTS OF MONEY 402 (1982) [hereinafter referred to as "MANN (1982)"]. For a defense of the French proposition, see Domke, Money in the Law, 24 J. COMP. LEG. 7 INT'L L. 51 (3rd ser., 1942).

German courts have applied a two-stage analysis in determining whether foreign exchange regulations should be recognized.[30] First, it determined whether to apply, in general, German law or a foreign law.[31] This was decided by determining with which legal system the transaction had its most important contacts.[32] If German law was found to be the applicable law, the foreign law was disregarded.[33] If the foreign law was the applicable law, German courts would then proceed to the second stage of the analysis—to determine whether the particular foreign law was public law or private law.[34] If the particular foreign law was found to be public law in character, it would not be given effect. While there is some disagreement among German courts and commentators with respect to the proper characterization of foreign exchange restrictions,[35] it seems clear though that if foreign exchange restrictions are characterized as public law, their effects will not be recognized under the German approach on the ground that public laws are strictly territorial in effect.

Courts and commentators in various countries have also characterized foreign exchange control regulations as "political laws," and, as such, have refused to recognize their effects on the ground that as "political laws" such regulations are strictly territorial in effect.[36] French courts and writers are also

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[30] *See generally* INTL. L. REP. 725, 726 (1955). *See also* Baker, *Enforcement of Contracts Violating Foreign Exchange Control Laws*, 3 INT'L TRADE L.J. 247 (1977) [hereinafter referred to as "Baker (1977)"].

[31] *See* Baker (1977), *supra* note 30, at 263..

[32] *Id.*

[33] *Ibid.* The first stage of the German approach effectively represents a proper-law-of-the-contract approach in that if German law is found to be the applicable law, the foreign law will be disregarded, including the foreign exchange control regulation in issue.

[34] *See* INTL. L. REP. 725, 726 (1955). This dichotomy of treatment may pose some difficult problems because public law and private law often overlap in the subject matters which they treat. In such cases, it may be difficult to neatly determine whether a particular law is clearly public law or private law in character. *See* Mann, Conflict of Laws and Public Law, 132 RECUIEL DES COURS 107, 116 (1971). "Wherever the line is drawn, it must be admitted that there is no straight separation between public law and private law today, the two become more and more entangled." Rashba, *Foreign Exchange Restrictions and Public Policy in the Conflict of Law* (pt. 1-2), 41 MICH. L. REV. 777, 795-96 (1943) [hereinafter referred to as "Rashba (1943)"]. *See generally*, P.M. NORTH, THE E.E.C. CONVENTION ON THE LAW APPLICABLE TO CONTRACTUAL OBLIGATIONS: A COMPARATIVE STUDY (1982).

[35] *See* INTL. L. REP. 725, 726 (1955). Some German courts and commentators have argued that foreign exchange control regulations are public law in character, presumably because they are directed toward the government objective of protecting the country's economy. *See* Baker (1977), *supra* note 30, at 264. *See also* MANN (1982), *supra* note 29, at 410-11, n. 51. Others, on the other hand, have argued that exchange control regulations are private law in character since they are intended to regulate the effect in private law of unlicensed transactions. *See* Baker (1977), *supra* note 30, at 264. *See also* Rashba (1943), *supra* note 34, at 796.

According to Professor Nussbaum, although exchange control is largely a matter of public law (namely administrative law), it has important effects on the law of contracts. To him, there is no plausible reason why a court in a situation governed by foreign law should shirk from using the "public law" provisions of the applicable legal system. *See* NUSSBAUM, MONEY (1939), *supra* note 1, at 488.

[36] *See generally* Rashba (1943), *supra* note 34, at 1089.

followers of this theory. They have characterized foreign exchange restrictions as "purement politique."[37] This rule is not confined to public law merely, but extends to rules which though technically a part of private law, are designed to supplement the commands and prohibitions of public law.[38] Considering the sweep and breadth of this approach, it is no small wonder how courts that support this view can, without much serious analysis, deny recognition of the effects of foreign exchange control regulations.[39] Indeed, it is hard to imagine any exchange control regulation that is not designed to further governmental interest, and which does not in furtherance of such interest, effect the equitable adjustment of private relationships. It may be a slight consolation to note that while this theory has been upheld in some jurisdictions,[40] it has also been rejected in others.[41]

B. Ordre Public and Public Policy

Continental courts have also refused to recognize the effects of exchange control regulations on the ground that such regulations, or their effects, would be contrary to ordre public or public order. The rough equivalent in Anglo-American law of ordre public is the concept of public policy.[42] As mentioned earlier, however, ordre public and public policy are not exactly the same in conceptual formulation,[43] although in their respective application the same results are generally reached.

Public policy—and the same is true with ordre public—is incapable of precise definition. In fact some writers have consigned it to uselessness, attacking it as an "obscure notion, fluctuating and imprecise, robbing the law of one of its most valuable merits: certitude, the security it (the law) gives to human relations."[44] it would perhaps be more helpful to examine the use to which this concept has been applied by courts in the context of foreign exchange control.

Public policy has both a negative and a positive aspect. Its negative aspect arises when it is invoked to bar the effects of exchange control regulations, e.g., when found to be retroactive, confiscatory, discriminatory or

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[37] *See* Fruetel (1942), *supra* note 10, at 45.

[38] *See* Rashba (1943), *supra* note 10, at 1089.

[39] For decided cases, *see* Fruetel (1942), *supra* note 10, at 45; Rashba (1943), *supra* note 34, at 1090-91.

[40] Fruetel (1942), *supra* note 10, at 45.

[41] *Id.* at 1091.

[42] *See* note 4, *supra*, and accompanying text.

[43] *Id. See also* Rashba, *supra* note 34, at 1115; Nussbaum, Note, *Public Order in Continental Law*, in CHEATAM, DOWLING AND GOODRICH, CASES AND MATERIALS ON CONFLICT OF LAWS 502 (1st ed. 1936).

[44] *See* Rashba (1943), *supra* note 34, at 798.

penal in character.[45] In that instance, the refusal of courts to give effect to foreign exchange control regulations (on grounds of conflict with the forum's public policy) is not influenced by the fact that the forum itself has an exchange control regulation. "The unfavorable attitude of courts which have refused to give effect to foreign exchange controls will not be influenced by the fact that the forum itself possesses an exchange control. Public policy is one-sided and self-motivated. There is neither inconsistency nor hypocrisy in the fact that a court will not carry out foreign measures injurious to the forum, although the forum has enacted, or may in the future enact, similar measures, injurious to others. No moral or ethical structure is involved in public policy concept; all that is involved is where public policies collide, the court will apply the policy of the forum rather than any other."[46]

Some courts, however, have relied upon the forum's public policy to recognize and sustain the effects of foreign exchange control regulations. This reflects the positive aspect of public policy. Thus, in one case it was held that "[w]hat we deem right for the preservation of our financial structure cannot be wrong when employed by others."[47] Indeed, as observed by Prof. Nussbaum, some courts have effectively given effect to foreign exchange regulations by refusing to enforce fraudulent transactions or transactions found to be designed to evade foreign law to the detriment of the community.[48]

At the risk of stating the obvious, it should be mentioned that this positive side of public policy appears only when the recognition of foreign exchange control regulation will not be contrary to the forum's public policy. Absent such a conflict, a court may be willing to consider the effects of foreign ex-

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[45]*See* Baker (1977), *supra* note 30, at 262; Cabot, *Exchange Control and the Conflict of Laws: An Unsolved Puzzle*, 99 UNIV. PENN. L. REV. 477, 490-91 (1951) [hereinafter referred to as "Cabot (1951)"]; Note, *The Treatment of Exchange Controls in the Conflict of Laws*, 34 VA. L. REV. 697, 702 (1948).

"Public policy leads a court to give effect to a contract which is or has become, invalid under its proper law because of the discriminatory or other offensive features of that law, e.g., cases denying effect to foreign currency regulation." G. DELAUME, TRANSNATIONAL CONTRACTS, The Effectiveness of Conflict of Law, Binder, I, Booklet 5.1, Release 85-1 (1985), Section 4.07, p. 34 [hereinafter referred to as "DELAUME (1985)"].

[46]A. NUSSBAUM, MONEY IN THE LAW 489-90 (1950) [hereinafter referred to as "NUSSBAUM, MONEY (1950)"]. *See also* Cabot (1951), *supra* note 45, at 490.

[47]Goodman v. Deutsch-Atlantische Telegraphen Geseelschaft, 166 Misc. 509, 510, 2 N.Y. 2d. 80, 81 (Sup. Ct. 1938); *See* Rashba (1943), *supra* note 34, at 1097.

[48]*See* A. NUSSBAUM, MONEY IN THE LAW, NATIONAL AND INTERNATIONAL 497-99 (1939) [hereinafter referred to as "NUSSBAUM, MONEY (1939)"]; *see also* MANN (1982), *supra* note 29, at 410. In England, Lord Justice Sankey, in the leading case of Foster v. Driscoll, 1 K.B. 470 [1929], stated that it may be against English public policy to enforce a contract if the real object and intention of the parties necessitates them joining in an endeavor to perform in a foreign and friendly country some act which is illegal in such country. This appears to be a good basis for English courts to recognize, in certain cases, the effects of foreign exchange control regulations. *See* MANN (1982), *supra* note 29, at 44. In the United States, a New York court has applied this principle to a contract made to defy foreign exchange controls, *see* Hesslein v. Matzner, 19 N.Y.S. 2d 462 (1940); *see also* Southwestern Shipping Corporation v. National Bank of New York, 6 N.Y. 2d 454, 160 N.E. 2d 836 (1959).

change control. In fact, it may well be consistent with the forum's public policy to recognize foreign exchange control in certain cases, *e.g.*, smuggling of currency abroad in violation of a foreign exchange control regulation of the country issuing such currency.[49]

1. Continental Application

In the continental countries, among the leading exponents of ordre public, as applied to foreign exchange control regulations, have been[50] the Swiss courts. This approach was forged in the case of *Nathan Institut A.G. v. Schweizerische Bank fur Kapitalanlagen*,[51] and had been steadfastly adhered to in subsequent cases.[52] That case involved an action for recovery of a debt owed by a German to a Swiss firm, which had been assigned to the plaintiff. The German debtor argued that under German exchange control regulations the assignment, made without the approval of the German Foreign Exchange Board, was invalid and that in any event performance other than by payment to a blocked account with a German bank would be impossible under the German regulations. The Swiss Federal Court, even though the assignment and the underlying contract were governed by German law, refused to apply German exchange control regulations branding them as "spoliatory encroachment" upon the vested rights of the creditor which was incompatible to Swiss public order and repugnant to the Swiss sense of honor and decency.[53]

2. Anglo-American Application

The use of public policy to bar the application of foreign exchange con-

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[49]*See* MANN (1982), *supra* note 29, at 410-11, *See* note 51, *infra*.

[50]It has become necessary to use this tense because, as Professor Mann has cautioned, it cannot be assumed with certainty that Swiss courts will always adhere to this view considering the changed circumstances prevailing since the end of World War II. *See Id, see also* note 8, *supra*, and accompanying text.

[51]Swiss Federal Court, BGE 50, II, 241 (1934). *See* Domke, *Foreign Exchange Restrictions: A Comparative Survey*, 31 J. COMPL. LEG. 7 INT'L. L. 54 (1939) [hereinafter referred to as "Domke (1939)"]; MANN, THE LEGAL ASPECTS OF MONEY 401 (1971) [hereinafter referred to as "MANN(1971)"].

[52]Rheinische Grundstuckz-Handelsgessellschaft m.b.h. V.A.G. fur Immobilientewerte, Swiss Federal Court, BGE 61, II, 242 (1935) (German transfer restrictions); Banco Transatlantico v. Schweirischer Bankverin, Swiss Federal Court, BGE 3, II, 283 (1937) (Spanish transfer restrictions); Schweizerische Kreditstanstalt ind Pavell, Swiss Federal Court, BGE 63, II, 303 (1937); Frankl et Cie v. "Fina," Swiss Federal Court, [1938] 5 NOUVELLE REVUE DE DROIT INTERNATIONAL PRIVE 419 (Austrian exchange legislation). *See also* NUSSBAUM, MONEY (1950), *supra* note 46, at 463.

[53]*See* Domke (1939), *supra* note 51, at 58. *See also* F.A. MANN, THE LEGAL ASPECTS OF MONEY 402-3 (1982)' [hereinafter referred to as "MANN (1982)"]; MANN (1971), *supra* note 36, at 401; F.A. MANN, THE LEGAL ASPECTS OF MONEY 356 (1953) [hereinafter referred to as "MANN (1953)"]; Fruetel, *Exchange Control, Freezing Orders and the Conflict of Law*, 56 HARV. L. REV. 48-9 (1942) [hereinafter referred to as "Fruetel (1942)"].

trol, regulations has been quite rare in American jurisprudence.[54] But it has been invoked,[55] or at least strongly alluded to in more recent cases.

In *Pan-American Securities Corp.* v. *Friedd Krupp A.G.,*[56] Justice Steinbrink of the Supeme Court of New York declared that the German restrictions then in issue were "dishonest" and "highly repugnant to [American] sense of honor and decency and reflect financial sadism at its worst." The language of Justice Steinbrink closely approximates the Swiss court's denunciation of German exchange control restrictions in the *Nathan-Institut* case.

In a much later case, *J. Zeevi and Sons, Ltd.* v. *Grindlays Bank (Uganda) Limited,*[57] the Court of Appeals of New York, by way of dicta made strong allusions to public policy.

> Laws of foreign governments have extraterritorial jurisdiction only by comity.... *The principle which determines whether we shall give effect to foreign legislation is that of public policy, and, where there is a conflict beween our public policy and the application of comity, our sense of justice and equity as embodied in our public policy must prevail.* (Citation omitted.) (Emphasis supplied.)[58]

By way of *obiter dicta,* the *Zeevi* court stated that even if choice of law principles did not dictate the application of New York law, the Ugandan exchange control legislation in issue would not, in any event, be given recognition because it was confiscatory and discriminatory, hence contrary to New York public policy.[59]

[54]Rashba (1943), *supra* note 34, at 1115.

[55]*See* WOLFF (1950), *supra* note 23, at 473. *Contra:* MANN (1982), *supra* note 29, at 404. "No American court has ever based its decision on the alleged incompatibility of foreign exchange control with American public policy." *Id.* According to Professor Mann (referring to Professor Wolff's conclusion) the misunderstanding arises from strong words which, in the pre-war period, American courts justifiably used in regard to the nature and effects of German exchange control. To him, such pronouncements did not constitute the *ratio decidendi.* One wonders, however, whether the strong language of the American courts, in the context of the circumstances at that time, did not reflect a view of American public policy, such that other than what Professor Mann sees as the *ratio decidendi* in the cases cited by Professor Wolff, such courts would recognize the effect of the exchange control regulations then in issue and disregard American public policy even if such effects did in fact fly in the face of such policy.

