# Currency Fluctuations: An Overview of Their Origin and Impact, Protective Measures, and Relevant Domestic and International Legal Regimes

By: David Wemhoff

Table of Contents

## Introduction

Currency is the lifeblood of commerce and the basis of investing. As a store of value and as a means of exchange, it enables ventures to transact business, provide services and goods, and make a profit for their efforts. Currency is the form of investment by those not actively engaged in creating value through provisioning of services or of goods. Different countries have different currencies, and in a globalized world, the need to exchange one currency for another is certain. Therefore, it is vital that currency value fluctuations be understood and also that it be properly accounted for in business planning by firms that do business across international borders.

Goods manufactured in one country will usually be available for sale in the currency of that country, and services performed by a firm in another country will usually be acquirable in the currency of that country. If a recipient of the services, or a purchaser of the goods, is in yet a third country, then payment will generally have to be made in the currency of the country where the goods are manufactured or from whence the services are provided. That means the purchaser or the recipient of services, who operates in yet a third currency, will have to convert their currency. Some currencies are considered “soft” currencies and not easily convertible (oftentimes because they are not usually traded on the exchange markets), while some are considered “hard” currencies and are freely convertible.

Seldom are currencies between two countries equal or on a par. That is, one United Sates Dollar ($ 1) never equals exactly one rupee or one peso. The difference between exchanging one unit of currency of one country for one unit of currency of another country is known as the rate of exchange or the exchange rate, and that rate is subject to some fluctuation. The fluctuation of currencies can be due to many things outside of the control of firms involved in cross border transactions. With that is a possibility of what is known as an “unfavorable shift in currency exchange rates” which can result in the gain, or the loss, of “millions of dollars…sometimes enough to create a tragedy for a company involved in commerce or investment.”[1]

[1] John W. Head, *Global Business Law: Principles and Practice of International Commerce and Investment* 3rd Edition (Carolina Academic Press, Durham North Carolina, 2012), 555-556.

## I. Significance of Exchange Rate Fluctuations

Exchange rates impact international businesses in two ways. These are termed direct impact and indirect impact.

Direct impact refers to the fluctuation of currencies in connection with a firm's own business dealings. There are three main concerns in that regard. First, the cost of buying products or items from a foreign country will vary as the rates of exchange vary thereby causing increased costs or leading to increased savings. Second, the sale price of the goods or services sold in a foreign country will change based on the change in the exchange rate. Third, in the event of borrowing money, the firm will have to consider the costs of repaying the loan if it is denominated in foreign currency and if exchange rates or even interest rates change.[2]

Indirect impact refers to the effect that changing exchange rates have on suppliers of those firms that manufacture goods for sale or who package services for sale. In other words, transactional costs, or to put it in the vernacular, the cost of doing business will either decrease or increase based on fluctuations in exchange rates.[3]

Before the 2007-2008 global financial crisis, currencies fluctuated, at the most, about five percent per month. However, since that crisis, currency fluctuations have been far greater and in relatively shorter periods of time. It has been noted that the British Pound has fallen 53% against the dollar and 46% against the euro in the last ten years.[4] With large fluctuations in the short term as well as in the long term, it is easy to see how important exchange rates are when considering the profitability of a business or an operation, and that has a huge impact on proper planning. Differing exchange rates therefore should have considerable significance for chief executive officers and chief financial officers.

As a minimum, business leaders should do at least three things. First, the effects of differing exchange rates should be addressed in all analyses. Second, the differences between exchange rates (as well as legal systems) have an impact on the control and the coordination of

---

[2] "How do exchange rates affect businesses?" QUORA, https://www.quora.com/How-do-exchange -rates-affect-businesses.

[3] Id.

[4] Ben Lobel, *Protecting your profits from currency volatility*, SMALL BUSINESS (July 18, 2018) http://www.smallbusiness.co.uk.

the corporation's operations.   Third, exchange rates affect inventory policies of corporations. All of this figures into something known as exchange rate risks and that implicates the profitability of companies.[5]

## II. Factors Affecting Currency Exchange Rates

Three main factors affect currency exchange rates.  The first is the existence of a trade deficit or a trade surplus between the two countries.  If Country A buys more goods from Country B than Country B buys from Country A, then there is more of a demand for the currency of Country B.  This greater demand makes that currency more valuable or increases the exchange rate of Country A currency as to Country B currency. [6]

The second is capital movement or the transfer of currency out of one country into the currency of another country or countries.  This occurs when one country buys the currency of another currency so as to purchase securities denominated in the currency of the selling country. Taking our example in the previous paragraph, Country B has a large quantity of Country A currency.  If Country A issues securities, or if corporations issue securities denominated in the currency of Country A, and if those securities offer a higher interest rate than does Country B or corporations from Country B, then the Country A currency would be used to purchase those securities.  Likewise, even if there is not a trade deficit between Country A and Country B, if Country A offers securities at a higher rate of return than Country B, then people and entities from Country B would purchase Country A currency, creating a demand for that currency. Also, capital movements can occur when the citizens or businesses of one country no longer have confidence in the currency of their home country and so they convert it into the currency of another country that has the confidence of the markets.  This is known as moving weak currency to purchase a stronger currency or using soft currency to acquire hard currency, which is tradable.[7]

The third deals with currency manipulations.  This can occur either by the government of a country in an attempt to weaken the currency and hence improve foreign exports, or it can

[5] Michael C. Ehrhardt, Eugene F. Brigham *Corporate Finance:  A Focused Approach* (4th Ed. South-Western Cengage Learning, 2011) 693, 714, 722.
[6] *Id.,* 698-699.
[7] *Id.*

occur by private parties on the currency exchanges as a way to increase profitability in the trading of currencies.[8]

## III. Macro Impact of Currency Valuations and Conventions Addressing Currency Exchange

Currency valuations or fluctuations have an impact on the overall economy. These effects are felt in several main areas. First, merchandise trade or a country's imports and exports are affected. Generally, a weaker currency helps to stimulate exports and makes imports more expensive. This in turn decreases a country's trade deficit and can improve its current account balance. Conversely, a stronger currency lessens a country's exports by making them more expensive while lowering the cost of imports thereby increasing a country's trade deficit. The reason for all of this lies in the fact that a weaker currency makes goods less expensive while a stronger currency makes goods more expensive.[9]

Economic growth as measured in terms of gross domestic product (GDP) is affected by currency fluctuations. If net exports increase, as with increasing currency value, then the GDP of a country also increases. Generally, that does not happen. Net exports increase as the value of the currency decreases. If the currency strengthens, then the value of net exports decreases impacting GDP in a negative way.[10]

A third effect of currency fluctuations is on capital flows into and out of countries. Strong governments, dynamic economies and stable currencies all encourage the flow of capital into a country. These things make sure that the exchange fluctuations do not result in a loss of value of an investment because depreciation of a currency is likely to discourage foreign investment. Depreciating currency leads to something called imported inflation which means that imported products tend to cost more. A stronger currency serves the same function as tightening monetary policy (higher interest rates) which would attract foreign investors and further appreciate the value of the domestic currency.[11]

---

[8] *Id.*

[9] Troy Segal, *Currency Fluctuations: How They Affect the Economy*, INVESTOPEDIA https://www.investopedia.com/articles/forex/080613/effects-currency-fluctuations-economy.

