C. *Scope of application of unified rules*

53. The scope of application would need to be clear, and cover the formulations of liquidated damages and penalty clauses commonly used in international trade.[38]

VIII. Conclusions

54. Liquidated damages and penalty clauses serve useful purposes, and are widely used. The case for unification rests on the desirability of ensuring their greater effectiveness. As clauses which only seek to pre-estimate compensation, although somewhat differently treated, are valid under all legal systems, the focus of unification would be the wider recognition of clauses seeking to coerce performance. It is difficult to determine whether, in general, current levels of contract performance in international trade are deficient, and need enhancement. It can be accepted, however, that whatever be the applicable law, contracting parties might for special reasons value the possibility of using, without uncertainty, a liquidated damages or penalty clause to increase the expectancy of performance.

55. Those legal systems which find clauses seeking to coerce performance unacceptable for policy reasons may, perhaps, be disposed to accept uniform rules validating such clauses subject to certain qualifications. Possible qualifications would be restricting the application of the rules to international contracts, excluding their application to consumer contracts, continuing to apply existing rules protecting a weaker contracting party against fraud and coercion and, in particular, making the unified rules applicable only upon express selection by the parties. While the foregoing survey has revealed policy differences on issues other than the coercion of performance, such differences appear to be more readily susceptible to compromise.

56. The benefits of liquidated damages and penalty clauses noted above are applicable to international commercial contracts in general, and not merely to international sales. The formulation of unified rules applicable to a wide range of contracts does not appear to create special difficulties.[39]

57. Two regional attempts at unifying the rules on liquidated damages and penalty clauses have been made, one by the Interparliamentary Consultative Council of Benelux,[40] and the other by the Council of Europe.[41] Both seek to make national law on such clauses conform to the unified rules adopted by them. States adopting these unified rules may find acceptable a limited derogation from them in favour of unified rules applicable to international trade contracts.

58. As to the means by which unification can be achieved, it is clear that legislative intervention is necessary as the differing legal rules have a mandatory character. The drafting of a model clause for adoption by contracting parties would not suffice. It is also apparent that the cost of a diplomatic conference convened solely to adopt a convention containing uniform rules on this topic would be disproportionate to the possible advantages to be gained through the adoption of such rules. An alternative approach is the drafting of a model law to be adopted by States, containing uniform rules. The drafting of such a model law could be referred to a working group on international contract practices.

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[38] Resolution (78) 3 recommends the following scope of application:

Article 1: "A penal clause is, for the purposes of this resolution, any clause in a contract which provides that if the promisor fails to perform the principal obligation he shall be bound to pay a sum of money by way of penalty or compensation."

However, paragraph 2 of the resolution also recommends to Governments "to consider the extent to which the principles set out in the appendix can be applied, subject to any necessary modifications, to other clauses which have the same aim or effect as penal clauses".

[39] Both the unified rules of Benelux and the Council of Europe are applicable to all types of contracts.

[40] By the Benelux Convention relating to the Penal clause, done at The Hague on 26 November 1973. The parties to the Convention are Belgium, Luxembourg and the Netherlands. The Convention has not yet entered into force.

[41] By resolution (78) 3 adopted by the Committee of Ministers of the Council of Europe on 20 January 1978.

D. Report of the Secretary-General: clauses protecting parties against the effects of currency fluctuations (A/CN.9/164)*

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INTRODUCTION

1. At its eleventh session, the Commission adopted a new programme of work. One of the items on that programme calls for a "Study of international contract practices, with special reference to . . . clauses protecting parties against [the effects of] currency fluctuations".[1] The Commission, at that session, requested the Secretary-General to prepare a study on the foregoing item for submission to it at its twelfth session.[2] This report has been prepared in response to the Commission's request.

2. The currency value problem at issue here may be said to arise from the combined operation of both a legal principle and an empirical fact. The legal principle is that which is usually referred to as "nominalism", that is, the doctrine that the quantum of a monetary obligation is in the eyes of the law to be measured in numerical (i.e. number-of-monetary-unit terms) rather than in terms of real or effective value. As a principal work on the subject explains, "[t]he nominalistic principle means that a monetary obligation involves the payment of so many chattels, being legal tender at the time of payment, as, if added together according to the nominal value indicated thereon, produce a sum equal to the amount of the debt. In other words, the obligation to pay £10 is discharged if the creditor receives what at the time of performance are £10, regardless of both their intrinsic and their functional value."[3] Or, as an English judge somewhat more bluntly put it, "A man who stipulates for a pound must take a pound when payment is made, whatever the pound is worth at that time."[4]

3. The other component of the problem is the commonplace fact that the value of a currency is subject to change over a period of time whether it be in terms of its exchange rate relation to other currencies or in its functional value measure by what it can buy and whether the change is brought about by a formal act of a monetary authority (e.g. devaluation) or occurs by reason of inflation or other factors related to the price of goods and services. A related observation in this context is the fact that as far as purchasing value is concerned the typical trend for a currency over time has been downwards.[5]

4. What this means, in simple terms, therefore, is that a creditor who lends 100 units of his national currency to a foreign borrower repayable in five years by payment of 200 units of the latter's national currency (based on the then prevailing exchange rate of 1 to 2) knows that he faces two risks: that the exchange rate situation may become such that at the time of repayment 200 units of the borrower's national currency is worth less than 100 units of his own, and, secondly, that even assuming no change in the exchange rate, the 100 units of his national currency which he will then receive will in terms of purchasing power be worth less than the 100 units he had lent to the borrower. Similarly, in the foregoing example, the borrower, assuming the loan was to be repaid in the creditor's currency, would face the risk that the exchange rate relation between the two currencies could be such that substantially more than 200 units of his own national currency would be required to pay off the nominal 100 units of foreign currency owed.

5. It becomes obvious, given the undoubted and so far unavoidable susceptibility of currencies to depreciation and appreciation, that the problem of how to maintain the value of a fixed monetary obligation (e.g. 100 units of currency X) is one of finding effective ways to either exclude, limit or compensate for, the operation of the principle of nominalism: how to ensure that the amount which one will receive tomorrow will be equivalent to the 100 units which one has foregone today and indeed that one does not end up receiving an amount in the currency of payment which by reason of intervening

[1] UNCITRAL, report on the eleventh session (A/33/17), para. 67 (*c*) (i) *b* (Yearbook . . . 1978, part one, II, A).

[2] *Ibid.*, para. 69.

[3] F. A. Mann, "The Legal Aspect of Money" with special reference to Comparative Private and Public International Law (3rd ed., Oxford, Clarendon Press, 1971), p. 76 (foot-note omitted) (hereinafter cited as Mann).

[4] *Treseder-Griffin and Another* v. *Co-operative Insurance Society Ltd.* (1956) 2 Q.B. 127, 144, per Denning, Lord Justice, as he then was.

[5] The problem of the depreciation of currency values is one that is also of special relevance to the current search for a unit of account in which to express the monetary obligations contained in many international conventions relating to the liability of parties engaged in the activity regulated under the Convention. Thus, with reference to the various transport conventions, it has been observed that "The inflation in all the countries over the world has resulted in an average depreciation of the currencies to 1/3 of the value it had in the year of 1934 with the consequences that the carrier's liability has eroded to the same extent". L. Hagbert, 'Gold Value Clauses in International Transport Conventions", 5 *International Business Lawyer*, 253, 259 (1977).

exchange rate relation changes is nominally even less than 100 units of the currency lent.