To be sure, it should also be pointed out that there have been American decisions which appear to have implied that foreign exchange control regulations are not contrary to American public policy, *e.g.,* French v. Banco Nacional de Cuba, 23 N.Y. 2d 46, 63; 242 N.E. 2d 704, 715; 295 N.Y.S. 2d 433, 499 (1968) (exchange control has long been recognized as a normal measure of government); Egyes v. Magyar Nemzetti Bank, 165 F.2d 539, 541 (1948), where Judge Clark said in a *dictum* that "in view of what has happened in the world it seems profitless to characterize the currency maneuvers of foreign governments as unconscionable"; Goodman v. Deutsch-Atlantische Telegraphen Gesellschaft, 166 Misc. 509, 510, 2 N.Y. 2d 80, 81. ("What we deem right for the preservation of our financial structure cannot be wrong when employed by others.").

[56]169 Misc. 495, 6 N.Y.S. 2d 993 (1938), *aff'd.* 256 App. Div. 955, 10 N.Y.S. 2d 205 (1939).

[57]37 N.Y.2d 220, 371 N.Y.S.2d 892, 333 N.E.2d 168 (1975).

[58]J. Zeevi and Sons, Ltd. v. Grindlays Bank (Uganda) Ltd, 37 N.Y.2d 220; 371 N.Y.S.2d 892; 333 N.E.2d 168 (1975).

[59]*See* Baker, Enforcement of Contracts Violating Foreign Exchange Control Laws, 3 INT'L. TRADE L.J. 251 (1977) [hereinafter referred to as "Baker (1977)"].

Under English law, the validiy or invalidity of a contract must be determined in accordance with English law, independently of the law of any foreign country whatever, if and insofar as the application of the foreign law would be opposed to the public policy of English law.[60] Indeed, the foreign exchange control regulation may be so oppressive or discriminatory in character or so inconsistent with treaty obligations or so obviously preparatory or incidental to acts of illegal warfare or of trade warfare, or so contrary to personal freedom that it may be denied recognition in England for being opposed to English public policy.[61] Thus, in *In re Helbert Wagg & Co. Ltd.*,[62] Justice Upjohn, while recognizing the undoubted right of a foreign state to protect its economy by measures of foreign exchange control, also held that an English court should be satisfied that the foreign law is a genuine foreign exchange law, *i.e.*, a law passed with the genuine intention of protecting its economy in times of national stress, and not a law passed ostensibly with that object, but in reality with some object not in accordance with the usage of nations. If not, an English court will refuse to allow the contractual rights of the parties to be affected by such law.[63]

C. Applicable Law of the Contract

Some courts, like English and American courts, would prefer to rest the non-application of foreign exchange control regulations through the application of choice of law principles, *i.e.*, by determining the law that should govern the contract in question.[64]

1. England

In English law, the aforementioned choice of law approach is termed the "proper law of the contract." The "proper law of the contract" is the law which is assigned as proper in view of the particular circumstances of the agreement.[65] Specifically, it means the "system of law by which the parties intended the contract to be governed, or where their intention is neither expressed nor to be inferred from the circumstances, the system with which the transaction has its closest and most real connection."[66]

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[60] 2 DICEY & MORRIS, THE CONFLICT OF LAWS 801-802 (1980) [hereinafter referred to as "DICEY & MORRIS 2"].

[61] *See* MANN (1982), *supra* note 53, at 405-406. "[F]oreign exchange control legislation will not be applied if it is used not with the object of protecting the economy of the foreign State, but as an instrument of oppression or discrimination." *Id.*, at 1024.

[62] [1956] Ch. 323.

[63] In re Helbert Wagg & Co. Ltd (1956); *see also* DICEY & MORRIS 2, *supra* note 60, at 804.

[64] *See* NUSSBAUM, MONEY (1950), *supra* note 46, at 425.

[65] *See* A. NUSSBAUM, PRINCIPLES OF PRIVATE INTERNATIONAL LAW 168 (1943).

[66] DICEY & MORRIS 2, *supra* note 60, at 747.

Thus, an English court will not give effect to a foreign exchange regulation unless "such [regulation] is part of the proper law of the contract."[67] In *Kleinworth Sons & Co.* v. *Ungarische Baumwolle Industrie A.G.* ([1939] 2 K.B. 678), the Court of Appeals of England, in an action for payment of a debt in England, refused to sustain the argument of the defendant that the debt should not be enforced because payment in London would necessitate unlawful acts in Hungary. The Court of Appeals declared that the argument would produce "preposterous results."[68] More striking was the position taken by Lord Reid in *Kahler* v. *Midland Bank*,[69] where he rejected the idea that it would be a good defense to an action on a contract, the proper law of which is English law, for the defendant to show that performance of his obligation in England would subject him to penal liability in his home country.[70]

English courts will, however, give effect to a foreign exchange regulation if the proper law of the contract is the restricting foreign state or if such regulation is part of the law of the place of perfomance.[71] The law of the place of performance assumes importance here, distinct from the ordinary proper law of the contract, because of a principle in English conflict law that English courts will not enforce a contract, even if English law is the proper law, if it is to be performed in a foreign country and such performance would be illegal under the foreign exchange control regulation in force in that country.[72] It is an open question, however, whether the same rule is to be applied to the performance of a contract governed by the law of a foreign country and to be performed in another foreign country if performance is prohibited by exchange control legislation in force in the second country but not in the first.[73]

2. United States

The term "proper law of the contract" is not much used in the United States, although the underlying idea is familiar knowledge.[74] In American conflict of laws, the choice of the governing law is made in the spirit of the "proper law" theory.[75]

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[67]*Id.* at 1023.

[68]*Ibid.*

[69][1950] A.C. 24.

[70]*See* DICEY & MORRIS 2, *supra* note 60, at 797-98.

[71]*Id.*

[72]*Id.* at 1025.

[73]*Ibid.*

[74]*See* NUSSBAUM, PRINCIPLES OF PRIVATE INTERNATIONAL LAW, *supra* note 65, at 168.

[75]*Id.*

Over time, American courts have used a number of different theories in determining the applicable law of the contract. They used the Storyean place of contracting-place of performance approach,[76] the more inflexible Bealean rule of law of the place of contracting which relegated the law of the place of performance to a subsidiary rule,[77] and a more flexible approach that determined the applicable law on the basis of the most significant relationship to

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[76]Prior to the publication of the first Restatement of Conflict of Laws in 1934, a majority of the American courts were influenced by the Storyean school, applying either the law of the place of contracting or the law of the place of performance. *See* Lando, New American Choice-of-Law Principles and the European Conflict of Laws in Contracts, 30 AM. J. COMP. L. 18, 19-20 (1982) [hereinafter referred to as "Lando (1982)"]. Under Storyean teachings, the place of contracting and the place of performance were the two points in space which might be selected to determine the law governing a contract. *See* NUSSBAUM, PRINCIPLES OF PRIVATE INTERNATIONAL LAW, *supra* note 65, at 159-60. The place of contracting was, however, significant only when it was also the place of performance. Where the two places did not coincide, the contract, as to its validity, nature, obligation and interpretation, was to be governed by the law of the place of performance. *Id.* at 159-60. The underlying principle behind the Storyean choice of law rules was the intent of the parties, the place of contracting and the place of performance being used to artificially derive this intent where it is not expressed. *Id.* at 160.

[77]Professor Beale rejected the intent theory that had underscored the Storyean school for being "theoretically indefensible " and "absolutely impracticable." *See* NUSSBAUM, PRINCIPLES OF PRIVATE INTERNATIONAL LAW, *supra* note 65, at 163; *see also* Reese, Discussion of Major Areas of Choice of Law, 111 RECUIEL DES COURS 315, 368 (1964) [hereinafter referred to as "Reese (1964)"]. Professor Beale fashioned rules that inflexibly regarded the place of contracting as the dominant spatial bearing or contact. The courts were considered powerless to depart, through their conflict rules, from the control of the *lex loci contractus*, and in no case could a contrary intent of the parties be taken into account. RESTATEMENT OF CONFLICT OF LAWS Sec. 332; *See* NUSSBAUM, PRINCIPLES OF PRIVATE INTERNATIONAL LAW, *supra* note 65, at 164. This inflexible rule was extended to the effects of the contract, disregarding the separate emphasis and distinction accorded to issues of validity and effects under more traditional private international law. NUSSBAUM, PRINCIPLES OF PRIVATE INTERNATIONAL LAW, *supra* note 65, at 164. *See* note 33, *supra*, and accompanying text. The place of contracting theory was supplemented by yet another inflexible rule—the law of the place of performance—to govern matters relating to the performance of a contract, viz. the manner of performance, the time and locality of performance, the person or persons by whom or to whom performance shall be made or rendered, the sufficiency of performance, and excuse for nonperformance. RESTATEMENT OF CONFLICT OF LAWS Sec. 358; *see* LANDO (1982), *supra* note 76, at 20; NUSSBAUM, PRINCIPLES OF PRIVATE INTERNATIONAL LAW, *supra* note 65, at 164.

After the publication of the Restatement of Conflict of Laws, a majority of the American courts came under the influence of Professor Joseph Beale, the Reporter of the American Law Institute on the Restatement of Conflict of Laws, preferring the place of contracting as the primary choice of law rule, the place of performance being relegated to a subsidiary role under the Bealean school. In relation to foreign exchange control regulations, the fallen role of the place of performance was, however, merely a formal one. As will be seen later, the aspect of the contractual relation assigned to, and dominated by, the place of performance happened to be the aspect where many of the American cases dealing with foreign exchange control regulation have turned, and the same can still be said today in light of the most recent American decisions.

the transaction and the parties.[78] Despite efforts of the American Law institute in its Restatement of Conflict of Laws Second to introduce consistency in choice of law principles, subsequent American court decisions are still conflicting.[79]

Whatever may be the state of American choice of law rules, American courts have generally refused, nevertheless, to resolve cases implicating foreign exchange control regulations under the rubric of control of the applicable law of the contract. There have been numerous cases where American courts refused to recognize the effects of foreign exchange control regulations when it found such regulations not a part of the governing law of the contract. The leading case on this point is *Central Hanover Bank* v. *Siemens & Halske Aktiengesellschaft*.[80] There the defendant, a German corporation, issued bonds in the United States, payment to be made in New York. The defendant defaulted after German exchange authorities refused permission to pay the bonds on their due dates. When sued for payment by the trustee of the bondholders, the defendant relied on German exchange laws as a defense. The court held that the bond transaction was clearly intended to be governed by New York law, and therefore, the defendant could not invoke the German exchange laws which were irrelevant.

The cases relating to bonds floated by German corporations through New York financial houses were all substantially the same. The United States was both the place of the contract and the place of performance. Consequently,

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[78] In 1971 the American Law Institute published the Restatement of Conflict of Laws Second. The Second Restatement was very different from its predecessor, replacing rigid conflict rules with flexible standards. *See* Lando (1982), *supra* note 76, at 28; Reese (1964), *supra* note 77. It was a compromise between the center-of-gravity approach proposed by the 1960 tentative draft and the policy-centered approach articulated by the new thinkers in Americn conflict of laws. *See* Lando (1982), *supra* note 76, at 28.

It recognized autonomy of the parties to choose the governing law subject to certain limitations. RESTATEMENT (SECOND) OF CONFLICT OF LAWS Sec. 137. In the absence of an effective choice of law by the parties, the applicable law would be the local law (domestic rules) of the state which, with respect to the particular issue had the most significant relationship to the transaction and the parties under the policy principles stated in Section 6 of the Second Restatement, principles culled from the theories of the new thinkers. RESTATEMENT (SECOND) OF CONFLICT OF LAWS Sec. 188(1). The place of contracting and the place of performance became merely two of the relevant spatial contacts to be considered. In ascertaining the place having the most significant relationship to the transaction and the parties, the contacts to be considered (in applying the principles stated in Section 6) were the place of contracting, the place of negotiation of the contract, the place of performance, the location of the subject matter of the contract, and the domicile, residence, nationality, place of incorporation and place of business of the parties. RESTATEMENT (SECOND) OF CONFLICT OF LAWS Sec. 188(2).

[79] *See* Lando (1982), *supra* note 76, at 30-31.

[80] 15 F. Supp. 927 (1936), *aff'd*, 84 F.2d 993 (1936), *cert. denied*, 299 U.S.585, 57 Sup.Ct. 110, 81 L.Ed. 431 (1936). *See* Fruetel (1942), *supra* note 53, at 39-40; Cabot (1951), *supra* note 45, at 485; Note, The Treatment of Foreign Exchange Control in the Conflict of Laws, *supra* note 45, at 697, 698-99; Notes and Comment, *Foreign Exchange Control in American Courts*, 26 ST. JOHN'S REV. 100-01 (1951).

only American law was held applicable, and German exchange control restrictions, preventing German debtors from performance, were disregarded.[81]

In *David v. Veitscher Magnesitwerke Action Gesellschaft,*[82] German exchange restrictions forbade payment of pensions to Jews. The plaintiff, a Jew, sued for payment against assets of the defendant deposited in the United States. The defendant, a German company, argued that German exchange restrictions made such payment illegal. The court held that the applicable law was the law of Pennsylvania, the place of performance, and refused to apply the German exchange restrictions.

Lann v. *United States Steel Works Corp.*[83] involved German bonds with a clause allowing the bondholder to demand payment in Germany, Holland or Sweden. The plaintiff, who had demanded payment in Holland, sued the defendant, the German bond issuer, for payment when it refused to pay due to German exchange restrictions. The court held that by exercising the option, Holland became the place of payment, and consequently, Dutch law governed. Since under Dutch law German currency legislation was no defense, judgment was rendered against the defendant.

In a number of cases, however, American courts applied foreign exchange control regulations where such regulations were part of the governing law. The more famous of these cases are the so-called "ship passage money" cases where, typically, emigrants from Germany bought ship passage to the United States from ship companies, with blocked Gèrman marks being used for payment of the passage tickets.[84] The passage tickets contained a condition that any refund would be made only in the country where the ticket had been sold.[85] The ship companies involved were later forced to cancel their voyages because of the outbreak of the war.[86] The emigrants, however, were, one way or the other, able to find their way to the United States.[87] The emigrants then sued the ship companies for refund of the passage money they had paid as well as for other actual damages.[88] The ship companies argued

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[81]*See* Notes and Comments, *Foreign Exchange Control in American Courts supra* note 80, at 101. *See also* Fruetel, *Exchange Control, Freezing Orders and the Conflict of Law*, 56 HARV. L. REV. 39 (1942) [hereinafter referred to as "Fruetel (1942)"].

[82]348 Pa. 335, 35 A.2d 346 (1944). *See* Cabot, *Exchange Control and the Conflict of Laws: An Unsolved Puzzle*, 99 UNIV. PENN. L. REV. 484 (1951) [hereinafter referred to as "Cabot (1951)"]. Note, *Use of Bretton Woods Agreement in Enforcement of Foreign Currency Restrictions by American Courts*, 63 COLUM. L. REV. 747, 748 (1953).

[83]166 Misc. 465, 1 N.Y.S.2d 951 (1938).

[84]*See* Cabot (1951), *supra* note 82, at 486; Fruetel (1942), *supra* note 81, at 51-52; Note, The Treatment of Exchange Controls in the Conflict of Laws, 34 VA. L. REV. 699-700 (1948); Notes and Comment, *Foreign Exchange Control in American Courts, supra* note 80, at 106.