[10] *Id.*

[11] *Id.*

The global financial crisis of 2007-2008 helped to clarify certain aspects of floating exchange rates, which is the regime that most countries have implemented worldwide. Pegging a currency to a certain rate of exchange hinders the ability of policy makers to be able to adapt to "business cycle disturbances" and pursue a rate of inflation that insulates that country's economy from deflationary pressures abroad. In a worldwide system that prizes high rates of capital mobility, it is best that countries maintain the ability to depreciate their currency.[12]

A 2011 study by Marilyne Huchet-Bourdon and J. Korinek refines these observations. Exchange rates (and hence the importance of a hard currency or one that is convertible or tradable) are an important part of "linking a country to the global supply chains." The researchers concluded that exchange volatility impacts trade flows slightly, though exchange rate movements do impact trade in the short run. Perhaps of greater note is that exchange rate levels affect trade significantly especially in agriculture, manufacturing, and mining. That having been said, currency rate fluctuations can have greater impact between different countries. For instance, the value of trade between the United States and the People's Republic of China is more greatly impacted by changes in currency valuation than that of the "US-Euro area or the Euro area-China." Regardless of the regions involved, a depreciating domestic currency makes more expensive the imported items that may be needed for domestic manufacturers or domestic firms to produce their products. The smaller firms are usually without the ability to employ the hedging mechanisms to protect against exchange rate changes when it comes to their suppliers.[13]

Foreign direct investments require a tradable, or hard currency. This is so in the eventuality of an expropriation of those investments by a host country. Compensation for taking the value of an investment or for taking property is to be "prompt, adequate and effective" which is the common standard for International Investment Agreements. The effective part of that standard requires hard currency or convertible currency in order to provide the required compensation.[14]

---

[12] Giancarlo Corsetti, Keith Kuester, and Gernot J. Muller, *Fixed on Flexible: Rethinking Exchange Rate Regimes after the Great Recession*, 65 IMF ECONOMIC REVIEW *IMF Economic Review* No. 3 (2017).

[13] Marilyn Huchet-Bourdon, J. Korinek, *To what extent do exchange rates and their volatility affect trade?* OECD TRADE POLICY WORKING PAPER NO. 119, 4-5.

[14] David Collins, *An Introduction to International Investment Law,* (Cambridge University Press, 2017), 188-190.

### A. International legal regimes and institutions

The World Trade Organization (WTO), formally coming into existence after the Marrakech Accords in 1994, builds upon and utilizes the General Agreement on Tariffs and Trade (GATT) which itself came into effect in 1947. Article XV of the GATT recognizes the need for countries to collaborate on currency exchange and cooperate with the International Monetary Fund (IMF), while at the same time calling the Contracting Parties (that is, signatories to the GATT) to coordinate policy "with regard to exchange questions within the jurisdiction of the Fund." This is as important as "questions of quantitative restrictions" and "other trade measures" that the Contracting Parties are required to respect. These principles are contained in Articles I through IV and XII of the GATT, and they form the central piece of the agreement. Devaluation of currencies, and manipulation of the currencies to gain trade advantages are a violation of these central principles of the WTO and the GATT.[15]

Article XV.2 makes it the responsibility of the Contracting Parties to "consult fully" with the IMF on "problems concerning monetary reserves, balances of payments or foreign exchange arrangements." The Contracting Parties are required to accept "all findings of statistical and other facts presented by the Fund relating to foreign exchange…" The Contracting Parties "shall accept the determination of the fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund, or with the terms of a special exchange agreement between that contracting party and the Contracting Parties." With this positive mandate, there is a prohibition as set out in Article XV.4 which is that "Contracting parties shall not, by exchange action, frustrate the intent of the provisions of this Agreement." Should a party take such action, that is utilize exchange action to effect quantitative controls, another party may report it to the IMF as set out in Article XV.5.
In the event a Contracting Party (to the GATT) that is also a member of the WTO should leave the IMF, it is required to enter into a suitable special exchange agreement with the WTO that maintains or supports the purposes of the IMF in terms that are consistent with the requirements set out by the GATT. (Article XV.6.)

[15] Chen Yu, "The Role of WTO in the Regulation of Currency Manipulation," August 15, 2016, A thesis submitted to McGill University in partial fulfillment of the requirements for the degree of Master of Laws, 12.

Article XVI addresses the use of government subsidies for industries. A debate between economists is whether currency devaluation is a form of subsidy that permits the imposition of countervailing duties by an injured country as set out in Article VI.3 to offset the subsidy.[16] A brief review of disputes submitted to the WTO pursuant to Article XXIII.2 revealed neither any disputes based on currency exchange rates as either a form of subsidy, or a quantitative restriction, nor any disputes claiming a violation of IMF policies and goals in regards to currency exchange rates.

The conclusion of some scholars and researchers is that the mechanisms in place as to the WTO are insufficient to deal with currency manipulations that negatively impact international trade in goods and services. This is a major issue considering the fact that some empirical research indicates "total currency manipulation may be as high as $ 1.5 trillion per year and is responsible for millions of lost jobs" in the United States alone.[17] Scholars and analysts view GATT Article XV.4 as difficult or impossible to invoke "given the ambiguity of the articles and the lack of precedents."[18]

Individual countries or a group of countries may informally work to correct currency exchange problems. Examples from history include the Plaza Accord of 1985 between the Group of 5 or G5 countries (France, West Germany, Japan, United States, and United Kingdom) to intervene in currency markets to halt the devaluation of the U.S. dollar as to the Japanese yen, and the 1987 Louvre Accord between the G5 and Canada to halt devaluation of the U.S. Dollar through taxes, public spending, and interest rate changes.[19]

Governments have also agreed to intervene in the foreign exchange or currency markets to affect the relative value of currencies. One example was a coordinated intervention by the G7 countries (Canada, France, Germany, Italy, Japan, the U.K., and the U.S.) in 1995 to again slow or stop the fall of the U.S. dollar against the yen. Another example was in 2000 when the G7 coordinated efforts to support the value of the euro shortly after its introduction, and again in

[16] "Debates over Exchange Rates: Overview and Issues for Congress," September 26, 2013 – June 22, 2018, EVERYCRSREPORT.COM, https://www.everycrsreport.com/reports/R43242.html#_Toc517440899.
[17] Yu, "The Role of WTO in the Regulation of Currency Manipulation," 12.
[18] *Id.,* 22.
[19] "Debates over Exchange Rates: Overview and Issues for Congress."

2011 to lessen the yen's appreciation.[20] However, the G7 and G20 countries in February, 2013 committed to letting the market determine currency exchange rates and to refrain from governments targeting exchange rates. [21] These pronouncements did not seem to take into account the quantitative easing undertaken by the central banks in the U.S. and in the European Union which some economists view as a way of creating devaluation of the currency of developed countries in violation of IMF and WTO rules.[22]

Companies doing business across borders have to be concerned with the amount of tariffs and customs duties. These are usually assessed at a rate that is a percentage of the value of the goods or items (and in some cases, services) being imported. Therefore, the date of the valuation of those goods or items, and the currency in which these are valued are important considerations for any firm. This valuation for customs purposes necessarily implicates the exchange rate. Part I of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 ("Agreement on the Implementation of Article VII") sets forth a regimen for customs valuation.