I. THE MAINTENANCE OF VALUE

6. Before going on to describe the variety of methods which have been employed in seeking to maintain the value of a monetary obligation between the time it is incurred and the time it is to be discharged, it may be useful to note more fully the various ways in which a currency may change in value and some of the factors underlying such change. This should enable one to perceive more readily the risk which the particular maintenance-of-value provision is designed to guard against and thus to understand what "value" is being maintained.

7. One of the more obvious ways in which the "value" of a currency may change is in its value relation to other currencies, i.e. its exchange rate vis-à-vis another currency: instead of being exchanged at the rate of 1K = 2M, for example, it is now exchanged at the rate of 1K = 1M (depreciation) or conversely at the rate of 1K = 3M (appreciation). In the past this kind of change occurred most typically through the action of the monetary authorities of the State concerned in formally devaluing or revaluing its currency in furtherance usually of an economic policy objective, such as increasing export of its goods, or sometimes in furtherance of a political decision, such as reducing its balance-of-payment surplus vis-à-vis another country.

8. The situation just described has undergone significant changes in recent years, reflecting the developments that have taken place in the international monetary system itself. Under the old system, as established by the Bretton Woods Agreement of 1944, which required members of the International Monetary Fund (IMF) to establish a par value for their currencies in relation to gold (and hence indirectly in relation to the currencies of other member States), devaluation or revaluation was a formal, clearly defined and deliberate act of government. It took place relatively infrequently and the new formal value once established remained operative until again changed by formal act of devaluation or revaluation.

9. However, since August of 1971 when the United States dollar was detached from the fixed parity system, most, if not all, of the currencies of international trade have been taken off the parity system and allowed to "float", with the result that the formal exchange value of such currencies is now determined by market forces rather than by the fiat of monetary authorities. Consequently, fluctuation of exchange values on a daily and even hourly basis has become an accepted fact, with little meaning left in the notion of formal devaluation or revaluation.[6]

10. Another sense in which the value of a currency may change is in its real or purchasing power, which though often related to, or reflected by, changes in the formal value of the currency, is nevertheless a separate and distinct phenomenon. In particular, changes in formal value become relevant only in the context of international transactions whereas purchasing power changes are of consequence even in the context of a wholly domestic transaction.

11. It is generally recognized that there are, in theory, two different aspects to the change in purchasing value question: changes on the side of money and changes on the side of goods and services, though there is considerable disagreement as to whether it is always possible in practice to separate one from the other or to decide which factor is in operation.[7] The best-known phenomenon on the money side is inflation, which, in the simplest terms, is said to occur when "too much money chases after too few goods", and is best illustrated where the price of an item goes up not by reason of factors on the production side such as increased costs or reduced supply but because the price is bid up by the availability of more money in the hands of buyers directed to its acquisition.[8]

12. Similarly, the ideal illustration of changes in purchasing power of a currency attributable to the goods and services side of the money-goods equation would be the case where the price of an item goes up in reflection simply of diminished supply. When, as in the case of an oil embargo, the item involved is an essential one, the effect of such higher prices becomes generalized throughout the economy in the form of higher average prices for goods and services.

13. It appears, therefore, from the foregoing analysis that the "value" sought to be maintained by value clauses in contracts could be either the formal value, related to exchange rate considerations, or functional value, related to purchasing power, or to both kinds of value.

14. Some of the devices by which it has been sought to maintain value will now be considered.

II. ATTEMPTED SOLUTIONS

15. Parallelling the two forms of monetary risk analysed above, two broad categories of value clauses have emerged which are designed to protect parties against one or the other or both of these risks. These categories may be conveniently labelled as: "pure mone-

[6] In reality, though, State monetary authorities have not totally abandoned the determination of the formal value of their currencies to free market forces. From time to time they have "intervened", typically by the purchase or sale of large volumes of currency, sometimes with funds "borrowed" from another monetary authority, in order to ensure that the value of their currencies remain within a pre-determined desirable range.

For a description of the par value system and the "floating currencies" system in the context of the Articles of Agreement of IMF, see, respectively, J. Gold, "The Legal Structure of the Par Value System", 5 *Law and Policy in International Business* 190 (1973); and J. Gold, "Floating Currencies, SDRs and Gold, IMF Pamphlet Series No. 22 (1977, IMF, Washington, D.C.) (hereinafter cited as "Gold, Floating Currencies").

[7] See Mann, at 74-75.

[8] It is, of course, never this simple in reality: the very fact of inflation generally means that the cost of production of the item is itself affected by "inflated" wages, price of raw materials, rent etc., so that the higher price of the item is in significant part attributable to higher production cost factors and not just to the amount of money in the hands of buyers.

tary clauses" and "purchasing value maintenance clauses".

A. *Pure monetary clauses*

16. These clauses are characterized by the fact that they typically are directed towards the formal value of a monetary obligation, which they seek by various monetary devices to safeguard. Among such devices are the following.

(a) *Compensatory interest rate*

17. This is one of the oldest and most obvious devices employed in the attempt to safeguard against the risk of diminished value of the sum received in discharge of a monetary obligation. The creditor, by anticipating what he believes could be the rate of depreciation of the currency of payment (using, for example, the known rate of inflation), stipulates for a rate of interest which he hopes will compensate for such depreciation. Thus, if he believes the rate of depreciation to be 10 per cent a year, he might stipulate for an interest rate of 15 per cent a year, in which case he would view the true return on his principal to be 5 per cent whilst the remaining 10 per cent would be characterized as a maintenance-of-value device.[9]

18. This device, while it can be effective in many cases and has the added merit of simplicity, nevertheless suffers from certain rather obvious limitations; the depreciation factor may be unpredictable, or there may be legal restrictions as to the limits of interest rates in the jurisdictions whose laws are pertinent to the legal relationship created.[10] Also, stipulation of a noticeably high interest rate may be psychologically unattractive to both borrower and lender, especially if competing lenders, by using other kinds of value devices, are able to keep their interest rates low in comparison.

(b) *Stipulation of exchange rate*

19. Another course often adopted by parties concerned about possible fluctuations in the relative value of the currencies involved in their transaction is to stipulate expressly a rate of exchange in their contract. Thus, the parties might stipulate that the loan amount of 100 units of m currency shall be repayable in k currency in five years from the date of the loan at 5 per cent interest per annum and at the conversion of 1m = 2k.

20. As thus appears, a device of this sort can be in the interest of both creditor and debtor to the extent it provides certainty by insulating their transactions from the inherent risk of exchange rate modifications. Correspondingly, however, each party thereby forfeits the chance that any such exchange rate modification would turn out in his favour.

21. An interesting variant of the fixed exchange rate device is to provide for a corresponding modification of the obligation to the extent of any variation in the exchange rate relationship between the currency of payment and another currency or to the extent that such a variation exceeds a certain percentage. Such a clause was before court in the English case of *Multiservice Bookbinding Ltd. and Others* v. *Marden.*[11] In that case a value clause in a mortgage loan agreement provided that the sum repayable under the loan "shall be increased or decreased proportionately if at the close of business on the day preceding the day on which payment is made the rate of exchange between the Swiss franc and the pound sterling (the currency of payment) shall vary by more than three per cent from the rate of 12.07⅝ francs to £1 prevailing at the date hereof".

22. In upholding the validity of this clause against the plaintiff's claim that it was unfair and unconscionable, the pound sterling having depreciated considerably as against the Swiss franc, the court observed that "... lender of money is entitled to ensure that he is repaid the real value of his loan and if he introduces a term which so provides, he is not stipulating for anything beyond the repayment of principal,"[12] and thus directly recognized the validity of maintenance-of-value devices.

