

**THE LEGAL IMPLICATIONS
OF THE EUROPEAN MONETARY UNION
UNDER U.S. AND NEW YORK LAW**

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“Money has been introduced by convention as a kind of substitute for a need or demand, and . . . its value is derived not from nature but from law and can be altered or abolished at will.”

ARISTOTLE, NICHOMACHEAN ETHICS
Book 5, ch. 5 (F. H. Peters trans., 156, 15th ed. 1893)

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GLOSSARY OF ABBREVIATIONS

| | |
|----------------|----------------------------------------------------------------|
| BIS: | <i>Bank for International Settlements</i> |
| DM: | <i>Deutsche mark</i> |
| EBA: | <i>ECU Banking Association</i> |
| EC: | <i>European Community</i> |
| ECB: | <i>European Central Bank</i> |
| ECOFIN: | <i>European Council of Finance Ministers</i> |
| ECU: | <i>European Currency Unit</i> |
| EMCF: | <i>European Monetary Cooperation Fund</i> |
| EMI: | <i>European Monetary Institute</i> |
| EMS: | <i>European Monetary System</i> |
| EMU: | <i>Economic and Monetary Union</i> |
| ERM: | <i>Exchange Rate Mechanism of the EMS</i> |
| ESCB: | <i>European System of Central Banks</i> |
| EU: | <i>European Union</i> |
| FFr: | <i>French franc</i> |
| IMF: | <i>International Monetary Fund</i> |
| IPMA: | <i>International Primary Market Association</i> |
| ISDA: | <i>International Swaps and Derivatives Association, Inc.</i> |
| OTC: | <i>Over-the-counter</i> |
| RTGS: | <i>Real-Time Gross Settlement</i> |
| SDR: | <i>Special Drawing Right of the IMF</i> |
| SWIFT: | <i>Society for Worldwide Financial Telecommunication</i> |
| TARGET: | <i>Trans-European Automated RTGS Express Transfer (system)</i> |
| UCC: | <i>Uniform Commercial Code</i> |
| US\$: | <i>United States dollar</i> |

EXECUTIVE SUMMARY

The legal implications of the European economic and monetary union (EMU) under the laws of New York State and other U.S. jurisdictions is one of the most important legal questions facing the international financial markets today. The Bank for International Settlements estimates that at the end of March 1995 the OTC derivatives market stood at \$47.5 trillion.¹ Approximately half of all derivatives contracts worldwide are believed to be governed by New York law, including most U.S. swap contracts, up to half of the swap contracts in the London derivatives market and a significant proportion of swap contracts in other offshore financial centers (e.g., Frankfurt, Paris, Tokyo, Hong Kong and Singapore).² The Deutsche mark is the world's second most widely used currency after the U.S. dollar, and taken together the 15 currencies of the European Union and the ECU basket currency form a powerful currency bloc.³

Aside from the derivatives market, eurobonds denominated in EU currencies are frequently issued by U.S. corporations in offshore transactions governed by New York law.⁴ As with derivatives contracts, many of these transactions involve long-term obligations. Finally, long-term loan agreements and cross-border commercial transactions governed by the laws of U.S. jurisdictions also involve obligations denominated in EU currencies.⁵

In May 1995 the European Commission's *Green Paper on the Practical Arrangements for the Introduction of the Single European Currency* predicted that under the laws of non-EU jurisdictions the proposed single currency would be recognized as the successor to existing EU national currencies at the fixed conversion rates at which the single currency will substitute EU national currencies.⁶ The Commission's Green Paper thus concluded that under the laws of non-EU jurisdictions the continuity of monetary obligations and other terms of a contract such as interest rates and other ancillary obligations could be expected.⁷

This study will address the issues raised by the Commission's Green Paper. Thus study reaches the following conclusions regarding the legal implications of EMU for transactions governed by the laws of U.S. jurisdictions, regardless of whether legislation ensuring the continuity of contracts is passed in particular American jurisdictions and regardless of whether such legislation applies prospectively or retroactively.

- All long-term debts denominated in EU currencies must be discharged in the new single European currency – the euro – at the official conversion rates at which the euro will substitute existing EU currencies.
- All foreign exchange transactions (e.g., FX forwards, cross currency swaps and currency options) in which an EU currency is used on one side of the transaction (e.g., a US\$/DM swap) must be discharged in the euro at the applicable conversion rates.
- All foreign exchange transactions involving the exchange of two currencies participating in EMU (e.g., a DM/FFr swap) should also be discharged in the euro at the applicable conversion rates. In the case of contracts involving periodic payments (i.e., a cross currency interest rate

¹See *infra* p. 3.

²See *infra* pp. 3-4.

³See *infra* p. 4.

⁴See *infra* p. 5.

⁵See *infra* p. 5.

⁶See *infra* p. 6.

⁷*Id.*

swap) the economic effect will be to impose an obligation on one party to make net payments for the remaining life of the contract, similar to an annuity. It may be necessary to explore the tax implications of this with the U.S. tax authorities.

- All fixed interest rate obligations (including fixed rate swaps) must be discharged at the rate specified in the contract.
- All floating interest rate obligations linked to particular EU national currencies should be discharged in accordance with the interest rates established by successor price sources for the euro in the event that existing price sources are no longer available after EMU.
- Force majeure clauses used in debt transactions which call for the discharge of EU currency debts in U.S. dollars or some other currency in the event that the currency of the contract is no longer available due to circumstances beyond the party's control will not be triggered by EMU.
- Impossibility clauses used in debt transactions which call for the discharge of EU currency debts in U.S. dollars or some other currency in the event that the currency of the contract is no longer used by the government of the country issuing such currency should not be triggered by EMU.
- All obligations denominated in the ECU basket currency should be discharged in the euro at the rate of one euro for one ECU, unless the terms of the contract and the surrounding circumstances establish a clear intention to the contrary.

Substantially identical legislation confirming the continuity of contracts in accordance with the above principles has been proposed in the three leading U.S. trading jurisdictions — New York, Illinois and California. This legislation has been enacted into law in New York and Illinois. This study reaches the following conclusions with respect to this legislation.

- Notwithstanding certain possible discrepancies, the New York and Illinois legislation confirms the continuity of contracts after EMU in a manner that is broadly consistent with the continuity regulations endorsed by the Council of the European Union.
- Any discrepancies between the EU Council regulations and the New York or Illinois legislation must be resolved by applying the applicable rules established under the EU Council regulations.
- Assuming that the New York and Illinois legislation applies retroactively, the legislation does not contravene the provisions of the United States Constitution prohibiting the states from enacting legislation that impairs the obligation of contracts. This is because state legislation confirming the continuity of contracts after EMU in a manner that is broadly consistent with the EU Council regulations is declaratory of existing law and does not impair pre-existing contractual obligations in any manner. In any case, such legislation has been enacted to protect a broad societal interest (i.e., the avoidance of needless litigation after EMU), and would therefore be upheld by American courts in deference to the judgment of the state legislatures.
- Because the New York and Illinois legislation recognizes the continuity of contracts in a manner that is broadly consistent with the monetary sovereignty of the European Union over the currencies of EU member states, the legislation does not infringe the U.S. Federal Government's undisputed authority over international monetary relations.

The conclusions reached by this study are based on the following legal considerations.

State Theory of Money

The State theory of money is widely accepted under U.S. and New York law. According to this theory money is a creature of law and it is the law of the country that issues a currency that determines what things are money and how, in case of a currency alteration, sums expressed in the former currency are to be converted into the new currency.⁸ Applying this theory, the U.S. Supreme Court has held that the obligation of a contract to pay money is to pay that which the law shall recognize as money at the time the payment is to be made.⁹ The U.S. Supreme Court has held that every contract for the payment of money is necessarily subject to the constitutional power of the government over the currency, whatever that power may be, and the obligation of the parties is therefore assumed with reference to that power.¹⁰ This power has been recognized by the U.S. Supreme Court as an attribute of sovereignty both in Europe and America.¹¹ The U.S. Supreme Court has recognized that legislation fixing the conversion rate at which an old currency is substituted by a new currency and providing for the discharge of debts originally denominated in the old currency at the fixed conversion rate in the new currency is derived from this power of a sovereign government over its currency.¹² Both the U.S. Supreme Court and the New York Court of Appeals have recognized that the monetary sovereignty of a country over its currency extends to the use of the country's currency by non-nationals outside the country's jurisdiction in contracts governed by the laws of other countries.¹³ The U.S. Supreme Court has applied the State theory expansively, holding that the monetary sovereignty of a government over its currency extends not only to the regulation of monetary obligations contained in private contracts, but also to the regulation of ancillary contractual obligations that are inextricably linked to such monetary obligations.¹⁴ Thus, the monetary sovereignty of a state over its currency can be regarded as extending to the regulation of interest rate obligations linked to monetary obligations.¹⁵

The State theory thus articulated by the Supreme Court has been applied on a number of occasions in American monetary history, including after the American Civil War when Congress authorized the issuance of paper "greenback" dollars not backed by gold, after the Spanish-American War of 1898 when the island of Puerto Rico was absorbed as a U.S. possession and the Puerto Rican peso was converted into the U.S. dollar, and again during the Great Depression of the 1930s after the U.S. abandoned the gold standard.¹⁶ The State theory of money has also been applied by American courts to cases involving foreign currencies, including the Pound sterling following Britain's abandonment of the gold standard in 1931, the German reichsmark substituted for the Austrian schilling following the 1938 Austro-German Anschluss, the Japanese military currency imposed on the Philippines during the Second World War, the Deutsche mark introduced in Germany in 1948 in substitution for the former German Reichsmark, the successive currencies introduced in China from 1933-55 and the Canadian dollar following the collapse of Bretton Woods in the early 1970s.¹⁷

The State theory of money also attracted some support from the New York courts in cases decided after the collapse of the Russian rouble following the First World War and the collapse of the Weimar German mark during the 1920s.¹⁸ In a small number of cases resulting from the collapse of these foreign currencies, as well as in cases decided after the collapse of the Confederate dollar issued by the rebel

⁸See *infra* pp. 35-36.