Article 1.1 states the general rule which is that the "customs value of imported goods shall be the transaction value, that is the price actually paid or payable for the goods when sold for export to the country of importation." This price is adjusted, and under Article 8.1 it is increased to account for commissions and brokerage fees (except buying commissions), container costs, and packing costs. Additionally, the value of labor and various parts, components or materials are added to the value of imported goods that are not completed. Member States of the WTO, of which there are 164 as of July 29, 2016,[23] are given the option in Article 8.2 of including or excluding from valuation of the goods the following: transport costs of the imported goods to the place of importation, handling charges as well as loading and unloading costs associated with the transport of the imported goods to the port of importation, and insurance costs. One can see with this the importance of considering the indirect effects of currency fluctuation.

---

[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Members,* WORLD TRADE ORGANIZATION, https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

The Agreement on the Implementation of Article VII addresses currency conversion. Article 9.1 states, that to the extent it is needed, the rate of exchange between currencies "shall be that duly published by the competent authorities of the country of importation…and shall reflect as effectively as possible…the current value of such currency in commercial transactions in terms of the currency of the country of importation." Each WTO Member establishes the conversion rate either as of the time of exportation or at the time of importation as set out in Article 9.2.

Bilateral trade agreements have gained a great deal of favor in recent years, particularly under the administration of President Donald Trump. Currency valuations are most prominent in terms of compensation for expropriation. If expropriation is found to be proper (that is, for a public purpose, done in a non-discriminatory manner, in accordance with due process of law) then compensation must be prompt, adequate and effective. (Art. 6.1.) This compensation must be "freely transferable" which implicates the convertibility of currency, and the fair market value of the asset nationalized or expropriated must be "denominated in a freely usable currency" on the date of expropriation or nationalization. (Art. 6.3.) Interest "at a commercially reasonable rate for that currency" is authorized. (Art. 6.3.) If valuation is done in a "currency that is not freely usable," then it shall be converted into currency that is "freely usable" at the market rate of exchange on the date of expropriation and interest shall be paid in terms of the freely usable currency until payment of the amount due. (Art. 6.4.)[24]

In a recent trade deal negotiated with the Republic of Korea, the US Treasury Department added a supplement or side deal concerning the manipulation of currencies.[25] The recently concluded United States Mexico Canada Agreement (USMCA) contains Chapter 33 entitled Macroeconomic Policies and Exchange Rate Matters. There the parties commit to certain practices and also to reporting for the purpose of transparency. The practices specifically state in Article 33.4.2 the following:

> "Each Party should:
>
> (a) Achieve and maintain a market-determined exchange rate regime;

[24] 2012 US Model BIT Treaty Between the Government of the United States of America and the Government of [Country] see https://www.state.gov/documents/organization/188371.pdf.

[25] A copy of this agreement was not available as of the time of writing this paper.

(b) Refrain from competitive devaluation, including through intervention in the foreign exchange market; and
(c) Strengthen underlying economic fundamentals, which reinforces the conditions for macroeconomic and exchange rate stability."

While the parties to the USMCA keep the right to intervene in currency exchange markets, they are to inform the other party or parties as that intervention affects the currency of the other party. (Article 33.4.3.) The reporting requirements include public disclosing monthly interventions in spot and forward foreign exchange markets, quarterly balance of payments portfolio capital flows, quarterly exports and imports, monthly foreign-exchange reserves data and forward positions in accordance with the IMF's "Data Template on International Reserves and Foreign Currency Liquidity." Additionally, the parties agree to the public disclosure of IMF reports on that country and the party's participation in the composition of official foreign exchange reserves (COFER). (Article 33.5.)

The IMF set up a system beginning in Summer, 1944 in which currencies would be pegged to other currencies so that the risk of exchange rate fluctuation could be minimized. This, as the conventional wisdom went, was necessary to allow emerging markets or developing countries to be able to attract and absorb investments from abroad and allow for economic growth in general. This would also insure currency convertibility, something that investors want wherever they go. Studies found that flexibility in setting exchange rates is important to maintaining some control over the economy, and so countries sought more flexibility in setting exchange rates.[26]

The 189 signatories to the IMF are committed to avoiding currency manipulation. The central provision of the IMF Agreement is Article IV Section 1 which states that each "member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates." This is important, as recited earlier, to facilitate exchange of "goods, services and capital" between countries, sustain "sound economic growth" and in general keep the "orderly underlying conditions that are necessary for financial and economic stability."[27]

[26] Head, *Global Business Law,* 532
[27] Articles of Agreement, International Monetary Fund, 2016.

Article IV.1(iii) sets out specifically that Member States are to "avoid manipulating exchange rates or the international monetary system" when to do so would "prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." Each Member State is to advise the IMF of the exchange arrangements that it will employ. There are two specific options in that regard and one general option. The first one is to maintain currency value "in terms of the special drawing right or another denominator, other than gold, selected by the member." The second is to enter into "cooperative arrangements" in which members set and maintain the value of their currencies in relation to those of other members. The final one is the catch all which states that members may have "other exchange arrangements of a member's choice." The objective is the same -- to insure stable exchange rates, without manipulation. The actions of each Member State is subject to review or monitoring by the IMF under Article IV.3, which can set up par values under Article IV.4.[28]

One major limitation on the Member States' actions in currency exchange matters is set out in Article VIII.3. Member States agree not to engage in "discriminatory currency arrangements or multiple currency practices" except as otherwise authorized or approved by the IMF.[29]

There are problems with the IMF's legal regime. While a procedure is set out for dealing with Members' exchange actions and policies, it is believed that "sanctions do not seem to be effective because there are no clear, transparent and binding procedures for the IMF to make investigations, which makes it difficult to prove the existence of a violation."[30] Without effective enforcement of findings, then Article IV becomes non-binding in practice.[31] Scholars and commentators are therefore calling for a more powerful mechanism in the IMF to enforce its findings or greater cooperation between the IMF and other international institutions or creating new institutions to handle the situation of currency manipulation.[32] These observations and

[28] *Id.*
[29] *Id.*
[30] Yu, "The Role of WTO in the Regulation of Currency Manipulation," 14-15.
[31] *Id.,* 16.
[32] *Id.*

conclusions are congruent with a growing chorus of scholars who state that international institutions are inadequate to handle currency manipulations.[33]

More and more countries are moving towards full capital account convertibility with some restrictions on capital controls. While there are some benefit to this, such as encouraging money to stay in the developing countries while the capacity of the country's economy is increased. That means this can be an intermediate step for the development of a sound banking sector and an exchange rate policy that allows flexibility plus an economy based on sound fundamentals.[34]