23. It is interesting to note in connexion with this case that although the value sought to be maintained by the clause in question was the real (i.e. purchasing) value of the money owed, the clause was in strict analysis directed to the formal (or exchange) value of the pound. The fact that the real value was probably also maintained arises from the strength and stability of the reference currency, the Swiss franc: the formal, though not the purchasing value would still have been maintained, had the purchasing values of both currencies gone down by exactly the same proportion resulting in no change in the exchange rate relationship between them.

24. Mention might also be made of another interesting aspect of this case: the interest rate stipulation. Interest was to be at 2 per cent above bank rate—a rate which, as the court observed, already "reflects at least in part the unstable state of the pound sterling".[13]

(c) *Denominating debt in currency of creditor or debtor*

25. One or the other of the parties to an international financial transaction may seek to insulate himself from the exchange risk factor by having the debt denominated in his own national currency. Such an arrangement is effective to protect the party concerned against the risk that the intervening exchange situation might, in the case of the creditor, reduce the sum he will receive in his own national currency and, in the case of the debtor, increase the amount he has to pay in his own currency.

[9] The arrangement need not, of course, be cast in the form of principal and interest: the same result can be achieved simply by stipulating for repayment of a lump sum which encompasses with it both a factor for use of money and a factor for depreciation as well as the principal advanced.

[10] Most countries do in fact have some form of restriction on interest rates (usury laws) but numerous exceptions are recognized; hence, reference must be made to the particular law concerned in order to determine its applicability to the factual situation at hand—e.g., whether it applies to international transactions, who may invoke the defence of usury, etc. Cf., for example, the provision of New York State usury law stating: "No corporation shall hereafter interpose the defense of usury in any action . . . " (*General Obligation Law,* Sect. 23A, McKinney's Consolidated Laws of New York, Section 5-521).

[11] All England Law Reports 489 (Ch. D. 1977).

[12] *Ibid.,* at 502.

[13] *Ibid.,* at 503.

26. Since the effect of such denomination is to shift the currency risk to the other party to the transaction, it is usually the party in a stronger bargaining position who is able to choose the currency of denomination. This does not necessarily mean that such parties always choose to have the debt denominated in their own currencies; other considerations may come into play and cause a different choice to be made. Thus, for example, the limited, or lack of, convertibility of a currency which might otherwise have been employed as the currency of account, will usually cause the debt to be denominated in a different currency, whether that of the other party or a third currency. Equally, it may be that the currency of one of the parties is the stronger and more stable of the two, in which case that currency might be chosen even though it is not that of the party in a stronger bargaining position because of the latter's belief that that currency is unlikely to lose value relative to his own.

27. It is no doubt for one or the other of the foregoing reasons that transactions between parties from developed countries and those from developing countries tend generally to be denominated in the currency of the former, whether such parties from developing countries be buyers (as of machinery), sellers (as of commodities), or borrowers (as in the Euro-currency market). Sometimes, however, and especially with intergovernmental loans, one may see part of the loan denominated in the currency of the borrower, usually for that portion of the loan required to defray local expenses in connexion with the project for which the loan is given.[14]

(d) *Denominating debt in specific third currency*

28. Sometimes the party who is in a position to make such determination will choose to denominate the debt in a currency neither his own nor that of the other party. The primary reason for such a choice is likely to be the strength and stability of the third currency as compared to those of the parties' countries. Thus British exporters who previously had denominated most of their transactions in pounds sterling have begun more and more to denominate them, especially long-term ones, in foreign currencies as a result of the sharp decline of the sterling in recent years.[15]

29. Often, however, transactions are denominated in a specific currency out of long-standing habit on the part of businessmen who have customarily employed that currency in the particular trade involved. Thus, for example, the United States dollar continues to be the primary currency of account and payment in many trades, its recent instability and weakness vis-à-vis such currencies as the Swiss franc or the German mark notwithstanding.

30. A variant of this device occurs in the lending practices of the International Development Association (IDA), an affiliate of the International Bank for Reconstruction and Development (World Bank), whose General Conditions provide, firstly, that "withdrawals (by the borrower) from the Loan Account shall be made in the respective currencies in which the expenditures to be financed out of the proceeds of the Loan have been paid or are payable . . .", and secondly, "that the principal of the Loan shall be repayable in the several currencies withdrawn from the Loan Account and the amount repayable in each currency shall be the amount withdrawn in that currency . . .".[16]

(e) *Optional currency clauses*

31. An optional currency clause is one which denominates the debt in more than one currency and gives to one of the parties the option of choosing in which currency the debt will be discharged. The party thus entitled would, therefore, wait until close to the day of payment before deciding, based on the intervening history of the currencies involved, which one should be paid in. Such clauses tend to be inserted in contracts in favour of creditors. Because of the enormous advantage they confer on the creditor and the corresponding disadvantage to the debtor, optional currency clauses are not popular in practice. Indeed, it has been observed that the only application of the optional currency device in the international money and capital market appears to be when it has been used as an incentive offered by a relatively weak borrower seeking to float a loan.[17]

32. A quite interesting form of the optional currency device occurs in the General Conditions of Lending of the World Bank. The optional currency device in this case is notable because it is the debtor who is given the option of selecting the currency of payment from a list of eligible currencies.

33. Under section 4.02 (*a*) of the General Conditions, the borrower may repay the sum due in a currency mutually agreed upon by the parties "or in such other eligible currency or currencies as may from time to time be designated or selected" pursuant to the section. An "eligible currency" is defined to be "the currency of any member of the Association which the Association from time to time determines to be freely convertible or freely exchangeable by the Association for currencies of other members of the Association for the purposes of its operations".[18] Provision is also made whereby a borrower may, upon the giving of the requisite notice, effect a change in the eligible currency in which payment is to be made.[19]

34. It should be noted, however, that these payment options are coupled with a clause by which the loan is valued in terms of the United States dollar of the weight and fineness in effect on 1 January 1960.[20] While the

[14] This practice is very much in evidence in the financial projects undertaken by the United Nations and its various specialized agencies in developing countries.

[15] See Gold, Floating Currencies, p. 16, and materials therein cited.

[16] IDA, General Conditions Applicable to Loan and Guarantee Agreements (15 March 1974), art. IV, sects. 4.01 and 4.02 (*a*).

[17] See *Report of the Committee on International Monetary Law to the 56th Conference of the International Law Association* (New Delhi, 1974), pp. 81-82 (hereinafter cited as "ILA 56th Report").

[18] IBRD, General Conditions Applicable to Development Credit Agreements (15 March 1974), art. IV, sect. 4.02 (*b*).

[19] *Ibid.*, sect. 4.02 (*c*).

[20] Sect. 4.03. The existence of this clause would seem to suggest that the option device is aimed more at the convenience of the debtor than at giving him a financial advantage.

effect of such "constant dollar" clause is to reduce the significance of the option as a means of taking advantage of possible depreciation in the value of the currency of denomination, there is remaining some possibility of an advantage to the debtor since the eligible currencies might not all have maintained the same value relationship either to the 1960 dollar or to one another.