⁹See *infra* pp. 37-39, 42-44, 51-57.

¹⁰See *infra* pp. 37-39, 51-53.

¹¹See *infra* p. 38.

¹²See *infra* pp. 42-43.

¹³See *infra* pp. 53-57.

¹⁴See *infra* pp. 54-56.

¹⁵See *infra* pp. 55-56.

¹⁶See *infra* pp. 37-39, 42-44, 51-57.

¹⁷See *infra* pp. 50-51, 61-69.

¹⁸See *infra* pp. 45-50.

forces during the American Civil War, American courts did not always strictly adhere to the State theory, sometimes seeking to revalorize contractual obligations denominated in collapsed currencies so as to ascribe a real economic value to such obligations.¹⁹ It appears that the State theory was not always applied in such cases because the currencies in question were not issued by a legitimate government (as in the case of the Southern Confederacy) or perhaps because of the harshness involved in strictly applying the State theory to obligations denominated in collapsed currencies.²⁰ These cases have little or no relevance to the highly organized plan by some of the United States' closest international allies for an orderly transition to a single European currency.²¹ Moreover, the State theory of money, in addition to being generally applied by American courts to obligations denominated in collapsed currencies, has also been applied by the U.S. International Claims Commission in cases involving the collapse of various foreign currencies after the Second World War (e.g., the Yugoslav dinar, the Hungarian pengö and the Romanian lei).²²

The State theory of money has constitutional underpinnings insofar as the U.S. Constitution implicitly recognizes that the power to establish foreign currencies is vested in foreign governments.²³ The State theory of money should be treated as part of federal law insofar as the question of how the introduction of a new currency by a foreign country will affect contractual obligations governed by the laws of U.S. jurisdictions implicates the monetary sovereignty of that country, and therefore affects the relationship of the United States with that country.²⁴

The State theory of money is also endorsed by the Uniform Commercial Code (UCC) which defines money as a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency.²⁵ This legislative definition of money, which has been adopted in all 50 states of the United States (including New York), has been recognized as a legislative incorporation of the State theory of money into American law.²⁶ Both the text of the UCC and the legislative history preceding its adoption clearly establish that money is a creature of law and that the nature of foreign currency must therefore be determined in accordance with the law of the foreign country that issues such currency.²⁷ In addition, the UCC definition of money explicitly rejects the narrow view that money is limited to legal tender, and will therefore regard the euro as the sole currency issued under the laws of EU member states during the proposed transitional period after the introduction of the euro single currency but preceding the introduction of euro notes and coins.²⁸

In addition, the 20 American jurisdictions (including California and Illinois) that have adopted the Uniform Foreign-Money Claims Act have expressly legislated that if, after an obligation is expressed in a foreign money, the country issuing or adopting that money substitutes a new money in place of that money, the obligation is treated as if expressed in the new money at the rate of conversion the issuing country establishes for the payment of like obligations denominated in the former money.²⁹ This

¹⁹See *infra* pp. 39-42, 47, 49-50, 67.

²⁰See *id.*

²¹See *infra* p. 42.

²²See *infra* pp. 87-89.

²³See *infra* pp. 80-81.

²⁴See *infra* pp. 33-35, 191-92, 215.

²⁵See *infra* pp. 81-85.

²⁶See *infra* pp. 81-83.

²⁷*Id.*

²⁸See *infra* pp. 90-91.

²⁹See *infra* pp. 85-86.

provision will be applied by all courts in the adopting jurisdictions regardless of governing law (e.g., by a Californian court in a case involving a foreign currency obligation governed by New York law).³⁰

The State theory of money is analogous to the act of state doctrine, which holds that the U.S. courts will not examine the validity of the acts of a foreign sovereign government done within its own territory.³¹ Thus, under the act of state doctrine, foreign legislation introducing a new currency and providing for the performance of obligations denominated in the old currency should be applied to contractual obligations whose situs is located within that foreign country (e.g., where the obligor is based in the foreign country and/or where payment is to be made in the foreign country, regardless of what law is the governing law of the contract).³²

The State theory of money is also widely recognized under the laws of foreign countries, and it is a generally accepted principle of international law that a state is entitled to regulate its own currency.³³ Interestingly, the State theory of money has been defined more broadly by the U.S. courts than in many foreign countries, permitting a sovereign to exercise its monetary sovereignty so as to alter or abrogate pre-existing contractual rights in the aftermath of a currency change.³⁴

Contractual Excuses Unavailable

Various contractual doctrines which might permit parties to avoid or otherwise terminate contractual obligations, such as the UCC doctrine of commercial impracticability and the common law doctrines of impossibility and frustration, would be unavailable after EMU.³⁵ This is because the State theory of money, in the manner in which it has been articulated by U.S. courts, is applicable to all U.S. contracts affected by EMU.³⁶ Thus, any contractual obligations denominated in or by reference to EU national currencies must be discharged in euros in accordance with the applicable provisions of the EU Council regulations on the introduction of the euro and the irrevocably fixed conversion rates at which the euro substitutes the EU national currencies. The continuity of all interest rate obligations can also be expected in accordance with the applicable provisions of the EU Council regulations and/or pursuant to successor interest rates established for the euro.³⁷

Foreseeability of EMU

The doctrines of commercial impracticability, impossibility and frustration only excuse performance under a contract where performance has been rendered impracticable, impossible or has been otherwise frustrated by the occurrence of an unforeseen event which could not have been anticipated or guarded against in the contract.³⁸ In general, American courts have adopted an expansive approach with respect to the foreseeability of international political and economic developments.³⁹ The advent of a single European currency has long been foreseeable, going back to the decision of the European Council to commission the Delors report in 1988, followed by the decision of the European Council in 1989 to launch the first stage of EMU in 1990, the signing of the Maastricht Treaty in 1992 and its entry into

³⁰See *infra* p. 86.

³¹See *infra* pp. 74-78.

³²*Id.*

³³See *infra* p. 87.

³⁴See *infra* pp. 51-58.

³⁵See *infra* pp. 101-30.

³⁶See *infra* pp. 102-05, 113-14, 117-18, 121, 124-25, 128.

³⁷See *infra* pp. 121-28.

³⁸See *infra* pp. 101-02, 105-07, 116-17.

³⁹See *infra* pp. 106-07.

force in 1993. Moreover the first plans for the introduction of a single European currency were laid in 1970, and it can be argued that the creation of a single European currency has been one of the goals of European integration since that time.⁴⁰ More broadly, in view of the widespread acceptance of the State theory of money and the fact that all countries have, at various times in history, changed their currencies, it may be argued that all currency alterations are inherently foreseeable.⁴¹

Benefit of the Bargain

The New York courts would be reluctant to entertain claims of commercial impracticability, frustration or impossibility where a contract can be performed according to its terms and the parties obtain exactly what they contracted for (i.e., the currency of the country designated in the contract).⁴²

Lawful Currency

Many legal documents, including the ISDA standard forms used for over-the-counter derivatives contracts, contain contractual definitions of EU currencies that define each such currency as the “lawful” currency of a particular country (e.g., the Deutsche mark is defined as the lawful currency of the Federal Republic of Germany). This formula clearly directs American courts to the laws of the Federal Republic of Germany (including the applicable provisions of the EU Council regulations) for a determination as to the meaning of the term “Deutsche mark”.⁴³ Other clauses used in many U.S. foreign currency debt documents call for payment in such coin or currency as at the time of payment is legal tender for the payment of debts. Such clauses also ensure the continuity of contracts after EMU.⁴⁴

Force Majeure/Impossibility Clauses

Force majeure clauses in many U.S. foreign currency debt documents call for the payment of debts in U.S. dollars in the event that the currency of the contract is no longer available due to the imposition of exchange controls or other circumstances beyond the party’s control. Such force majeure clauses would not be triggered by EMU because such clauses refer to situations where the currency in question is in circulation but access to such currency is restricted through exchange controls or other similar restrictions.⁴⁵ Moreover, force majeure clauses are only triggered by unforeseeable events.⁴⁶

Impossibility clauses often call for repayment in U.S. dollars where the currency of the contract is no longer used by the government of the country issuing such currency. Such clauses could give rise to interpretive difficulties when applied to EMU.⁴⁷ However, all obligations created by contracts containing force majeure or impossibility clauses should, in accordance with the State theory of money, be performed in euro under the EU Council regulations because the clauses are general in nature and were not drafted with specific reference to the introduction of the euro.⁴⁸

EMU Continuity Clauses

Since 1995 a large number of U.S. bond issuers have adopted language that expressly ensures the continuity of contracts after EMU in accordance with the applicable provisions of the EU Council

⁴⁰See *infra* pp. 8-11, 107-09, 118, 121.

⁴¹See *infra* p. 108.

⁴²See *infra* pp. 110-11, 120-21.

⁴³See *infra* pp. 136-37.

⁴⁴See *infra* p. 137.

⁴⁵See *infra* pp. 137-38.

⁴⁶*Id.*

⁴⁷See *infra* pp. 138-39.