### B. United States laws and institutions regarding currency exchange

The United States Government has tools to deal with the manipulation of currencies, and these tools have been strengthened over the last thirty years. The development of United States trade law shows a remarkable growth in the importance of currency exchange in the thinking of government officials and economic planners. The Exchange Rates and International Economic Policy Coordination Act of 1988 (22 U.S.C. §§ 5301-5306) (ERIEPCA) came into existence in August, 1988. This legislation was a recognition by the United States Congress that "currency values have a major role in determining the patters of production and trade." Along with that observation, the Congress found that exchange rates had become "increasingly volatile," contributed to "substantial and persistent imbalances in the flow of goods and services," and that some major trading partners manipulated the value of their currencies to "gain a competitive advantage" over the United States in terms of trade. All of this was occurring as "capital flows between nations have become very large compared to trade flows". Therefore, in order to obtain a "more stable exchange rate" for the dollar, certain procedures to improve the "coordination of macroeconomic policy" were authorized all of which was to be in accordance with the Plaza Accords of 1985 designed to provide "more orderly adjustment of foreign exchange markets" and allow for policy changes that assist "adjustments toward a more appropriate and sustainable balance in current accounts."[35]

---

[33] Yu, "The Role of WTO in the Regulation of Currency Manipulation," 16; Laurence Howard, *Chinese Currency Manipulation: Are There Any Solutions?* 27 EMORY INTERNATIONAL LAW REVIEW 1215-1247 [2013].
[34] Head, *Global Business Law,* 466-470.
[35] 22 U.S.C. §§ 5302, 5303.

The President of the United States was directed to "confer and negotiate" with other countries for "better coordination of macroeconomic policies" and to achieve "more appropriate and sustainable levels of trade and current account balances" as well as exchange rates. The Secretary of the Treasury was given the responsibility of doing an annual study of the exchange rate polices of foreign countries and doing so in conjunction with the IMF. In the event that it was determined that a country was engaging in currency manipulation, then the Secretary could engage in negotiations with that country to change that policy or practice of manipulation. The Secretary was required to provide a report as to currency exchange rate policies and international economic policies to the appropriate committees of the House of Representatives and the Senate on October 15 of every year.[36]

In the 1980s and the 1990s the Secretary found China, Taiwan, and South Korea manipulated their currencies.[37] As time passed, even greater recognition was given to the importance of currency exchange in terms of international trade. Additional tools were developed and approved that allowed the Administration, namely the President with the Secretary of the Treasury, to implement the needed policies to stabilize currencies while at the same time making trade more equitable.

"Fast Track" or trade promotion authority is authority Congress gives to the President to enter trade agreements on an expedited manner. Part of that authority is to have the President describe the efforts undertaken to obtain "international exchange rate equilibrium" as set out in the Omnibus Trade and Competitiveness Act of 1988 (P.L. 100-418.) The Trade Act of 2002 (19 U.S.C. §§ 3803-3805) gave the President the authority to look for distortions in international trade and act to enter into agreements doing away with such distortions.

The identification and removal of currency manipulation was established as a principal focus of negotiating trade deals with the passage of the Trade Priorities and Accountability Act of 2015 (19 U.S.C. §§ 4201-4210).[38] Section 4201(b)(11) and (12) states:

---

[36] 22 U.S.C. §§ 5304, 5305.
[37] "Debates over Exchange Rates: Overview and Issues for Congress."
[38] *Id.*

"(11) Currency.

"The principal negotiating objective of the United States with respect to currency practices is that parties to a trade agreement with the United States avoid manipulating exchange rates in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other parties to the agreement, such as through cooperative mechanisms, enforceable rules, reporting, monitoring, transparency, or other means, as appropriate.

"(12) Foreign currency manipulation

"The principal negotiating objective of the United States with respect to unfair currency practices is to seek to establish accountability through enforceable rules, transparency, reporting, monitoring, cooperative mechanisms, or other means to address exchange rate manipulation involving protracted large scale intervention in one direction in the exchange markets and a persistently undervalued foreign exchange rate to gain an unfair competitive advantage in trade over other parties to a trade agreement, consistent with existing obligations of the United States as a member of the International Monetary Fund and the World Trade Organization."

The Trade Facilitation and Trade Enforcement Act of 2015 (TFTEA) (P.L. 114-125) which passed on February 24, 2016, addresses many aspects of foreign trade in its eleven (11) titles. Title VII is devoted exclusively to "Engagement on Currency Exchange Rate and Economic Policies." Title VII increases the focus on the currency exchange situation and on the policies that trading partners implemented in regards to their currencies. In 19 U.S.C. § 4221(a)(1), The Secretary of the Treasury is given the duty of submitting a report to Congress every 180 days that sets out the "macroeconomic and currency exchange rate policies of each country that is a major trading partner of the United States." Each report is to contain certain information (19 U.S.C. § 4421(a)(2)(A)(I) through (V)): I) that "country's bilateral trade balance with the United States," II) the "current account balance as a percentage of its gross domestic product" of each such country, III) the "change in that country's current account balance as a percentage of its gross domestic product" for a three year period prior to the submission of the report, IV) the country's "foreign exchange reserves as a percentage of its short-term debt", and V) the percentage of a country's foreign exchange reserves as a percentage of its gross domestic product. An "enhanced analysis of macroeconomic and exchange rate policies" is required for those countries that are major trading partners of the United States and have a "significant bilateral trade surplus" with the United States, have a material current account surplus and are "engaged in persistent one-sided intervention in the foreign exchange market." (19 U.S.C. § 4421(a)(2)(A)(ii).) The enhanced analysis examines developments, trends and policies in the country examined as to the currency markets, the existence of currency interventions, trends in the exchange rate, the degree of undervaluation, trade restrictions and patterns, and "patterns in reserve accumulation" in that country.[39] (19 U.S.C. § 4421(a)(2)(B).)

For those countries subjected to an enhanced analysis, the President of the United States, through the Secretary of the Treasury, is to "commence enhanced bilateral engagement". The goal of this enhanced bilateral engagement is to do several things: a) "urge implementation of policies to address the causes of the undervaluation of" the currency, the "significant bilateral trade surplus," and "current account surplus"; b) express U.S. concern for undervaluation of currency and trade surplus; c) advise that the President can take action if these U.S. concerns are not adequately addressed; and d) "develop a plan with specific actions to address that undervaluation and those surpluses." (19 U.S.C. § 4421(b)(1).)

The remedial action which the President can take is set out in 19 U.S.C. § 4421(c)(1). The President can a) prohibit the Overseas Private Investment Corporation (OPIC) from "approving any new financing (including any insurance, reinsurance, or guarantee) with respect to a project located in that country on or after such date"; b) prohibit the U.S. government from procuring goods or services from that country; c) instruct the U.S. Executive Director of the IMF to conduct "additional rigorous surveillance" of the exchange rate policies and macroeconomic conditions and policies of the target country for the purpose of finding currency manipulations; and d) direct the U.S. Trade Representative to consult with the Secretary of the Treasury as to whether or not a trade agreement should be entered into with a country that is the subject of enhanced review. Waivers of these provisions are available if to implement them as to a specific country the national security of the U.S. would be harmed or the "adverse impact" on the U.S. economy would be greater than not implementing these procedures.

TFTEA established an Advisory Committee on International Exchange Rate Policy. Consisting of six members known for their "objectivity and demonstrated expertise in finance, economics, or currency exchange," the Advisory Committee exists to advise the Secretary of the

[39] 19 U.S.C. § 4421(c)(2).