35. Reference might also be made to an important protective factor which operates in favour of such institutional lenders as the World Bank and IDA, which consists of the fact that much of the funds given out in loans by these institutions is itself borrowed. By properly structuring the terms (e.g. their respective maturity dates) of its loans and its own debts the institution is able to shift the currency risk from itself to its own creditor. Thus, for example, if the institution has borrowed 1,000 units of a currency to finance a loan to a client, it stipulates to receive payment in exactly the same currency which is then passed through in discharge of its own obligation to its creditor, who, therefore, bears the risk of any intervening depreciation of such currency.[21]

(f) *Combination of currencies device*

36. One of the more complex maintenance-of-value devices encountered in international trade involves relating the value of the debt amount to the exchange rate performance of a number of major currencies against a particular major currency in which the debt is denominated.

37. Thus in a contract for the sale of machinery between the foreign trade corporation of a socialist country and a Hong Kong purchaser, the price, expressed in United States dollars, being payable by instalment over a five-year period, the following "monetary valorisation clause" was used:

"The monetary valorisation clause referred to (in a preceding clause) is based on the arithmetic average of the mean of buying and selling rates for the following six convertible currencies: Belgian franc commercial, Swiss franc, Swedish crown, Deutsch mark, Canadian dollar and Japanese yen in their relation to the US dollar as certified at the date of signing the contract by (a named London bank) or other banks in London mutually agreed by the parties involved.

"In case of any change in the arithmetic average of the mean of buying and selling rate of (the) US dollar against the above six currencies at the close of business on the due date of repayments, and if the change exceeds 2 (two) per cent, the amount of each payment shall be adjusted accordingly.

"In case no rates are available on the mentioned dates, the rates certified at the close of business of the last proceeding day on which the respective foreign exchange market was opened, will be used."

38. The merits and disadvantages of such a device have been well-stated by the Committee on International Monetary Law of the International Law Association. Commenting on a similar device employed by certain Persian Gulf oil-producing States for protecting the value of the funds due to them during the conversion of such funds from the currency of account to that of payment, the Committee, in its report to the 56th Conference of the Association, observed:

"Such a monetary clause has one specific merit, namely its careful adjustment to the evolution of the parities of the most frequently used major currencies in international trade. It has allowed an effective adjustment of oil prices in accordance with recent monetary events. It would therefore be tempting to recommend its insertion in the various arrangements, more or less long-term, dealing with the supply of raw materials. Yet the disadvantages are of some importance. The first ensues from the complex operation of such a clause. Apart from the relatively modest problem of its drafting, it requires rather intricate calculations which only major enterprises and States with already properly qualified staff may have done. This is a genuine limitation on the wider use of the clause. Furthermore it only operates as an effective protective device with regard to variations of parity, no matter whether they are compatible or not with international obligatiors of States in force which means that they can cope exclusively with one legal phenomenon, namely exchange rate modifications. They do not offer any protection against economic developments affecting currencies, neither against depreciation nor appreciation in terms of purchasing power."[22]

(g) *Reference-to-gold clauses*

39. Of all the value maintenance devices in use in both domestic and international monetary transactions, the most venerable and for a long time the most widely used is unquestionably the "gold-value" clause in its many different forms. While its variants are numerous, the essence of the gold-value clause is an attempt to link the value of the monetary obligation to a specified value in gold (expressed in terms of weight, fineness, and/or quantity) in such a way that the quantum of the obligation at any time (and more specifically at the time of repayment) is the amount in the currency of payment required to "buy" gold of the specified value; in other words, the debt is discharged only by payment of an amount in the currency of payment regarded as the monetary equivalent of gold of the specified value at the time of such payment.

40. While it is beyond the scope and purpose of this report to attempt a comprehensive review of the variety of gold and gold-value clauses,[23] the following two rep-

[21] This pass-through aspect is emphasized by the fact that if the institution has had to purchase the currency required by the borrower with another currency, the borrower is deemed in effect to have borrowed that portion of the loan in the latter currency. See World Bank and IDA General Conditions, sects. 4.02 and 4.04 respectively.

[22] ILA 56th Report, p. 87.

[23] Something close to such a comprehensive review is contained in the ILA Monetary Law Committee's report. See also, G. R. Delaume "Gold and Currency Clauses in Contemporary International Loans", 9 *American Journal of Comparative Law* 199 (1960). Numerous references are collected in A. Nussbaum, *Money in the Law—National and International* (1950).

resentative approaches will nevertheless serve to illustrate the gold-value technique. One of the better-known approaches is that embodied in section 344 of the Czechoslovak International Trade Code, which seeks to tie the value of the obligation to the gold content of the currency of denomination and requires a proportionate adjustment of the obligation to the extent of any variation in such gold content exceeding a defined range.

41. A standard clause based on this approach provides as follows:

"In case of a change in the gold content of the US$ which is at present 0,888671 grammes of fine gold / or of the pound sterling which is at present 2,48828 grammes of fine gold / or in case of a change in the official price of gold in the United States of America which is at present 35 US$ a Troy ounce of fine gold/ the value of the contract not yet paid, the value of the merchandise not yet delivered and the value of the instalments/claims/inclusive of interest shall be converted as on the date of the change in the gold content of the US$ /or of the pound sterling or of the change of the official price of gold in the USA/ in proportion to the change occurred so that the equivalent in gold of all these deliveries and of the sum total of these payments remain the same as they would have been had the change not occurred."

42. From the context of international conventions come the other illustration. Article 22 of the Warsaw Convention,[24] as amended by the Hague Protocol of 1955, is typical of the gold-value technique employed in many similar conventions, which consists of denominating the obligation therein expressed in a specific gold currency with provision for conversion into the currency of payment on a gold-value basis. After fixing various monetary limits of liability in francs, article 22 goes on to state in paragraph 5 as follows:

"The sums mentioned in francs in this article shall be deemed to refer to a currency unit consisting of sixty-five and a half milligrammes of gold of millesimal fineness nine hundred. These sums may be converted into national currencies in round figures. Conversion of the sums into national currencies other than gold shall, in case of judicial proceedings, be made according to the gold value of such currencies at the date of the judgement."

43. The enormous attractiveness of gold as a value-maintenance device is, of course, easy to appreciate. Among the recognized attributes of gold which have made it ideal for use first as money and then as the international measure of currency value are its assumed intrinsic value and its history of maintaining its value over time, appreciating as necessary to compensate for value changes on the part either of currency or of goods and services. It is precisely these attributes of gold which commend it to the creditor or other party desirous of conserving the value of a fixed monetary obligation. To such a party, thus gold appears as in effect a non-depreciating currency, a perception reinforced by the role of gold as the measure of currency value under the international monetary system in effect until recent times.

44. The fate of the gold-value clause has been closely linked to the role of gold in the domestic and international monetary systems. Thus, for instance, in the days when gold coins actually were part of the domestic money of many States, the creditor could and often did achieve value maintenance simply by stipulating to be paid in gold coins rather than in any form of money.[25] Even after gold coinage had for all practical purposes disappeared from domestic circulation, the prevailing monetary system generally retained as its cornerstone the concept of gold convertibility. Notionally this amounted to a guarantee by the national monetary authority of the gold value of its currency, by being ready upon demand to convert such currency into gold. In such a situation, as one commentator has observed, "the denomination of an obligation in gold (was) nothing more than a lawful alternative to denomination in the national monetary unit",[26] with the result that there was little practical significance to the reference to gold provision in that context.