[85]Notes and Comments, *Foreign Exchange Control in American Courts, supra* note 80, at 106.

[86]*Id.*

[87]*Ibid.*

[88]*Ibid.*

that the emigrants were entitled only to blocked currencies, in accordance with exchange control restrictions in countries where the tickets were sold to and purchased by the emigrants.[89] In the majority of the cases, the courts upheld the defense based on the foreign exchange restrictions,[90] and while the courts failed to lay down a consistent rule, the theory underlying most of these decisions was that the parties themselves made the law of the restricting country the governing law of the passage contract.[91] Apparently, the condition relating to the place of refund was taken also as a notice of the law that would govern the contract.[92] These uecisions, however, are more of the exception rather than thè rule.

II

EXCHANGE CONTROL UNDER THE REGIME OF THE FUND AGREEMENT

Exchange control has far-reaching effects. It can be used legitimately as an instrument of economic reform, but it is also an ideal instrument for economic nationalism and ultimately of economic warfare.[93] In the context of the latter, it would be but natural for the courts of the country imposing the restrictions to enforce such restrictions vigorously and to the fullest extent possible. It would also be natural for the courts of other countries to seek, through any, or a combination, of the "lines of defenses" adverted to in Part I, to avoid them. It was under this latter economic and legal scenario that delegates of forty-four countries met at Bretton Woods, New Hampshire for the United Nations Monetary and Financial Conference.[94] It was in this Conference that the IMF was established and the Fund Agreement was drafted and signed by the participating countries.[95]

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[89]*See* Cabot (1951, *supra* note 82, at 486; Note, *The Treatment of Foreign Exchange Controls in the Conflict of Laws*, *supra* note 84, at 700.

[90]Note, *The Treatment of Foreign Exchange Controls in the Conflict of Laws*, *supra* note 84, at 700. In one of the cases litigated before the New York courts and which was appealed to the New York Court of Appeals (Appellate Division), the New York Court of Appeals took the opposite view. *See* Rosenbluth v. N.V. Amerikaansche Stoovaart Maatschappij, 27 N.V.S.2d 922 (1941), *aff'd mem*, 262 App. Div. 1002, 30 N.Y.S.2d 843 (1941), *leave to appeal denied*, 263 App. Div. 708, 31 N.Y.S.2d 666.

[91]*See* Notes and Comments, *Foreign Exchange Control in American Courts*, *supra* note 80, at 106-7.

[92]*Id.*, at 107.

[93]Meyer, *Recognition of Exchange Controls After the International Monetary Fund*, 62 YALE L.J. 867, 868 (1953) [hereinafter referred to as "Meyer (1953)"]. For a detailed discussion of the economic experience during the inter-war period, *see* LEAGUE OF NATIONS, INTERNATIONAL CURRENCY EXPERIENCE (1944).

[94]The United Nations Monetary and Financial Conference was held on July 1-22, 1944.

[95]The Fund Agreement was to enter into force when countries listed in Schedule A to the Fund Agreement with quotas totalling at least $5,720 million completed certain necessary steps. This event occurred on December 27, 1945, with the completion of such steps by twenty-two countries with quotas totalling the equivalent of $6,772.5 million: Belgium, Bolivia, Canada, China, Columbia, Czechoslovakia, Egypt, Ethiopia, France, Greece, Honduras, Iceland, India, Iraq, Luxembourg, Netherlands, Norway, Philippines, South Africa, United Kingdom, United States and Yugoslavia. *See* J. GOLD, MEMBERSHIP AND NONMEMBERSHIP 17 (1974).

A. The Purposes of the IMF

The IMF was established for the following purposes:

> (1) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems
> (2) To facilitate the expansion and balanced growth of international trade, and to contribute to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
> (3) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
> (4) To 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.
> (5) To give confidence to members by making the general resources of the [IMF] temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
> (6) In accordance with the above, to shorten the duration and lessen the disequilibrium in the international balance of payments of members.[96]

Since the maintenance of exchange restrictions had been viewed as one of the major causes of the chaos in the world economy, one of the central aims of the Fund Agreement became the elimination of foreign exchange restrictions which hamper the growth of world trade.[97] Exchange control, however, should be distinguished from exchange restrictions. Exchange control is a more comprehensive term,[98] and includes any form of governmental regulation with respect to any financial intercourse with foreign countries whatever the currency.[99] Exchange restriction is merely a specie of exchange control. This distinction is important because it is observed by the Fund Agreement.

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[96]Fund Agreement, Article 1.

[97]Fund Agreement, Article 1(iv). *See* Aufricht, Exchange Restrictions Under the Fund Agreement, 2 JOURNAL OF WORLD TRADE LAW 297 (1968) [hereinafter referred to as "Aufricht (1968)"]; Krispis, Money in Private International Law, 120 RECUIEL DES COURS 285 (1967) [hereinafter referred to as "Krispis (1967)"]; Meyer (1953) *supra* note 93, at 868; Note, *United States Enforcement of Foreign Exchange Control Laws—A Rule In Transition?*, 10 N.Y.U. J. INT'L. L. & POL. 535 (1978).

[98]*See* 2 P. WOOD, LAW AND PRACTICE OF INTERNATIONAL FINANCE 5-13 (1986) [hereinafter referred to as "WOOD 2"]; Gold, "Exchange Contracts," Exchange Control, and the IMF Articles of Agreement: Some Animadversions on Wilson, Smithett & Cope Limited v. Terruzzi, 33 INT'L. & COMP. L.Q. 777, 782 (1984) [hereinafter referred to as "Gold, Teruzzi"]; Kewenig. *Exchange Control, The Principle of Nondiscrimination and International Trade*, 16 BUF. L. REV. 377, 378 (1966).

[99]A. NUSSBAUM, MONEY IN THE LAW 446 (1950) [hereinafter referred to as "NUSSBAUM (1950)"].

B. Exchange Control Under The Fund Agreement

The Fund Agreement contains, among others, a series of undertakings by members with respect to their monetary conduct and relations. From a cursory reading of the Fund Agreement it is apparent that these undertakings must have an impact on private persons and their transactions.[100] In fact, numerous cases have already been decided by the courts of various member countries in which the Fund Agreement or domestic legislation connected therewith had been relied upon as having some bearing on the issues.

Among the provisions of the Fund Agreement, it is the provision on exchange control regulations which has spawned the most litigation and court decisions.[101]

While the IMF member countries that participated in the Bretton Woods Conference may have vented their disdain for exchange control and its disruptive effects on the world economy, nevertheless they were aware that emergencies could arise or that unforeseen circumstances could develop that might adversely affect a member country's economic condition and balance of payment position. In such situations, they recognized that affected member countries may be compelled to resort to exchange control as part of the ameliorative policies and remedial measures that such countries may put into place.[102] This realism is recognized in the Fund Agreement. Thus, the underlying assumptions of the Fund Agreement is that member countries should not resort to exchange control unless compelling reasons require its practice.[103]

The Fund Agreement recognizes exchange control in three main Articles. These Articles govern the maintenance or imposition of exchange control on capital transfers and current international transactions.

1. Control of Capital Transfers

Under Article VI, Section 3 member countries are allowed to control

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[100]*See* 1 J. GOLD, THE FUND AGREEMENT IN THE COURTS (1962) [hereinafter referred to as "GOLD, COURTS I"].

[101]*See* cases in GOLD, COURTS I and GOLD, THE FUND AGREEMENT IN THE COURTS (1982) [hereinafter referred to as "GOLD, COURTS II"]. Sir Joseph Gold, former General Counsel of the IMF, has been collating and reporting cases involving the provision of the Fund Agreement in exchange control regulations. His work on this issue appears in the IMF Staff Papers and has been consolidated in three books.

[102]Gold, Terruzzi, *supra* note 98, at 778.

[103]*Id.* This view is consistent with, and does not contradict, Article 1(v) of the Fund Agreement. It is a reasonable construction of the Fund Agreement's treatment of exchange control as it harmonizes the intent of Article 1(v) and the specific Articles that deal with and regulate exchange control. *See* discussions *infra*.

capital transfers without the necessity of seeking approval by the IMF.[104] Regulation of capital transfers is allowed by the Fund Agreement because of the destabilizing effects that outflows of "hot money" had in the period prior to the establishment of the IMF.[105] Control of capital transfers is still considered by many governments to be essential in the management of domestic money supply.[106]

2. Regulation of Current International Transactions

Under Article VIII, Section 2(a) no member may, without IMF approval or unless authorized by other provisions of the Fund Agreement, impose restrictions on the making of payments and transfers for current international transactions.[107] This Article essentially serves the purpose of establishing a multilateral system of payments in respect of current international transactions and eliminating foreign exchange restrictions that hamper the growth of world trade.[108] However, far from absolutely eliminating exchange restrictions on current international transactions, Article VIII, Section 2(a) explicitly allows the IMF to derogate from such general prohibition by expressly authorizing it to approve and authorize the imposition of such restrictions.

"Current transactions" is defined by the Fund Agreement as payments which are not for the purpose of transferring capital including, without

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[104] In interpreting this Article, the IMF stated that:

> Subject to the provisions of Article VI, Section 3 concerning payments for current transactions and undue delay in transfers of fund in settlement of commitments:
>
> (a) Members are free to adopt a policy of regulating capital movements for any reason, due regard being paid to the general purposes of the Fund and without prejudice to the provisions of Article VI, Section 1.
>
> (b) They may, for that purpose, exercise such controls as are necessary, including making such arrangements as may be reasonably needed with other countries, without approval of the Fund.

Decision No. 541-56/39, July 25, 1956. *See* SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND AND SELECTED DOCUMENTS 141 (12th Issue 1986).

[105] *See* Gold, Terruzzi, *supra* note 98, at 778.

[106] *See* Gold, Terruzzi, *supra* note 98, at 778. In the comprehensive revision of the Fund Agreement by the Second Amendment, which took effect on April 1, 1978, no proposal was made to limit the authority of members to control capital transfer. However, the possibility of giving the IMF a more extensive role in this aspect was outlined in the Outline of Reform prepared by the Committee of the IMF's Board of Governors on Reform of the International Monetary System and Related Issues. *See* INTERNATIONAL MONETARY REFORM: DOCUMENTS OF THE COMMITTEE OF TWENTY, 1974, at 12-13; *see also* J. GOLD, INTERNATIONAL CAPITAL MOVEMENTS UNDER THE LAW OF THE INTERNATIONAL MONETARY FUND (IMF Pamphlet Series No. 21, 1977).

[107] Article VIII, Section 2(a) provides:

> Subject to the provisions of Article VII, Section 3(b) and Article XIV, Section 2, no member shall, without the approval of the Fund impose restrictions on the making of payments and transfers for current international transactions.

[108] Fund Agreement, Article I (iv). *See* Gold, Terruzzi, *supra* note 98, at 779.

limitation, (i) all payments due in connection with foreign trade, or other current business, including services, and normal short-term banking and credit facilities, (ii) payments due as interest on loans and as net income from other investments, (iii) payments of moderate amount for the amortization of loans or depreciation of direct investments and (iv) moderate remittances for family living expenses.[109] The IMF may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions.[110]

The definition of "current transactions" under the Fund Agreement is important because it includes some categories of payments that economists would categorize as capital in character,[111] *e.g.*, amortization of loans and depreciation of direct investments (or repatriation of capital investments). Thus, the recognition of the right of IMF members to restrict capital transfers under Article VI, Section 3 does not extend to those categories of transactions that would be considered as capital transactions or transfers but for their characterization as current transactions pursuant to Article XXX(d).[112]

Two other terms mark the scope of the obligations imposed by Article VIII, Section 2(a)—"payment" and "transfer."

In determining the correct interpretation of restriction on "payments," the IMF considered three possible approaches.[113] First, any interference with payments, no matter how indirect, would be a restriction on payment.[114] Under this view, an import prohibition even if for health reasons would constitute a restriction since payment cannot be made for the prohibited import.[115] The second approach was to treat as a restriction any interference with payments, direct or indirect, that was imposed for balance of payment reasons.[116] This view while excluding the absurd situations that the first approach could

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[109]Fund Agreement, Article XXX(d).

[110]*Id.*

[111]*See* J. GOLD, THE INTERNATIONAL MONETARY FUND AND PRIVATE BUSINESS TRANSACTIONS 12 (IMF Pamphlet Series No. 3, 1965); Fawcett, *The International Monetary Fund and International Law*, 40 BRITISH YEARBOOK INT'L. L. 32 (1964) [hereinafter referred to as "Fawcett (1964)"], 45; Report of the Chairman, Committee on Monetary Law, Proceedings and Committee Reports of the American Branch of the International Law Association (1965-1966), International Law Association, Amer. Branch, p. 115.

[112]*See* note 111, *supra.*

[113]J. GOLD, THE INTERNATIONAL MONETARY FUND AND PRIVATE BUSINESS TRANSACTIONS, *supra* note 111, at 9-10.

[114]*Id.* at 10.

[115]*Id.* This interpretation is the most unpersuasive. As revealed in Sir Joseph's example, it fails to consider (and in fact wrongly resolves in the affirmative) whether there is a restriction on payment when the right to engage in a particular transaction does not exist. The question of restriction on payment must be premised on the right to engage in the questioned transaction. Without such right, there seems to be no cogent reason to dwell on matters pertaining to payment since the transaction in question cannot exist.

[116]J. GOLD, THE INTERNATIONAL MONETARY FUND AND PRIVATE BUSINESS TRANSACTIONS, *supra* note 111, at 10.

encompass, nevertheless extended itself to trade restrictions (as also did the first interpretation), thereby putting into question whether essentially trade policies and practices were intended to be regulated by the IMF. This, however, could not have been the envisioned role of the IMF since proposals for the establishment of an international trade organization that would regulate trade policies and practices were already being considered before, during and after the Bretton Woods conference.[117] The third approach, which was the interpretation adopted,[118] was a more technical or formal approach that focused on the character of the interference.[119] It regarded an interference on payment a "restriction on payment" if it was, in form, a direct limitation on the use or availability of currency as such.[120] Thus, if importation of certain goods is regulated and a license for importation of such goods is required but foreign exchange is unreservedly available to the importer after a license is issued, the import regulation would not constitute a restriction on payment.[121]

"Transfer" means the conversion of a home currency into a foreign currency.[122] Under Article VIII, Section 2(a), an IMF member may not prevent a nonresident from converting into foreign currency the proceeds of current international transactions nor prevent such nonresident from using such proceeds for another current international transaction.[123]

3. Exchange Control Under Transitory Arrangements

Under Article XIV[124] a member that notifies the IMF of such member's intent to avail itself of transitional arrangements may, notwithstanding any

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[117] *Id.*

[118] *Id.* at 10.

[119] *Id.*

[120] *Ibid.*

[121] *Ibid.*

[122] *Id.* at 11-12.

[123] *Id.* at 11.. However, if a nonresident does not or fails to convert such proceeds or to use them in settlement of another current international transaction, they may become capital in the view of the monetary authorities of the restricting member and thus subject to capital controls.

[124] Article XIV provides:

Section 1. Notification to the Fund

> Each member shall notify the Fund whether it intends to avail itself of the transitional arrangements in Section 2 of this Article, or whether it is prepared to accept the obligations of Article VIII, Sections 2, 3 and 4. A member availing itself of the transitional arrangements shall notify the Fund as soon thereafter as it is prepared to accept these obligations.

