

Foreign Exchange Rates: Legal Aspects and the Management and Minimization of Risk

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Résumé de l'article

La rentabilité économique d'un contrat international est directement liée à la monnaie qui y est stipulée et aux risques de variations de taux de change qui peuvent survenir. L'ampleur du risque dépend de la durée du contrat et de la stabilité des pays impliqués. L'auteur analyse divers moyens à la disposition des parties au contrat pour minimiser le risque monétaire. En prenant l'exemple de l'Argentine, pays instable à plusieurs niveaux, il explique les éléments qui doivent être considérés par les parties dans le choix de la monnaie de paiement et dans la rédaction du contrat.

Il détaille ensuite les clauses qui peuvent être insérées dans un contrat pour s'assurer qu'il sera bien exécuté dans la devise stipulée, en soulignant pertinemment les limites imposées à l'application de telles clauses par les lois de certains pays.

Foreign Exchange Rates : Legal Aspects and the Management and Minimization of Risk

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ABSTRACT

The profitability of an international economical contract is directly linked to the currency determined in it and to the risks of potential foreign exchange variations. The length of the contract and the political and economical stability of the concerned country define the magnitude of the risk. The author explains various means available to the contracting parties to minimize the currency risk : taking into consideration Argentina, in many ways an unstable country, he explains the elements that must be taken into account for the selection of the payment currency and the drafting of the contract.

He then itemizes the clauses that can be inserted in a contract so as to insure that it will be effectively executed in the determined currency while underlining that many of these clauses do not have any effect due to the legislation of certain countries.

RÉSUMÉ

La rentabilité économique d'un contrat international est directement liée à la monnaie qui y est stipulée et aux risques de variations de taux de change qui peuvent survenir. L'ampleur du risque dépend de la durée du contrat et de la stabilité des pays impliqués. L'auteur analyse divers moyens à la disposition des parties au contrat pour minimiser le risque monétaire. En prenant l'exemple de l'Argentine, pays instable à plusieurs niveaux, il explique les éléments qui doivent être considérés par les parties dans le choix de la monnaie de paiement et dans la rédaction du contrat.

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INTRODUCTION

1. In all types of international contracts the right choice of currency in which monetary obligations will be carried out is the relevant point upon which the economic result of the whole transaction may depend for all parties.

In an export transaction, if the exporter invoices are in a foreign currency, depreciation of the latter will mean risking a loss, where even his production costs may not be covered. In an import transaction, to buy in the seller's currency may lead the importer to higher costs than he can afford in order to remain competitive in his own local market.

2. The magnitude of the risk involved depends on the length of the contract, on whether the countries involved have hard and freely convertible currencies or not, on the type of contract and other factors which will have an influence on the chances of minimization of that specific risk. Normally, there are a number of solutions :

a. For the debtor, to buy the contract's currency in advance through the forward exchange market; or to borrow in his local currency, buy the contract's currency and make time deposits in the latter, with maturity dates matching the dates his own payments are due; or to try to compensate the exposure to foreign currency risk by the generation of credits in that same currency.

b. For the creditor, to borrow money in the contract's currency and sell it in advance through the forward exchange market.

With the exception of the last one mentioned in point a., these solutions are expensive, since interest and premiums will have to be taken into account, yet it is a way of eliminating the risks. But they are not always available : forward exchange contracts are usually inexistent for longer periods, and they may not exist at all for certain currencies.

c. The use of *swaps*, which substantially is an operation involving the exchange of one currency for another one and the compromise to reverse the exchange at a given future date.

d. Using mixes of different currencies, or internationally accepted artificial currency units, such as Special Drawing Rights, European Units of Account, European Composite Units, and the like. This helps to share the risk among all the parties to the transaction.

e. The risk of an exporter may be eventually covered through an institutional insurance guarantee.

f. Large multinational corporations may centralize their world-wide currency risks management, and therefore decide their international transactions — trade as well as financing — on the basis of compensation of the different risks.

3. But as soon as we get into longer terms, and specially if one or more parties are domiciled in a less stable country, or if some or all of the obligations are to be executed in such a country, the risk attached to exchange rate variations increases considerably.

4. Then, it is no longer a question of just making the right choice of the contract's currency, but also of introducing the appropriate clauses and, as far as possible, to foresee events which could eventually arise during the contract's lifetime.

5. A complete analysis of the subject would be of such length as to justify writing a whole book.

First, because of the different categories of contracts in which the risk we are considering may arise : of course, the first thought goes to sales of products, but the same sort of question has to be dealt with in insurance and reinsurance, transfer of technology, licenses, franchising, loans and finance, joint ventures, leasing, transport, construction, investment in share capital, etc.

Second, because the position of the different parties to each of these contracts (importer — exporter; insurer — insured; franchisor — franchisee, etc.) is generally different. Last, but not least, the foreign currency exchange restrictions which may eventually exist in one or more of the countries involved are also relevant.

6. Therefore, this presentation can only deal with very few aspects of the problematics involved. And since I come from Argentina, a country which has long suffered from inflation — even hyperinflation — instability of all sorts, brisk variations and adjustments in all types of economic variables, including foreign exchange rates, I will focus on

Argentina's experience as an example of the kind of problems a party to an international contract will have to pay attention to in order to prevent the risks we are talking about.