45. Hence the reference-to-gold clause achieved significance only when, as a result of a number of developments in the monetary sphere—including the cessation of domestic gold convertibility, legal tender legislation designed to force acceptance of bank notes and other forms of money, devaluations, and so forth—the value of a monetary obligation linked to gold no longer coincided as a matter of course with the nominal value of the debt as expressed in the national currency. Stipulating for the debt to be valued on a gold basis generally yielded for the creditor at the time of eventual repayment more units of the currency of payment than he would otherwise have received. Under these conditions the reference-to-gold clause grew in importance and popularity, serving well the needs of the creditor (and indirectly the interest of the borrower in the greater availability of credit) as well as the interest of others, such as, for example, the claimant under the compensation provisions of such international agreements as the Warsaw Convention which employ the gold-value device to denominate monetary obligations.

46. The success of the gold and gold-value clause occurred in an atmosphere of growing concern by national authorities as to the effect of such clauses on public confidence in the national currency and its implications for the sovereign authority to determine the value within the country's borders of such currency. These concerns were particularly pronounced in countries such as France and the United States where extensive use of

[24] Convention for the Unification of Certain Rules Relating to International Carriage by Air, done at Warsaw, 1929. Other conventions employing a similar technique include the Convention on the Contract for the International Carriage of Goods by Road (CMR), 1956 (Germinal franc); the Convention Relating to the Limitation of the Liability of Owners of Sea-going Ships, 1957 (Poincaré franc); and the Convention on Civil Liability for Oil Pollution Damage, 1969 (Poincaré franc).

[25] Such clauses are thus more accurately described as "gold clauses" rather than "gold-value clauses".

[26] See Silard, "Maintenance-of-Value Arrangements in International Transactions", 5 *Law and Policy in International Business* 398, 401-402 (1973).

the gold clause mingled with open resistance by creditors and obligees to acceptance of the national money in discharge of obligations owed them. Already in 1873 the French Cour de cassation had declared the gold and gold-value clause (and similar protective clauses) contrary to "ordre public" and inconsistent with existing legal tender legislation when employed with reference to a domestic transaction.[27]

47. Similarly in 1933 the United States Congress adopted the historic Joint Resolution by which it declared gold clauses contrary to public policy and decreed that obligations denominated in gold dollars may be discharged by coin or paper currency. While the exact ramifications of this enactment are still not settled,[28] yet its effect was to further throw into question the validity and usefulness of the reference-to-gold clause, particularly in view of the dominant role played by the United States dollar in international transactions, where denomination in United States dollars was, and remains, quite common. Furthermore, at about the same time or shortly thereafter a number of other countries enacted similar restrictive legislation which had the effect at the minimum of further limiting the scope of apparent validity of the gold-value (and other) protective clauses.[29]

48. The usefulness and the suitability of a reference to gold as a value-maintenance device has been further undermined by developments within the international monetary system. There is little doubt that a major reason why the gold-value clause worked so well—at least on the international level—was because it was well-adapted to the prevailing international monetary system under which gold was recognized as the common denominator of national currencies. Thus under the system established by the Bretton Woods Agreement of 1944, not only was gold made the ultimate reference of value for national currencies, but there was also established an official price for gold. This price of $US 35 per troy ounce was maintained essentially by the readiness of the United States authorities to convert United States dollars into gold for foreign monetary authorities at the set price and also the readiness to freely buy and sell gold in the open market.

49. This situation effectively came to an end on 15 August 1971 when, in response to continuing pressures on the dollar brought about in part by the mixed inflationary and recessionary effects of the Indo-China war and its aftermath, the President of the United States decided to suspend the free convertibility of the dollar into gold. The ensuing international monetary crisis culminated in the emergence of a two-tier gold market—one for transactions between central banks in which the price of gold remained at an established official level and one for private transactions in which the price of gold was allowed to be determined by free market forces. The result was not only a substantial divergence between the official and the market price of gold, but also a wide and persistent fluctuation in such free market price.[30]

50. With the entry into effect on 1 April 1978 of the Second Amendment to the Articles of Agreement of IMF, the process of demonetization of gold which has been in progress for the last few years is now complete. Under the Amendment, exchange arrangements may include "(1) the maintenance by a member of a value for its currency, in terms of the special drawing right or another denominator, other than gold, selected by the member . . .".[31] Gold, in other words, far from being the ultimate reference of value of national currencies has become no more than a commodity with all the consequences of price instability that this entails.

51. Under these circumstances therefore gold has lost one of its chief virtues as a value-maintenance device, namely its ability to confer stability of value and certainty to a monetary transaction.

(h) *The unit-of-account method*

52. The most important value-maintenance device in use today is the composite unit of account or "basket of currencies" method. This approach involves denominating the debt not in terms of an individual currency or multiple currencies, but in a unit of account composed of cumulative proportions of a selected number of currencies chosen on the basis of some criterion deemed relevant for the purposes for which the unit of account will be used and which also determines the relative weighting to be given each currency making up the unit.

53. The unit of account thus differs from the familiar multiple currency clause in which the debt is denominated in a number of alternative currencies in each of which, at the option of the party entitled to choose, the debt may be discharged, for in the case of the unit of account each unit represents proportionate amounts of all the currencies of which it is composed. This holist dimension to the unit of account also distinguishes it from the seemingly similar case where designated parts of the debt are denominated in different currencies such that analytically each part of the debt, with its corresponding currency of denomination, could be considered a separate obligation.[32]

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[27] Cass. Civ. 11 February 1873, S. 1873, 1.97, as construed in *Compagnie d'assurance La New York* v. *Deschamps*, Cass. Req. of 7 June 1920, S. 1920, 1. 193.

[28] See paras. 76-80 below.

[29] The legal issues are more fully discussed below, paras. 72 to 86.

[30] In view of subsequent developments in the international monetary system and the position taken later in this report as to the feasibility of a return to a gold-based maintenance-of-value device, it does not seem necessary to explore in fuller detail the problems created for the application of the gold-value clause in the two-tier gold market situation, such difficulties as deciding on the basis of which price the gold is to be valued and if on the basis of the market price, what the relevant date and place is. See, on these questions, P. Heller, "The Warsaw Convention and the Two-Tier Gold Market", 7 *Journal of World Trade Law*, 126 (1973). *Contra*, T. Asser, "Golden Limitations of Liability in International Transport Conventions and the Currency Crisis", 5 *Journal of Maritime Law and Commerce* 645 (1974). See also Gold, Floating Currencies, pp. 55-63.

[31] Second Amendment to the IMF Articles of Agreement, sect. 2 (*b*).

[32] Commenting on the purpose of such an arrangement, the ILA Monetary Law Committee concluded that it was probably fair to say that "in general, these combinations are primarily not meant to maintain value, but rather to allocate amounts in the currencies of the different countries where they are to be spent". ILA 56th Report, p. 83.