Treasury as to the impact of international exchange rates and financial policies on the economy of the United States.[40]

Of note, the April, 2018 Report to Congress lists six countries as major trading partners of the United States that underwent special review or are on the Monitoring List. These six countries are China, India, Korea, Germany, Switzerland, and Japan.[41]

## IV. Protecting Profitability and Investments

Given the fact that currency exchange rates fluctuate as a result of factors beyond the control of most people, prudent investors and prudent business enterprises should take steps to protect their investment and to protect their profits. This is particularly the situation now as the Federal Reserve under Chairman Jerome Powell is considering raising the federal funds rate (and hence the federal funds target rate). Rising interest rates "impact the most liquid market in the world: foreign currency."[42]

Capital flows into a country through something called foreign direct investments (FDI) or as part of foreign portfolio investment. The former pertains to foreigners taking stakes in corporations or entities or business enterprises in what is known as the host country. The latter pertains to investing in securities (debt or equity) from overseas governments or corporations. Currency valuations or exchange rate fluctuations have differing impacts on whether one engages in FDI or portfolio investing.[43]

Foreign portfolio investors are widely believed to have at least four main strategies at their disposal to protect their investment portfolios from the risks of unfavorable currency fluctuations. The first way is by hedging one's bets by buying either a currency-hedged mutual fund or an exchange-traded fund (ETF).[44] ETFs are a good choice as they are an efficient tool

[40] 19 U.S.C. § 4422.
[41] *Report to Congress: Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States* U.S. DEPARTMENT OF THE TREASURY OFFICE OF INTERNATIONAL AFFAIRS (April 2018), 3-5.
[42] Bryan Borzykowski, *4 ways to protect yourself from foreign-currency risk*, CNBC (April 2, 2014), https://www.cnbc.com/2014/04/02/4-ways -to-protect-yourself-from-foreign-currency-risk....
[43] Troy Segal, *Currency Fluctuations: How They Effect the Economy*, INVESTOPEDIA, https://www.investopedia.com/articles/forex/080613/effects-currency-fluctuations-economy.
[44] Borzykowski, *4 ways to protect yourself from foreign-currency risk*.

for an investor and do the hedging for the investor thereby saving time and effort.[45] Currency ETFs are denominated in a specific currency and can be traded on the margin.[46] A second strategy for portfolio investors is to short overvalued currencies. [47] For example, if the investor believes that the currency of Country A will be devalued, he or she can purchase Country A's currency for a price pursuant to a contract that allows him or her to exchange Country A currency for dollars at a certain rate of exchange. The investor then later buys back Country A currency at reduced value after it has depreciated to a predetermined point, and realizes a gain to cover the devaluation. That gain is the difference between the price at which Country A currency was traded for dollars and the price paid for the devalued currency. Market hedge funds are a good way to implement this strategy,[48] and currency options as well as currency futures give the trader or the investor the option to purchase currency at a set rate before a determined date are yet two other ways.[49]

A third strategy is to buy currency of a country that has a higher interest rate than the United States.[50] This is a risky venture given that interest rates are largely subject to the decisions of the foreign governments. However, Ed Boyle, the vice president and portfolio manager of global fixed income for American Century Investments, stated that "If you believe that a country's rate can be sustained at its current level, then you could make a handsome profit without much effort."[51] A fourth strategy is to buy undervalued currencies.[52] This is best done, according to Shahab Jalinoos, managing director of foreign exchange strategy at UBS, by examining a) a country's current account deficit (if it is importing more than it is exporting, the currency may be overvalued), b) inflation differentials (a higher relative rate indicates that a country will lose its competitiveness and so the currency will decline in value), and c) the dynamics of certain markets.[53] Of note, many consider the United States dollar an undervalued currency, and so it is likely that many investors buy dollars to protect their investments.

---

[45] Elvis Picardo, *How to Avoid Exchange Rate Risk, Investopedia*, INVESTOPEDIA, www.investopedia.com.
[46] *Id.*
[47] Borzykowski, *4 ways to protect yourself from foreign-currency risk*.
[48] Picardo, *How to Avoid Exchange Rate Risk*.
[49] *Id.*
[50] Borzykowski, *4 ways to protect yourself from foreign-currency risk*.
[51] *Id*.
[52] *Id.*
[53] *Id.*

Companies involved in providing services or goods across international borders need to be aware of other strategies. IsraTransfer is devoted to facilitating trade between the United States and Israel. IsraTransfer offers a comprehensive and practical set of rules that one should at least consider, if not also implement, when faced with foreign currency conversion scenarios, and those involved in international trade as opposed to just investing, would do well to consider these rules.

First, business owners need to be aware of the exchange rates that impact them directly. Second, past rates should be researched to develop a best case and worst case scenario for the exchange of currencies in a six month window. Third, the flow of cash in one's business or field needs to be thoroughly understood. Fourth, foreign purchases should be timed to maximum profits based on the best information on exchange rates. Fifth, if paying salaries overseas, then consider varying date for sending the funds to make the payments. Sixth, always consider passing costs on to consumers or customers. Seventh, consider currency options that allow the owner of an option the right to exchange currency at an expected more favorable rate sometime in the future. Eighth, consider currency forward contracts[54] that permit buying now, paying later when it comes to currencies. A down payment will be required, and IsraTransfer indicates that is 10% when it comes to Israeli shekels versus United States dollars.[55]

IssaTransfer's advice to use forward contracts is reflected in many other forums with some modifications. Proper forecasts, determination of the baseline profit, and simplifying the foreign exchange strategy are all recommended strategies. It is suggested that instead of relying on banks to make the foreign currency transactions, money transfer specialists are a way to protect the bottom line by preventing loss of profits due to exchange rate fluctuations, and do so

[54] When purchasing goods, or services, manufactured in or provided from a foreign country, the seller normally requires payment in the currency of the seller's country. Therefore, the purchaser has to convert the currency of the country in which it finds itself into the currency of the seller country. Payment is required at a certain time, date, place and currency as set forth in the contract. Purchasers may go the spot market prior to the date that payment is due to purchase the required currency, but that entails a risk of an exchange rate that could be disadvantageous to the purchaser. The idea of a currency forward contract is to minimize risk of a depreciating home country currency or an appreciating host country currency or what is known as "unfavorable currency exchange rate fluctuations." Forward contracts also allow flexibility in "critical terms" such as the "amount of the currencies involved, delivery date, and exchange rate" (or forward rate). Forward contracts can be periods of time as short as a week and up to a year, however, they are most usually used for periods of thirty, sixty, or ninety days. Head, *Global Business Law*, 555.

[55] *How Exchange Rate Fluctuations Affect International Businesses (and Ways to Protect Yourself),* ISRATRANSFER (May 3, 2017) http://Isratransfer.com; Head, *Global Business Law,* 555.

very inexpensively.  These specialists are constantly monitoring the foreign exchange markets and providing personalized services more so than banks. [56]

### A. Contractual provisions[57]

Cross-border business transactions will be pursuant to an agreement, which should be written.  An essential term of the agreement is the amount to be paid, the denomination of the currency, and the date of performance or payment.  There are two main legal conventions of private international law that govern these essential terms.  The first is the Vienna Convention or the Convention for the International Sale of Goods (CISG), and the other is the Uniform Commercial Code (UCC).  Both make reference to contractual provisions arranging for payment of the sums due at a specific time.  However, there is no mention of currency issues or of rules pertaining to the denomination of the price of the goods in a certain currency.  Everything is left up to the contract and hence to the prudence of the parties.