7. One last introductory remark : the parties will not necessarily prefer the currency of their own country. Many considerations could be made about the different factors which will influence each party's preference when choosing a currency. Such would be :

a. the creditor might try to stick to the hardest one, or to the one he believes will climb in value. And conversely the debtor.

b. A party may prefer not to take any risk, and therefore insist on payment in the currency in which most of its costs are to be born, or in the currency which is dominant in the market in which he has to compete.

c. In long term contracts, it will always be advisable to have indexation clauses, no matter which is the chosen currency. If such a provision is made, the currency problem becomes less substantial, but doesn't disappear completely.

d. The parties to the contract may not be independent from each other : loans or sales among a parent company and its foreign subsidiary are not the same as if the parties were independent. The group policy may be to concentrate exchange risks or the benefits of higher competitiveness in one particular subsidiary or, on the contrary, in the parent company.

e. Depreciation of one given local currency may run parallel to internal inflation, or be completely independent. Appreciation of that currency generally is independent of internal prices. When currency fluctuation is independent of market prices, the choice of currency is strongly linked to competitiveness. For example : in a market where local products compete with imported goods, the importer will have to be very careful in selecting in which currency he is buying. If he does it in a foreign currency which is harder than his national one, he may very well have to sell at a loss when the foreign currency increases its value ; should the foreign currency depreciate, he will make additional profits. In the same example, if the market is dominated by foreign products, this risk will be almost non-existent.

8. Therefore, due to the variety of factors involved, and to the obvious limits in a conference of this nature, I shall mainly deal with the contractual provisions to ensure that the obligation will be honoured in the currency which was stipulated and with the juridical risks involved.

I. OPTION OF DIFFERENT CURRENCIES

9. The contract may grant one of the parties, creditor or debtor, the right to choose among different currencies.

This option is a very good way of eliminating currency exchange risks. The only trouble is that it covers only one party's risk, while it increases the other party's. Nevertheless, in some cases it may work out quite equitably. Let us consider an international sales contract : the seller may need the option in order to keep the balance between a substantial part of his costs, whereas for the buyer the choice of the hardest currency may be indifferent, since the market he intends to sell in is also dependant on the same hard currencies. Or the other way round : for the buyer it is essential to be able to choose, let's say his national currency, because the goods he imports have to compete with local production, the price of which will be independent of currency fluctuations. Whereas for the seller, in this last example, it may be acceptable to get paid in a softer currency, because otherwise he would be out of international competitiveness anyway.

10. It may be agreed that the choice has to be made at a certain date (for example a fixed date, or at the date of maturity, or at the date of payment, or a certain number of days before payment day).

In countries with exchange rate fluctuations which sometimes may vary between five or ten per cent a day, or which may have maxidevaluations of one hundred or even two hundred per cent, these options may be of substantial importance. (In this sort of country, it might also be necessary to foresee that the rate to be applied is the rate of the same day of payment, since what would be logical — for instance, to consider the rate of exchange of the last labor day previous to the payment day — may be dangerous if that day is, by chance, one of these critical days of large and sudden changes in the value of the different currencies.)

11. The exchange risk is, in these cases, totally concentrated on the party which does not have the option. But, of course, nothing is mathematical in law. When such risk variations happen, the party who has the right of option may feel very sure, and even make a big profit out of this sort of clause. But the other party will have to bear the equivalent loss. And if the loss is too substantial, national legislations may provide some remedy to restore the contract's equilibrium.

Such would be, for example, Articles 1071 and 1198 of the *Argentine Civil Code*.

12. The first one establishes that the law doesn't protect the abusive exercise of any rights, and any exercise in contradiction with the finality of the law when recognizing such rights, or any exercise exceeding the limits imposed by good faith, moral or good customs, will be so considered.¹ The courts have made a very ample application of this

1. La ley no ampara el ejercicio abusivo de los derechos. Se considerará tal al que contrarie los fines que aquélla tuvo en mira al reconocerlos o al que exceda los límites impuestos por la buena fe, la moral y las buenas costumbres.

provision in cases of contracts in foreign currencies, as well as in cases of contracts with indexation clauses.

13. Article 1198 is the one which introduces the *rebus sic stantibus* principle into our private legislation : if, in a bilateral commutative, or unilateral onerous contract, due to extraordinary and *unforeseeable* causes, one party's performance becomes excessively onerous, this party may ask the court for rescission of that contract. The other party may offer to equitably improve the effects of the contract.²

This article has also been of wide application in the jurisprudence of the Argentine courts and very often in cases of a clause of payment in foreign currency, both in internal and in international contracts. Nevertheless it has to be mentioned that the Third Conference of Civil Lawyers (Santa Fe, August 1989) declared that this improvidence doctrine is applicable to foreign currency obligations, *except* in international transactions, provided that the value of the opposite party's performance has not changed, or if the obligations are linked to imported goods and in so far as the latter have incidence on the final cost, or if they are originated in bank loans in which foreign currency has been effectively lent.

14. This has also been the predominant jurisprudence during the last years for *on lending* cases (B Chamber of the Commercial Court of Appeals of the city of Buenos Aires, May 29th, 1984, *Barachini vs Banco Español*; A Chamber of the same court, May 8, 1984, *Menning vs Banco Sudameris* and D Chamber of the same Court, March 3, 1984, *Vallejo vs Banco Español*), that is to say, in all cases where there was a real link to a performance valued in foreign currency. But the courts have applied the improvidence doctrine when the foreign currency clause was used as a mere indexation or stabilization clause (for instance, II Chamber of the Civil and Commercial Federal Court of Buenos Aires, November 23rd, 1984, *Noetinger vs Banco de la Nación Argentina*). In other words, the stabilization clause has been declared valid nearly unanimously by the courts, but subject to readjustment when it became exaggeratedly onerous due to unforeseeable causes, if compared with the real values involved in the transaction.