54. The best-known of the basket-of-currencies unit of account is the IMF Special Drawing Rights (SDR). Other international units of account include the transferable rouble of the Council for Mutual Economic Assistance, the European Economic Community (EEC) unit-of-account (EU), the European composite unit (EURCO) and the Arab currency-related unit (ARCRU), the last two being used primarily in the private international bond market.[33]

55. The SDR, which was set up in 1969, is, as revised in June 1978, a composite of the currencies of the 16 unit countries whose share of total world export of goods and services in the period 1972-1976 exceeded one per cent on the average. These currencies range from the United States dollar, with a relative weighting of 33 per cent, to the Spanish peseta, with a weighting of 1½ per cent.[34] With the coming into effect of the Second Amendment to the IMF articles and the widespread recognition and use by States of the SDR both as a unit of account and as a *numéraire* of value in bilateral and multilateral transactions between themselves, it may be justified to conclude that the SDR has virtually replaced gold in the international monetary system.[35]

56. Since, however, there remain some very important States not members of IMF and whose currencies are not convertible into SDR values and since, furthermore, only States and not individuals, may own or operate SDR accounts, the extent to which the SDR can become not only a universal unit of account but also a maintenance-of-value reference for private transactions is still an open question. Clearly much depends on the future evolution of the SDR, whether, for example, a way could be found acceptable to non-IMF members to relate their currencies to SDR values and what the attitude of courts would be to value-clauses in private contracts linked to the SDR.[36]

57. The merit of the basket-of-currencies method of value protection is that it provides a relatively stable reference of value since its composite nature ensures that the weakness of one currency is balanced by the strength of another, thus counteracting the fluctuation tendency. Its composite nature also allows for flexibility and adaptability: depending on the purposes in view and the parties concerned, the number, identity and relative weights of the component currencies could be chosen to suit the particular situation.[37]

58. There are two major disadvantages to the device. The first is that it does not necessarily provide a hedge against depreciation in purchasing value. Thus, for example, the relative values of the currencies in the basket might be maintained as between themselves while in fact, because of the impact of inflation on those currencies, the over-all value of the unit in terms of purchasing power may have fallen considerably over the period in question. Secondly, because of the need to keep the unit under constant review both as regards the relationships among the component currencies and as regards the overall value of the unit itself as well as the need to make authoritative calculations regarding the value of a particular currency in terms of the unit, considerable administrative and technical expertise is required to establish and operate a unit of account of the sort under consideration. This tends to make it impractical for use except by sophisticated parties who can understand its operation and have access to the means of obtaining the requisite calculations.[38]

B. *Purchasing value maintenance clauses*

59. These clauses, as the heading suggests, are in essence directed towards maintaining the purchasing rather than the formal exchange value of the monetary obligation to which they relate. Consequently, they ordinarily take the form of a linkage between the amount of the monetary obligation owed and the price of goods and services, such that a change in the latter (usually, if of a certain size) causes a corresponding adjustment in the amount of the debt.

60. While such compensatory value clauses are familiar and easy to apply in the case of a domestic transaction in which typically only one currency and one set of price levels are involved, their use in an international transaction raises some interesting questions as regards the currency whose purchasing value is at stake. Although in practice value clauses of this sort generally refer to the domestic purchasing power of the currency of account, there seems to be nothing in principle which would preclude reference instead to the domestic purchasing power of some other relevant currency such as, for example, of the creditor's or the payor's country. This is particularly so where the latter currency is the currency of payment. The creditor may, in specifying the currency of payment, have planned to use the funds to make purchases in the country in whose currency he is to receive payment and he may be concerned that changes in the domestic purchasing value of that currency might conceivably not be fully reflected in the exchange rate

[33] For a useful survey of the most important basket-of-currencies units of account in use in world trade and international financing, see report of the United Nations Committee on Contributions, *Official Records of the General Assembly, Thirty-third Session, Supplement No. 11* (A/33/11).

[34] The full list of SDR currencies, with their corresponding weightings, is as follows: United States dollar (33 per cent); Deutsche mark (12½ per cent); French franc (7½ per cent); Japanese yen (7½ per cent); pound sterling (7½ per cent); Italian lira (5 per cent); Netherlands guilder (5 per cent); Canadian dollar (5 per cent); Belgian franc (4 per cent); Saudi Arabian riyal (3 per cent); Swedish krona (2 per cent); Iranian rial (2 per cent); Australian dollar (1½ per cent); Austrian schilling (1½ per cent); Norwegian krone (1½ per cent); Spanish peseta (1½ per cent).

[35] Until the Second Amendment the SDR was, of course, itself also defined in terms of gold.

[36] On the latter question, there appears to be some grounds for optimism. See Gold, Floating Currencies, pp. 60-63.

[37] Compare, for example, the make-up of the SDR with that of the EEC unit of account (EU) which contains specific amounts of the currencies of all of its nine members.

[38] Even as regards the SDR, IMF publishes currency values on a current basis for only 32 or so countries, although such calculations will be made for any other member currency upon request. One can certainly foresee difficulties for a court, say, in a developing country faced with an SDR-related clause in a contract whose construction and application is dependent on such prior calculations.

between that currency and the currency of account at the time of payment. It would seem therefore that the facts of each particular case should determine the appropriate currency and relevant price level reference.[39]

61. The following appear to be the major types of compensatory purchasing value clauses.

(a) *Index clauses*

62. The most important and most familiar type of compensatory purchasing value clause, the index clause, seeks to link the amount due to the party to be paid to movements in the price of goods and services either as a whole (general index clause) or with respect to specific items (specific index clause). Such a clause will generally specify the source to which one must look for the authoritative figures on the relevant price movement, e.g. figures published by the United Nations Statistical Office, the commerce or trade ministry of the particular country concerned or even a particular trade association. Where no such source is identified or where, as often occurs in intergovernmental transactions, there is a vague reference to a price level—e.g. "the world market price of X commodity"—different problems of interpretation and application may arise, especially for a tribunal lacking the means or resources to conduct the appropriate verifications.[40]

63. As regards the general index clause, which reflects more truly the concern for the over-all purchasing value of the currency involved than does the specific index clause, numerous examples occur of their use both at the domestic and the international levels, particularly in the form of cost-of-living adjustments to wages or as factors necessitating an adjustment in the price of work agreed to be done. Thus, for example, the compensation system of staff members of the United Nations consists of two elements— a fixed salary portion and a graduated post adjustment added to or subtracted from the base salary depending on the cost of living at the location in comparison to that in New York which serves as the reference point. This cost-of-living portion is subject to automatic adjustment whenever the cost-of-living index is determined to have moved upward by at least a certain percentage. Again, it is quite common in countries permitting it for the value of such long-term obligations as rent to be protected by an index clause, usually of the general type, providing for an augmentation of the rent payable by the same percentage as that by which the price may have risen.

64. The specific index (or price escalation) clause is commonly encountered where, as in the case of a construction project, it is anticipated that the party to be paid will incur recoverable additional costs of a known nature but of indeterminate size during the period of performance of the contract—increases in the cost of labour and material, for example. The index clause in such a case would then be linked to the specific item or items as to which price movement could be anticipated.

65. An illustrative case is a contract between a public works corporation of a developing country and a foreign construction company which contained a price escalation clause based on the two elements of wages and the price of materials and goods. As to the former, it was provided that if there was any increase or decrease necessitated by the decision of the Government or by agreement with a recognized trade union during the life of the contract, "then the net amount of such increase or decrease shall be added to or deducted from the Contract Sum as the case may be". Similarly, as to materials and goods a schedule of current market prices was established at the commencement of the contract as the "basic price" of each item and then followed the following provision:

> "If during the progress of the works the market price of any of the materials and goods (listed in an appendix) varies from the basic price thereof, then the difference between the basic price and the market price payable by the Contractor and current when such materials or goods are bought shall be added to or deducted from the Contract Sum as the case may be."

66. The foregoing example brings out a further point which deserves to be noted in this context. While it is generally the case that index clauses serve the interest of the creditor because of the basic tendency of price levels to move upwards, there may also be circumstances where the price level of the reference items declines and the index clause enables the debtor to benefit from such a decline. Hence a well-drawn clause will usually provide for such a case. Such a balanced clause, for instance, using the price of oil in the United States as the index would have worked to the benefit of the party to be paid during the period of high prices brought about by the shortages of 1973 and to the benefit of the payor when the shortages abated and prices declined significantly.