Section 2. Exchange Restrictions

> A member that has notified the Fund that it intends to avail itself of transitional arrangements under this provision may, notwithstanding the provisions of any other articles of this Agreement, maintain and adapt to changing circumstances the restrictions on payments and transfers for cur-

other provisions of the Fund Agreement, 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. The availing member, however, is required, among others, to have continuous regard for the policies of the IMF, and soon as conditions permit, to take all possible measures to develop commercial and financial arrangements with other members that will facilitate international payments and the promotion of a stable system of exchange rates.

Moreover, the availing member must withdraw restrictions maintained pursuant to Article XIV as soon as such member is satisfied that it will be able, in the absence of such restrictions, to settle its balance of payments in a manner that will not unduly encumber their access to the general resources of the IMF. And to guard against abuse in the use of exchange restrictions maintained or imposed pursuant to Article XIV, the availing member is required to consult the IMF annually regarding the further retention of exchange restrictions.

C. Article VIII, Section 2(b)

Considering that the Fund Agreement allows under certain circumstances the maintenance or imposition of exchange control, it would only be natural that a multilateral agreement such as the Fund Agreement would contain a provision that would govern the effect, and the treatment by members, of exchange control that other members may maintain or impose. Thus, Article VIII, Section 2(b) of the Fund Agreement provides that:

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rent international transactions that were in effect on the date on which it became a member. Members shall, however, have continuous regard in their foreign exchange policies to the purposes of the Fund, and, as soon as conditions permit, they shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate international payments and the promotion of a stable system of exchange rates. In particular, members shall withdraw restrictions maintained under this Section as soon as they are satisfied that they will be able, in the absence of such restrictions, to settle their balance of payments in a manner which will not unduly encumber their access to the general resources of the Fund.

Section 3. Action of the Fund Relating to Restrictions

The Fund shall make annual reports on the restrictions in force under Section 2 of this Article. Any member retaining any restrictions inconsistent with Article VIII, Sections 2, 3 and 4, shall consult the Fund annually as to their further retention. The Fund may, if it deems such action necessary in exceptional circumstances, make representations to any member that conditions are favorable for the withdrawal of any particular restriction, or for the general abandonment of restrictions, inconsistent with the provisions of any other articles of this Agreement. The member shall be given a suitable time to reply to such representations. If the Fund finds that the member persists in maintaining restrictions which are inconsistent with the purposes of the Fund, the member shall be subject to Article XXVI, Section 2(a).

> 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. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

In view of the Fund Agreement's thrust toward the elimination of exchange restrictions, Prof. Nussbaum has argued that Article VIII, Section 2(b) of the Fund Agreement makes the document internally inconsistent, labelling Article I(iv) and Article VII, Section 2(b) as an "innate contradiction."[125] This argument is flawed because it assumes that the Fund Agreement does not distinguish between "exchange control" and "exchange restriction" and that the Fund Agreement was intended to eliminate completely the use of exchange control.

The Fund Agreement was not intended to eliminate absolutely and completely the use of exchange control as a legitimate means of alleviating pressure on balance of payment. Nor did the Fund Agreement completely prohibit and ban the use of exchange restrictions under all circumstances. As discussed earlier, Article VIII, Section 2(a) explicitly authorizes the IMF to approve and authorize the imposition of exchange restrictions on payments and transfers of current international transactions. Moreover, Article XIV allows a member to avail itself of transitional arrangements that would derogate from the prohibition under Article VIII, Section 2(a) and authorize availing members to "maintain and adapt to changing circumstances" restrictions on payments and transfers on current international transactions that were in effect on the date it became a member of the IMF.

Furthermore, the Fund Agreement distinguishes between exchange control in general and exchange restriction. In the context of the Fund Agreement, "exchange restriction" refers to the governmental prohibition of, limitation on, or hindrance to the availability or use of exchange in connection with current international transactions[126] and capital transactions.[127] Government regulations not having any of the foregoing effects are not exchange restrictions. The Executive Directors of the IMF have held that "[t]he guiding principle in ascertaining whether a measure is a restriction on payments and transfers for current transactions under Article VIII, Section 2, is whether it involves a direct governmental limitation on the availability or use of exchange as such."[128] The same principle, by analogy, may well apply to restrictions on

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[125] NUSSBAUM, MONEY (1950), *supra* note 99, at 540.

[126] *See* J. GOLD, THE INTERNATIONAL MONETARY FUND AND INTERNATIONAL LAW (IMF Pamphlet Series, 1965).

[127] Fund Agreement, Article VI, Section 3.

[128] Decision No. 1034-(60/27), June 1, 1960. *See* SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND AND SELECTED DOCUMENTS 281 (12th Issue 1986).

capital transactions, although restrictions on capital transfers are allowed under the Fund Agreement.[129]

1. Extraterritorial Effect of Article VIII, Section 2 (b)

There seems to be no serious doubt from the language of Article VIII, Section 2 (b), despite the lapses of ambiguity that will be discussed later, that the said provision was intended to give extraterritorial effect to the exchange control regulations of IMF member countries as applied to certain contracts. Even the United States and England, the leading exponents of the restrictive interpretation of this provision, have not posited that the provision was not intended to have that effect. Nor have they advocated that the provision should not yield such a result. They recognize such effect,[130] although confining it to the narrow realm of the type of contract that they believe to be the subject matter of the provision.

a. The IMF Interpretation

In all the history of Article VIII, Section 2 (b) it has been interpreted by the IMF only once. The IMF interpretative decision revolved entirely around the effect of the provision. The IMF Board of Executive Directors held 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.
>
> The meaning and effect of this provision are as follows:
>
> 1. Parties entering into exchange contracts involving the currency of any member of the Fund and contrary to exchange control regulations of that member which are maintained or imposed consistently with the Fund Agreement will not receive the assistance of the judicial or administrative authorities of other members in obtaining the performance of such contracts. That is to say, the obligations of such contracts will not be implemented by the judicial or administrative authorities, for example by decreeing performance of the contracts or by awarding damages for their non-performance.
> 2. By accepting the Fund Agreement members have undertaken to make the principle mentioned above effectively part of their national law. This applied to all members whether or not they availed themselves of the transitional arrangements of Article XIV, Section 2.
>
> An obvious result of the foregoing undertaking is that if a party to an exchange contract of the kind referred to in Article VIII, Section 2(b) seeks to enforce such contract, the tribunal of the country before which the proceedings are brought

[129] Fund Agreement, Article VI, Section 3.

[130] Between England and the United States, it is England that has given fuller meaning to the extaterritoriality of Article VIII, Section 2 (b). Discussed *infra*.

will not, on grounds that they are contrary to the public policy (ordre public) of the forum, refuse recognition of the exchange control regulations of the other member which are maintained or imposed consistently with the Fund Agreement. It also follows that such contracts will be treated as unenforceable notwithstanding that under private international law of the forum, the law under which the foreign exchange control regulations are maintained or imposed is not the law which governs the exchange contract or its performance.[131]

b. Consistency With the Fund Agreement: A Condition for Extraterritoriality

While the IMF interpretation confirmed that Article VIII, Section 2 (b) resulted in granting extraterritorial effect to exchange control regulations of IMF member countries, it should be emphasized that such effect can arise only if the exchange control regulations are maintained or imposed consistently with the Fund Agreement. This condition is obviously a logical consequence of the objectives of the Fund Agreement to establish a multilateral system of payments and to eliminate (although not absolutely[132]) exchange restrictions in general, and is of crucial importance in achieving such goals.[133]

When is an exchange control regulation maintained or imposed consistently with the Fund Agreement? An exchange control regulation is consistent with the Fund Agreement if it is impliedly allowed by the Fund Agreement itself or if it is expressly authorized by the IMF pursuant to and in accordance with the Fund Agreement.[134]

It has been suggested, however, that not all exchange control regulations generally authorized by the Fund Agreement itself without need of specific approval of the IMF should be viewed as necessarily consistent with the Fund Agreement within the meaning of the consistency condition of Article VIII, Section 2 (b).[135] This view questions and casts doubt on the wisdom of automatically treating exchange control regulations over which the IMF has no jurisdiction (obviously referring to restrictions on capital transfer which do not require IMF approval) as being consistent with the Fund Agreement and thus, requiring extraterritorial recognition of such regulations.[136] Under this proposition, the IMF should in those cases, at least when formally requested,

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[131]Decision No. 446-4, June 10, 1949. *See* SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND AND SELECTED DOCUMENTS 273-74 (12th Issue 1986).

[132]*See* discussions *supra*.

[133]*See* Williams, *Extraterritorial Enforcement of Exchange Control Regulations Under the International Monetary Fund Agreement*, 15 VA. J. INT'L. L. 320, 356 (1975) [hereinafter referred to as "Williams (1975)"].

[134]*See* 3 J. GOLD, THE FUND AGREEMENT IN THE COURTS 534 (1986) [hereinafter referred to as "GOLD, COURTS III"]; *see also* Williams (1975), *supra* note 133, at 360. For examples of exchange control regulations consistent with the Fund Agreement, *see* discussions under part II, B.

[135]EDWARDS, JR., INTERNATIONAL MONETARY COLLABORATION 481-84 (1985).

[136]*Id.* at 483-84.

make a contemporary assessment of the particular country's measure in relation to the Fund Agreement, taking into account the specific provisions and purposes of the Fund Agreement.[137]

The problem with this interpretation is that it loses sight of the fact that with respect to those exchange control regulations which it views as "beyond the jurisdiction" of the IMF (e.g. restrictions on capital transfers) the IMF members, by allowing the imposition of such regulations without need of specific IMF approval, effectively agreed in principle and recognized in advance that those regulations are not inconsistent with the purposes of the Fund Agreement.[138] Obviously, it is quite different to say that as a matter of legal fact these regulations are actually consistent with the Fund Agreement. A restriction on capital transfer, while allowed by the Fund Agreement without need of specific IMF approval, would certainly not be authorized under the Fund Agreement if it effectively restricts current international payments and transfers as well.[139] Such a restriction would certainly be inconsistent with the Fund Agreement, whether viewed under the specific provision that authorizes it or the Fund Agreement's general purposes.[140]

The words "maintained" and "imposed" have timing significance. The word "maintained" has been interpreted by some writers to refer to exchange control regulations which were in force on December 27, 1945, the date when the Fund Agreement entered into force.[141] It should also refer to exchange control regulations in effect at the time of accession to the Fund Agreement in order to cover the regulations of those states which acceded to the Fund Agreement after it had already entered into force.

On the other hand, the word "imposed" has been read to refer to newly introduced exchange control regulations,[142] *e.g.*, those that have been put in place after December 27, 1945 or after accession to the Fund Agreement. There seems to be no plausible reason, however, why the word "imposed" should not refer also to those exchange control regulations that were initially subsumed in the word "maintained" but which have been modified or amended subsequently. It would be an oddity in construction to interpret Article VIII, Section 2 (b) as excluding such changed regulations from its purview.[143]

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[137] *Ibid.*

[138] *See* GOLD, COURTS III, *supra* note 134, at 534.

[139] J. GOLD, THE INTERNATIONAL MONETARY FUND AND INTERNATIONAL LAW, *supra* note 126, at 13-14.

[140] This is not to say, however, that the IMF has regulatory authority over restrictions on capital transfers as such. It does not. This is an area where IMF member countries have not surrendered any portion of their sovereign power. *See* GOLD, COURTS III, *supra* note 134, at 540-41.

[141] F.A. MANN, THE LEGAL ASPECTS OF MONEY 395 (1982) [hereinafter referred to as "MANN (1982)"]; Williams (1975), *supra* note 133, at 356.

[142] Williams (1975), *supra* note 133, at 357; GOLD, COURTS III, *supra* note 134, at 66.

[143] *See* GOLD, COURTS I, *supra* note 100, at 66.

In the determination of consistency, the IMF must be regarded as the final arbiter of that question.[144] The American Law Institute has, however, opined that a statement by the IMF that a particular exchange control regulation is not consistent with the Fund Agreement would be conclusive, while a statement that it is consistent would merely be entitled to great weight and the courts are the ones required to make the final decision on the matter.[145] Almost along the same line is the opinion suggested by one writer that national courts can make a determination independently of the IMF.[146]

The views that courts have the same competence as the IMF fail to consider that it is the IMF that administers the Fund Agreement and that under Article XXXIX it is the IMF that has been granted the competence to interpret the provisions of the Fund Agreement.[147] Moreover, it would be too presumptuous to say that national courts have the same technical expertise as the IMF over matters being regulated by the IMF.

The view of the Reporter of the American Law Institute appears to be the most disturbing because it suggests that U.S. courts may disregard an interpretation of the IMF that a particular exchange control regulation is consistent with the Fund Agreement. This view, while conceivably true in municipal terms, can not certainly hold water from the point of view of international law, the matter being a treaty obligation.[148]

The Reporter's comment seems to suffer from the old notorious practice of appealing to separation of powers as an excuse for judicial disregard of international obligations.[149] This tactic has long been buried.[150] Under contemporary international law, a state is internationally responsible for the actions of its judicial organs.[151] This state responsibility is succinctly captured in the following words of Lord McNair, an eminent authority on international law:

> ...a State has a right to delegate to its judicial department the application and interpretation of treaties. If, however, the courts commit errors in that task or decline

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[144]*See* EDWARDS, JR., INTERNATIONAL MONETARY COLLABORATION *supra* note 135, at 480-81

[145]AMERICAN LAW INSTITUTE, FOREIGN RELATIONS OF THE UNITED STATES (REVISED), Tentative Draft No. 6, Vol I, Sec. 822, comment c.

[146]Williams, *Foreign Exchange Control Regulation and the New York Court of Appeals: J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda) Ltd.* 9 CORNELL L. J. 239, 247-48 (1976).

[147]*See* EDWARDS, INTERNATIONAL MONETARY COLLABORATION, *supra* note 135 at 37-39.

[148]*See* The David Adams Claim (United States v. Great Britain), 6 U.N. REP. INT'L. ARBITRAL AWARDS 85. *See also* McNAIR, THE LAW OF TREATIES 345-50 (1961) [hereinafter referred to as "McNAIR (1961)"].

[149]*See* L. HENKIN, INTERNATIONAL LAW, CASES AND MATERIALS 564 (1980).

[150]*Id.*

[151]*Ibid.; see also* I. BROWNLIE, SYSTEMS OF THE LAW OF NATIONS, STATE RESPONSIBILITY 144 (Part I 1983).

> to give effect to the treaty or are unable to do so because the necessary change in, or addition to, the national law has not been made, their judgments involve the State in a breach of treaty.[152]

Under the norm *pacta sunt servanda* states are required to observe treaty obligations in good faith.[153] The implication of the Reporter's comment—that a court can disregard an IMF ruling on the matter of consistency of a particular exchange control regulation with the Fund Agreement—would seem to fly in the face of this norm. It certainly detracts from the spirit of good faith for a court to disregard the ruling of a body that has, by treaty stipulation, competence on the matter.

c. The Content of the Rule of Extraterritoriality

Under Article VIII, Section 2 (b) exchange contracts which involve the currency of any IMF member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with the Fund Agreement are unenforceable in the territories of any IMF member. This result is the heart of the rule of extraterritoriality. Any lesser consequence would render the rule meaningless.