⁴⁸See *infra* p. 139.

regulations on the introduction of the euro, and ISDA has recently adopted an EMU continuity clause for swap contracts documented under the ISDA standard form.⁴⁹

Obligations in ECU

The official ECU issued by the European Monetary Institute explicitly falls within the legal definition of money that has been adopted in 43 American jurisdictions. Under the laws of such jurisdictions the replacement of all references to ECU by references to euro at the rate of one euro to one ECU in private ECU obligations defined by reference to the official ECU would therefore be enforced in accordance with the applicable provisions of EC law.⁵⁰

The argument can also be advanced that the official ECU falls within the general legal definition of money under New York law.⁵¹ Nonetheless, it is not certain that the official ECU would be recognized as legal money under New York law.⁵² Assuming that ECU obligations governed by New York law are not monetary obligations but rather creatures of contract, the replacement of references to ECU by references to euro in obligations denominated in the official ECU and governed by New York law will still be assured under recent legislation enacted by the New York State Legislature.⁵³ This legislation also provides, consistent with the EU Council regulations, that references to the ECU in contracts not defined by reference to the official ECU shall be presumed to be references to the official ECU, unless a contrary intention by the parties is demonstrated.⁵⁴ Furthermore, the legislation also prevents parties from invoking the doctrines of commercial impracticability, frustration and impossibility as a means of terminating or otherwise discharging ECU obligations based on EMU.⁵⁵ In view of the long-standing foreseeability of the development of the ECU as a currency in its own right (even before the Maastricht Treaty was signed) it is unlikely that such doctrines could have been invoked in any case.⁵⁶

Finally, the contractual definitions of the ECU used for the vast majority of private ECU obligations governed by New York law refer to the official ECU and will therefore ensure the 1:1 replacement of references to ECU in private ECU obligations by references to euro after EMU.⁵⁷

Bilateral Friendship Treaties

The United States has entered into bilateral treaties of friendship with a majority of EU member states (including France and Germany) which require the United States not to take unreasonable measures that would impair the rights or interests of nationals of such EU member states in their enterprises or their capital.⁵⁸ Also, the United States is required under these treaties not to impose restrictions which would burden or interfere with payments or funds transfers between the U.S. and such EU member states.⁵⁹ A failure to recognize the continuity of financial obligations after EMU in accordance with the applicable provisions of the EU Council regulations might be inconsistent with the spirit if not the letter of these requirements.

New York and Illinois State Legislation Regarding EMU

⁴⁹See *infra* pp. 139-42.

⁵⁰See *infra* pp. 162-64.

⁵¹See *infra* pp. 148-50, 164-66.

⁵²*Id.*

⁵³See *infra* pp. 169-70.

⁵⁴See *infra* pp. 170-73.

⁵⁵See *infra* pp. 173-75.

⁵⁶See *infra* pp. 156-61, 173-74.

⁵⁷See *infra* pp. 177-81.

⁵⁸See *infra* pp. 184-85.

⁵⁹See *infra* pp. 185-86.

In July 1997 the New York and Illinois State Legislatures enacted legislation that confirms the continuity of contracts after EMU.⁶⁰ Notwithstanding certain possible discrepancies, this legislation confirms the continuity of contracts denominated in EU national currencies and the ECU in a manner that is broadly consistent with the EU Council regulations on the introduction of the euro.⁶¹ This approach is consistent with the fact that the enactment of any legislation by an American state legislature that fails to fully recognize the monetary sovereignty of the European Union over the currencies of EU member states would represent an unconstitutional infringement on the Federal Government's undisputed authority over international monetary relations.⁶² In accordance with standard principles of statutory construction, any possible discrepancies between the New York or Illinois state legislation and the EU Council regulations must be reconciled by ascribing an interpretation to the state legislation such that it conforms to the EU Council regulations.⁶³ In addition, in the case of any conflict between the state legislation and the EU Council regulations, the applicable provisions of the EU Council regulations shall prevail insofar as the State theory of money is rooted in federal common law.⁶⁴

It has been suggested that the New York and Illinois EMU legislation does not have any retroactive effect with respect to contracts entered into prior to the enactment of the legislation in mid-1997.⁶⁵ While the text of the legislation might imply that it only applies prospectively, both the legislative history and the purpose of the legislation demonstrate a legislative intent that the legislation should apply retroactively.⁶⁶ In any case, regardless of whether the New York and Illinois legislation has any retroactive effect, all relevant contractual obligations created before the passage of the legislation must be discharged in accordance with the EU Council regulations on the introduction of the euro in view of the application of the State theory of money under U.S. federal law.⁶⁷

While the New York and Illinois legislation does not address the question of bond redenomination, the provisions of the EU Council regulation facilitating the redenomination of bonds should still be applicable to transactions governed by New York law and the laws of other U.S. jurisdictions by virtue of the State theory of money.⁶⁸

Constitutionality of Retroactive Contract Continuity Legislation

The legislation passed by the New York and Illinois State Legislatures confirming the continuity of contractual obligations after EMU would withstand constitutional challenge.⁶⁹ Assuming the legislation applies retroactively, the legislation will not impair contractual obligations insofar as it confirms the continuity of contractual obligations in a manner that is consistent with the State theory of money.⁷⁰ Notwithstanding certain possible discrepancies, the New York and Illinois legislation confirms the continuity of contracts after EMU in a manner that is broadly consistent with the continuity regulations adopted by the Council of the European Union.⁷¹ By confirming the continuity of contracts consistently with the EU Council regulations, the New York and Illinois legislation is declaratory of existing law and

⁶⁰See *infra* p. 191.

⁶¹See *infra* pp. 191-92, 198-205.

⁶²See *infra* pp. 191-92, 215-21.

⁶³See *infra* pp. 191-92, 200-04.

⁶⁴See *id.*

⁶⁵See *infra* p. 192.

⁶⁶See *infra* pp. 193-97.

⁶⁷See *infra* pp. 192-93, 197.

⁶⁸See *infra* pp. 60-61, 205-06.

⁶⁹See *infra* pp. 206-21.

⁷⁰See *infra* pp. 206-14.

⁷¹See *infra* pp. 191-92, 198-205.

does not impair pre-existing contractual obligations in any manner.⁷² In any case, the legislation has been enacted to protect a broad societal interest (i.e., the avoidance of needless litigation after EMU), and will therefore be upheld by American courts in deference to the judgment of the state legislatures unless it is not appropriately tailored to the public interest it was designed to meet.⁷³

Constitutionality of State Legislation Affecting International Monetary Relations

The enactment of legislation by the New York and Illinois State Legislatures confirming the continuity of contracts after EMU does not infringe the U.S. Federal Government's undisputed authority over international monetary relations because the legislation recognizes the continuity of contracts in a manner that is broadly consistent with the monetary sovereignty of the European Union over the currencies of EU member states.⁷⁴ The enactment of such legislation by a state legislature does not infringe the Federal Government's authority over international monetary relations so long as the legislation is fully consistent with the State theory of money.⁷⁵ This is consistent with the official position of the Federal Government towards EMU which recognizes that it would be inappropriate for the U.S. Government to enter the debate of how EMU should be structured since this question is one which Europeans must answer for themselves.⁷⁶ The state legislation would be best insulated from constitutional challenge by evidence that Congress and the executive branch of the Federal Government implicitly acquiesce in the enactment of legislation by the state legislatures in this area. Nonetheless, it is highly unlikely that the failure of the state authorities to consult the Federal Government would of itself prejudice the constitutional validity of the state legislation.⁷⁷

Conclusion

This study concludes that the introduction of the single European currency presents few uncertainties for the continuity of contracts governed by New York law and the laws of other U.S. jurisdictions. In accordance with the State theory of money, all such contractual obligations must be discharged in accordance with the applicable provisions of the EU Council regulations on the introduction of the euro. The legislation enacted in New York and Illinois confirming the continuity of contracts after EMU is broadly consistent with the EU Council regulations. Possible discrepancies between the state legislation and the EU Council regulations can be overcome by interpreting the state legislation so as to harmonize it with the EU Council regulations. In any case, in the event of a conflict between the EU Council regulations and the New York or Illinois legislation, the provisions of the EU Council regulations shall prevail by virtue of the State theory of money

Contractual obligations denominated in the official ECU and governed by the laws of most U.S. jurisdictions (but not New York) shall be automatically discharged in accordance with the provisions of the EU Council regulations. ECU obligations governed by New York law shall be discharged either pursuant to the EU Council regulations or in accordance with the substantially identical provisions of the New York legislation confirming the continuity of contracts after EMU.

Because the state legislation confirms the continuity of contracts in a manner that is broadly consistent with the applicable EU legislation, it will not retroactively impair the obligation of contracts contrary to the provisions of the United States Constitution. Nor will the state legislation infringe the U.S. Federal Government's authority over international monetary relations. This is because the state legislation generally defers to the monetary sovereignty of the European Union over the currencies of EU member states.

⁷²See *infra* pp. 211-13.

⁷³See *infra* pp. 207-08, 213-15.

⁷⁴See *infra* pp. 215-22.

⁷⁵*Id.*

⁷⁶See *infra* p. 220.

⁷⁷See *infra* pp. 217-18, 220-21.

I. INTRODUCTION

A. Outline of Study

This study attempts to analyze how the continuity of contracts governed by the laws of New York State and other U.S. jurisdictions will be treated in the event that existing European Union (EU) currencies are replaced by a new single European currency. This analysis will be taken in several stages.