UCC Section 2-304(1) does not specify the currency to be used to make a purchase: "The price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer." The provision that payment is "due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery" (Section 2-310(a)) should makes clear the need that the money used not have depreciated or appreciated unacceptably to the seller and the buyer respectively since the inception of the contract.  Therefore, Section 2-301 makes the contract the prime vehicle as far as determining the currency to be used and how the allocation of currency fluctuation risk is to be done.  That section states:  "The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract."[58]  The prudent businessman or businesswoman will make sure that currency fluctuation risks are adequately addressed in the contract.

---

[56] Lobel, *Protecting your profits from currency volatility*.

[57] The following discussion focuses primarily on those firms that are providing goods or services across international borders.

[58] Uniform Commercial Code, from Legal Information Institute, Cornell Law School found at https://www.law.cornell.edu/ucc/2/2-304 as accessed November 15, 2018; Uniform Commercial Code, from Legal Information Institute, Cornell Law School found at https://www.law.cornell.edu/ucc/2/2-301 as accessed November 15, 2018; Uniform Commercial Code, from Legal Information Institute, Cornell Law School found at https://www.law.cornell.edu/ucc/2/2-310 as accessed November 15, 2018.

The CISG places a premium on the provisions of the contract, though there is language in the CISG which can be cited as implicating the need to insure exchange rates are properly taken into account. Article 53 requires the buyer to "pay the price for the goods and take delivery of them as required by the contract and this Convention" while Article 54 is a bit more expansive in that it requires that the buyer "pay the price" which "includes taking such steps and complying with such formalities as may be required under the contract or any laws and regulations to enable payment to be made." Article 57 sets the payment to be made at the seller's place of business or where the goods or title to the goods are handed over to the buyer. [59] This article should trigger in the minds of the parties at least an inquiry into the currency to be used and hence a consideration of value fluctuations of that currency. [60]

The International Institute for the Unification of Private Law (UNIDROIT) developed a set of Principles of International Commercial Contracts ("the UNIDROIT principles"). These principles are not legally binding[61] but parties may agree to form contracts based on these principles, which assists with the resolution of any disputes should they arise. The UNIDROIT Principles address currency issues, and set out a general rule in Article 6.1.10 that in the event "a monetary obligation is not expressed in a particular currency, payment must be made in the currency of the place where payment is to be made." The Comment recognizes that this general rule applies when a contract is silent on the currency to be used to meet a monetary obligation, which is "infrequent." The Comment also recognizes that in the event that damages need to be assessed for non-performance, another provision of the UNIDROIT principles applies, namely Article 7.4.12.[62]

Article 6.1.9 addresses the issue of the currency of payment and operates from the position that the contract or agreement between the parties specifies the currency of payment. The buyer may make payment in the currency of the "place for payment" unless the contract expressly rejects such or "that currency is not freely convertible" as set out in Article 6.1.9(1). If it becomes "impossible" for the obligor to make payment in the currency specified in the

---

[59] United Nationals Convention on Contracts for the International Sale of Goods, United Nations Commission on International Trade law, United Nations, (New York, New York, November, 2010).
[60] United Nations Convention on Contracts for the International Sale of Goods (1980)(CISG), Elisabeth Haub School of Law, Pace University, http://cisgw3.law.pace.edu/cisg/text/treaty.html.
[61] Head, *Global Business Law,* 138.
[62] UNIDROIT Principles of International Commercial Contracts, International Institute for the Unification of Private Law, (Rome, Italy, 2016).

contract, then under Article 6.1.9(2) the obligor may make payment in the currency of the "place for payment" regardless of the provisions of Article 6.1.9(1). If payment is made in the "currency of the place for payment," then Article 6.1.9(3) states that payment is to be made at the "exchange rate prevailing there when payment is due." The obligee may require the obligor to pay at a rate of exchange "either when payment is due or at the time of actual payment" if the obligor fails to make payment when due. (Article 6.1.9(4).)[63]

Entities that do not specify in the contract the currency to be used, or that do not clearly spell out the exchange rate, may find themselves quite disappointed if matters go into litigation. In *Procter & Gamble Co. [P&G] v. Svenska Cellulos Aktiebolaget [SCA]*, [2012] EWHC[64] 498 (Ch). 2, P&G was selling goods to SCA based on their budget that priced the goods in euros while payments were due in British Pounds Sterling for certain goods shipped to SCA from Manchester, U.K. SCA argued that all payments were to be made in British Pounds Sterling upon a fixed exchange rate of "£/Euro of 1.49164." That came from an annotation on the bottom of a document called a "firm plant budgets" that was an attachment to the contract. SCA argued that this was either an implied or an explicit term for a fixed exchange rate, but the English court disagreed. The English court also disagreed that the court should rectify the agreement and establish "£/Euro of 1.49164" as the fixed exchange rate.[65]

In *Hess Corporation v. Stena Drillmax III Ltd*, [2012] EWCA[66] Civ 522, Hess agreed to charter Stena's drilling rig for five years. Hess was to pay a "daily operating rate" that was invoiced in U.S. dollars, though a schedule or annex to the contract listed a number of operating costs delineated in various currencies. A contract clause stated that the exchange rate published by the London edition of the *Financial Times* immediately before the date of the invoice applied to all sterling to dollar conversions ($ 2 to 1 £). Hess argued that exchange rate applied for the life of the contract, and the Court agreed. To reach that end, the Court tried to determine the

---

[63] *Id.*
[64] England and Wales High Court.
[65] Tracey Petter and Thomas Leyland, *Exchange Rate Risk – Lessons When Drafting and Interpreting Contracts*, DENTONS.
[66] England and Wales Court of Appeal.

intent of the parties as well as what made business sense and what risks the parties tried to allocate.[67]

Project financing is an area in which selection of currency impacts the payment of principal and interest. With a varying currency, one could easily see how a loan could lessen in value or become more difficult to repay. The contract concerning the loan agreement should set forth the currency terms of the loan to remove any uncertainty and to hopefully mitigate any risk.[68] Along those lines, the International Institute for Sustainable Development (IISD) issued a white paper in which it concluded that "currency risk is inherently expensive" for project development in emerging markets.[69] Therefore, the IISD further concluded, "An obvious way to solve the issue of currency risk in project finance is to provide more local currency financing."[70] This required developing local capital markets and local financial systems and also supporting the use of local currency financing of infrastructure projects.[71]

The currency in which payment is denominated in the contract, as well as the actions of the parties after payment is due, has a huge impact on the denomination of any monetary judgment, at least in the United States. In an important case from February 2, 2018, the District Court of Appeals in *Leidos, Inc. v. Hellenic Republic,* 881 F.3d 213, 220 (D.C. Cir. 2018) held "a district court may not convert a judgment to dollars if the movant contracted in euros, received its arbitral award in euros, requested euros in its complaint and filed three propose orders seeking euros, before reversing course post-judgment."