(b) *Quantity adjustment clauses*

67. In the situation here contemplated, the parties agree that a loss in purchasing power of the currency in which the amount due from the payor is denominated will be compensated for not, as in the usual case, by an augmentation of the amount payable, but by a corresponding reduction in the performance obligation of the other party. Thus, in the case of a seller, he may be allowed to adjust the quantity of the goods to be delivered to the new value of the amount he is to receive.

[39] In its discussion of this issue, the ILA Monetary Law Committee seems to suggest that reference to the purchasing value of the money of account is the fair and appropriate course of action (ILA 56th Report, p. 94). It is not entirely clear, however, why this should always be so. Where the money of account and that of payment are the same, no problem arises; where they differ, however, a contrary argument can at least be made. Thus, for example, where, in keeping with trade practice, the obligation is denominated in a specific third currency (e.g. the United States dollar), no convincing reason appears why a change in the domestic purchasing value alone of that currency should be any more relevant to the parties and particularly to the creditor than a change in the purchasing value of the currency of actual payment which in this example is that of the creditor's country.

[40] This is an important factor in considering the suitability of such clauses in international transactions, where the clause may fail to be applied, say, by a court in a developing country not equipped with the resources to easily conduct the necessary verification.

68. The situation could arise, for example, in a case where the goods are being supplied by the vendor on a cost-plus-fee basis to a buyer who, because of exchange control regulations in his own country, is limited to an absolute ceiling in the amount he can transmit abroad. If in such a case intervening cost increases or loss of value of the buyer's currency makes the amount, which the buyer is permitted to transmit, insufficient to pay for the agreed quantity, such insufficiency could be remedied by a corresponding reduction in the quantity to be supplied.

69. Other circumstances noted by ILA, in which quantity adjustment clauses operate, are in the field of development aid and in the supply of commodities under a medium- or long-term arrangement where the donor or obligor allocates a fixed monetary amount for the purpose and the actual quantity of goods (e.g. agricultural equipment) supplied or commodity provided is made to vary in accordance with the real economic value of the allotted funds at the time of consummation of the transaction.[41]

(c) *Hardship clauses*

70. One possibility which the parties have always had for dealing with changed circumstances such as those likely to be brought about by currency fluctuations is the inclusion of a "hardship clause" in their contract by which the party adversely affected by such circumstances is enabled to initiate the process of renegotiation with the other party with the hope of then working out a mutual accommodation in light of such monetary developments.

71. It appears that the use of the hardship clause for this purpose is on the increase and could perhaps become an accepted mode of coping with the currency fluctuation problem especially among businessmen with a long-standing relationship and mutual trust.[42]

III. Legal and policy issues

72. Any proposal regarding the use of maintenance-of-value clauses in international contracts cannot overlook the legal and policy framework in which such clauses have to operate. In particular, national legislation and expressions of policy regarding the validity or enforceability of such clauses deserve close attention since, with regard at any rate to private contracts, there is in the final analysis a national law to which reference must be made in deciding on the validity or application of a term of such contracts. It is proposed in this part of the report to highlight some of these legal and policy issues by examining briefly the situation in a selected number of countries whose approach to these issues has had great influence not only on the policies of other countries but more generally on the entire legal climate with respect to such clauses in international trade and finance. The countries to be considered are France, the United States and the United Kingdom.[43]

[41] See ILA 56th Report, pp. 96-98.

[42] See Gold, Floating Currencies, pp. 7-14.

[43] A wide-ranging survey of the situation in many countries appears in Mann, especially p. 146 ff.

A. *France*

73. As already noted above (para. 46) beginning from 1873, the French Cour de cassation had taken the position that gold and other value clauses were invalid on the ground that they were contrary to public policy as expressed in legal tender legislation compelling acceptance of inconvertible paper money (*cours forcé* legislation) and thus undermined the authority of the State to establish the value of such currency and to ensure its compulsory circulation. It was, however, recognized that the public policy rationale behind this holding applied most clearly as regards strictly domestic transactions and not in the case of a transaction having a predominantly international character.[44]

74. However, this entire line of reasoning was finally reversed in 1957 by a decision of the same court denying the correctness of the public policy argument by which maintenance-of-value clauses had therefore been struck down.[45] Yet the situation in France remains far from clear, for, apart from the fact that some later cases have treated the international character of the transaction before them as relevant to the issue of validity, there is also superimposed the question of the effect of a law of 1958-1959,[46] prohibiting the indexing of obligations to the price level of goods and services except where there is a direct relationship to the subject-matter of the contract or the business of one of the parties.

75. In summary, the legal situation in France may perhaps be stated as follows: under French law maintenance-of-value clauses, even in domestic transactions, appear to be valid unless they contravene the provisions of the law of 1958-1959.

B. *United States of America*

76. Perhaps the best-known anti-gold-clause legislation is the 1933 Joint Resolution of the United States Congress which not only prohibited the use of gold and gold-value clauses as contrary to public policy, but went on to decree that:

> "Every obligation, heretofore and hereafter incurred whether or not any such (gold or gold-value) provision is contained therein or made with respect thereto, shall be discharged upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public and private debts."[47]

Although this provision has now been repealed as regards future transactions,[48] it remains important not only because of prior contracts still governed by it but also as one of the major pieces of legislation that have determined the course of development of value clauses in international transactions and as such still deserves study.

[44] Thus developed the well-known "paiements internationaux" exception to invalidity of value clauses under French law. See Mann, p. 151, note 3.

[45] Cass. Civ. 27 June 1957, D. 1957, 649. See Mann, p. 153, for a discussion of this case.

[46] Law of 30 December 1958, as amended by law of 4 February 1959. Code civil (Dalloz), art. 1243.

[47] 31 United States Code, sect. 463 (*a*).

[48] See para. 80 below.

77. As can be seen from the wording of the foregoing provision, the Joint Resolution unequivocally foreclosed the use of gold or gold-value clauses—the most popular and best-established value maintenance clause of the time—in any domestic contract. The question was whether it also jeopardized the validity of such a clause in an international transaction. At least four situations can be distinguished with respect to this question: (*a*) where the contract is between a United States party (citizen or resident) and a foreign party and the dollar is the currency of payment, (*b*) where the contract is between a United States party and a foreign party and the dollar is the unit of account but not the currency of payment, (*c*) where the contract is between two foreign parties and the dollar is the currency of payment, and (*d*) where the contract is between two foreign parties and the dollar is only the unit of account but not the currency of payment.

78. As regards these cases, it need only be observed that United States courts have generally drawn no distinction between domestic and international transactions nor have they recognized any distinction based on nationality or domicile of the parties;[49] similarly, foreign courts have by and large applied the provisions of this legislation to debts payable in United States dollars without regard to nationality issues.[50] Yet it remains possible that the court of a particular forum may refuse, on grounds of public policy, to give effect to this legislation, especially where to do so would deprive domestic creditors (e.g. bondholders) of United States debtors of the benefit of their value maintenance stipulation. Furthermore, since the Joint Resolution is in terms directed at debts payable in United States dollars, the question of obligations merely denominated in United States dollars as the unit of account but payable in some other currency may be regarded as still open.[51]

79. Another issue which may be regarded as still unresolved is the effect of the Joint Resolution on the validity of index clauses. While some commentators hold the view that such clauses come within the scope of that legislation,[52] others have expressed doubt as to its applicability to that context.[53] What seems clear, though, is that cost-escalator-type clauses appear to be frequently used in practice in the United States, particularly in labour contracts and also among public utilities.