- First, the study will outline the historic evolution of European economic and monetary union (EMU) and the manner in which the transition to EMU is proposed to be achieved.
- Second, the study will consider the circumstances in which American courts will hold that financial obligations denominated in EU currencies are governed by the laws of particular jurisdictions (e.g., New York State or a foreign country).
- Third, assuming that the law of a U.S. jurisdiction such as New York law is the governing law of the contract, the study will then explore whether American courts would accept that the question of what a currency such as the Deutsche mark or the French franc consists of is exclusively defined by the laws of the state issuing such currency (e.g., the laws of Germany or France, as the case may be).
- Fourth, the study will assess the extent to which various legal doctrines such as the Uniform Commercial Code doctrine of commercial impracticability or the common law doctrines of impossibility and frustration could be invoked as a means of terminating or otherwise discharging contractual obligations in the aftermath of EMU. This discussion will also touch on the remedies open to parties following a breach of contract.
- Fifth, the study will examine various currency definitions that are used in the North American financial markets, and consider the continuity clauses that have been adopted by certain market participants to ensure the continuity of contracts in the aftermath of EMU. The study will also look at contractual provisions affecting bond redenomination.
- Sixth, the study will consider the special concerns pertaining to the legal status of obligations denominated in the European Currency Unit (the ECU), the basket currency which under the Maastricht Treaty is set to become a currency in its own right.
- Seventh, the study will discuss the possible relevance of various bilateral friendship treaties between the United States and EU member states and the relevance of the Bretton Woods Agreement to the introduction of the single European currency.
- Eighth, the study will outline the content of the recent legislation passed by the New York and Illinois State Legislatures to ensure the continuity of contracts after EMU.
- Ninth, the study will consider whether the retroactive application of this legislation to pre-existing contractual obligations would be contrary to the provisions of the United States or New York State Constitutions.
- Tenth, the study will consider whether the enactment of this legislation by state legislatures constitutes an unconstitutional infringement by the state authorities on the undisputed authority of the Federal Government over international monetary relations.

B. The Maastricht Treaty

In 1993, the then 12 member states of the European Economic Community — Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and the United Kingdom — entered into the Treaty on European Union.¹ The Treaty is commonly referred to as the “Maastricht Treaty”, so named after the small town in the Netherlands where the treaty was signed. Since 1992 three more countries — Austria, Finland and Sweden — have joined the European Union, thereby acceding to the terms of the Treaty.² Under the Treaty the member states of the EU agreed to a number of significant amendments to the treaty establishing the then European Economic Community, including an agreement to establish among themselves the European Union and to replace the European Economic Community with the European Community.³

The most far-reaching provisions of the Maastricht Treaty relate to the agreement by the EU member states, subject to the fulfillment of certain conditions, to replace their individual national currencies with a single European currency no later than January 1, 1999.⁴ Two member states, Denmark and the United Kingdom, have negotiated opt-outs under the Treaty which free them from the obligation to participate in the proposed monetary union, even if they satisfy the preconditions to monetary union.⁵ The remaining member states are legally obliged to participate in EMU if they satisfy the preconditions laid down by the Maastricht Treaty.

C. Impact of EMU on U.S. Financial Markets

The Treaty clearly has important legal implications for financial obligations maturing after January 1, 1999 that are governed by the laws of U.S. jurisdictions, particularly New York. A multitude of financial obligations contained in derivatives and eurobond transactions are governed by the laws of New York State and are denominated in the national currencies of EU member states and the ECU. Set forth below are statistical details demonstrating the extent to which derivatives and eurobonds affected by EMU are governed by New York law.

1. OTC Derivatives Market

According to a triennial report published by the Basle-based Bank for International Settlements in May 1996, the global notional amount outstanding of derivatives contracts in the so-called over-the-counter (OTC) markets at the end of March 1995 is estimated to have stood at \$47.5 trillion (with a gross market value of \$2.2 trillion), of which 61% applied to interest rate instruments and 37% to foreign exchange instruments.⁶ A very significant proportion of such interest rate and foreign exchange derivatives contracts are both governed by New York law and affected by EMU. This point can be demonstrated by several factors.

¹TREATY ON EUROPEAN UNION, Feb. 7, 1992, 31 I.L.M. 247 (1992).

²See Treaty concerning the accession of the Kingdom of Norway, the Republic of Austria, the Republic of Finland and the Kingdom of Sweden to the European Union, June 24, 1994, E.U.-Nor.-Aus.-Fin.-Swed., 1994 O.J. (C 241) and 1995 O.J. (L 1/1), as ratified by the Republic of Austria, the Republic of Finland and the Kingdom of Sweden, 1995 O.J. (L 1/221).

³TREATY ON EUROPEAN UNION, Feb. 7, 1992, tit. I, art. A, tit. I, art. g, 31 I.L.M. 247 (1992).

⁴TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Feb. 7, 1992, arts. 3a, 102a-109m, O.J. (C 224) 1 (1992), [1992] 1 C.M.L.R. 573 (1992) [hereinafter EC TREATY].

⁵EC TREATY, Protocol (No 11) on Certain Provisions Relating to the United Kingdom of Great Britain and Northern Ireland; EC TREATY, Protocol (No 12) on Certain Provisions Relating to Denmark.

⁶BANK FOR INTERNATIONAL SETTLEMENTS, CENTRAL BANK SURVEY OF FOREIGN EXCHANGE AND DERIVATIVES MARKET ACTIVITY 1995 1, 22-24 (May 1996).

- U.S. counterparties to OTC derivatives contracts select New York law as the governing law of their contracts in order to ensure the enforceability of netting provisions.⁷ It has been suggested that “[n]early 100 percent of all swap contracts between U.S. counterparties, irrespective of the currency in which the deal is made, are governed by New York law” and that “[p]erhaps half of all derivative contracts are governed by New York law.”⁸ Thus the standard forms of the International Swaps and Derivatives Association (ISDA), which document many OTC derivatives contracts, designate either New York or English law as the governing law of the contract.⁹
- After London, New York is the largest center of foreign exchange and derivatives market activity in the world. In April 1995 the reported average U.S. daily turnover of OTC foreign exchange and interest rate derivative contracts was \$164 billion in notional amounts, accounting for over 14% of the global turnover during the same period.¹⁰ The vast majority of U.S. derivatives contracts are governed by New York law.
- London is the leading international center of foreign exchange and derivatives activity, and in April 1995 the reported average U.K. daily turnover of OTC forex and interest rate contracts was \$351 billion in notional amounts, accounting for over 30% of the global turnover during that period.¹¹ An October 1995 report by the London Investment Banking Association estimated that up to half of the swaps entered into in the London markets are governed by New York law.¹² This preference by U.S. counterparties operating outside the United States to select New York law as the governing law of the contract must also mean that New York law governs a significant portion of derivatives contracts in the world’s five other important centers of foreign exchange and derivative market activity: Tokyo, Singapore, Hong Kong, Frankfurt and Paris (in April 1995 Japan, Singapore, Hong Kong, Germany and France accounted for over 11.5%, 6.5%, 5%, 4.5% and 4.5%, respectively, of the global turnover in OTC derivatives contracts).¹³
- Many OTC derivatives contracts governed by New York law involve obligations denominated in European Union currencies. Thus, the reported foreign exchange derivatives turnover in April 1995 shows that the Deutsche mark was used on one side of the transaction in over 23% of all forex derivatives transactions during that period, Pound sterling in over 9% of such transactions, the French franc in over 7.5% of transactions, the ECU in over 2.5% of transactions, and the remaining 12 EU currencies in over 15% of transactions.¹⁴ The Deutsche mark was the underlying currency in over 12.5% of the notional amount outstanding of OTC interest rate derivatives at March 1995, and EU currencies can be reasonably expected to account for a significant proportion of the 31.5% of interest rate instruments whose underlying currencies were currencies other than the U.S. dollar, the Deutsche mark or the Japanese yen.¹⁵

⁷See LONDON INVESTMENT BANKING ASSOCIATION, *THE PRACTICAL IMPLICATIONS OF CONVERTING LONDON’S CAPITAL MARKETS TO A SINGLE CURRENCY* para. 28 (Oct. 1995).

⁸Simon Boughey, *The EMU Threat*, I DERIVATIVES STRATEGY, No. 10, Oct. 1996, at 26, 28.

⁹INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *MULTICURRENCY-CROSS BORDER MASTER AGREEMENT* Schedule Part 4(h) (1992); INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *LOCAL CURRENCY-SINGLE JURISDICTION MASTER AGREEMENT* Schedule Part 3(e) (1992).

¹⁰See BANK FOR INTERNATIONAL SETTLEMENTS, *supra* note 6, at 32.

¹¹*See id.*

¹²LONDON INVESTMENT BANKING ASSOCIATION, *supra* note 7, at para. 28.

¹³See BANK FOR INTERNATIONAL SETTLEMENTS, *supra* note 6, at 32.

¹⁴*See id.* Statistical Annex Table 9A.

¹⁵*See id.* at 26.

These transactions are spread out over all markets, and there is no concentration of local currency transactions in the leading financial centers.¹⁶

- Many derivative obligations denominated in currencies affected by EMU or calculated by reference to interest rates linked to EU currencies will mature after January 1, 1999. As of March 1995, some 43% of OTC interest rate derivative contracts had maturities of 1-5 years and 13% had maturities of over 5 years, while 16% of OTC foreign exchange instruments had maturities of 1-5 years and 5% had maturities of over 5 years.¹⁷

In conclusion, based on the above statistics, there is a very significant amount of outstanding OTC derivatives instruments governed by New York law that are denominated in EU currencies and that will mature after January 1, 1999.

2. Eurobond Market

In March 1995 the Euroclear securities clearance system operated by the Brussels office of Morgan Guaranty Trust Company of New York released a report regarding the impact of EMU which estimated that there were some \$600 billion of securities denominated in EU currencies within its system alone and that many of these securities are issued under the laws of non-EU jurisdictions.¹⁸ By 1996 the eurobond market for debt securities sold to investors outside the country of the currency in which the debt is denominated had grown to an annual new issue volume of over \$650 billion.¹⁹ International capital market issues in core EMU currencies (in order of size, the Deutsche mark, French franc, Italian lire, Dutch guilder, Luxembourg franc, ECU, Finnish markka, Belgian franc and Irish pound) accounted for \$194 billion in 1996.²⁰ North American issuers accounted for \$19 billion of EMU currency borrowings in 1996.²¹ Eurobonds issued by U.S. issuers on offshore markets are usually expressly governed by New York law.