The expression of the effect flowing from the provisions of Article VIII, Section 2(b) in terms of an obligation not to enforce contravening exchange contracts readily suggests that a distinction is being drawn between positive, direct enforcement and negative enforcement of exchange control regulations. Article VIII, Section 2(b) does not require IMF members to take positive action to ensure compliance with an IMF member's exchange control regulations, rather it requires IMF members to recognize the exchange control regulations of other members and to take specific negative action to prevent such regulations from being subverted.[154] This distinction is supported by the fact that a proposal to create a positive obligation, by making it an offense to agree to exchange contracts that violate an IMF member's exchange control regulations was defeated at the Bretton Woods Conference.[155]

The preservation and effectiveness of the rule of extraterritoriality, however, depends upon the inability of the courts to resort to the familiar

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[152] McNAIR (1961) *supra* note 140, at 346.

[153] ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW [MAX PLANCK INSTITUTE FOR COMPARATIVE PUBLIC LAW AND INTERNATIONAL LAW 364-71(1984)]; Harvard Research in International Law, Draft Convention on the Law of Treaties, 29 AM. J. INT'L. LAW 977 (1985 Supplement); Kunz, The Meaning and Range of the Norm Pacta Sunt Servanda, 35 AM. J. INT'L. LAW 180 (1945).

[154] *See* GOLD, COURTS III, *supra* note 134, at 342; Gold-Terruzzi, *supra* note 98, at 782. *See also* Note, United States Enforcement of Foreign Exchange Control Laws—A Rule In Transition?, *supra* note 97, at 552.

[155] 1 PROCEEDINGS AND DOCUMENTS OF THE UNITED NATIONS MONETARY AND FINANCIAL CONFERENCE, Bretton Woods, New Hampshire, July 1-22, 1944, Doc. No. 236, at 334 and Doc. No. 307, at 502, cited in Williams (1975), *supra* note 133, at 362.

techniques discussed in Part I of this paper in blocking the operation of foreign exchange control regulations. If those techniques would be equally availing now as in the pre-Bretton Woods era, then extraterritoriality would be all but a matter of wishful thinking.

It was, therefore, hardly unexpected that the IMF Board of Executive Directors, if it were to keep faith with the spirit of the rule, concluded and held that unenforceability of contravening exchange contracts should result regardless of public policy considerations of the forum and conflict of law rules on choice of law.[156]

(i.) The Relation With Public Policy

As shown in Part I, public policy (or ordre public) of the forum has been for many years a basis for refusing to recognize foreign law when that law would have been applicable under the conflict of law rules of the forum.[157] The Fund Agreement, however, created a different legal environment. The purposes of the Fund Agreement and the particular provisions implementing them establish a monetary order that governs, in particular, the relations of member countries *inter se.* This monetary order, arising as it does from a treaty, constitutes an order superior to that of the member countries' respective municipal monetary orders. Viewed from an international plane, this superiority means that the policies of the Fund Agreement permeate each member's national monetary order and assert supremacy over such national order, with the latter deferring to the former.

In the setting of this new legal environment, and in light of Article VIII, Section 2(b), public policy may no longer be used by IMF member countries as a basis for refusing to recognize exchange control regulations of member countries that meet the conditions provided in Article VIII, Section 2(b).[158] Article VIII, Section 2(b) represents an international public policy,[159] and as such, dominates municipal public policy.[160] It is a policy that calls upon IMF member countries to recognize exchange control regulations of member countries in the manner required by the provision.

It should be noted that this international public policy asserts itself only in the relations of member countries *inter se.* The Fund Agreement does not require that member countries give effect to such policy in relation to a non-

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[156] *See* note 131, *supra*, and accompanying text.

[157] *See also* Gold, *"Exchange Contracts," Exchange Control and the IMF Articles of Agreement: Some Animadversions on Wilson, Smithett & Cope Limited v. Terruzzi*, 33 INT'L & COMP. L.Q. 617 (1984) [hereinafter referred to as "Gold, Terruzzi,"].

[158] *Id. See also* MANN (1982), *supra* note 141, at 375-376; Williams (1975), *supra* note 133, at 375-376; Fawcett (1964), *supra* note 111, at 44, 63-64.

[159] Gold, Terruzzi, *supra*, note 157, at 617. Meyer, *Recognition of Exchange Controls After the International Monetary Fund*, 62 YALE L. J. 896 (1953) [hereinafter referred to as "Meyer (1953)"].

[160] *See* GOLD, COURTS III, *supra* note 134, at 620.

member country.[161] Nor can it be regarded as being binding upon nonmember countries in their relations with member countries.[162]

It has been suggested that since so many of the countries of the world are members of the IMF, public policy as a basis for refusing to recognize foreign exchange control regulations should no longer be available even to nonmembers.[163] Despite the ideal holistic effect of the suggestion, it is of doubtful validity. First of all, it suffers from lack of symmetry. It does not assert that member countries should observe the same policy in their relations with nonmember countries. Secondly, the perceptible attempt of member countries to limit the application of this policy in their relations with each other, some courts giving no more than lip service to Article VIII, Section 2 (b), argues against the emergence, even as of this time, of this policy as a customary rule of international law.

The notion of an international public policy dominating national public policy, especially national economic and monetary policy considerations, has received different reactions from member countries. Some courts have been guided by that notion and have decided cases in that spirit. Others, as insinuated earlier, seem to pay no more than lip service to the policy of Article VIII, Section 2 (b).

West Germany is one member that has been consistently guided by the policy of Article VIII, Section 2 (b). The cases decided by West German courts and the legal principles enunciated in such cases live up, almost to an ideal degree, to the spirit of this policy.[164]

In contrast, however, U.S. courts seem to have managed to neutralize the primacy of the policy enunciated in Article VIII, Section 2 (b) by exploiting its ambiguous language and resorting to narrowing interpretations of the provision.[165] By proceeding on a narrow interpretation, the courts seem to have adroitly side-stepped the highly sensitive issue of assimilating into national policy the policy of Article VIII, Section 2 (b). For once a contract is determined to be not an exchange contract, as such term is narrowly construed, it becomes relatively easy to stick to the traditional role of public policy *vis-a-vis*

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[161] *See* Birger v. Tuner, 427 N.Y.S.2d 904 (1980); Varas v. Crown Life Insurance Company 203 A.2d 505, 510 (1964); Stephen v. Zivnostenska Banka National Corporation, 140 N.Y.S.2d 323, 326 (1955). *See also* GOLD, COURTS III, *supra* note 134, at 798; GOLD, THE FUND AGREEMENT IN THE COURTS 91 (1982) [hereinafter referred to as "GOLD, COURTS II"]; J. GOLD, THE FUND AND NON-MEMBER STATES: SOME LEGAL EFFECTS (IMF Pamphlet Series No. 7, 1966).

[162] *See* Krispis, Money in Private International Law, 120 RECUIEL DES COURS 306 (1967) [hereinafter referred to as "Krispis (1967)"].

[163] *See* Williams, *Extraterritorial Enforcement of Exchange Control Regulations Under the International Monetary Fund Agreement*, 15 VA. J. INT'L. L. 376 (1975) [hereinafter referred to as "Williams (1975)"].

[164] *See* Sir Joseph Gold's suggested summary of German law on the application of Article VIII, Section 2 (b), in GOLD, THE FUND AGREEMENT IN THE COURTS 284-87 (1986) [hereinafter referred to as "GOLD, COURTS III"].

[165] *Id.* at 620.

foreign exchange control regulations since the policy of Article VIII, Section 2 (b) asserts itself only in cases involving contracts covered by this provision.[166]

In this regard, one can get the sense, on the basis of recent court opinions, that purely national motivations and considerations continue to have a powerful and compelling influence over the resolution of U.S. cases that implicate Article VIII, Section 2 (b). A glaring example is the case of *J. Zeevi and Sons, Ltd.* v. *Grindlays Bank (Uganda) Limited.*[167] The decision was redolent with domestic policy considerations of preserving New York as a "preeminent" international financial center.[168] It would not be unjustified to surmise that these considerations greatly colored the decision of the court.[169]

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[166]Sir Joseph Gold, however, is of the view that there is an international public policy in relation to exchange control regulations even when Article VIII, Section 2 (b) does not apply. GOLD, COURTS II, *supra* note 161, at 221-22; GOLD, COURTS III, *supra* note 164, at 424-25; Gold, *Exchange Control: Act of State, Public Policy, the IMF's Articles of Agreement, and Other Complications*, 7 HOUS. J. INT'L. L. 13, 39-40 (1984). The view of Sir Joseph Gold appears to be based on the notion of international monetary interdependence among members of the IMF. The writer agrees that such interdependence can, in part, be the source and basis of normative principles in the treatment by national courts of exchange control regulations of IMF member countries. For instance, in the restructuring of an IMF member's external debt, to the extent that such member's exchange control regulations form part of the package of fiscal and monetary reforms approved by the IMF (such measures being a usual condition to external debt restructuring agreements), there seems to be no justifiable reason why these exchange control regulations should not be recognized by other IMF members even in situations that involve contracts (and this regardless of the narrowness or broadness of the interpretation that may be given to the term "exchange contracts") that do not fall within the ambit of Article VIII, Section 2 (b). But here, the basis for the policy is not merely the notion of international monetary interdependence but also, and more importantly, the fact that the members' governments actively support, and are almost always party to the public debt aspect of, the restructuring program. Member countries should ensure that the restructuring program succeeds in rehabilitating the floundering member's economy. Such a program, and the cooperation of member countries, in fact, fall well within the purposes of the Fund Agreement, which purposes no doubt ought to be assimilated into each member's national policy. The writer, however, has reservations about the extension of the international public policy to dissimilar situations. The writer believes that the expansive position suggested by Sir Joseph Gold, if taken beyond the restructuring example (and similar situations), may actually beg the question with respect to the meaning, of "exchange contracts." The term "exchange contracts" was intended to convey a meaning, to cover certain contracts and to exclude others. Viewed in this light, there would be no intention to impress an affirmative policy with respect to contracts that were not intended to be subsumed in the term "exchange contracts." If it were otherwise, the writer can not comprehend why a more general term was not used.

[167]37 N.Y.S.2d 220, 333 N.E.2d 168, 371 N.Y.S.2d 892 (1975).

[168]*See also* GOLD, COURTS III, *supra* note 164, at 606-08, 620.

[169]The primacy of the policy enunciated in Article VIII, Section 2 (b) seems to have been favorably endorsed by the Reporter of the American Law Institute in the revision work of the Restatement of Foreign Relations Law of the United States. *See* GOLD, COURTS III, *supra* note 164, at 708. The Reporter commented that when presented with a defense in an action to enforce an exchange contract covered by Article VIII, Section 2 (b) based on alleged inconsistency of the contract with an exchange control regulation of a member country, a U.S. court would proceed as follows: (1) decide whether the regulation is applicable to the transaction, (2) inquire whether the exchange control is maintained and imposed consistently with the Fund Agreement, and (3) determine whether the contract is an "exchange conract" under Article VIII, Section 2 (b). AMERICAN LAW INSTITUTE, FOREIGN RELATIONS LAW OF THE UNITED STATES (REVISED), Tentative Draft No. 6, Volume 1, § 822, comment a. If the answers to all three questions are affirmative, the court must give effect to the foreign exchange control regulation and deny the claim.

In general, the American scenario is not unique. National courts have oftentimes been captive to the practice of deciding sensitive issues by determining first, on the basis of national interest and other compelling policy considerations, the desirable result of a given case. Once that result becomes clear, it then becomes a matter of marshalling the requisite legal arguments to support the result. This practice is so commonplace that it hardly needs citation of supporting authorities. However, in the new era of international fiscal and monetary relations marked by the Bretton Woods Conference, when the thrust is toward a global fiscal and monetary system, the continuance of the practice adverted to above represents another dark chapter in the story of misguided nationalism and parochialism.

(ii.) The Relation With Private International Law

Ordinarily, in cases involving contracts or transactions with a foreign element, the forum's court would determine questions bearing on enforceability, among others, on the basis of the law determined by the forum's conflict of law rules as the applicable law.[170] And, as discussed in Part I, the reasons given by the courts in refusing the application of foreign exchange control regulations are that such regulations are not part of the governing law, or, in case the said regulations do form part of the governing law, that the regulations are not part of the law of the place of performance of the contract or transaction. Article VIII, Section 2 (b) overrides this approach.

By operation of Article VIII, Section 2 (b), the relevant exchange control regulations (i.e. the regulations of the member whose currency is involved) have to be applied for the purpose of addressing the issue of whether or not an exchange contract violates such exchange control regulations. According to the IMF interpretation, effect should be given to the exchange control regulations of the member whose currency is involved even if the exchange contract in question is not governed by the law of that member or even if that member is not the place of performance.

An interesting question that has been raised (and which has been the subject of some debate) is whether Article VIII, Section 2 (b) is (or expresses) a substantive rule or a conflict of law rule.

It is submitted that Article VIII, Section 2 (b) is not a conflict of law rule, but rather a substantive rule. Indeed as Professor Mann points out, Article VIII, Section 2(b) is not couched in terms of a conflict rule.[171] It mandates the unenforceability of contravening exchange contracts. For this reason, it is uncharacteristic of a conflict rule. Conflict rules merely direct the forum to the

[170] Of course, even if the contract is determined to be enforceable under the foreign law, the forum may still decline to enforce the contract or transaction if it is contrary to the forum's public policy, or under any of the other exceptions to comity.

[171] *See* F.A. MANN, THE LEGAL ASPECTS OF MONEY 374 (1982) [hereinafter referred to as "MANN (1982)"].

applicable governing law and do not expressly determine the appropriate disposition of the question to be resolved.[172]

As a substantive rule (binding upon all members of the IMF), Article VIII, Section 2 (b) necessarily makes conflict of law rules irrelevant. Substantive rules are discrete and distinct from conflict rules. Its force as a rule of law does not depend upon its favorable reception and recognition under traditional conflict of law rules.[173] It constitutes the law among the members of the IMF with respect to the treatment of exchange contracts that contravene the applicable exchange control regulations.

To regard the interpretation of the IMF Board of Directors of Article VIII, Section 2(b)[174] as suggesting that the provision is some form of an international conflict of law rule[175] would be incorrect. The interpretation of the IMF Board of Directors merely clarifies that the pre-Bretton Woods approach in barring the application of foreign exchange control regulations by the use of traditional conflict of law analyses would no longer be available under the regime of the Fund Agreement. It said so since such conflict of law approach and analyses would obviously be inconsistent with the purpose of the rule expressed in Article VIII, Section 2 (b) and would allow the frustration of its application and observance.[176]

The confusion may lie in the fact that the unenforceability mandated by Article VIII, Section 2 (b) depends on the legal position that an exchange contract bears in relation to a foreign exchange control regulation, that of the member whose currency is involved. This obviously directs the forum to that foreign exchange control regulation, and as such makes it seem that the application of such foreign exchange regulation was a product of an application of conflict of law rules. This seeming tendency should, however, be viewed in the light of the legal regime being established by the Fund Agreement. The Fund Agreement is determined to give recognition to the exchange control regulations of member countries for the limited purpose contemplated by Article VIII, Section 2 (b).[177] As such, and with respect to a particular exchange contract, the life of the substantive rule it expresses is and ought to be drawn from the relevant exchange control regulation. To this extent, it also

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[172] *E.g.*, "The forms and solemnities of contracts, wills and other public instruments shall be governed by the law of the country in which they are executed." CIVIL CODE OF THE PHILIPPINES, Art. 17(1).