2. En los contratos bilaterales conmutativos y en los unilaterales onerosos y conmutativos de ejecución diferida o continuada, si la prestación a cargo de una de las partes se tornara excesivamente onerosa, por acontecimientos extraordinarios e imprevisibles, la parte perjudicada podrá demandar la resolución del contrato. El mismo principio se aplicará a los contratos aleatorios cuando la excesiva onerosidad se produzca por causas extrañas al riesgo propio del contrato.

En los contratos de ejecución continuada la resolución no alcanzará a los efectos ya cumplidos.

No procederá la resolución, si el perjudicado hubiese obrado con culpa o estuviese en mora.

La otra parte podrá impedir la resolución ofreciendo mejorar equitativamente los efectos del contrato.

15. But if a clause of direct payment in foreign currency in real international transactions has been recognized as valid, an *option clause* leading to unequal performances among the parties, will be declared subject to the abuse doctrine or be amended by application of the improvidence doctrine.

16. And here it seems to be necessary to mention what should be understood by the words *foreign currency*. A currency is foreign if it is different from the one which has legal course in the country the payment is due to be made.³

But, since the jurisdiction will not always coincide with the place of payment (for instance, if the lawsuit is presented before a court of the place where the debtor is domiciled), it should be taken into account that very often a court might not consider that the payment is in foreign currency, if the currency involved is the one of the court's country.

Anyway, when the words "foreign currency" are mentioned in the following comments, we want to make clear that we are referring to the first concept.

17. Contractual options may only include currencies which are foreign to the country of payment or may consider national and foreign currencies. Generally not to include local currency in the choice, leads to less complications. A court in Brazil will surely care less about the choice between Swiss francs, Deutsche mark and U.S. dollars, than if one of the choices is cruzados.

II. PLACE OF PERFORMANCE. OPTIONS FOR THAT PLACE

18. The choice of the place of performance may be of substantial importance. This is a matter which exceeds this conference, but a few words should be said about it.

19. If nothing specific is agreed in the contract, the place of performance or the place of payment may be the one which determines the law to be applied. The latter may not only be the private law, but also the public economic law, such as exchange control laws of that chosen country.

20. This subject will be dealt with by another speaker. But I would like to point out at least a few of the problems connected with it : will the same law be applicable to a guarantee which might eventually be given outside of the country of payment, in order to ensure payment in the contractually chosen currency? Some private international law systems, such as the Montevideo Treaties, foresee that accessory contracts are

3. BEQUIGNON, *La dette de monnaie étrangère*, 1925, page 5.

ruled by the law of the principal one. This would lead to a possible exception a foreign guarantor may be wanting to oppose, by invoking the exchange control of the country where the principal obligation is due, thus turning the guarantee completely useless.

21. And further : are foreign exchange regulations and restrictions applicable by the courts? The strictly traditional answer to that question has been negative,⁴ since the economic *ordre public* was, in principle, not considered to have extraterritorial effects. Nevertheless, in the famous *Kahler vs Midland Bank Ltd.* case, the House of Lords ruled in 1950 that the law applicable to a contract "not merely sustains, but because it sustains, may also modify or dissolve the contractual bond. The currency law is not part of the contract, but the rights and obligations under the contract are part of a legal system to which the currency belongs". By reasoning thus, the House applied the currency restrictions imposed by Czechoslovakia. This criterium has been applied more and more by different courts in many countries, specially after the Bretton Woods agreements. My feeling is that we are still very far from being able to say it is universally accepted : nevertheless, it is another point where a risk exists.

22. On the other hand, since the place of performance or of payment is also a connection point to the jurisdiction, what has to be kept in mind is that even if a court is bound to the application of foreign law, it will never rule against its country's *ordre public* regulations. And going even further : even if the law chosen in the contract, or applicable by means of the choice of the place of performance or of payment, and the court handling the case is foreign to the country where the exchange control regulations make a proper fulfillment of the obligations questionable, the practical effect will depend upon the chance to execute the sentence in a different country, not affected by the exchange control. Because it is clear that even at the time the sentence comes up for execution in the local court, this court will have to adjust its decisions to the official exchange control laws.

23. Another distinction has to be mentioned : some authors point out that, in fact, there may not be such thing as a unique place of performance : according to that theory when we talk about international contracts, even if the chosen place of payment may be a country foreign to the debtor, a difference has to be made between the place where the debtor fulfills his obligation (and that would be the country of his domicile) and the place of destination of the payment or remittance, which may be the creditor's domicile or elsewhere.⁵

4. As well as for foreign taxes and penalties.

5. Such would be what the Germans, based on Articles 269 and 270 of their Civil Code (*Bundesgesetzbuch*) call the difference between *Erfüllungsort* or *Zahlungsort*, on one side, and *Bestimmungsort* on the other.

24. Should the place of payment not be agreed upon in the contract, the solutions may be unpredictable : in some countries like Great Britain, the United States and Switzerland, in case of non-indication, the place of payment is the creditor's domicile. Whereas in France, Belgium, Argentina and Germany, ⁶ for instance, the place of payment would be the debtor's domicile.

