EXCHANGE CONTROL AND THE INTERNATIONAL MONETARY FUND

Traders dealing overseas have of necessity become familiar with the currency risks present when the price of goods is calculated in one currency and paid in another and with the steps that may be taken to minimise those risks. However, the danger of entering into a contract with a foreign resident which it subsequently turns out was illegal is not considered as often—and yet the consequences are potentially more serious. The danger can arise quite easily, not through any formal invalidity in the contract, but because either party has failed to comply with his domestic exchange control regulations. The effect can be twofold: the contract may be illegal under the law of the jurisdiction whose regulations have been infringed and as a result because of private international law rules it may be unenforceable in the other jurisdiction. The end product could be to deny any remedy to enforce the contract in both jurisdictions.

The purpose behind exchange control is the preservation of foreign exchange resources and the maintenance of currency value. Small individual transactions may be assumed to be harmless, but taken cumulatively their effect can become marked. As a result legislation in most jurisdictions is extremely wide in its terms with a view to embracing even small dealings. For example, the position in Australia is governed by the *Banking Act* 1959 (Cth) and the *Banking (Foreign Exchange) Regulations*. Under regulation 8(1) the consent of the Reserve Bank is required *inter alia* for any payment to be made to or received for a person not resident and for the creation or transfer of any right to receive payment or services in favour of such person. It has been pointed out[1] that this is wide enough to cover even the most mundane transactions involving a non-resident: a foreign tourist agreeing to hire a taxi. Where the requisite consent is lacking the legislation has been infringed.

The effect of such an infringement does vary between jurisdictions. But using Australia as an example again, as far as any contract entered into before the 1974 amendments to the legislation was concerned the

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1 Horton, *Australian Exchange Control—Its Civil Consequences* (1973) 47 ALJ 124.

civil consequence of such an infringement was illegality and invalidity.[2] Let us take the instance of a contract for the sale of machinery by an Italian resident to an Australian and see what might happen, assuming the Australian failed to seek Reserve Bank consent. If the Italian party defaulted in his obligations the Australian party would have no remedy in Australia. His right to sue in Italy would depend upon the construction of the Articles of Agreement of the International Monetary Fund to which both Italy and Australia belong with some hundred other members. The guiding principle is incorporated in article VIII(2)(b).

The relevant portion of article VIII(2)(b) provides '(b) 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.' But what is the meaning of the words 'exchange contracts' and when are regulations 'maintained or imposed consistently with this Agreement'? There has been much disagreement about the meaning of 'exchange contracts', but two main views have emerged. What may be termed the narrower view is that an 'exchange contract' is a contract to exchange the currency of one country for the currency of another. The wider view is that an 'exchange contract' includes any contract which in any way affects a country's exchange resources—this would involve contracts for the sale of goods or services, whereas the narrower view would not.

The question has recently been considered by the English Court of Appeal in the case of *Wilson Smithett & Cope Ltd v Terruzzi*.[3] The defendant in that case, an Italian resident, had established an account with the plaintiffs who were dealers and brokers in metals in England to enable him to speculate on the London Metal Exchange. At a time when the price of zinc was very high he gave the plaintiffs instructions to sell short on his behalf in anticipation of a fall in the market. The procedure for carrying out his instructions was for the plaintiffs to conclude the appropriate contract of sale or purchase on the floor of the Exchange, the terms being incorporated in a similar contract concluded subsequently between the plaintiffs and the defendant. After the contracts for the sale of zinc had been entered into,

2 T M Duche & Sons (UK) Ltd v Walworth Industries (Aust) Pty Ltd [1962] SR (NSW) 165.
For a summary of the consequences in the United Kingdom see Mann, THE LEGAL ASPECT OF MONEY (3rd ed 1971) at 388-398.

3 [1976] 1 All ER 817.

the price continued to rise until it reached an unprecedented level and, in the events which followed, this resulted in there being a substantial balance owing to the plaintiffs on the defendant's account. His defence to an action in the English High Court for its recovery finally rested upon whether, because he had not received Italian exchange control permission, the zinc contracts to which he was a party were unenforceable under English law as 'exchange contracts'.

The Court of Appeal unanimously upheld the first instance decision of Kerr J that the contracts were not 'exchange contracts'. In so doing the members of the Court accepted the narrower view of the meaning of these words. Some support for the wider view had been found in the judgment of Lord Denning MR in the earlier Court of Appeal decision of *Sharif v Azad*,[4] but on this occasion the Court, including Lord Denning, firmly rejected it. The wider view had been suggested by Dr F A Mann in an article appearing in the British Year Book of International Law[5] in 1949 and in his book THE LEGAL ASPECT OF MONEY,[6] on the basis of the construction he gave to the wording of article VIII and also of what he considered to be the paramount purpose of the International Monetary Fund—'the promotion of international monetary co-operation'.[7] In arriving at their conclusion the Court of Appeal stressed one of the other main purposes of the Fund[8] which is the promotion of international trade. Article VIII (2)(a) actually says that no member without the approval of the Fund is to impose restrictions on making payments and transfers for current international transactions. Ormrod LJ reached the conclusion that: 'this is a clear indication to my mind that the policy of the IMF Agreement is to control capital transfers on the one hand and to keep restrictions on current international transactions to a minimum in the interests of expanding world trade'.[9]

It seems clear that the narrower view is the more expedient. The wider view includes any contract affecting a country's exchange resources. This could apply to any agreement under which a person in a foreign country agrees to spend his own domestic currency, whether in kind or converted into the currency of that foreign country—bringing us back to the situation of the foreign tourist hiring a taxi.