3. Exchange-traded Derivatives Markets

According to the Basle report, the total reported notional amount of outstanding exchange-traded derivatives stood at \$16.4 trillion at the end of March 1995.²² Almost all (96%) exchange-traded business consists of interest rate contracts (comprising futures and options).²³ U.S. commodities exchanges such as the Chicago Mercantile Exchange, the Mid-America Commodity Exchange, Financial Instruments Exchange (FINEX), which forms part of the New York Cotton Exchange (NYCE), and the Philadelphia Stock Exchange accounted for 17% of the global share of such interest rate contracts as of April 1995.²⁴ It appears, however, that most exchange-traded interest rate instruments affected by EMU are traded on European exchanges, and that a comparatively small amount of long-term contracts implicated by EMU are traded on U.S. exchanges.

4. Other Cross Border Transactions

¹⁶See *id.* Statistical Annex Table 3-B.

¹⁷See *id.* at 27.

¹⁸EUROCLEAR OPERATIONS CENTER, MEMORANDUM ON ECONOMIC AND MONETARY UNION - COMMENTS AND ISSUES FROM THE EUROCLEAR OPERATOR 2, 9 (Mar. 1995).

¹⁹See INTERNATIONAL PRIMARY MARKET ASSOCIATION, THE INTERNATIONAL CAPITAL MARKET: AN EMU POSITION PAPER 12-13 (Autumn 1997).

²⁰See *id.* at 14-15.

²¹See *id.* at 15.

²²BANK FOR INTERNATIONAL SETTLEMENTS, *supra* note 6, at 33.

²³See *id.* at 33.

²⁴See *id.* at 35.

Many long-term loan agreements and cross-border commercial transactions governed by the laws of U.S. jurisdictions also involve obligations denominated in EU currencies.

D. Preparations for EMU by U.S. Financial Markets

The preparations of the international financial markets for the introduction of the single currency got underway in 1993 with the establishment of various study groups to consider the implications of EMU. In April 1993 an ad hoc working group was established with the assistance of the European Commission and the ECU Banking Association to consider the legal definition of the ECU. This group enjoyed the participation of representatives of various U.S. financial institutions, law firms and international trade associations, including ISDA and the International Primary Market Association (IPMA).²⁵

As awareness of the legal implications of EMU in the international financial markets increased, U.S. eurobond issuers began to adopt language updating the description of their ECU bonds in 1994 and 1995 to take account of the ECU's development as a currency in its own right.²⁶ Beginning in early 1995 a number of U.S. issuers began to include specific language in their debt documents ensuring the conversion of obligations denominated in EU national currencies (e.g., the Deutsche mark, the French Franc) into the single currency in accordance with the applicable provisions of EC law.²⁷

In May 1995 the European Commission²⁸ released its Green Paper on the Practical Arrangements for the Introduction of the Single Currency.²⁹ The Commission Green Paper predicted that under the laws of non-EU jurisdictions the recognition of the single currency as the successor currency to existing EU national currencies at the fixed conversion rates, as well as the continuity of the other terms of a contract such as interest rates and other ancillary obligations, could be expected.³⁰

In late 1995 IPMA and ISDA released a joint statement recommending a standard definition of the ECU for use in terms and conditions of securities and derivatives contracts designed to take account of EMU.³¹ The adoption of this language followed a consultative process with ISDA and IPMA members and contacts, including a large number of U.S. financial institutions and law firms.

In 1995 there was a flurry of speculation in the international financial media regarding the legal ramifications of EMU for EU currency contracts governed by New York law.³² U.S. based working groups were established to consider the legal implications of EMU for North American financial markets in late 1995 and early 1996. The first such group, the Wall Street Committee on the Transition to EMU, held its inaugural meeting in March 1996,³³ and this was followed by the establishment of an ISDA New York EMU Working Group in May 1996. Representatives of Wall Street financial institutions, law firms and trade associations began to consider whether the continuity of foreign currency contracts governed by New York law might be best protected against the impact of EMU through the enactment of legislation by

²⁵The author was pleased to represent the law firm of Davis Polk & Wardwell, New York City, in the deliberations of this working group which held its last meeting in June 1995.

²⁶See *infra* pp. 161, 179-81.

²⁷See, e.g., MORGAN STANLEY GROUP INC., GLOBAL MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Mar. 29, 1995) (on file with Securities and Exchange Commission); see *infra* pp. 139-41.

²⁸The European Commission is broadly responsible for initiating new European Community policies and for implementing existing Community policies. See generally T. C. HARTLEY, THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW 11-17 (3d ed. 1994).

²⁹European Commission, Green Paper on the Practical Arrangements for the Introduction of the Single Currency, COM(95)333 final.

³⁰*Id.* at 60; see also European Commission (DG II), The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations 9 (Nov. 1997).

³¹INTERNATIONAL PRIMARY MARKET ASSOCIATION AND INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION INC., JOINT STATEMENT ON THE LEGAL DEFINITION OF THE ECU (Nov. 1995).

³²See, e.g., David Shireff, *Single-Money Nightmare*, EUROMONEY, Dec. 1995, at 28; *A Legal Basket Case*, THE ECONOMIST, Dec. 9, 1995, at 78.

³³Wall Street Committee on the Transition to European Monetary Union, Minutes (Mar. 29, 1996) (on file with author).

the New York State Legislature.³⁴ The ISDA New York EMU Working Group, which was expanded to include the Financial Markets Lawyers Group, the Public Securities Association and the Securities Industry Association, forwarded a draft legislative proposal to the New York State Legislature in Albany in early 1997.³⁵ In July 1997 the legislation passed both Houses of the New York State Legislature and was signed into law by the Governor of New York as an amendment to the New York General Obligations Law.³⁶

Similar legislative proposals have been forwarded to the Illinois and California State Legislatures, and in July 1997 the legislative proposal drafted by the New York EMU working group was enacted in Illinois as the Illinois Euro Conversion Act.³⁷

³⁴See Niall Lenihan, *Wall Street Committee on the Transition to European Monetary Union*, EMU, the Continuity of Contracts and New York Law (Mar. 29, 1996) (unpublished manuscript, on file with author); Memorandum from Daniel P. Cunningham and R. Brent Jones, *Cravath, Swaine & Moore*, to Financial Markets Lawyers Group, International Swaps and Derivatives Association and Securities Industry Association, Economic and Monetary Union and Continuity of Contract Under New York Law 32-34 (Feb. 24, 1997) (on file with author).

³⁵New York EMU Working Group, An Act to amend the general obligations law to the continuity of contracts and the single currency of the European Union (Mar. 7, 1997) (on file with author).

³⁶S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604).

³⁷Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30).

II. EUROPEAN MONETARY UNION

A. *Historic Evolution of EMU*

There is nothing new about the idea of introducing a single currency for a number of different countries. Gold served as the single currency of the international monetary system while countries subscribed to the gold standard.¹ During the Bretton Woods conference at the end of the Second World War the economist John Maynard Keynes unsuccessfully advocated the adoption of a single world currency which he proposed to call the “bancor”.² Since 1960 three regional transnational currencies have been established: the CFA (Communauté Financière Africaine) franc issued by the Central Bank for West African states on behalf of seven African countries participating in the West African Monetary Union; the CFA franc issued by the Bank for Central African states on behalf of six African countries participating in the Central African Monetary Union; and the East Caribbean dollar issued by the Eastern Caribbean Central Bank on behalf of eight Caribbean island states.³

The concept of a European monetary union grew out of the increased economic integration of post-War Europe that followed the Marshall Plan in the late 1940s, leading to the establishment of the European Coal and Steel Community in 1952 and the European Economic Community in 1958.⁴ Arising out of a suggestion by the former German Chancellor Willy Brandt,⁵ steps towards the introduction of a single European currency were taken in 1969 when the original six member states of the European Economic Community (Belgium, France, Germany, Italy, Luxembourg and the Netherlands) decided to draw up a plan for the creation of an economic and monetary union.⁶ This led to the publication of the Werner report in 1970⁷ and the adoption of a Resolution on the attainment in stages of economic and monetary union by the six member states in March 1971.⁸

These plans for the introduction of a single European currency were upset by the violent upheavals in the international monetary system caused by the collapse of the Bretton Woods system of near-fixed exchange rates during the early 1970s, resulting in the announcement by President Nixon in August 1971 that the U.S. dollar would no longer be convertible into gold.⁹ The European Economic Community responded to the advent of floating exchange rates by adopting a new Resolution on the attainment of economic and monetary union in March 1972 which established a plus or minus 2.25% band within which the currencies of member states would be permitted to float.¹⁰ With the withdrawal of the U.K.,

¹See generally ROBERT GUTTMANN, HOW CREDIT-MONEY SHAPES THE ECONOMY: THE UNITED STATES IN A GLOBAL SYSTEM 354-63, esp. at 360 (1994).

²See JOHN MAYNARD KEYNES, PROPOSALS FOR AN INTERNATIONAL CLEARING UNION (1943), reprinted in 3 THE INTERNATIONAL MONETARY FUND, 1945-1965: TWENTY YEARS OF INTERNATIONAL MONETARY COOPERATION 20 (J. Keith Horsefield ed., 1969); see also GUTTMANN, *supra* note 1, at 386-91.

³See F.A. MANN, THE LEGAL ASPECT OF MONEY 506-09 (5th ed. 1992); Rutsel Silvestre J. Martha, *The Fund Agreement and the Surrender of Monetary Sovereignty to the European Community*, 30 COMMON MKT. L. REV. 749, 752-53 (1993).

⁴See generally DANIEL GROS & NIELS THYGESEN, EUROPEAN MONETARY INTEGRATION 3-10 (1992); PAUL KENNEDY, THE RISE AND FALL OF THE GREAT POWERS 420-29 (1989).