[173] *See* GOLD, COURTS III, *supra* note 164, at 573-74 (The provision makes mandatory norms of foreign exchange control regulations. Accordingly, no rule of private international law can be called in aid to prevent application of the foreign exchange regulations to which the provision applies.); *see also* GOLD, COURTS II, *supra* note 161, at 66.

[174] Discussed *supra*.

[175] In the sense that it is superior to traditional municipal conflict of law rules and analysis.

[176] "The purpose of the rule is to provide a certain measure of support for the exchange control regulations of a member if they are consistent with the Articles of Agreement." GOLD, COURTS II, *supra* note 161, at 66.

[177] GOLD, COURTS II, *supra* note 161, at 66.

raises that exchange control regulation to the level of a substantive rule that ought to be recognized by all member countries.

It is important to note, however, that in the ultimate analysis, the bottom line of these differing views is that courts may no longer resort to the pre-Bretton Woods approach of barring the application of foreign exchange control regulations on the ground that the foreign law of which the exchange control regulation is a part is not the governing law, or that the relevant foreign country is not the place of performance under the forum's conflict of law rules.

The importance, in substantive rule terms, and applicability of exchange control regulations is, however, limited. It is confined to the precise purpose of addressing the issue of enforceability of exchange contracts found to be in violation of the relevant exchange control regulation. In that narrow but important aspect, the courts or administrative agencies of any member country, in the event that member becomes the forum of a suit or other proceeding implicating an exchange contract, may not lend assistance in enforcing such contract, if it contravenes the exchange control regulation of any other member country whose currency is involved.

However, questions relating to contracts in general (e.g. capacity of the parties, compliance with legal formalities, substantive validity of the terms of the contract) would still be resolved by the law determined by the forum's conflict rules to be applicable to such questions. These areas are not preempted by Article VIII, Section 2 (b).[178]

(iii.) The Meaning of Unenforceability

The use of the term "unenforceable" in the text of Article VIII, Section 2 (b) has raised some controversy among scholars[179] about its meaning.[180] The view supported by most writers is that it means exactly what it suggests literally; accordingly, Article VIII, Section 2 (b) does not render an exchange contract invalid, void or illegal.[181] The minority view is that Article VIII, Section 2 (b) operates to render the exchange contract invalid.[182]

It is submitted that Article VIII, Section 2 (b) does not operate to render an exchange contract invalid, void or illegal. It merely commands member countries to desist from giving assistance in obtaining the performance of an exchange contract that violates the relevant member's exchange control

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[178] *See* GOLD, THE FUND AGREEMENT IN THE COURTS 67, 141 (1982) [hereinafter referred to as "GOLD, COURTS III].

[179] *See* GOLD, COURTS III, *supra* note 164, at 774-75.

[180] *See* 2 P. WOOD, LAW AND PRACTICE OF INTERNATIONAL FINANCE 5-16 (1986) [hereinafter referred to as "WOOD 2"].

[181] *See* GOLD, COURTS II, *supra* note 178, at 140-41.

[182] *See* MANN (1982), *supra* note 171, at 377-79, 398-99. Other writers sharing this view are cited in GOLD, COURTS III, *supra* note 164, at 774.

regulations. Other legal consequences beyond this small, but obviously important, measure of support given by the Fund Agreement for exchange control regulations of member countries are no longer within the province of the Fund Agreement, and neither are these consequences, in the precise context of Article VIII, Section 2 (b), relevant considerations for member countries for the purpose of complying with the mandate of the provision.[183]

This interpretation is more in accord with what has been stated earlier that Article VIII, Section 2 (b) does not, and was not designed to, enforce by positive and affirmative action the exchange control regulations of member countries. Holding offending exchange contracts to be void or illegal, especially where that would be the consequence under the laws of the member whose currency is involved, would amount to a positive and direct enforcement of exchange control regulations.

Such an interpretation also squares with the IMF interpretation. In the words of the IMF Executive Board of Directors, Article VIII, Section 2 (b) means that parties to an exchange contract that contravenes the exchange control regulations of a member whose currency is involved "will not receive the assistance of judicial or administrative authorities of other members in obtaining performance of such contracts."[184]

Cognizance of the precise consequence contemplated by Article VIII, Section 2 (b) for exchange contracts that violate relevant exchange control regulations is important. Its importance goes beyond mere philosophical or academic discussion; its implications strike at the heart of judicial or administrative disposition of cases that involve exchange contracts.

It is very possible that the law of the forum or the governing law provides that a supervening event, such as a change in the applicable law, will not have

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[183]This is not to suggest that courts are obligated, by implication, not to declare illegal or void exchange contracts found to be in violation of the relevant exchange control regulations. No such implication can be drawn from Article VIII, Section 2 (b). Courts are free to give, and are by no means constrained by the terms of Article VIII, Section 2 (b) from giving full effect to foreign exchange control regulations, and may enforce by positive and direct action such regulations. Such a broader measure is in fact recognized by Article VIII, Section 2 (b), the second sentence of which provides that:

> In addition, members may by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either country more effective, provided that such measures and regulations are consistent with the Agreement.

But that is a matter addressed exclusively to the policy of each forum. Thus, for example, in Banco Frances e Brasileiro S.A. v. Doe, 370 N.Y.S. 2d 591, 539 (1975), the court allowed recovery of damages by a state bank in an action involving a scheme to circumvent exchange control regulations, despite the recognition that the terms of Article VIII, Section 2 (b) did not require a member to take additional action beyond refusing to lend assistance in enforcing the performance of exchange contracts that violate the relevant exchange control regulations. In fact some courts have taken the position that exchange contracts that violate the relevant exchange control regulations are void. *See* Clearing Dollar Case, 22 INT'L L. REP. 730 (1955).

[184]Decision No. 446-4, June 10, 1949. *See* SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND AND SELECTED DOCUMENTS 273 (12th Issue 1986).

the effect of making a contract or transaction, illegal or void at its inception, legal or lawful. In this context, if Article VIII, Section 2 (b) is construed as declaring void or illegal offending exchange contracts, then an exchange contract will remain void or invalid despite the fact that at the time of suit or before judgment, the relevant exchange control regulations have been modified and changed in such a way that the exchange contract in question can no longer be characterized as an offending exchange contract.

On the other hand, if the offending exchange contract is merely unenforceable, and if at the time of suit or before judgment, the relevant exchange control regulations have been abrogated, or have been changed or modified in such a way that the exchange contract in question is no longer in violation of exchange control regulations, then the exchange contract would be enforceable.[185] As pointed out by Sir Joseph Gold in his critique of Professor Mann's view, nothing would be protected by regarding a contract as unenforceable when, at the time performance is sought, the contract has become consistent with all applicable exchange control regulations.[186] Under such circumstances, no policy of the Fund Agreement would be served by refusing to enforce the exchange contract.[187]

Corollary to the foregoing, an exchange contract would be unenforceable, even if at the time it was made it was not contrary to the then prevailing exchange control regulations, if at the time of suit for enforcement it has become, by reason of subsequent changes or modifications to such exchange control regulations, contrary to the changed or modified exchange control regulations.[188] To hold otherwise would be to deny recognition to the relevant member's exchange control regulations; and thus, eschew from the historic purpose of the provision, which is to give some measure of support to the exchange control regulations of member countries.[189]

Moreover, unenforceability should still result even if the change or modification in the exchange control regulations took place after the filing of the suit for enforcement so long as the said change or modification takes effect before judgment. The same arguments and considerations discussed above apply to this situation.

The rule of unenforceability brings out another important facet of Article VIII, Section 2 (b), one that limits the applicability and reach of the provision. Article VIII, Section 2 (b) applies only to wholly executory exchange contracts and to exchange contracts that have been partially performed, where the

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[185] *See* GOLD, COURTS II, *supra* note 178, at 141.

[186] GOLD, Article VIII, Section 2 (b) and the Unenforceability of Certain Exchange Contracts: A Note, in 4 IMF STAFF PAPERS 330, 334 (1954-55).

[187] *Ibid.*

[188] GOLD, COURTS II, *supra* note 178, at 141.

[189] *See* Gold, Article VIII, Section 2 (b) and the Unenforceability ot Certain Excange Contracts: A Note, IMF STAFF PAPERS 330, 334 (1954-55).

performance of the outstanding part would violate the relevant exchange control regulations.[190]

2. The Scope of Article VIII, Section 2 (b)

The scope of Article VIII, Section 2 (b) is determined largely by the meaning of "exchange contracts." The term, however, is not defined in the provision. Neither has it been interpreted by the IMF.

As with any problem of interpretation, we shall turn for guidance to the drafting history of Article VIII, Section 2 (b), the works of scholars, and the decisions of the courts.

a. **The Drafting History**

The *travaux preparatoires*[191] of Article VIII, Section 2 (b) raises some interesting insights on the possible meaning of "exchange contracts." It is, however, inconclusive. The *travaux preparatoires* leaves a number of important questions unanswered. The most that can be gathered from them are inferences which cannot be corroborated by the records of the Bretton Woods Confrence.

The United States and English delegates to the Bretton Woods Conference are largely responsible for what is now Article VIII, Section 2 (b). The provision arose in the context of negotiations on par value and exchange rate policies, in view of the strong concern of the English delegates with respect to the possible erosion of the value of the sterling.

The provision first appeared as part of the section then bearing the heading "Foreign Exchange Dealings Based on Par Values." It read as follows:

> Exchange transactions in the territory of one member involving the currency of any other member, which evade or avoid the exchange regulations prescribed by that other member and authorized by this Agreement, shall not be enforceable in the territory of any member.[192]

The words "exchange transactions" were apparently used in a technical sense, *i.e.*, transactions involving an exchange of currency of one member for the currency of another member.[193] This reading is supported by the fact that

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[190]*See* GOLD, THE FUND AGREEMENT IN THE COURTS 797 (1986) [hereinafter referred to as "GOLD, COURTS III."]

[191]The drafting history of Article VIII, Section 2 (b) is found in PROCEEDINGS AND DOCUMENTS OF THE UNITED NATIONS MONETARY AND FISCAL CONFERENCE, PUBLICATION NO. 2866, DOC. NOS. 32, 172, 191, 236, 238, 307, 326, 343, 370, 374, 393, 448, INT'L ORG. & CONF. SER. 1, No. 3 (U.S. State Dept. 1948) [hereinafter referred to as "PUBLICATION NO. 2866"].

[192]DOC. NO. 32, PUBLICATION NO. 2866, at 54.

[193]*See* Nussbaum, Exchange Control and the International Monetary Fund, 59 YALE L. J. 421, 426 (1950).

the provision was concerned with protecting par values. The Fund Agreement prior to the Second Amendment which abolished the par value system, recognized that purchase and sale of currencies, at unregulated rates, could be harmful to the value of a member's currency, having itself established the standards by which such transactions could be regulated. In fact, "exchange transactions" is used in other provisions of the Fund Agreement,[194] and is there employed to denote the same technical sense.

On July 7, 1944, the Polish delegation proposed an addition to the draft that would require members to cooperate in making effective controls and regulations.[195]

> To cooperate with other member countries in order to enable them to render really effective such controls and restrictions as these countries might adopt or continue, with the approval of the Fund, for the purpose of regulating international movement of capitals.[196]

On July 9, 1944, the English delegation submitted a revised version of the first draft:

> Exchange transactions in the territory of one member involving the currency of any other member, which evade or avoid the exchange regulations prescribed by that other member and authorized by this Agreement, shall be an offense in the territories of all members.[197]

On July 11, 1944, the Drafting Committee of Commission I submitted the following language as a variation:

> Exchange transactions in the territory of one member involving the currency of any other member which are outside the prescribed variation from parity set forth in (a) above shall not be enforceable in the territory of any member country.
>
> Each member agrees to cooperate with other members in their efforts to effectuate exchange regulations prescribed by such members in accordance with this Agreement.[198]

On July 12, 1944, the Drafting Committee discussed the three versions with Commission I.[199] Commission I, however, did not make a choice

[194] Article IV, Sections 3 and 4; Article XI, Section 2.

[195] *See* GOLD, COURTS II, *supra* note 178, at 432; Meyer, *Recognition of Exchange Controls after the International Monetary Fund,* 62 YALE L. J. 882 (1953) [hereinafter referred to as "Meyer (1953)"].

[196] DOC. NO. 191, PUBLICATION 2866, at 230; *see also* GOLD, COURTS II, *supra* note 178, at 432; Meyer (1953), *supra* note 195, at 982.

[197] DOC. NO. 236, PUBLICATION 2866, at 334; *see also* GOLD, COURTS II, *supra* note 178, at 432.

[198] *See* DOC. NO. 307, PUBLICATION NO. 2866, at 502; *see also* DOC. NOS. 326 AND 343, PUBLICATION NO. 2866, at 542-43 and 575-76, respectively.

[199] DOC. NO. 370, PUBLICATION NO. 2866, at 599. *See* GOLD, THE FUND AGREEMENT IN THE COURTS 433 (1982) [hereinafter referred to as "GOLD, COURTS II"; Williams, *Extraterritorial Enforcement of Exchange Control Regulations Under the International Monetary Fund Agreement,* 15 VA. J. INTL. L. 326 (1975) [hereinafter referred to as "Williams (1975)"].

between the first draft and the variation proposed by the Drafting Committee.[200] Instead, Commission I referred the matter to a new Special Committee, which committee later asked the Drafting Committee to reconcile the difference between the language of its proposed variation and that of the first version.[201]

On July 16, 1944, the Drafting Committee came out with a provision appearing for the first time as Article VIII, Section 2 (b), which with a few changes, would become the present text of Article VIII, Section 2 (b).

> Exchange contracts, which involve the currency of any member and 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 country.
>
> In addition, members may, by mutual accord, co-operate in measures for the purpose of making the respective exchange control regulations of either member more effective, provided that such measures and regulations are consistent with the Agreement.[202]

In July 18, 1944, a text of the Fund Agreement was circulated, in which the present language of Article VIII, Section 2 (b) appeared. The Second Report of the Drafting Committee accompanying the text of the Fund Agreement declared:

> All material contained in this report has been approved in principle by the Commission at previous sessions. The present report contains, however, a new formulation of certain provisions to which I should specifically draw the attention of the Commission.

These are:

> 2. Paragraph (b) of Section 2 of Article VIII... dealing with the enforceability of exchange contracts contrary to the exchange control regulations of members and measures of cooperation to enforce exchange control regulations....[203]

The transposition of the provision from its originally contemplated place—as part of the Article on par values—to Article VIII, dealing with the general obligations of members, and its extrusion from its originally contemplated context are not explained in the records. Neither do the records shed any light regarding the motivation for the shift. Nor does it explain the purpose of the change from "exchange transactions" to "exchange contracts" and the meaning of the new words.