25. The choice of the place of payment is also directly connected with the risk and costs of the payment the debtor has to carry out. If explicitly or implicitly the place of payment is the debtor's domicile, then the creditor is taking the risk of money exchange regulations, and of transfer of the funds abroad. Inversely, if the place of payment is the creditor's domicile, or anywhere abroad, these risks are to be borne by the debtor.

26. There seems to be agreement among authors and the court decisions of nearly everywhere in the world, about the fact that the chosen or implicit place of payment is also the place according to which market's rate of exchange the payment is to be made.

Therefore, it seems to be essential not only to choose the place of performance or of payment carefully, but also, if possible, to include an option for the creditor so that he can choose among two or more different places. That sort of option is absolutely legal from the point of view of private international as well as internal national law. Among the different places, if possible, one should be a place where the debtor has assets.

27. Due to the type of problems we have been mentioning, when the domicile of the debtor is in a country with exchange restrictions, and even more so if it is a country with troubles in its balance of foreign payments, letters of credit should be used, and the creditor or seller should have them confirmed by a bank of his own country, or of a country with freely convertible currency.

28. It finally seems important to state that the place of payment need not necessarily coincide with the location of the court chosen to enforce the payment. A national court may very well pass sentence in a case in which the due payment is to be made in a different country.

III. IS FOREIGN CURRENCY "MONEY"?

29. The law of the country where the obligation has to be carried out may accept, or may not, that the qualification of "money" applies to

6. Nevertheless, even if Article 269 of the *Bundesgesetzbuch* provides that the place of payment is the debtor's domicile; Article 270 rules that the debtor has to transfer the money to the creditor at his own risk and cost.

foreign currencies. In this last case, it may become much more difficult to enforce payment to be effectively made in the agreed currency.

30. Once again, Argentina is one of the many countries for which “money”, and therefore monetary obligations, are only those to be carried out in one of the local currencies. By saying “one of its local currencies” I am not obviously referring to any anarchy in the monetary system (as it was in the seventies of last century when each province — and often even private banks — had the right to issue money) but to the fact that legally, besides the current paper currency, we still have a gold currency, which, in practice, has become completely outdated.

31. That is why it is worthwhile paying attention to Argentina’s experience : high inflation, monetary chaos, and heavy devaluations have made foreign currency transactions very commonplace. But with one additional ingredient : due to the same reasons, the periods of official control and restrictions on foreign currencies exchange have been longer than the periods of free conversion. And sometimes the difference between the official rate and the parallel or black market rate (which is not always that black, but the result of the conversion of the Argentine currency in the neighbour market of Montevideo, Uruguay) have amounted to over 100 %.

32. Therefore, if foreign currency is not considered as money and, as we will explain immediately, the consequence of this is that the amount of foreign currency involved is to be converted into local currency and the debtor may be deemed to have complied by paying the equivalent amount in that local currency, one additional very substantial issue is to determine which rate of exchange is going to be considered, and what clauses can be used, specially in international contracts, to protect the true value of the credit.

In other words, here we have another *RISK*, with capital letters, perhaps the biggest.

33. Let us go into a few details with the Argentine example.

34. Article 617 of the *Civil Code* establishes that if the obligation consists in giving money which is not of legal course in the country, it will be considered an obligation to give quantities of goods; and consequently it will be regulated by the rulings concerning this category of obligations.⁷

35. Up to very recently, the courts and the doctrine have unanimously made a very strict interpretation of this article, and came to the conclusion that foreign currency is not “money” in Argentina, but a fungible good. Nevertheless, nobody forgot that, even implicitly, this “fungible good” is, in fact, a *monetary good*.

7. Si por el acto por el que se ha constituido la obligación, se hubiere estipulado dar moneda que no sea de curso legal en la República, la obligación debe considerarse como de dar cantidades de cosas.

It could not have been otherwise, since there are numerous rulings which refer to foreign currencies as “money”: so Article 8, paragraph 2, of the *Commercial Code*, which declares that “exchange operations” are “commercial acts”; thus the fact that banks are allowed to open accounts for their customers in foreign currencies, and that they pay their clients in the chosen currency; the fact that the federal state issued bonds in foreign currencies, which are allowed to be quoted in local stock exchanges, and are not only quoted in local currencies, but also in U.S. dollars. And the government has always paid interest and principal in dollars, even to Argentine residents; thus the fact that not only in the herein before mentioned cases, but also in the cases of debts in foreign currencies which were brought to be executed before the courts, these have always been recognised to generate interest in the currency of the obligation.

36. Furthermore, in international transactions it is unquestionable that foreign currency is money : if it were not, a sales contract would not be a sale, but an exchange, with a somewhat different ruling in our Civil and Commercial Code. And other contracts, a leasing, for instance, would be an innominated or atypical contract. These consequences are not only against the logic and the reality of international trade, but also very complicated from the point of view of the applicable legal rulings.

37. On the other hand, Article 619 provides further complications, since it establishes that if the obligation was to pay an amount of a certain type of national currency, the debtor is considered to be paying correctly if he pays in that specific type of currency, as well as if he pays in any other type of national currency, at the rate of exchange of the day the obligation is due.⁸ Of course, this would literally only apply to different national currencies; but, in fact, it has been used by analogy to solve the case of obligations in foreign currencies.

38. Authors have talked about a debtor’s “right of substitution” of the foreign currency for the local one. This means that if the debtor pays in the foreign currency, payment has to be accepted by the creditor. He would not be entitled to ask for the equivalent amount in local currency, except if the contract states that payment is to be made in the “equivalent of [...]” so and so many foreign monetary units.