⁵See GROS & THYGESEN, *supra* note 4, at 12.

⁶The Final Communiqué of the Conference of the Heads of State or Government on 1 and 2 December 1969 at the Hague, para. 8, reprinted in Monetary Committee of the European Community, Compendium of Community Monetary Texts 13 (1974) [hereinafter 1974 Monetary Compendium].

⁷Report to the Council and the Commission on the Realization by Stages of Economic and Monetary Union in the Community, 3 Bull. E.C. No. 11 (Supp. 1970), 3. The report was named after Pierre Werner, former Prime Minister of Luxembourg, who chaired the study.

⁸Resolution of the Council and of the Representatives of the Governments of the Member States of 22 March 1971 on the attainment by stages of economic and monetary union in the Community, reprinted in Monetary Committee of the European Community, Compendium of Community Monetary Texts 33 (1989) [hereinafter 1989 Monetary Compendium].

⁹See GROS AND THYGESEN, *supra* note 4, at 12-15; GUTTMANN, *supra* note 1, at 137-43 (1994).

¹⁰Resolution of the Council and of the Representatives of the Governments of the Member States of 21 March 1972 on the application of the Resolution of 22 March 1971 on the attainment by stages of economic and monetary union in the Community, 1972 J.O. (C 83/3), reprinted in 1974 Monetary Compendium, *supra* note 6, at 33; see also Agreement of 10 April 1972 between the Central Banks of the Member States of the Community on the narrowing of the margins of fluctuation between Community currencies, reprinted in 1974

Italy and France from this arrangement, the joint float had in effect become a Deutsche mark zone by the mid-1970s.¹¹

European monetary integration was given a fresh impetus with the passage of a Resolution in 1978 establishing the European Monetary System (EMS), which established bands of 2.25% above and below bilateral central exchange rates within which member currencies could float.¹² The EMS requires that when the market exchange rate for two currencies reaches the limit of its fluctuation margins, central banks from both countries must intervene to keep the exchange rate within the band.¹³ The 2.25% exchange rate margins of the EMS survived until 1993 when it was decided, in response to pressure on the currency markets, to widen the bands to 15%.¹⁴ With the exception of the Greek drachma and the Swedish krona, the currencies of all EU member states have at various times participated in the exchange rate mechanism of the EMS.

The project for European monetary union began to gather fresh momentum in 1988. Arising out of a proposal by Hans-Dietrich Genscher, former German Foreign Minister, the then 12 member states of the European Economic Community decided at the European Council summit meeting in Hanover in June 1988 to commission a report under the chairmanship of Jacques Delors, President of the European Commission, regarding the introduction of a single European currency.¹⁵ The direct antecedents of the Maastricht Treaty provisions on EMU can be traced to the Delors report of April 1989, which recommended a three-stage process for the achievement of economic and monetary union.¹⁶ The European Council summit meeting in Madrid in June 1989 decided to launch the first stage of EMU on July 1, 1990.¹⁷ The main features of the first stage involved increased co-ordination of economic and monetary policies between the member states and increased integration of financial and capital markets.¹⁸ The launch of the first stage did not require any amendments to the Treaty of Rome, under which the European Economic Community was established.

The second and third stages of EMU were laid down in the Maastricht Treaty, which was signed in February 1992.¹⁹ The Treaty did not enter into force until November 1993 due to the fact that the enabling legislation underwent a protracted passage in the 12 member states. Three member states (Denmark, France and Ireland) held popular referenda to ensure the passage of the Treaty. While the French and Irish referenda were passed, the Danish referendum resulted in an initial rejection of the Treaty, only to be overturned after Denmark had been granted an opt-out from the Treaty provisions

Monetary Compendium, *supra* note 6, at 60; Council Statement of March 12, 1973, *reprinted in* 1974 Monetary Compendium, *supra* note 6, at 63.

¹¹See GUTTMANN, *supra* note 1, at 396; GROS & THYGESEN, *supra* note 4, at 15-21; John H. Works, Jr., *The European Currency Unit: The Increasing Significance of the European Monetary System's Currency Cocktail*, 41 BUS. LAW. 483, 488-90 (1986).

¹²Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters (Dec. 5, 1978), *reprinted in* 1989 Monetary Compendium, *supra* note 8, at 45; *see also* Agreement of 13 March 1979 between the central banks of the Member States of the European Community laying down the operating procedures for the European Monetary System, *reprinted in* 1989 Monetary Compendium, *supra* note 8, at 50.

¹³See Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters (Dec. 5, 1978), § 3.4, *reprinted in* 1989 Monetary Compendium, *supra* note 8, at 45.

¹⁴See *infra* p. 10.

¹⁵Committee for the Study of Economic and Monetary Union, Report on Economic and Monetary Union in the European Community (1989), paras. 1, 15, ann. 1, *reprinted in* Agence Europe Docs. No. 1550/1551 (Apr. 1989) [hereinafter Delors Report]; *see also* GROS & THYGESEN, *supra* note 4, at 311-17, 326-27.

¹⁶Delors Report, paras. 31-32, 39-66; *see also* GROS & THYGESEN, *supra* note 4, at 317-23; JOHN A. USHER, THE LAW OF MONEY AND FINANCIAL SERVICES IN THE EUROPEAN COMMUNITY 146-49 (1994).

¹⁷European Council Madrid Presidency Conclusions, paras. 1-4 (June 1989).

¹⁸See GROS & THYGESEN, *supra* note 4, at 344-52.

¹⁹TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Feb. 7, 1992, arts. 109e-109m, O.J. (C 224) 1 (1992), [1992] C.M.L.R. 573 (1992) [hereinafter EC TREATY]; *see also* Martha, *supra* note 3, at 751; USHER, *supra* note 16, at 149-50.

relating to EMU. Legal proceedings challenging the validity of the Treaty ensued in various national courts, including those of France, Germany and the U.K.²⁰

Against this backdrop, Europe experienced one of the most turbulent currency crises in recent history, causing some to question the credibility of the proposed monetary union.²¹ As a result of this short-lived currency crisis in September 1992 and July 1993, a re-alignment of European currencies participating in the exchange rate mechanism (ERM) of the EMS took place while Italy and the United Kingdom withdrew altogether from the ERM.²² Finally, in August 1993 the ERM's margin of fluctuation was widened from 2.25% to a new 15% band, subject to a bilateral arrangement between Germany and the Netherlands to maintain the 2.25% margin between their currencies.²³

After the Maastricht Treaty had finally entered into force in November 1993, the second stage of EMU began on January 1, 1994.²⁴ Three new member states — Austria, Finland and Sweden — subsequently acceded to the Treaty by joining the European Union on January 1, 1995 after a series of popular referenda in 1994.²⁵

B. Second Stage of EMU

The start of the second stage of EMU on January 1, 1994 saw the establishment of the Frankfurt-based European Monetary Institute (EMI), precursor to the future European Central Bank (ECB). The second stage is designed to promote progressive convergence among the economies of the EU member states as a prelude to a decision by the Council of the European Union, meeting in the composition of the Heads of State or of Government of the member states,²⁶ as to which member states “fulfill the necessary conditions for the adoption of a single currency”.²⁷ This decision must be made after taking into account two reports submitted to the Council by the European Commission and the European Monetary Institute which examine the achievement of a high degree of sustainable convergence by reference to the fulfillment by each member state of certain economic convergence criteria.²⁸ These criteria relate broadly to the achievement by member states of specified inflation rates, budget deficits, government debt ratios, exchange rates and interest rates.²⁹ The Council must also take into account the opinion of the European

²⁰See, e.g., T.C. HARTLEY, *THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW* 7 (3d ed. 1994); Kevin D. Makowski, *Solange III: The German Federal Constitutional Court's Decision on Accession to the Maastricht Treaty on European Union*, 16 U. PA. J. INT'L BUS. L. 155 (1995).

²¹See Guttman, *supra* note 1, at 408-18.

²²See *id.* at 414-17.

²³See USHER, *supra* note 16, at 141.

²⁴EC TREATY, art. 109e(1).

²⁵See Treaty concerning the accession of the Kingdom of Norway, the Republic of Austria, the Republic of Finland and the Kingdom of Sweden to the European Union, June 24, 1994, E.U.-Nor.-Aus.-Fin.-Swed., 1994 O.J. (C 241) and 1995 O.J. (L 1/1), as ratified by the Republic of Austria, the Republic of Finland and the Kingdom of Sweden, 1995 O.J. (L 1/221).

²⁶The European Council, which holds summit meetings at least twice a year, consists of the Heads of State or of Government of the 15 member states and their foreign ministers and establishes the general political guidelines for the European Union. The Council of the European Union, consisting of representatives of the governments of the 15 member states, takes the final decision on most EC legislation. See generally HARTLEY, *supra* note 20, at 17-23.

²⁷EC TREATY, art. 109j.

²⁸See *id.* art. 109j(1).

²⁹See *id.* art. 109j(1); *id.* Protocol (No 6) on the Convergence Criteria Referred to in Article 109j of the Treaty Establishing the European Community; *id.* Protocol (No 5) on the Excessive Debt Procedure. For an indication as to how the convergence criteria will be interpreted by the Council, the Commission and the EMI, see European Council Madrid Presidency Conclusions, *The Scenario for the Changeover to the Single Currency*, ann. 1, para. 3 (Dec. 1995) [hereinafter European Council Madrid Presidency Conclusions]; European Commission, Report on Convergence in the European Union in 1996, COM(96)560 final; European Commission (DG II), Report on Convergence in the European Union in 1995 (Nov. 1995); European Monetary Institute, Progress Towards Convergence 1996 (Nov. 1996); European Monetary Institute, Progress Towards Convergence (Nov. 1995); European Monetary Institute, The Changeover to the Single Currency 1, 5 (Nov. 1995) [hereinafter EMI Changeover Scenario].