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[200] *See* GOLD, COURTS II, *supra* note 199, at 433.

[201] DOC. NO. 374, PUBLICATION NO. 2866, at 605. *See* GOLD, COURTS II, *supra* note 199, at 433; Meyer (1953), *supra* note 195, at 882; Williams (1975), *supra* note 199, at 326.

[202] DOC. NO. 413, PUBLICATION NO. 2866, at 671. *See* GOLD, COURTS II, *supra* note 199, at 434; *see also* Meyer (1953) *supra* note 195, at 882; Williams (1975), *supra* note 199, at 326-27.

[203] DOC. NO. 448, PUBLICATION NO. 2866, at 808.

All these unanswered points make unsatisfactory reliance on the drafting history of Article VIII, Section 2 (b) as a compelling source of light for divining the meaning of "exchange contracts." Despite the incompleteness of the records, some commentators have, however, relied on the *travaux preparatoires* to support their respective interpretations.

II. The Commentaries

Professor Nussbaum, an influential writer on Article VIII, Section 2 (b), is the leading proponent of the restrictive interpretation of "exchange contracts." He construes them in a very narrow sense, *i.e.*, as meaning contracts whose object is to exchange currencies.

> Already the first words, "exchange contracts," confront us with a grave problem. That phrase is by no means self-explanatory. "Exchange transactions" is more familiar and is used repeatedly elsewhere in the Agreement. As was seen, Section 2 (b) was originally drafted in terms of "exchange transactions." Obviously "exchange contract" was supposed to have a narrower significance. This gives at least some hint at interpretation. Exchange transactions are generally understood to mean transactions which have as their immediate object exchange, that is, international media of payment. The meaning of "exchange contracts" cannot be broader... The criteria of "exchange contracts" must be gathered from the [Fund] Agreement itself. The latter is exclusively concerned with the handling of media of payment as such. Therefore, contracts involving securities or merchandise cannot be considered as exchange contracts except where they are monetary transactions in disguise.[204]

Professor Nussbaum's analysis is unsatisfactory. He does not explain why "transactions" was changed to "contracts." Neither does he try to explain away the significance, no matter how *de minimis*, if that be the case, of the extrusion of the provision from its original context, as a measure to protect the par value of the currencies of members. Moreover, it is glaringly inaccurate to say that the Fund Agreement is "exclusively concerned with the handling of international media of payment as such." Article 1 of the Fund Agreement quite clearly provides for a much broader economic concern than the mere handling of international media of payment. These omissions and inaccuracy lend a certain remarkableness to the way Professor Nussbaum arrived at his "obvious" conclusions as to make his extrapolations distressing.

Professor Mann, another leading writer on Article VIII, takes the opposite view. He construes "exchange contracts" in an expansive sense.[205] His

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[204]Nussbaum, Exchange Control and the International Monetary Fund, *supra* note 193, at 426.

[205]A broad interpretation is supported by a number of other prominent scholars. *See* Fawcett, The International Monetary Fund and International Law, 40 BRITISH YEARBOOK INT'L L. 32 (1964) [hereinafter referred to as "Fawcett (1964)"]; Meyer (1953), *supra* note 195, at 886-87; Krispis (1967), *supra* note 97, at 286-90; Schnitzer, The Legal Interpretation of Article VIII, 2 (b) of the Bretton Woods Agreement, in Report of the Forty-Seventh Conference of the International Law Association, Dubrovnik (1956), Annex III; Meichsner, The Legal Interpretation of Article VIII, 2 (b) of the International Monetary Fund Agreement, in Report of the Forty-Seventh Conference of the International Law Association, Dubrovnik (1956); Williams (1975), *supra* note 199, at 344. *See also* EDWARDS, JR., INTERNATIONAL MONETARY COLLABORATION 488 (1985).

view puts emphasis on the general economic character and objectives of the Fund Agreement. He argues that "exchange contracts" are contracts which in any way affect a country's exchange resources.[206] According to him, such interpretation would be in better harmony with the purpose of the Fund Agreement and the true intentions of its authors.[207] He suggests, in effect, that the word "exchange," is a surplusage and ought to be disregarded, no matter how inconsistent that excision may be with settled principles of interpretation.[208]

Professor Mann's view that the broad interpretation is in better harmony with the "true intentions" of the authors of Article VIII, Section 2 (b) cannot be taken at face value. As earlier analyzed, the *travaux preparatoires* does not shed light on the "true intentions" of the Drafting Committee. There are no recorded minutes of any discussions with respect to the change in language of Article VIII, Section 2 (b), much less its extrusion from its original context.

Sir Joseph Gold, who is, perhaps, the most prolific writer on Article VIII, Section 2 (b), also argues for a broad interpretation of "exchange contracts." As with Professor Mann, he emphasizes the broader economic character of the provisions of the Fund Agreement, as distinguished from the narrower economic concern of protecting par values (before that system was eliminated by the Second Amendment to the Fund Agreement).[209] Unlike Professor Mann, however, Sir Joseph does not propose to disregard the word "exchange." To Sir Joseph, the word "exchange," which technically refers to international media of payment, characterizes and broadens, but not unrestrictedly, the word "contracts."[210] He, therefore, suggests that "exchange contracts" are contracts under which international payments or transfers are to be made, whatever else may have to be rendered or done under the terms of the contracts.[211]

Sir Joseph's views regarding the role of the word "exchange" and the generic character of the word "contracts" are plausible, and are not inconsistent with settled principles of interpretation. However, despite the demonstrably broader economic character of the Fund Agreement and the plausibility of Sir Joseph's view regarding the function of the word "exchange," it is still uncertain whether the drafters of the provision did intend to give the

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[206] *See* F.A. MANN, THE LEGAL ASPECTS OF MONEY 385 (1982) [hereinafter referred to as "MANN (1982)"].

[207] *See Ibid.*

[208] *See Ibid.*

[209] GOLD, COURTS III, *supra* note 190, at 787.

[210] *See Id.* at 788.

[211] *See* GOLD, COURTS III, *supra* note 190, at 788. The characterizing function of the word "exchange" then serves to prevent contracts not involving settlement by means of international media of payment from being swept into the word "contracts." *See,* Gold, *"Exchange Contracts," Exchange Control, and the IMF Articles of Agreement: Some Animadversions on Wilson, Smithett & Cope Limited v. Terruzzi.* 33 INT'L & COMP. L. Q. 794 (1984) [hereinafter referred to as Gold, Terruzzi].

words "exchange contracts" a broader meaning than "exchange transactions." It is possible that the drafters intended to reach only the narrower class of contracts adverted to by Professor Nussbaum. The lack of precision in the drafting of the provision deters us from declaring definitely what the drafters really meant by the words "exchange contracts."

c. The Court Interpretations

The words "exchange contracts" have received at least two conflicting interpretations from the courts. The New York courts and the English courts have given the words a restrictive meaning, although the English courts have expressed and have shown a willingness to disregard the form of the contract in order to render unenforceable transactions found to fall within the class of contracts that they understand to be within the contemplation of the words "exchange contracts." The West German courts, on the other hand, have given the term an expansive interpretation. Each interpretation has been influenced substantially by the writings of Professors Nussbaum and Mann.

(i.) The View of the New York Courts

Initially, it seemed that the New York courts were inclined to interpret Article VIII, Section 2 (b) broadly.

In *Perutz* v. *Bohemian Discount Bank*,[212] the New York Court of Appeals, the highest court of New York, affirmed the lower court's dismissal of a suit to recover pension money from a Czechoslovakian bank on the ground that Czechoslovakian currency law governed the transaction. The suit was commenced by a naturalized American citizen, who was formerly a Czechoslovakian citizen. At the time of suit, the currency laws of Czechoslovakia prohibited its residents from making payments in foreign currency or in foreign exchange to a nonresident unless licensed by the Czechoslovakian currency authority.

The *Perutz* case raised two important points. First, it held that Czechoslovakian currency control laws could not be deemed offensive to U.S. policy since both the United States and Czechoslovakia, at that time, were members of the IMF. Second, it applied Czechoslovakian currency laws to a pension contract, a contract which under a restrictive interpretation of Article VIII, Section 2 (b) would not fall within the scope of the provision.

The case, however, did not expressly mention Article VIII, Section 2 (b). Moreover, the *Perutz* court did not explain how the Fund Agreement required the court to defer to and recognize the effect of Czechoslovakian currency laws.

[212] 304 N.Y. 533, 110 N.E.2d 6 (1953).

The silence of the *Perutz* court regarding the applicability of Article VIII, Section 2 (b) to pension contracts was perhaps serendipitous. Because ten years later, the New York Court of Appeals would hold that "exchange contracts," as used in Article VIII, Section 2 (b), referred only to contracts that had for their immediate object the exchange of the currency of one member for the currency of another country.

In *Banco do Brasil, S.A. v. A.C. Israel Commodity Co., Inc.*,[213] a U.S. corporation and a Brazilian company entered into an agreement for the purchase and sale of Brazilian coffee. The plaintiff, an instrumentality of the Brazilian government sought to recover damages from the U.S. corporation, alleging that the latter participated in, and profited from, a scheme to evade Brazilian currency control laws. Brazil at that time required all residents to sell foreign currency to the Brazilian government, at the rate of 90 cruzeiros for every dollar in the case of U.S. dollars. According to the plaintiff, the scheme allowed the Brazilian company to sell the dollars in the free market at the rate of 220 cruzeiros to one dollar, and allowed the U.S. corporation to pay less dollars for the coffee. In an *obiter*[214] the court accepted Professor Nussbaum's view, and expressed the opinion that the provision was applicable only to contracts for the exchange of one currency for another.[215]

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[213] 12 N.Y.2d 371, 190 N.E.2d 235 (1963).

[214] The case was decided on a different ground. The court threw out the plaintiff's case on the ground that even if Article VIII, Section 2 (b) was applicable, its only effect was to render the exchange contract unenforceable. It added that the use of the "unenforceability device" for the effectuation of the purposes of the Fund Agreement "impliedly concede[d] the unavailability of the more direct method of enforcement at the suit of the aggrieved government." Banco do Brasil, S.A. v. A.C. Israel Commodity Co., Inc., 12 N.Y.2d 371, 190 N.E.2d 236 (1963).

[215] The court's view was expressed as follows:

> Subdivision (b) of section 2 has been construed as reaching only transactions which have as their immediate object "exchange," that is, international media of payment (Nussbaum, *Exchange Control and the International Monetary Fund*, 59 Yale L. J. 421, 426), or a contract where the consideration is payable in the currency of the country whose exchange controls are violated (Mann, *The Exchange Control Act, 1947*, 10 Mod. L. Rev. 411, 418). More recently, it has been suggested that it applies to "contracts which in any way affect a country's exchange resources" [Mann, *The Private International Law of Exchange Control Under the International Monetary Fund Agreement*, 2 International and Comp. L. Q. 97, 102; Gold and Lachman, The Articles of Agreement of the International Monetary Fund and the Exchange Control Regulations of Member States, Journal du Droit International, Paris (July-Sept., 1962)].... Again it is suggested that an adverse effect on the exchange resources of a member *ipso facto* "involves" the "currency" of that member (Gold and Lachman). *We are inclined to view an interpretation of subdivision (b) of section 2 that sweeps in all contracts affecting any members' exchange resources as doing considerable violence to the text of the section. It says "involve the currency" of the country whose exchange controls are violated; not "involve the exchange resources."* (Emphasis supplied.)

Banco do Brasil, S.A. v. A. C. Israel Commodity Co., Inc., 12 N.Y.2d 371, 190 N.E.2d. 236 (1963).

The court's *obiter* signalled the entrenchment of the restrictive interpretation in the jurisprudence of New York. In *J. Zeevi and Sons, Ltd.* v. *Grindlays Bank (Uganda) Limited*,[216] a case involving a letter of credit, the New York Court of Appeals held that such letters of credit were not within the scope of Article VIII, Section 2 (b) since they were not exchange contracts. The court, quoting *Banco do Brasil*, reiterated that it frowned on an interpretation of Article VIII, Section 2 (b) which would sweep in all contracts affecting any members' exchange resources since that would do violence to the text of the provision.[217]

(ii.) The View of the English Courts

The development of English jurisprudence on the interpretation of "exchange contracts" bears some resemblance to that of New York. Initially, it seemed that English jurisprudence would take a broad view of "exchange contracts."

The broad view was articulated in the case of *Sharif* v. *Azad*.[218] *Sharif* involved a transaction in which the plaintiff gave to the defendant a check in the amount of 6,000 rupees, issued by a Pakistani and drawn against a bank in Karachi, in exchange for the defendant's check in the amount of 300 pound sterling, drawn against a bank in Manchester, England. The Pakistani authorities did not allow the rupee check to be encashed by the defendant's brother, and instead, placed the proceeds of the rupee check in a blocked account. The proceeds could not be used without the permission of the Pakistani authorities. In view of this turn of events, the defendant stopped payment on the sterling check. The plaintiff sued the defendant for the amount of the check, and the defendant defended by alleging that the transaction was illegal.

Lord Denning, in finding that the transactions were "exchange contracts," held:

> The words "exchange contracts" are not defined, but I think that they mean any contract which in any way affect the country's exchange resources.[219]

Lord Diplock, another member of the Court of Appeals, though espousing a "liberal" construction, linked the meaning of "exchange contracts" to the object of the Fund Agreement to protect the "currencies" of member countries. He said:

> The expression "exchange contract" is nowhere defined... in the Bretton Woods Agreement.... I think that it should be liberally construed having regard

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[216] 37 N.Y.2d 220, 371 N.Y.S.2d 892 (1975).

[217] *Id.* at 900.

[218] 3 All ER 785 (1966), 1 QB 605 (Ct. App.) (1967).

[219] All ER, at 787 [1966].

to the objects of the Bretton Woods Agreement to protect the currencies of the states who are parties thereto....[220]

In finding the transactions to be "exchange contracts," Lord Diplock emphasized the nature and purpose of each transaction, *i.e.*, though not expressly articulated, to exchange the currency of one member country for the currency of another member.[221] As later developments proved, Lord Diplock's "liberal" construction, was not meant to espouse as broad a construction as that put forward by Lord Denning. Lord Diplock would interpret "exchange contracts" to mean contracts whose purpose and object were to exchange currencies, and his exhortation for a "liberal" construction would mean nothing more than reaching "monetary transactions in disguise."

The *Sharif* interpretation was abandoned[222] by Lord Denning himself in *Wilson, Smithett & Cope Ltd.* v. *Terruzzi,* a case involving a contract for the purchase and sale of metals.[223] Here Lord Denning took the view that "exchange contracts" meant contracts to exchange the currency of one country for the currency of another.[224] This new interpretation was, as with the New York cases that articulated the same view, influenced substantially by the writings of Professor Nussbaum.[225]

The two other Lords comprising the *Terruzzi* court shared the view of Lord Denning. Both Lords, as with Lord Denning, accepted Professor Nussbaum's restrictive view, and rejected Professor Mann's broad interpretation.[226]

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[220] All ER, at 789 [1966].