39. Another question which leads to discussions is the last part of the herein before mentioned Article 619 : is it mandatory that the conversion date be the maturity date? Considering the problems already mentioned before in chapter II., would it not be more just to either use

8. Si la obligación del deudor fuese de entregar una suma de determinada especie o calidad de moneda corriente nacional, cumple la obligación dando la especie designada, u otra especie de moneda nacional al cambio que corra en el lugar del día del vencimiento de la obligación.

the rate of the date of effective payment, or to give the creditor the option? This is the solution of Law-Decree 5965/63, Article 44 for bills of exchange and promissory notes.⁹

Finally, the majority of authors and also of the courts have accepted this principle. The reason is clear : the idea behind the *Civil Code*'s ruling, is that the creditor has to receive enough local currency as to be able to buy the contract currency. If he does not receive it, he will not be able to buy it until payment is really made.

What could be called the minority position among authors and the courts, defend their point by saying that on the maturity date the creditor can buy whatever amount of whatever foreign currency is due to him. Therefore, what the delinquent debtor owes to the creditor is a "value". This means that he will run the risk of depreciation of the national currency, in terms of internal inflation. As can be seen, it finally is a question normally leading to not too distant solutions : in one case the depreciation will be measured by the rate of foreign currencies, in the other by internal price indexes. But if this can be sometimes irrelevant to parties of a local contract, of course the difference may be very important in the case of international contracts. The right provisions should therefore always be taken to prevent this part of the exchange risk.

40. Based on these legal rulings, a very important distinction has been made : normally, notwithstanding the rulings we just studied, if there is no special stipulation, the foreign currency will implicitly be considered "money", but the debtor may pay in Argentine currency at the rate of exchange of the maturity date. The main point is then, as was already pointed out : what if there is an official rate of exchange, at which nobody can freely buy the contract currency? We will come back to that a bit later.

41. The second and different case would be that the contract, or the obligation, foresees that it is an essential condition that fulfillment of the obligation be effectively in foreign currency. If so, it is admitted that we are in presence of a proper obligation to give a so called "monetary good", and nothing else can be given instead. Specially, payment in national currency at an official rate of exchange would be unacceptable.

In this last case the nonfulfillment of the obligation is ruled by the general rulings related to nonfulfillment of obligations to give goods : the creditor will be entitled to the value plus damages and losses. Since, there again, in the case of foreign currency, to establish the value

9. A plenary decision of the Commercial Court of Appeals of the city of Buenos Aires has reinforced this doctrine in a case where a bill of exchange stated that payment had to be made in equivalent Argentine currency at the date of maturity. The court granted the creditor the right to convert the foreign currency at the rate of the day of payment (*Draletti vs Fruhwirt*, October 29th, 1986).

there may be a discussion on the applicability of official rates or free or black — or parallel — rates, we may come back to the same place we left in the first example. But there is a very important difference : since the debtor is not entitled to pay in Argentine currency, he will be in default, and that gives the other part the right to rescind the contract, plus losses and damages. And that may, in many cases,¹⁰ be the best way out.

42. But, since the subject of this conference is “risks”, the conclusion is that if proper attention is not paid to the problem, in any case there is a risk, and very often quite a big one.

IV. GOVERNMENT RESTRICTIONS : UNAVAILABILITY OF THE CHOSEN CURRENCY. PAYMENT IN LOCAL CURRENCY : AMOUNT AND MARKET TO CONSIDER THE CONVERSION. FURTHER OPTIONS

43. As was pointed out before, one way or the other, we always get back to the fact that one of the parties will have to buy the foreign currency : either the debtor in order to pay, or the creditor with the local currency in which he was paid. (We will not discuss the case of local contracts, where it has been very often interpreted that the foreign currency as the contract’s currency has to be considered as a way of keeping the contract’s values constant, with the same or similar legal treatment as any other indexation clause.)¹¹

44. The problem arises when there is no legal way of buying foreign currency because of state control over that market, and restrictions on transactions arising therefrom. The debtor will be excused to perform *in natura* in the foreign currency, because of *force majeure*. He will be allowed to pay the equivalent in local currency at the official rate of

10. Not always : it would be of no sense in a case where the creditor is trying to collect a loan.

11. It seems useful to point out that in some countries, indexation clauses linked to the value of foreign currencies are absolutely invalid. Such is the case of Germany, according to a law of 1949, which requires the approval of the Bundesbank for stabilization clauses linked to foreign currencies for money debts payable in DM. The same sort of legal restrictions exists in a few other countries, like Brazil, Colombia, Costa Rica, México, the Netherlands, and Perú (See K. ROSENN, *Law and inflation*, Philadelphia, 1982, p. 138). In Argentina, according to law 23.091, Articles 1 and 3, rents for real property leases may neither be agreed in foreign currencies nor can they be validly subject to indexation linked to foreign currencies. In fact, many such contracts are agreed in foreign currencies, and people usually honour their compromises, without invoking the legal protection. But besides this exception, indexation clauses linked to the value of foreign currencies are valid. Nevertheless a few authors sustain that indexation clauses linked to foreign currency are not valid (see J. MOSSET ITURRASPE, “Dólar e imprevisión”, (1981-D) *La Ley Review*, p. 865).

exchange. Even if in many countries you can read the daily “parallel” or “black” rate of exchange in the newspapers, no court can use an illegal market to convert foreign currency.

45. If this is a situation believed to be transitory, one possible clause to prevent that sort of risk should be to allow the creditor to refuse payment until the legislation allows the debtor to buy the agreed currency. Or, until the creditor is allowed to buy that currency.