The Coinage Act of 1792 was for a very long time considered as requiring United States courts to render judgments only in United States dollars.[72] That changed with 1982 amendments.[73] The valuation date and issues of currency conversion are reviewed by federal courts.[74] The Court also noticed that the "fluidity of foreign exchange rates is a recognized feature of modern macroeconomics. *See Molinos Valle Del Cibao, C. por A. v. Lama,* 633 F.3d

---

[67] Petter and Leyland, *Exchange Rate Risk – Lessons When Drafting and Interpreting Contracts*.

[68] Head, *Global Business Law,* 431-436.

[69] Wim Verdouw, David Uzsoki, Carlos Dominguez Ordonez, *Currency Risk in Project Finance*, (August, 2015), INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT.

[70] *Id.*

[71] *Id.*

[72] *Int'l Silk Guild v. Rogers,* 262F.2d 219, 224 (D.C. Cir. 1958).

[73] *Leidos, Inc. v. Hellenic Republic,* 881 F.3d 213, n.5 (D.C. Cir. 2018)

[74] *Leidos,* at 220; *Complex, S.A. v. Labow,* 783 F.2d 333, 336-337 (2nd Cir. 1986).

1330, 1336 (11th Cir. 2011)"[75] and that futures contracts in a given currency may be purchased as set out in *In re Amoco Cadiz Oil Spill*, 954 F.2d 1279, 1329 (7th Cir. 1992).[76] Finally, the court pointed out that current and historic foreign exchange rates are published by the Federal Reserve which publishes the rates on its website, and that courts "routinely take judicial notice of exchange rates."[77]

The *In re Amoco Cadiz Oil Spill* case is worthy of further examination because it establishes the principle in U.S. law that private parties set the terms for commercial transactions. When parties denominate a certain currency for a commercial transaction, the contract governs as to what currency an award or judgment will be rendered. U.S. courts now agree with the British Courts in that it is good for commerce to render judgements in currencies denominated by the parties. The Seventh Circuit Court of Appeals ruled:

> "Computing an award in cruzeiros and then converting to dollars creates a risk that the parties did not accept--the risk that the judge will select an inapt date or use a currency no one had included in hedging plans. Fights over conversion dates are inevitable whenever judges enter dollar awards to redress injuries denominated in other currencies. Compare Agfa-Gevaert, A.G. v. A.B. Dick Co., 879 F.2d 1518, 1524-25 (7th Cir.1989), with Ingersoll Milling Machine Co. v. Granger, 833 F.2d 680, 692 (7th Cir.1987). Thus the English rule should be used in the United States too--not because the choice-of-law provision in this contract requires it, but because it is the right rule for commerce. The court should enter the judgment in the currency the parties themselves selected for their dealings, the currency in which the loss is felt. All problems about conversion dates vanish, and the parties' hedging strategies (or lack thereof) proceed unimpeded."[78]

Various terms may be inserted into contracts to limit or define or share the risk of currency fluctuations. The International Chamber of Commerce (ICC) provides a sample contract, with various provisions, for the international sale of goods. Called the International Sales Contract, this template requires the parties to fill out blocks on a form and it contains some standard language in Section B called General Conditions. Block A-2 allows the parties the option of naming the choice of currency for the payment of the contract price, and reference is

---

[75] The *Molinos Valle Del Cibao, C. por A. v. Lama* case presents a situation in which a foreign exchange transaction went wrong as a private party failed to provide the dollars in place of Dominican Republic pesos needed by an American company selling flour in the Dominican Republic.

[76] *Leidos,* at 219.

[77] *Leidos,* n. 6.

[78] *In re Amoco Cadiz Oil Spill,* 954 F.2d 1279, 1328 (7th Cir. 1992).

made to Article 4 of Section B. Article 4 of Section B discusses the price and Article 5 discusses when payment is due, however, there is no provision made for currency fluctuations and the impact such may have on the buyer or the seller. A Force Majeure Clause in Article 13.1 is of questionable use in resolving any disputes that may arise from fluctuating currencies because a party to the contract could reasonably anticipate currency fluctuations, and take that into account.[79]

Currency fluctuations are certainly a fact of doing business on an international scale, and something of which a prudent businessperson must take account. Contractual provisions are a way to determine the currency for payment, limit uncertainty, and reduce or allocate risk. What follows is a survey of some provisions that practitioners or business leaders may consider inserting in their contracts.

The parties can determine the choice of currency and its valuation on a certain date: "The seller is entitled to have the price expressed either in x or in y and to opt for the currency value at the date of the contract, at the date of the commercial invoice, or at the date of payment. If a date is not provided for in the contract, the date of payment shall prevail as the date of conversion."[80]

Shortfalls can be assigned to the buyer who is given the option of choosing the currency form payment though the price is in United States Dollars:

> "All purchase prices are expressed in US Dollars….The Buyer may pay all amounts due under this Agreement, including the purchase price and indemnification or other amounts owed under this Agreement, in either (i) US Dollars; or (ii) the Buyer's local currency ("Local Currency")….If the Buyer makes payment of any amount in Local Currency, it shall pay upon Seller's demand any shortfall…of the US Dollar equivalent of the amount paid in Local Currency…compared to the US Dollar Purchase Price….Seller shall calculate the US Dollar Equivalent by applying the spot exchange rate quoted in

---

[79] *ICC International Contract*, INTERNATIONAL CHAMBER OF COMMERCE, https://iccwbo.org/resources-for-business/model-contracts-clauses/ ; the Force Majeure provision states: "A party is not liable for a failure to perform any of his obligations in so far as he proves: (a) that the failure was due to an imp0ediment beyond his control, and (b) that he could not reasonably be expected to have taken into account the impediment and its effects upon his ability to perform at the time of the conclusion of the Contract, and (c) that he could not reasonably have avoided or overcome it or its effects."

[80] Yasmine Berrahou, Alexandra Dufour, Salome Roucel, *Contractual limitation of currency risks*, (February 13, 2015), ASSOCIATION OF CORPORATE COUNSEL, http://www.acc.com/legalresources/quickcounsel/contractual-limitation-of -currency-risks.htm.

[the…EXCHANGE RATE SOURCE] on the day it first receives payment of the amount paid in Local Currency."[81]

Another clause gives a company the choice of currency depending on whether the designated currency goes above or below a certain rate: "Prices provided for at the date of signature of the contract are quoted in x. In the event x goes above or below the rate in effect at the date of signature of the contract, prices will be quoted in y."[82]

The contracting parties may agree as to how to allocate the risk between themselves: "Prices expressed in X are converted on the basis of the official exchange rate at the date of signature of the contract. The buyer shall support any loss caused by a fluctuation of the exchange rate occurring until the complete performance of the contract. The loss shall be calculated on an annual basis."[83]

There are also provisions which allow equal sharing of any loss: "Prices provided for at the date of signature of the contract are set in accordance with the exchange rate operative on that day. A currency fluctuation of more than p% over a year from the date of signature of the contract to the date of delivery, impacting the price, shall be equally supported by both parties."[84]

The parties can decide to freeze the rate of exchange between themselves: "Notwithstanding any exchange rate fluctuation, the parties agree that the price shall be settled in X, on the basis of 1x equals 1y."[85]