Parliament, and the Council's decision must be made on the basis of the recommendations of the European Council of Finance Ministers (ECOFIN).³⁰

In the Presidency Conclusions of the Madrid European Council of December 1995, which laid down the changeover scenario for the introduction of the single currency, it was agreed that the decision of the Council will be made "as soon as possible in 1998" on the basis of "the most recent and reliable actual data for 1997."³¹

The Maastricht Treaty requires the Council, meeting in the composition of the Heads of State or of Government of the 15 member states no later than July 1, 1998, to confirm which member states fulfill the necessary conditions for the adoption of the single currency.³² The Treaty provides that immediately after either the date of the Council's decision or on July 1, 1998 the members of the Executive Board of the European Central Bank will be appointed by common accord of the governments of the participating member states, and both the ECB and the European System of Central Banks (ESCB) will be established and will prepare for their full operation from January 1, 1999.³³ The ESCB will be composed of the ECB and the national central banks and will be governed by the decision-making bodies of the ECB.³⁴ The two main decision-making bodies of the ECB will be the Executive Board appointed by the governments of the member states and the Governing Council comprising the members of the Executive Board and the Governors of the national central banks.³⁵ The Maastricht Treaty provides that the basic tasks to be carried out through the ESCB are to define and implement the monetary policy of the Community; to conduct foreign exchange operations; to hold and manage the official foreign reserves of the member states; and to promote the smooth operation of payment systems.³⁶

The Maastricht Treaty provides that the third stage of EMU shall start no later than January 1, 1999.³⁷ The legal implications of this timetable have not been clarified, and it has been suggested that these procedures might be capable of being used after the specified deadlines have expired.³⁸

C. Changeover to the Single Currency: 1999-2002

1. Introduction of the Euro and Changeover Scenario

The Maastricht Treaty provides that at the starting date of EMU the Council shall, acting with the unanimity of the member states participating in EMU, adopt the conversion rates at which their currencies shall be irrevocably fixed and at which irrevocably fixed rate the ECU shall be substituted for these currencies, and the ECU will become a currency in its own right.³⁹ The European Council has

³⁰EC TREATY, art 109j.

³¹European Council Madrid Presidency Conclusions, *supra* note 29, ann. 1, para. 6.

³²EC TREATY, art. 109j(4). This decision must be made by a qualified majority vote of the Council. EC TREATY, art. 109j(4). Qualified majority voting is a system of weighted voting which accords greater numbers of votes at European Council meetings to the more populous member states (France, Germany, Italy, Spain and the U.K.), while at the same time requiring a two-thirds majority of votes and the affirmative support of at least a majority of the member states before any decision can be taken. *See id.* art. 148.

³³EC TREATY, art. 109l(1); *id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, art. 50.

³⁴*See id.* arts. 106(1), 106(3); *id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, arts. 8 and 9(3).

³⁵*See id.* art. 106(3); *id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, arts. 9(3), 10, 11 and 45.

³⁶*Id.* art. 105(2); *id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, art. 3.1. For a description of the proposed operational framework for the new central bank, see European Monetary Institute, *The Single Monetary Policy in Stage Three: Specification of the Operational Framework* (Jan. 1997).

³⁷*Id.* art. 109j(4).

³⁸*See* USHER, *supra* note 16, at 154-56.

³⁹EC TREATY, art. 109l(4).

decided that the single currency will be named the euro, rather than the generic term “ECU” used in the Treaty.⁴⁰

The Treaty also provides that the Council shall, acting with the unanimity of the member states participating in EMU, also take other measures necessary for the rapid introduction of the euro as the single currency of the participating member states.⁴¹ The details regarding the changeover to the single currency were fleshed out in the December 1995 Presidency Conclusions of the Madrid European Council, which expressly followed the changeover scenario adopted in the November 1995 EMI report on *The Changeover to the Single Currency*.⁴² As stated in the Madrid Presidency Conclusions, EMU “will start on January 1, 1999, with the irrevocable fixing of conversion rates among currencies of participating countries and against the euro and with the single monetary policy which will be defined and implemented by the European System of Central Banks (ESCB) in euro.”⁴³ At this point it is helpful to quote from the Madrid Presidency Conclusions in full:

A Council regulation entering into force on January 1, 1999 will provide the legal framework for the use of the euro. From that date the euro will be ‘a currency in its own right’ and the official ECU basket will cease to exist. This Regulation will have the effect that the national currencies and the euro will become different expressions of what is economically the same currency. As long as different national monetary units still exist, the Council Regulation will establish a legally enforceable equivalence between the euro and the national currency units (‘legally enforceable equivalence’ means that each monetary unit is assigned, in a legally enforceable way, an unchangeable countervalue in terms of the euro unit at the official conversion rate and vice versa)... [T]he Regulation will ensure that private economic agents will be free to use the euro; at the same time they should not be obliged to do so. As far as possible, they should be allowed to develop their own mechanisms of adjustment to the changeover.... The Regulation will also provide that national banknotes will continue to remain legal tender within the boundaries of the respective national territories until the completion of the changeover to the single currency.... By January 1, 2002 at the latest, euro banknotes and coins will start to circulate alongside national notes and coins. Euro notes and coins will have legal tender status. In line with the increasing circulation of euro notes and coins, national notes and coins will be withdrawn... [N]ational notes and coins will cease to be legal tender at the latest 6 months after the introduction of euro notes and coins. By that deadline, the changeover will be complete.⁴⁴

The Madrid Presidency Conclusions laid down further markers with respect to the status and usage of the euro during the transitional period beginning on January 1, 1999 and ending no later than January 1, 2002:

- the ESCB will encourage the use of the euro in the foreign exchange markets, and its operations in these markets will be effected and settled in euro;
- the payment system’s infrastructure will need to be in place so as to ensure the smooth functioning of an area-wide money market based on the euro;
- national central banks can provide conversion facilities for those financial institutions which have not been able to equip themselves with such facilities to translate amounts from euro into national monetary units and vice-versa;

⁴⁰European Council Madrid Presidency Conclusions, *supra* note 29, para. 2.

⁴¹ EC TREATY, art. 1091(4).

⁴²European Council Madrid Presidency Conclusions, *supra* note 29, ann. 1, para. 4; EMI Changeover Scenario, *supra* note 29.

⁴³*Id.* ann. 1, para. 8.

⁴⁴*Id.* ann. 1, paras. 9, 14.

- new tradeable debt will be issued in euro by the participating member states as from January 1, 1999. By July 1, 2002 at the latest, public debt denominated in the former national currencies will be redeemable only in the single currency.⁴⁵

2. EU Council Regulations

The European Council Madrid Presidency decided that the legal framework for the use of the euro should be laid down in a regulation adopted by the EU Council.⁴⁶ A regulation is a legislative enactment that is directly applicable in all member states of the European Union.⁴⁷ It was subsequently decided to establish the legal framework for the use of the euro in two separate regulations, both of which were finalized in June and July 1997.⁴⁸

The first regulation — the Council regulation on certain provisions relating to the introduction of the euro — deals with the replacement of references to the ECU by references to the euro, the continuity of contracts and rounding rules. The second regulation — the Council regulation on the introduction of the euro — deals with the substitution of the euro for the EU national currencies participating in EMU, the status of the euro during the proposed three-year transitional period, the discharge of obligations during the transitional period, bond redenomination, netting arrangements during the transitional period, the introduction of euro banknotes and coins, and other related issues. The first regulation entered into force in June 1997,⁴⁹ while the second regulation will be adopted immediately after the decision which member states will participate in EMU has been taken as early as possible in 1998.⁵⁰

The main reason why the legal framework for the use of the euro was set forth in two separate regulations arose out of the need to provide legal certainty well before the introduction of the euro.⁵¹ Since certain provisions can only be enacted after the Council has confirmed which member states fulfill the necessary conditions for the adoption of the single currency, it became necessary to draft a second regulation addressing those legal issues where there was an urgent need for legal certainty well before the introduction of the euro.⁵² It appears that there is some uncertainty as to the application of the regulation that will be adopted after the selection of the participating member states in those member states that do not initially participate in EMU,⁵³ and it may be that this possibility also argued for the adoption of a regulation that would clearly be directly applicable in all member states of the EU.

3. Euro as the Single Currency

In accordance with the Madrid Presidency Conclusions, the Council regulation on the introduction of the euro is expressly based on the immediate introduction from January 1, 1999 onwards of the euro as the single currency of the participating member states and the substitution of the euro in place of the

⁴⁵*Id.* ann. 1, paras. 8, 11.

⁴⁶*Id.* ann. 1, para. 9.

⁴⁷See EC TREATY, art. 189.

⁴⁸Resolution of the European Council of 7 July 1997 on the legal framework for the introduction of the euro, Annex Draft Council Regulation on the introduction of the euro, 1997 O.J. (C 236/04) [hereinafter Draft Council Regulation on the introduction of the euro]; Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, 1997 O.J. (L 162/1).

⁴⁹Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 6, 1997 O.J. (L 162/1).

⁵⁰Resolution of the European Council of 7 July 1997 on the legal framework for the introduction of the euro, 1997 O.J. (C 236/04).

⁵¹See Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (4)-(5), 1997 O.J. (L 162/1).

⁵²See Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (5), 1997 O.J. (L 162/1).