46. Another very important point related to this risk, is to register the operation with the corresponding authority, if so required, and even if such registration is an option. Usually, that sort of registration gives the creditor the right to be paid in the contractual currency, thus meaning that he will eventually be allowed to buy foreign currency at the official rate of exchange.

For example : a technology transfer or license agreement should be registered in order to allow the payment of royalties. The same applies to investments, eventually regulated by a foreign investment law. In Argentina, for instance, for many years there was really no problem of investing in almost any kind of business without any permission or registration. Only in some specific cases the investment would be void if made without the authorities’ permission. What would the reason be then for registration? Only registered investments had the right to send dividends and capital back in foreign currency bought at the official rate of exchange.¹² These bureaucratic steps will solve some of the possible problems in many international contracts.

47. The clause giving the creditor the right to refuse acceptance of payment before he can officially buy the agreed foreign currency may prove important in several situations.

For example, let’s suppose a contract where a company sells some machinery to an affiliate company located in a country “x”, which will lease the equipment to some third party in that very same country. Let’s suppose that the equipment is agreed to be paid over a long period of time (let’s say six years), and that somehow the lease has been agreed in installments which are linked to the affiliate’s payments to the parent company. Since it is an import of capital goods, if there are foreign currency controls and official market rates, the import will be registered at the Central Bank or equivalent authority. In this case the affiliate company would never be able to buy to foreign currency before the date of maturity of each installment.

The only way to avoid exposure to the currency risk will be that the lease is agreed in the same currency as the importation, and that the lessee is not allowed to advance any payments before the authority allows the remittances.

12. A very recent law, passed in September 1989, liberalized foreign investments in Argentina almost completely.

48. Further, if the solution cannot come via registration of the contract with an official authority, or if the country involved is in such shortage of foreign currency that it may delay payments beyond the possibilities of the party's patience — which may very often be the case, for instance with loans, etc. — some other clauses may help out.

49. To see what could be best, the monetary regulations of the country involved should be carefully studied. For instance, it should be found out :

a. if it is legal to export and import foreign currencies. Very often you will find out that nothing impedes that, even if there are restrictions to buy and sell foreign currency in the country anybody may carry or transfer such currencies abroad;

b. if it is legal to import and export the country's own currency. In most cases this is so;

c. if there are any bonds in foreign currency, which can be imported and exported freely from and to the country;

d. what the reality of the markets in the involved country are, in terms of functioning of parallel markets, local operations made in foreign currencies, etc.

50. If I may take Argentina again as an example :

a. a large "black" or "parallel" market for foreign currencies develops quickly each time the government imposes controls and official rates of exchange. Many important goods, such as real estate, are nearly always only offered in foreign currency;

b. it is perfectly legal to import and export local currency;

c. in practice, there have never been restrictions to hold or carry foreign currency;

d. for many years the so called External Bonds¹³ issued in U.S. Dollars, which quote at the Argentine stock markets in Australes¹⁴ as well as in Dollars, and are also quoted and handled in foreign markets, have existed. These bonds may also be freely imported and exported.

51. Under these conditions, there should be no difficulty in eliminating any possible risk by ways of the appropriate clauses. For instance :

a. it could be established that payment in x foreign currency is the condition of the contract. Consequently, the debtor would never be in a condition to enforce payment in local currency at the official rate of exchange.

b. it could be foreseen that if there is any legal restriction for the debtor to buy or to hold that specific currency, the creditor may choose the right to be paid as many Australes as would be necessary to

13. Bonos Externos de la República Argentina.

14. Austral is the Argentine currency since 1985.

buy the amount of foreign currency due, alternatively, and also at the creditor's choice, in the markets of two or three cities where the Austral is quoted : generally it will be Montevideo, Uruguay, New York, or Zürich.¹⁵

c. it may give the creditor a further option, namely to have the right to be paid in External Bonds for the face value of the obligation, with a surplus to compensate the difference in quotation below par. In other words, adding the difference which would be needed to buy, with the proceeds of the sale of these bonds, the amount due of foreign currency in two or three optional markets, which usually, in our example, would be the same, that is to say, Montevideo, New York or Zürich.

52. All these clauses and options, since they refer to completely legal standards, have been accepted by the courts.¹⁶ The main reasoning behind that acceptance can be found in a principle expressed by Lord Denning in the case *United Railways of Havana c. Regla Warehouses Ltd.* (1961), where he said that "the creditor is entitled to be put into as good a position as if the debtor had done his duty and paid on the due date".

53. Therefore, according to Article 520 of the *Argentine Civil Code*, the default in accomplishing non monetary obligations will lead to the consequent indemnization of damages and losses, and these will be no different, to start with, than the contractual means of conversion of the debt.

54. More recently it has even been sustained that even in the case of absence of any special stipulation the court has the duty to find out what the implicit or tacit will of the parties to the contract has been. And that, therefore, the choice of the market which has to be taken into account for the conversion into local currency, has to be one which guarantees against any change in the substance of what was agreed.¹⁷

15. In practice, such a clause will be effective to convince the debtor to obtain the due currency anywhere, even on the black market. This is because the quotations in markets where there are very few operations, like New York, are extremely inconvenient.

16. It has to be pointed out, nevertheless, that these clauses are more preventive rather than executed. Generally, as was already mentioned in the previous footnote, it would be more onerous to the debtor to pay according to the literal application of such clauses, than to honour his debt in the currency of the contract, even if this may mean that he has to buy it on the so called "black market".