There can also be provisions that include a trigger that allows a revision of the price when a certain level is reached: "If the parity between y and x, based on a 1y equals 2x rate, varies by more than p%, the price shall be automatically and accordingly adjusted." Another trigger is indexation or the use of an index that is correlated with movement of a currency. [86]

There are more complex provisions that may be inserted into contracts. Pegging or indexing the contractual rate of exchange can be done by relating it to other events, sources, or

---

[81] "General Contract Clauses: Payment Terms: Currency Conversion," Practical Law Standard, WESTLAW Thomson Reuters.
[82] Berrahou, Dufour and Roucel, *Contractual limitations of currency risks*.
[83] *Id.*
[84] *Id.*
[85] *Id.*
[86] *Id.*

contracts. For example, the exchange rate can be determined by a sublicense agreement between a licensee and a sub-licensee. Another is using the monthly rate of exchange utilized by a party "in its worldwide accounting system." Yet another is using the monthly average daily rates of exchange published by the European Central Bank "for the monthly period in which Net Sales are accounted" or "upon the exchange rate published by the Wall Street Journal as of the fifteenth day of such month" or "the last day of the Calendar Quarter in which the applicable payment obligation became due and payable" or "the average of the closing exchange rates reported in The Wall Street Journal…for the first, middle and last Business Days of the applicable reporting period". The exchange rate can also be based on the actions of other parties or parties to the contract (e.g., ""its normal practices used to prepare its audited financial statements for internal and external reporting purposes"). As indicated in the *Leidos* case, the Federal Reserve also regularly publishes exchange rates that could be used. Finally, parties may agree to use the exchange rate published by a trusted third party such as Oanda at oanda.com. [87]

## B. Insurance

Parties may agree in their contract to obtain insurance to cover any changes in the exchange rate.[88] Generally, what this means is that a financial institution or bank is contacted and their risk management department sets up the requisite forward contracts[89] as more fully set forth above in the discussion concerning portfolio risk mitigation. The functioning of the foreign exchange or currency markets is detailed in the following section, and the banks or financial institutions that provide insurance to cover foreign currency exchange risk, deal with these markets.

When currency gets to the point that it is no longer convertible, then a business enterprise may turn to governmental or international public institutions. The United States Government's Overseas Private Investment Corporation (OPIC) is designed to protect against the loss of an investment. This investment loss can be due to expropriation of property in a foreign country, loss of property by virtue of war or civil strife, or the inconvertibility of currency. OPIC

[87] *Currency; Exchange Rate Sample Clauses*, LAW INSIDER, https://www.lawinsider.com/clause/currency-exchange-rate.

[88] Berrahou, Dufour and Roucel, *Contractual limitations of currency risks*.

[89] See for example, Santander Bank, International Risk Management: exchange rate risk and insurance management, found at https://en.portal.santandertrade.com/bank-with-us/china/international-trade-guide-risk-co.... as accessed November 12, 2018.

provides insurance for losses due to the inconvertibility of a currency that may occur during the course of an investment. Investment includes the furnishing of "commodities or services under lease or other contract…." and so OPIC insurance is available to firms doing business in foreign countries[90] and is available to handle what is known as *Harstatt* risks which occurs when a bank fails or is closed before providing the currency after having accepted the exchanged currency.

Another form of insurance is provided by the World Bank through the affiliated Multilateral Investment Guarantee Agency (MIGA). The insurance provided by MIGA is designed to cover investors against losses from the "inability to convert local currency into foreign exchange for transfer outside of the host country."[91] MIGA pays compensation in the currency that is stated in the guarantee contract between MIGA and the investing company.

C. Currency Exchange Mechanics

Regardless of whether an investor wishes to protect his or her portfolio or whether a business enterprise seeks to protect the profitability of its operations overseas, the foreign exchange market is the necessary means to accomplish these goals. Indeed, the largest financial market in the world is the foreign exchange market.[92] Foreign exchange traders working for commercial and investment banks, corporate treasury officials, and institutional investors are the most notable participants in these markets.[93] These trades occur over the counter and are known as spots or forwards. The value date is the date upon which the currencies are exchanged between parties, while the trade date is the date upon which the terms of the exchange are established, and the latter date is usually two days prior to the value date.[94]

The United States Securities and Exchange Commission explains that there are three main ways by which to trade foreign currency. One is on an exchange that is regulated by the Commodity Futures Trading Commission or the CFTC. The Chicago Mercantile Exchange is an example and it offers currency futures and options on currency futures. Trades on the exchange

[90] Head, *Global Business Law,* 552.
[91] *Id.,* 553
[92] Ray Bhala, *Risk Trade-Offs in the Foreign Exchange Spot, Forward and Derivative Markets*, 1 THE FINANCIER 34-49 (August, 1994) as quoted in Head, *Global Business Law: Principles and Practice of International Commerce and Investment*, 556.
[93] Head, *Global Business Law,* 556.
[94] *Id.*

serve to provide contracts "of a set unit size, a fixed expiration date, and centralized clearing." This provides more certainty for traders and it also provides more security because a clearing corporation acts as the "single counterparty to every transaction and guarantees the completion and credit worthiness of all transactions."[95]

Foreign currency exchanges, or FOREX, can also occur on an exchange that is regulated by the SEC. One example is the Philadelphia Stock Exchange now known as the NASDAQ OMXX PHLX. It offers options on currencies and like the CFTC exchange, and like the CFTC exchange it provides investors with currency contracts of a set unit, a fixed expiration date and centralized clearing.[96]

Finally, there is an off-exchange market also known as over the counter or the OTC in short. Parties trade directly with a counterpart but there is neither an exchange nor is there a central clearinghouse. Without a central marketplace and without a central clearing organization, traders do not have certain protections for obtaining the best price which a central market allows or in the event of default by a party which a central clearing house protects against. The Commodity Exchange Act regulates traders and allows them to engage in OTC trading provided that they follow the rules of the federal agency, and so some protection is provided to individuals.[97]

Forex trading for speculative purposes is a risky proposition for a number of reasons. One could be quoting conventions are not uniform thereby leading to confusion and loss. Transaction costs may not be transparent and can be so excessive that a profitable trade becomes a losing trade. It is possible to lose an entire investment in a foreign currency because a certain amount has to be deposited as most trades are done with financial leverage, and a loss could require that more be paid than was deposited. Most trading strategies are in short term movements in the currency markets and that requires close monitoring if not also monitoring with the appropriate computer programs which in turn is an investment. Finally, in the foreign

---

[95] Forex, U.S. SECURITIES AND EXCHANGE COMMISSION, https://www.sec.gov/answers/forcurr.htm.
[96] Head, *Global Business Law,* 556.
[97] *Id.*

exchange, especially in the OTC, fraud is a very real possibility.[98] As one commentator put it, participating in the foreign exchange markets is not for the faint of heart.

## Conclusion

The need to recognize the importance of currency exchange rate in a globalized economy has always been present with investors and firms doing business across international borders. The United States has come to recognize the importance of currency exchange and has implemented a legislative regime to monitor and correct situations in which foreign countries may be manipulating their currencies or to correct those situations in which trade imbalances are caused by undervalued currencies. The action by the United States comes at a time when the international institutions and trading conventions appear too weak to effectively regulate currency imbalances that are harmful to economic growth.

[98] *Id*.