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4 [1967] 1 QB 605.
5 29 BYBIL 259 at 274.
6 3rd ed (1971) at 441.
7 Article I (i) of the Articles of Agreement of the International Monetary Fund.
8 Article I (ii).
9 [1976] 1 All ER at 824.

Such a broad interpretation of the possible ambit of article VIII may seem rather fanciful, and yet it was one that Kerr J felt that he had to deal with in his judgment in *Terruzzi's* case. He also said: 'It would be extremely difficult, if not impossible for every contracting party to seek to satisfy itself before entering into an ordinary international contract concerning goods or services or choses in action that all necessary permissions had been obtained. Yet all such contracts can be said to affect the exchange resources of (at least) the payer's country. This difficulty could only in practice be overcome by covering the enforceability of all such contracts by insurance, but this would substantially add to the cost and hamper internationl trade.'[10] The problem with the wider view is to know how to draw the line between significant and insignificant contracts. This same difficulty may exist with the narrower view, but at least it does not have repercussions on international contracts for the sale of goods, services, etc.

It is to be hoped, therefore, that the decision in Teruzzi's case may help the narrower view to gain ground. But the wider interpretation has already been adopted by a court in Schleswig-Holstein *(Lessinger v Mirau)*[11] and possibly in Paris *(Re Anna De Boer)*[12] and has been given some support in Luxemburg *(Societe Filature v Epoux)*.[13]

So, returning to the example of the Australian seeking to sue in Italy, the availability of a remedy would depend upon whether the Italian court in question accepted the wider or narrower view. It need hardly be said that this position is highly unsatisfactory from the point of view of a party who may have to enforce an international contract, the only method of avoiding trouble being to check that a valid consent was originally obtained. If the country of one of the parties to the contract was not a member of the International Monetary Fund then ordinary conflicts principles of public policy would apply and the result would be even more uncertain.[14]

As far as Australia is concerned, it is questionable whether an argument based upon article VIII(2)(b) could ever be successful in an Australian court. Although approval for Australia to become a member of the International Monetary Fund was given by the *International Monetary Agreements Act* 1947 (Cth), the power given in s 11 to make regulations giving effect to the Articles of the Fund has

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10 [1975] 2 All ER 649 at 662.
11 [1955] 22 ILR 725.
12 [1961] Journal du Droit International 721.
13 [1955] 22 ILR 727.
14 See Dicey & Morris THE CONFLICT OF LAWS (9th ed 1973) at 915-923.

not been used. It has been suggested therefore that the Articles cannot apply in Australia.[15] This view must be coloured by the marked difference between that article and the new regulation 45 of the *Banking (Foreign Exchange) Regulations*, introduced in 1974. Regulation 45 provides: 'No act or thing done, or contract or other transcation entered into, is invalid or unenforceable by reason only that the provisions of these regulations have not been complied with.' This regulation reverses the position which maintained previously—that contracts were invalid if the Regulations had been infringed with respect thereto—but at the same time gives rise to a number of new questions. In particular, is it visualised that a contract now enforceable in Australia, although in breach of the Regulations, should be unenforceable in States belonging to the Fund? An interesting question is whether the Regulations (which do not distinguish capital and current transactions) are maintained 'consistently with this Agreement' within article VIII(2)(b) or indeed whether because they impose restrictions on current international transactions they infringe article VIII(2)(a) and can only have legal validity after confirmation by the Fund. Kerr J declined to decide that latter question in *Terruzzi's* case in relation to the Italian legislation in the absence of evidence of actual inconsistency between the administration of the legislation and the Fund Agreement. The question was, however, decided in a Belgian case.[16]

The overall position is unsatisfactory because of the lack of uniformity between jurisdictions. This is almost inevitable as different governments and courts place varying importance on the value of exchange stability as compared with the freedom of international trade. To a certain extent these two purposes of the Fund will always conflict and it is hopeless to seek a short term solution. It would be charitable to the scheme of exchange control legislation in Australia to say that the conflict between it and the Fund Agreement is no worse than in some other jurisdictions. It remains to be seen whether any point resting on that conflict can be taken in an Australian court.

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15 Sexton, *Tightening the Foreign Exchange Net* 3 Aust Bus L Rev 254.

16 Emek v Bossers & Mouthaan (1955) 22 ILR 722 a decision of the Commercial Tribunal of Courtrai. Part of the reasoning rejecting a defence under article VIII(2)(b) was that defendants had failed to prove that the Fund had 'confirmed' a Dutch Exchange Control Decree.