17. This has been the substance of the decision of the 4th. Chamber of the Court of Appeal of Rosario, in the case *Racca vs Perfiles Cromados, S.R.L.*, April 30th, 1985, when it was pointed out that the conversion into local currency is always an option for the debtor, *except* if that conversion makes the contract "meaningless". In such a situation the debtor has to pay an additional compensation for the damage caused by the conversion at the official rate. For further explanations, see A. BOGGIANO, *Obligaciones en moneda extranjera (Estudios de derecho privado comparado y derecho internacional privado)*, Buenos Aires, Depalma, 1987, p. 9.

55. Accordingly, a new jurisprudential tendency is becoming more realistic on these subjects. Following the herein before mentioned author's ideas,¹⁸ there have been two very important decisions concerning the foreign currency clauses : one in an international case, the other in a local case. I will briefly refer to both, including the latter, because if the courts accept the clauses in internal contracts, it is a sign that there will be no doubt in accepting them in international ones.

56. The first was sentenced by Chamber E of the Commercial Court of Appeals of Buenos Aires on March 1st, 1984. A provincial bank acted as intermediary for a foreign bank (actually the Los Angeles branch of another Argentine bank) in a so called *on lending* credit granted to an Argentine company.

The debtor sued the provincial bank because it would not accept payment in Argentine pesos converted at the officially controlled and fixed rate of exchange. The bank's refusal was based on the argument that it acted only as an intermediary for the foreign bank, and that payment had to be foreign currency in Los Angeles.

Since this was impossible at the time because of the exchange control restrictions, the bank did not want to accept the payment until the government would allow the remittances.

The court accepted the claim because, it said, the provincial bank could not prove that the payment in pesos at the official rate of exchange was not enough to buy the dollars, specially because, according to the terms of the contract, it could have asked for payment in pesos at the rate of exchange of the place of payment, that is to say, Los Angeles, or on any other market, in Argentina or elsewhere. So, the bank could not deny the debtor his right to pay off his debt.

This clearly means that a clause of the sort we mentioned before, has been declared absolutely valid (*Arrebillaga vs Banco de la Provincia de Santa Cruz*).

57. The second case may be of even greater importance. It was sentenced by the C Chamber of the Civil Court of Appeals of the city of Buenos Aires. In this case, a lady who had bought an apartment, agreed to pay \$US 12,000 in U.S. banknotes the day the apartment was going to be handed over, coinciding with the transfer of the rights of property before a notary public.

On the fixed date she showed up not with the dollar notes, but with the equivalent in pesos, at the official rate of exchange. Since the seller refused to accept that payment (and for other reasons which are of no interest to our conference), she sued him.

The lawsuit was rejected because in the contract it had been agreed that payment in dollar banknotes was an essential condition of

18. A. BOGGIANO, *supra*, note 17.

the sale. The court said that this clause had to be interpreted in good faith. And this would not be the case if the seller could be forced to accept an equivalent which clearly was unacceptable to him, this being proved by the fact that at the time of the contract the exchange control already existed, and that in the meantime the existence of a so called "parallel market" had become public, which, notwithstanding its illegality, reflected the real value of the dollar vis à vis the Argentine peso in foreign markets.

Under these conditions the respect of the autonomy of the will and the freedom of contracts granted by Article 1197 of the *Civil Code* has to prevail over Articles 617 and 619, specially since the difference between both values was so substantial (*Vignola vs Colombo Marchi*, November 26, 1985).

V. SPECIFIC PROBLEMS TO TAKE INTO ACCOUNT : GUARANTEES IN FOREIGN CURRENCIES

58. Law-decree Nr. 15.348/46 (ratified by law Nr. 12.962), created a specific registered pledge¹⁹ on mobile goods (a sort of mobile mortgage). This guarantee is very frequently used, because of its practical convenience, since it allows the owner to keep and use the good while the real right of the creditor is registered.

According to Article 1 of that law (as amended by law-decree Nr. 6810/63), this sort of guarantee may only be constituted in foreign currency in two cases : a. if the guaranteed credit is the price of imported goods²⁰; b. if the creditor is an international financial institution of which the Argentine Republic is a member.

In all other cases the privilege linked to this guarantee can only be in opposition to other third parties up to the amount of local currency resulting from the conversion of the foreign currency on the date of the guarantee.

59. Since the rate of inflation substantially increased in the seventies, there was much discussion on the subject of indexation clauses in mortgages and registered pledges. The point has to do with the "specialty principle", relevant to making the privileges of these guarantees opposable to third parties.

Law Nr. 21.309 solved the problem declaring that the "specialty principle" had to be duly respected if the stabilization or readjustment

19. Prenda con registro, or prenda sin desplazamiento.

20. And, according to uniform jurisprudence, only if the creditor is the direct seller. In other words, it would not be acceptable if the importer wants to guarantee the price when he resells the imported good.

clauses were duly registered, with clear reference to the chosen indexes, original index numbers, periodicity of its application, and rates of interest.

60. The immediate question was : are foreign currency adjustment clauses acceptable? And even further : can a mortgage in foreign currency be registered?