80. As noted above, the Joint Resolution of 1933 was repealed by an Act of 28 October 1977, section 4 (*c*) of which declares that the 1933 Joint Resolution "shall not apply to obligations issued on or after the date of enactment of this section."[54] It is difficult to assess what the impact of this repeal will be on the use of value, especially gold-value, clauses since developments in the international monetary system noted above have reduced gold to the status of a commodity like any other, thus taking away its unique suitability as a value maintenance device. The repeal does, however, have the positive effect of removing a major legal cloud hanging over the development of maintenance-of-value devices.

C. *United Kingdom of Great Britain and Northern Ireland*

81. Apart from the dictum of Denning, Lord Justice (as he then was), in a 1956 case decided on other grounds,[55] there appears to have been no serious question raised in England as to the validity of value-maintenance clauses in general and the gold-value clause in particular. In that case, L. J. Denning drew a distinction between domestic and international contracts and strongly implied that gold-value clauses, while accepted in the latter situation, were contrary to public policy and, therefore, unenforceable in the former. This view, criticized by many commentators,[56] has, however, not been followed. Indeed, as far back as 1934 the House of Lords, in a leading case on value-clauses, enforced a gold-value clause, though without express consideration of the public policy argument.[57] Also, as noted above, in a recent case, another English court, at first instance, expressly refused to follow L. J. Denning's dictum and instead enforced a clause pegging the value of a domestic obligation to the exchange value of a strong foreign currency.[58]

82. Moreover, in a clear departure from the nominalistic approach, Lord Denning himself had joined the majority of the House of Lords in holding, in the groundbreaking case of *Miliangos* v. *George Frank (Textiles) Ltd. (1976) AC 443,* that an English court can render judgement in a foreign currency and that the operative rate of exchange for converting the judgement amount is that in effect on the date when the judgement is enforced.

83. The conclusion would seem warranted then that English law appears to pose no obstacles to the use of value-maintenance devices—at least of the type likely to be employed in modern circumstances.

84. As regards the matter of policy—the demonetization of gold under the current international monetary system has clearly removed one of the major considerations behind the various legislative and judicial efforts to curtail or altogether eliminate the use of value (especially gold-value) clauses, namely, the fear that the status of legal tender of inconvertible national currency such as bank-notes would otherwise be undermined.

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[49] See, for example, *Guaranty Trust Co.* v. *Henwood, et al.,* 307 US 247 (1939), *Bethlehem Steel Co.* v. *Zurich General Accident and Liability Ins. Co.,* 307 US 265 (1939). For the view that different considerations should apply to domestic and to international transactions, see Note, "The Unit of Account: Enforceability Under American Law of Maintenance-of-Value Provisions in International Bonds", 71 *Yale Law Journal* 1294, especially at 1307 ff.

[50] See authorities cited in Mann, p. 159, notes 1-3.

[51] See Silard, Maintenance-of-Value, pp. 404-405. It seems also to be generally agreed that the Joint Resolution of 1933 did not prohibit the use of foreign currency clauses for value protection. See Mann, p. 187, note 2.

[52] See, in particular, Evan, "Inflation and the Declining Scope of Compulsory Monetary Nominations", *Proceedings and Committee Reports of the American Branch of the International Law Association,* 70 note 9, 80-81 note 54.

[53] See Nussbaum, *op. cit.,* p. 307, and Mann, p. 144.

[54] 91 Stat. 1229, 31 United States Code, sect. 463, note.

[55] *Treseder-Griffin* v. *Co-operative Insurance Society* (1956) 2 Q.B.127.

[56] See Mann, p. 155, note 2.

[57] *Feist* v. *Société intercommunale belge d'électricité (1934) A.C.161.*

[58] *Multiservice Bookbinding Ltd. and others* v. *Marden.*

This leaves the fear of their supposed inflationary tendency as the remaining rationale against the unrestricted use of value-maintenance devices. This concern has been stated as follows:

> "Once value-safeguarding clauses, or particular types of such clauses, have come into common use, price increases in individual sectors or in the economy as a whole would be transmitted to a large number of already constituted financial claims. This would inevitably have repercussions on the general price level, which in turn would affect the reference figures of value-guarantee clauses, thereby inducing renewed price rises."[59]

85. There exists, however, some disagreement even among economists as to how well-grounded this fear is.[59] At any rate, it has been argued that a well-managed system of sanctioning of value-maintenance devices may be beneficial not only in providing effective control of their use but also in avoiding resort to alternatives which may be harmful to the economy.[60]

86. A further argument in support of value clauses in certain circumstances may be adduced from the perspective of equity. At least as regards loans floated domestically by large institutions, corporate and otherwise, a significant number of the subscribers are often individuals of fairly modest means—the elderly, widows, and other small investors. It may, therefore, be thought somewhat unfair on such investors not to permit them to protect the purchasing value of their investment and thus in effect to allow such economically stronger and sophisticated borrowers to repay the loan in substantially depreciated money.[61]

IV. Conclusions

87. The foregoing review of devices designed to protect parties from the effects of currency fluctuations appear to support the following conclusions:

(*a*) As long as monetary obligations remain outstanding for more than a short period and as long as such obligations are subject to changes in value consequent upon fluctuations in relevant currency values, the need will exist for value-protection devices and parties will seek to obtain such protection as best they can;

(*b*) The existence of a fair and balanced method of value maintenance benefits both creditor and debtor not only in the stability (and hence relative certainty of expectations) that it can provide for both parties, but also in the inducement that it provides to the sources of capital to make such available, thus stimulating economic development and trade;

(*c*) Legal regulation of value-maintenance devices has so far concentrated on the advancement of monetary and economic policy with little attention to the objective of providing a check on the possible abuses of such devices by powerful creditors to the detriment of needy borrowers;

(*d*) While the history of value-maintenance clauses worldwide is replete with legal regulations of varying scope and stringency, there appears as of today no insurmountable obstacles to the use of such devices with regard to international transactions;

(*e*) The concerns that have historically underlain State restriction of value-maintenance devices—at least on the level of international transactions—have either lost their basis or can be regarded as supportable risks in the light of countervailing benefits.

(*f*) Of all the value-maintenance devices which are, or have been, in use in international commercial and financial transactions, the basket-of-currencies unit-of-account method appears to have the most chance of success under modern conditions and of such units-of-account, the SDR appears to offer the most practicable starting-point for a unit-of-account-based maintenance-of-value clause.

V. Recommendations

88. The Commission may wish to:

(*a*) Refer this item to the Working Group on International Negotiable Instruments, with a mandate to consider the entire question of value maintenance in international transactions with specific reference to the desirability and feasibility of work by the Commission on this topic and in the light of alternative proposals put before the Working Group by the Secretariat;

(*b*) Request the Secretariat to carry out further studies on this topic in consultation with the Study Group on International Payments, including, if necessary, the circulation of a questionnaire to Governments and interested international organizations and trade and banking circles, and to submit a report on its findings to the Working Group with appropriate recommendations.

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[59] Deutsche Bundesbank, Value Guaranty Clauses: Synopsis of the Bundesbank's Policy in Granting Permits. Quoted in Silard, Maintenance-of-Value, p. 407.

[60] See Silard, *op. cit.*, pp. 407-408, citing a case study of the experience of many Latin American countries and of the Central Bank of the Federal Republic of Germany.

[61] A fairly strong argument in this tenor is made in Evan, *op. cit.*