[221] "... I should be prepared to hold that the following were "exchange contracts," viz: (i) the agreement between the plaintiff and Latif whereby the plaintiff agreed to pay Latif 300 pound sterling for the rupee cheque; (ii) the agreement between the defendant and the plaintiff whereby the [defendant] agreed to issue to the plaintiff his cheque for 300 pound sterling in exchange for the rupee cheque drawn by Latif...." 1 All ER, at 789-90 [1966].

[222] Even if the *Sharif* case was decided under the restrictive view, the outcome would have been the same. The transactions in *Sharif* were indubitably an exchange of currencies—rupees for pound sterling.

[223] 1 All ER 817 (Ct. App.) [1977].

[224] *See* 1 All ER, at 822-23 [1977].

[225] Lord Denning said:

> There are two rival views. First, the view of Professor Nussbaum.... He said that an exchange contract is exclusively concerned with the handling of international media of payments as such. Therefore, contracts involving securities or merchandise cannot be considered as exchange contracts except when they are monetary transactions in disguise....
> Second, the view of Dr. F.A. Mann.... He said that exchange contracts are contracts which in any way affect a country's exchange resources—a phrase which I accepted without question in Sharif v. Azad, in the belief that, coming from such source, it must be right. 1 All ER, at 821 [1977].

[226] *See* 1 All ER, at 826-27 [1977] (Lord Ormrod's opinion); 829-32 (Lord Shaw's opinion).

The restrictive view was unanimously reaffirmed by the House of Lords in *United City Merchants (Investment) Ltd.* v. *Royal Bank of Canada*, a case involving a contract for the purchase and sale of a glass fiber plant and a letter of credit, as the means of payment.[227] Here Lord Diplock clarified his opinion in the *Sharif* case. He held:

> ...I accept as correct the narrow interpretation that was placed on the expression "exchange contracts" in [Article VIII, Section 2 (b)] of the Bretton Woods Agreement by the Court of Appeal in Wilson, Smithett & Cope Ltd. v. Terruzzi.... It is confined to contracts to exchange the currency of one country for the currency of another; it does not include contracts entered into in connection with sales of goods which require the conversion by the buyer of one currency into another in order to enable him to pay the purchase price.[228]

The *United City Merchants* case raised two other significant points. First, it articulated a qualification to the restrictive view.[229] According to Lord Diplock, the court in considering the application of Article VIII, Section 2 (b) "should look at the substance of the contracts and not at the form," and that it should not enforce a contract that is "a mere monetary transaction in disguise."[230] This was what he meant by "liberal" construction in the *Sharif* case.

In this case, the seller of a glass fibers plant agreed to inflate the actual sale price by fifty percent, and, after receiving the "price" under a letter of credit arrangement, to pay over the difference to a U.S. company associated with the Peruvian buyer. The scheme allowed the Peruvian buyer to obtain government permission to buy the U.S. dollars needed to pay for the plant, thereby enabling the Peruvian buyer to open a letter of credit with a Peruvian bank upon payment of the necessary amount in Peruvian currency. The scheme would have allowed the Peruvian buyer to hold U.S. dollars abroad, which was illegal under Peruvian currency regulations.

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[227] 2 All ER 720 [1982] (House of Lords).

[228] 2 All ER, at 729 [1982].

[229] The qualification was originally articulated by Professor Nussbaum. *See* Nussbaum, *Exchange Control and the International Monetary Fund*, 59 YALE L. J. 427 (1950). Its emergence in English jurisprudence was set in the *Terruzzi* case. Lord Denning mentioned it in passing in his opinion. It was accepted affirmatively by Lord Ormrod. *See* 1 All ER, at 826 [1976]. It was perceived by Lord Shaw as the sense contemplated by Lord Diplock in his opinion in the *Sharif* case, and the sense in which Professor Mann's view could be validly accepted.

> It is, however, clear from the illustrations which [Lord Diplock] gives that what was contemplated by that statement were contracts which, though ostensibly made for other purposes, had the object and ultimate outcome of bringing about an exchange of currencies.

1 All ER, at 832 [1976].

Thus, to Lord Shaw, it was not enough that the exchange resources of a member country were affected by the transaction, as would be the natural result in transactions involving payment in another country's currency. The underlying purpose, object and effect of the transaction, casting aside the ostensible appearance, should be an exchange of currencies.

[230] *See* 2 All ER, at 729 [1982].

The second important point relates to the application of the qualification. The House of Lords disregarded the well-settled rule[231] that the underlying contract is separate and distinct from the letter of credit transaction between the issuing bank and/or confirming bank and the beneficiary-seller. It viewed the purchase and sale and the letter of credit as integral parts of one transaction, denied enforceability to part of the transaction corresponding to the over-price, and prevented the seller from recovering from the confirming bank the amount of the over-price.[232]

(iii.) The View of the West German Courts

The West German courts are the leading exponents of the broad interpretation of "exchange contracts." Under their interpretation, "exchange contracts" refer to any contract that affects the exchange resources of a member country. The view is influenced largely by the writings of Professor Mann, one of the leading proponents of the broad interpretation.

So far as can be discovered, the broad view was first articulated in *Lessinger* v. *Mirau*, a case involving a contract of loan.[233] There the court held:

> Undoubtedly, the contract of loan is a contract in the sense of Article VIII of the Bretton Woods Agreement. It is also an exchange contract within the meaning of this provision. For exchange contracts are contracts which, in whatever manner, prejudice the foreign exchange resources of a member. (Mann, "Der internationale Wahrungsfonds und das internationale Privatrecht," in J.Z., 1953, p. 444.) This interpretation is the only one compatible with the purpose of the control of foreign exchange resources. (Translation.)[234]

It was reiterated and applied, eight months later, in the *Clearing Dollar* case,[235] a case involving a purchase contract. There the court again placed much emphasis on exchange resources. In finding the purchase contract to be an exchange contract, the court held that if the contract were fulfilled it would involve the foreign exchange holdings or the currency of another member country.[236]

The relation of the meaning of "exchange contracts" to the exchange resources of a member is derived from the phrase "that involve the currency of

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[231] "It is trite law that there are four autonomous though interconnected contractual relations involved [in an international sale of goods to be financed by means of a confirmed letter of credit]: (1) the underlying contract for the sale of goods, to which the *only* parties are the buyer and the seller.... (4) the contract between the confirming bank and seller...." (Emphasis supplied.) 2 All ER, at 725 [1982].

[232] *See* 2 All ER. at 729-30 [1982].

[233] April 1, 1954, Oberlandesgericht, Scheswig-Holstein, reported in 22 INT'L L. REP. 725 [1955].

[234] 22 INT'L L. REP., at 727 [1955].

[235] December 28, 1954. Landesgericht, Hamburg, reported in 22 INT'L L. REP. 730 [1955].

[236] *See* INT'L. L. REP., at 731 [1955].

any member." This phrase has been construed by Professor Mann, along with others who espouse the broad view, to refer to the effect produced on the exchange resources of any member.[237]

3. The Applicable Exchange Control Regulations

The phrase "involve the currency of any member" supplies the test for determining the relevant exchange control regulations that will govern the question of enforceability of "exchange contracts." The exchange control regulations that determine whether or not an "exchange contract" is enforceable are those of the member whose "currency" is "involved."

The meaning and application of the test is again the subject of debate. To some adherents of the restrictive interpretation of the words "exchange contracts," the relevant exchange control regulations are those of the member whose currency is to be exchanged.[238] However, Professor Nussbaum, the leading proponent of the restrictive view, does not seem to agree with such an interpretation. He believes that a member's currency is also "involved," even if it is not one of the currencies to be exchanged under the contract, where that member's currency is used to acquire one of the currencies in the exchange.[239]

The emphasis on "currency" is consistent with the restrictive, literal interpretation of "exchange contracts." But the conclusion that a member's currency must be one of the currencies to be exchanged, in order for that member's exchange control regulations to be relevant, is not supported by even a literal reading of Article VIII, Section 2 (b). The provision uses the word "involve." As pointed out by Professor Nussbaum himself, a member's currency is also "involved" where it is necessary to the performance of the contract.

Among those who posit the broad interpretation of the words "exchange contracts," the prevalent view seems to be that the exchange control regulations that are dispositive of the question of enforceability of an "exchange contract" are those of the member whose exchange resources would be affected by the transaction.[240] Exchange resources would cover assets of any

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[237] *See* discussions *infra*.

[238] *See* Banco do Brasil, S.A. v. A. C. Israel Commodity Co., 12 N.Y.2 d 371, 190 N.E.2d 235, 236 (Ct. App. 1963); *see also* GOLD, THE FUND AGREEMENT IN THE COURTS 754 (1986) [hereinafter referred to as "GOLD, COURTS III"].

[239] *See* NUSSBAUM, MONEY IN THE LAW 543-44 (1950). This view is shared by Professor Edwards, Jr., who, though construing the words "exchange contracts" to mean all contracts, nevertheless, believes that a member's "currency" is "involved" only (a) if the contract stipulates that member's currency or (b) payment or transfer of that member's currency is in fact necessary to the performance of the contract. *See* EDWARDS, JR., INTERNATIONAL MONETARY COLLABORATION, 488-89 (1985).

[240] *See* MANN (1982), *supra* note 206, at 391-92; Krispis, Money in Private International Law 292 (1967); Williams, *Extraterritorial Enforcement of Exchange Control Regulations Under The International Monetary Fund Agreement*, 15 VA. J. INT'L. L. 345-49 (1975). Sir Joseph Gold, on the other hand, anchors the test on the effect of the contract on the "balance of payment" of a member. *See* GOLD, COURTS III, *supra* note 238, at 789-90.

type, even land, movables or intangibles, which belong to residents of a member.[241]

This interpretation is consistent with the economic sense in which the words "exchange contracts" are construed under the broad view. It requires, however, a reformation of the word "currency." This approach will not pass muster under principles of interpretation unless it can be convincingly established that the word was used mistakenly and that it frustrated the *clear* intent of the drafters.

The *specific* intent of the Drafting Committee, however, cannot be established with certitude. As discussed earlier, the *travaux preparatoires* fails to provide any convincing evidence regarding the intent of the Drafting Committee. An appeal to the general principles of the Fund Agreement and the economic character of its Articles, without more, is not enough. The purposes of the Fund Agreement are too general and broad to establish the *specific* intent of the Drafting Committee. A perusal of the Fund Agreement shows that its Articles admit of derogations from the general purposes of the Fund Agreement. Moreover, it is not pretended that the Articles carry out the general economic purposes of the Fund Agreement to their fullest extent. Some provisions in fact merely lay the basis for cooperation and largely leave it to the members to adopt measures that will fully realize the relevant aim of the provision.[242]

In an "exchange contract," it is possible that several sets of exchange control regulations will be involved, where the parties thereto belong to different countries, and are subject to the exchange control regulations of their respective countries. It is, therefore, possible that an "exchange contract" will be in compliance with one set of exchange control regulations, but contrary to another set of regulations. Under such a situation, a member that is asked to enforce the "exchange contract" must decline and hold the contract unenforceable. Where the "currencies" of several members are involved in, or where the "exchange resources" of several members are affected by, an "exchange contract," the "exchange contract" should not contravene any of the members' exchange control regulations. The policy of Article VIII, Section 2 (b) is not to ensure or mandate the enforceability of "exchange contracts" that comply with the relevant exchange control regulations. Rather, it is to render unenforceable "exchange contracts" that contravene a member's exchange control regulations.

III.
CONCLUSION

The lack of precision and clarity of the text of Article VIII, Section 2 (b) gravely beclouds the scope of the provision, and leaves us not very far from the

[241]*See* MANN (1982), *supra* note 206, at 391; Williams (1975), *supra* note 240, at 346.

[242]*See e.g.*, Article VIII, Section 2 (b), 2nd sentence.

exchange control jurisprudence existing before the Bretton Woods Conference.

One major goal of the Fund Agreement is to support the balance of payment positions of member countries. Exchange control regulations are generally employed to protect the balance of payments and exchange resources. One way by which the Fund Agreement intended to provide that support was to give extraterritorial effect to the exchange control regulations of member countries, and to mandate the unenforceability of exchange contracts that contravene such regulations, by making mandatory norms of exchange control regulations.

The intended degree and extent of this type of support is, however, rendered unclear by the textual flaws of Article VIII, Section 2 (b). A clarification of this matter is important in order to achieve symmetry in its application. The application of this provision affects member countries and private transactions. If a multilateral treaty were to make sense in this context, it should avoid susceptibility to uneven application.

One member should not get more support than the other just because a member that happens to be the forum of question interprets the provision broadly or narrowly. That it was the intention to achieve an evenhanded application of the provision is shown by the inclusion of the second sentence of the provision,[243] which leaves it to the members to agree on measures that would make their respective exchange control regulations more effective.

A uniform interpretation (and application) by the courts of Article VIII, Section 2 (b) cannot be expected under the present language. Domestic policies continue to be of compelling importance to many courts. A recent example is the decision of the New York Court of Appeals in the rehearing of the case of *Allied Bank International* v. *Banco Credito Agricola de Cartago*.[244] The decision, which vacated an earlier one that recognized Costa Rica's right to defer unilaterally the servicing of its external debt pending its debt restructuring negotiations, voiced strong concern for maintaining New York as a leading financial center.[245]

The debate regarding the proper construction of Article VIII, Section 2 (b) has already spanned several decades. The wealth of commentaries on this subject has only managed to give rise to conflicting court interpretations. No further erudition can hope to resolve the conflict.

[243]"In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement." Fund Agreement, Article VIII, Section 2 (b).

[244]757 F.2d 516 (1985), *cert. denied*, 106 S.Ct. 30 (1985).

[245]757 F.2d, at 521 ("The United States has an interest in maintaining New York's status as one of the foremost commercial centers in the world."). The *amicus* brief of the U.S. State Department was no less equal to the task. *See* GOLD, COURTS III, *supra* note 238 at 606-08, 620.

The problem can be resolved only by an interpretative decision of the IMF Board of Executive Directors or an amendment of the provision clarifying its scope and the test for determining whose exchange control regulations would be relevant in disposing of the question of enforceability.

But perhaps, even an interpretative decision of the IMF Board of Executive Directors may not be sufficient to put the problem to rest. In the United States, there is already a growing view that interpretative decisions of the IMF are only persuasive authority. This view has been advanced by the American Law Institute's Reporter for Tentative Draft No. 6 of the Institute's revised treatise on Foreign Relations of the United States. That sentiment is not unknown to some courts in the United States. In the recent case of *Callejo* v. *Bancomer*,[246] the New York Court of Appeals, while noting that Sir Joseph Gold had expressed the view that interpretative decisions were binding on member countries, including the United States, refused to express its views on the matter. Instead, it stated that it would use the IMF interpretation involved in that case as "merely persuasive rather than binding authority."[247]

The more direct solution of amending Article VIII, Section 2 (b) seems to be the better one. Whether member countries will be willing to go by this route will be influenced greatly by the world economic situation. With the current debacle on defaulting Third World Debt and the increasing nationalistic sentiments gripping many countries, including major Western economies, it is unlikely that such an approach will be forthcoming.

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[246] 764 F.2d 1101 (1985).
[247] *See* 764 F.2d, at 1119.