The first question was answered positively by nearly all the authors and, in fact, worked without any inconvenience in practice.²¹

The second question has been very controversial. Until recently the Property Register of the city of Buenos Aires, based on a administrative ruling, refused the registration of mortgages in foreign currency. In a very important case, the public notary who was in charge of the registration of a mortgage for the Banco de la Nación Argentina given in guarantee for an *on lending* loan in U.S. Dollars and Belgium Francs to the largest private hospital of South America, Sanatorio Güemes, sued the Register. The A Chamber of the Civil Court of Appeals of the City of Buenos Aires, declared the restriction unconstitutional and ordered the registration of the mortgage in foreign currencies.²²

VI. CONTINUATION : BANKRUPTCY

Someone may think we are going too far in our pessimism about all the risks involved in international contracts. But, as I repeated several times, unfortunately Argentina, once the seventh country in the world economy, far ahead of most European countries, has suffered so many events in the last fifty years, that the experience may be worthwhile looking at.

What happens to the foreign currency clauses in the case of a debtor's insolvency?²³

In Argentina, as in many other continental law countries, we have regulations on bankruptcy and also on what we call "preventive insolvency procedure".²⁴ In the first case, the debtor loses the administration

21. See A. ALTERINI, "Las cláusulas de estabilización y el principio de especialidad en la hipoteca", in 84 *El Derecho Review*, p. 799, specially p. 812.

22. The author mentioned *supra*, note 21, had already stated that unconstitutionality. See, A. ALTERINI, "Obligaciones en Moneda Extranjera y la Hipoteca", (1987-E) *La Ley Magazine*, p. 881.

23. The importance of the point can be appreciated with an example. At the time the "Sasetru" group went bankrupt in 1981, it owed the equivalent of \$US 1,000,000,000. — Five per cent, approx. \$US 50,000,000 — were owed to European banks, in U.S. Dollars. After a long judicial fight, the Supreme Court approved an agreement with the creditors to pay in eight years, with an indexation clause linked to the active interest rates. Today, the whole debt of the group amounts to approx. forty million dollars. The difference between internal inflation and foreign currency rates is, obviously, enormous.

24. *Quiebra* on one hand, *concurso preventivo de acreedores* on the other.

of his business, and he is replaced by the official receiver, who is a Public Accountant appointed by the court. The goal of the procedure is to liquidate the assets, and to pay the creditors. In the second case, the goal is to suspend any individual execution of the credits, but the debtor continues to administrate under the court's control. He has to propose an agreement which is voted by the creditors and has to be approved by the court. If he fails to do so, or if the creditors reject his proposal, or if the court doesn't approve it, he automatically is declared bankrupt. When in direct bankruptcy, the debtor has a chance to also offer an agreement which has to be voted under the same rules just mentioned.

61. Consequently, there are three cases to be considered :

For the so called "insolvency preventive procedure", Article 20 of law Nr. 19.551 (as amended by law 23.917) rules that debts in foreign currencies are only converted into local currency for the purpose of the voting rights of the creditor and for the balance the receiver has the obligation to prepare. Therefore, debts remain in the foreign currency in which they were originally incurred.

In the case of bankruptcy, Article 131 establishes that debts in foreign currency are to be converted into local currency at the rate of exchange of the date the bankruptcy was declared, or, if the creditor chooses so, at the date of maturity if that date is prior to the former. This is based on the principle of *pars conditio creditorum*.

The third case, agreement after bankruptcy has been declared, has no specific treatment in the bankruptcy law. The court's decisions have fluctuated based on different reasonings, from the strict position — according to which once the credit has been converted into national currency, it has to remain so, no matter what further developments there are — to a more flexible one where, recognizing that substantially this case is the same as the first one, they ruled that Article 20 has to be applied. This was the decision in the *Pierre Marques S.A.* case, sentenced by the D Chamber of the Commercial Court of Appeal of the City of Buenos Aires.

VII. TAXES : IS A GAIN OR A LOSS ARISING FROM FOREIGN CURRENCY RATES VARIATIONS TO BE TAKEN INTO ACCOUNT FOR FISCAL PURPOSE?

The answer is definitely, *yes*. Taxation is always based on national currency. Therefore, even if the specific subject goes far beyond the purposes of this presentation, it seems necessary to state that the appreciation of the foreign currency in which a contract is agreed, results in a taxable income for the creditor and a loss or higher cost to the debtor. Conversely, a depreciation of the foreign currency the creditor

expects to be paid in, is a loss, and to the debtor a lower cost which will increase his taxes.

I don't think that these factors will be decisive in choosing the contract's currency, but the influence of taxation has to be kept in mind, specially when it comes to choosing one of the possible remedies to minimize the risk : for example, interests are also subject to taxation, and sometimes in international financing the banks state that local taxes have to be paid by the borrower.

CONCLUDING OBSERVATIONS

The subject of this presentation was risks involved in the variations in the currency rates of exchange.

Of course I have only been able to refer to some of the infinite problems involved. I did it with a double limitation : firstly, since I am a lawyer, my personal professional turn of phrase, which makes it very difficult for me to talk as an economist or business administrator would. Secondly, my country's experience, which has proved that more important than deciding in which currency we want a contract to be carried out, and managing the exchange risk by ways of economic counterbalances, the most complicated point is how to foresee in contractual clauses that payments really are effective in the chosen currency.

You may have the impression, after following this presentation, that handling the sort of risk I concentrated on is so complicated that it may be better to stay at home and not take part in any international transaction. But, in fact, this is not so. In practice, most obligations are duly honoured at maturity. The cases we talk about are, in the long run, only exceptions.

Nevertheless, I would like to finish by recommending that no contract where currency risk is involved, should be made without careful advice on the legal consequences and the necessary provisions be given due attention.