⁵³See EC TREATY, art. 109l(4); Draft Council Regulation on the introduction of the euro, *supra* note 48 (“This Regulation shall be binding in its entirety and directly applicable in all Member States, in accordance with the Treaty, subject to Protocols No. 11 and No. 12 and Article 109k(1)”).

participating national currencies.⁵⁴ This approach rejects a dual currency regime whereby the euro and national currencies exist side by side for a transitional period after 1999.⁵⁵

In this regard the regulation draws a careful distinction between a currency and a legal tender: the euro will be the currency of the participating member states while banknotes denominated in the old national currencies will remain legal tender until after the end of the transitional period.⁵⁶

Thus, it is provided that as from January 1, 1999 the currency of the participating member states shall be the euro; the currency unit shall be one euro; one euro shall be divided into one hundred cents; and the euro shall be substituted for the currency of each participating member state at the irrevocably fixed conversion rate adopted for each such currency by the Council pursuant to the Treaty.⁵⁷

During the transitional period beginning on January 1, 1999 and ending on December 31, 2001 the euro shall also be divided into the national currency units (i.e., the units of the currencies of participating member states as those units are defined immediately prior to EMU) according to the irrevocably fixed conversion rates.⁵⁸ Thus, during the transitional period the national currency units will be defined as subdivisions of the euro, thereby establishing a legal equivalence between the euro unit and the national currency units.⁵⁹ The euro unit and the national currency units are therefore units of the same currency.⁶⁰ During the 3-year transitional period the national currency units will simply be denominations or expressions of the euro.⁶¹

At a date yet to be decided the European Central Bank and the central banks of the participating member states shall put banknotes denominated in euro into circulation, which banknotes shall be the only banknotes which have the status of legal tender in all the participating member states.⁶² Banknotes denominated in a national currency unit shall remain legal tender within their territorial limits until six months after the end of the transitional period at the latest, but this period may be shortened by national law.⁶³ Subject to the provisions of the regulation, the monetary law of the participating member states will continue to apply during the transitional period.⁶⁴

Thus the euro will be the single currency of the participating member states as and from January 1, 1999. As is stated by the European Council and the EMI, in January 1999 the national currencies and the euro will become different expressions of what is economically the same currency.⁶⁵ Thus, "the changeover will necessarily be characterized by a temporary co-existence in each participating country of two monetary units."⁶⁶ There will be a legally enforceable equivalence between the euro unit and the

⁵⁴See Draft Council Regulation on the introduction of the euro, *supra* note 48, arts. 2-3, 5-6; European Commission (DG II), Explanatory Note to Legal Framework for the use of the euro, Working Document of the Commission Services, II/354/96-EN (1996) (on file with author); Communication to the Commission from President Santer, Commissioner de Silguy and Commissioner Monti re working document on elements for the legal framework for the use of the euro, II/354/96-EN (1996) (on file with author); *see also* FINANCIAL LAW PANEL, ECONOMIC AND MONETARY UNION: THE RELATIONSHIP BETWEEN NATIONAL CURRENCIES AND THE EURO 6-9 (Nov. 1996).

⁵⁵See European Commission (DG II), Explanatory Note to Legal Framework for the use of the euro, Working Document of the Commission Services, II/354/96-EN (1996) (on file with author).

⁵⁶Draft Council Regulation on the introduction of the euro, *supra* note 48, arts. 2, 15.

⁵⁷*Id.* arts. 2-3.

⁵⁸See *id.* arts. 5, 6(1).

⁵⁹See *id.* preamble (8).

⁶⁰See *id.* preamble (13).

⁶¹See Memorandum from the City of London Joint Working Group on EMU Legislation for the European Commission, Directorate General II, attaching comments on Legal Framework for the use of the euro 2 (July 12, 1996) (on file with author).

⁶²See Draft Council Regulation on the introduction of the euro, *supra* note 48, art. 10.

⁶³See *id.* art. 15, preamble (19).

⁶⁴See *id.* art. 6(1).

⁶⁵European Council Madrid Presidency Conclusions, *supra* note 29, ann. 1, para. 9; EMI Changeover Scenario, *supra* note 29, at 13.

⁶⁶EMI Changeover Scenario, *supra* note 29, at 12.

national monetary unit whereby each monetary debt denominated in a national unit is assigned a fixed and unchangeable countervalue in terms of the European monetary unit at the official conversion rate and vice-versa.⁶⁷ The legally enforceable equivalence between the euro and the national tenders will be facilitated by the establishment of conversion facilities that will translate amounts from euro into national monetary units and vice-versa by financial institutions or, for those financial institutions unable to equip themselves with such facilities, by the national central banks, as part of the ESCB.⁶⁸

4. Issuance of Euros

The important role to be played by the new European Central Bank also establishes the status of the euro as the single currency of the participating member states. The Maastricht Treaty confers upon the ECB what many would regard as one of the hallmark monetary functions of a sovereign state: the ECB will have the exclusive right to authorize the issue of banknotes within the participating member states.⁶⁹ The Treaty further provides that both the ECB and the national central banks may issue such banknotes and that the banknotes issued by the ECB and the national central banks shall be the only such notes to have the status of legal tender within the Community.⁷⁰

5. Rounding

The EU Council regulation on certain provisions relating to the introduction of the euro lays down rules with respect to rounding.⁷¹ Under the regulation conversion rates between the euro and the participating national currencies are to be adopted with six significant figures (i.e., a rate which has six figures counted from the left and starting by the first non-zero figure).⁷² Monetary amounts to be converted from one national currency unit into another national currency unit must first be converted into a monetary amount expressed in the euro unit, which amount may be rounded to not less than three decimals and must then be converted into the other national currency unit.⁷³ Monetary amounts to be paid or accounted for when a rounding takes place after a conversion into the euro unit shall be rounded up or down to the nearest cent.⁷⁴ Monetary amounts to be paid or accounted for which are converted into a national currency unit shall be rounded up or down to the nearest sub-unit or in the absence of a sub-unit to the nearest unit, or according to national law or practice to a multiple or fraction of the sub-unit or unit of the national currency unit.⁷⁵ If the application of the conversion rate gives a result which is exactly half-way, the sum shall be rounded up.⁷⁶

6. No Compulsion, No Prohibition

Significantly, the European System of Central Banks will carry out its monetary policy operations in the euro unit.⁷⁷ With respect to banks in the private sector it has been decided that private economic

⁶⁷See European Council Madrid Presidency Conclusions, *supra* note 29, ann. 1, para. 9; EMI Changeover Scenario, *supra* note 29, at 20.

⁶⁸See European Council Madrid Presidency Conclusions, *supra* note 29, ann. 1, para. 8; EMI Changeover Scenario, *supra* note 29, at 12, 18, 31-34.

⁶⁹EC TREATY, art. 105a(1); *id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, art. 16.

⁷⁰*Id.*

⁷¹Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, arts. 4-5, preamble (10)-(12), 1997 O.J. (L 162/1); *see also* European Commission (DG II), The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations 4-7 (Nov. 1997).

⁷²*See id.* art. 4(1), preamble (12).

⁷³*See id.* art. 4(4).

⁷⁴*Id.* art. 5.

⁷⁵*Id.*

⁷⁶*Id.*

⁷⁷*See* European Council Madrid Presidency Conclusions, *supra* note 29, ann. 1, para. 8; EMI Changeover Scenario, *supra* note 29, at 17-18; Draft Council Regulation on the introduction of the euro, *supra* note 48, preamble (9).

agents should be neither compelled nor prohibited from using the euro unit as a means of payment during the 3-year transitional period.⁷⁸ This “no compulsion, no prohibition” principle is fleshed out in the EU Council regulation on the introduction of the euro. It is provided that, subject to anything which parties may have agreed, acts to be performed under legal instruments stipulating the use of or denominated in a national currency unit shall be performed in that national currency unit and acts to be performed under legal instruments stipulating the use of or denominated in the euro unit shall be performed in the euro unit.⁷⁹ It is further provided that, notwithstanding this provision, any amount denominated either in the euro unit or in the national currency unit of a given participating member state and payable within that member state by crediting an account of the creditor can be paid by the debtor either in the euro unit or in that national currency unit, and the amount paid shall be credited to the account of the creditor in the denomination of his account, with any conversion being effected at the irrevocably fixed conversion rates.⁸⁰

Thus, an obligation denominated in a national currency of a given participating member state can be discharged in the euro unit where the amount due is payable within that member state by credit transfer to the creditor’s account. An obligation denominated in euro can also be discharged in the national currency unit of a given participating member state where the amount due is payable within that member state by credit transfer to the creditor’s account. The preamble to the EU Council regulation indicates that these provisions are designed to ensure that credit transfer payments inside a participating member state can be made either in the euro unit or the respective national currency unit, and that these provisions should also apply to those cross-border payments which are denominated in the euro unit or the national currency unit of the account of the creditor.⁸¹

It is important to understand that the provision permitting payments to be made either in the euro unit or the national currency unit of a given participating member state is intended to operate as a derogation from the general rule that acts to be performed under legal instruments stipulating the use of a particular national currency unit or the euro unit shall be performed in the stipulated unit.⁸² In particular, the regulation envisages the limited application of this provision to cross-border payments denominated in the euro unit or the national currency unit of that member state where the creditor’s account is located.⁸³ For example, if Counterparty A in New York has an obligation to pay Counterparty B an amount of FFfr. 5 million, and that amount is to be paid by crediting Counterparty B’s FFfr. account with its bank in Paris, Counterparty A would be entitled to discharge its obligation by instructing its bank to make the payment in the euro unit rather than in the French franc unit to Counterparty B’s bank. On the other hand, if the amount is to be paid by crediting Counterparty B’s FFfr. account in London, Brussels, Frankfurt or Luxembourg, Counterparty A would not, under the EU Council regulation, be entitled to pay the amount in the euro unit.⁸⁴

It will of course be necessary to ensure the smooth functioning of payment systems to facilitate the crediting of accounts in the euro unit.⁸⁵ From January 1, 1999 the ESCB will support the smooth functioning of a euro area-wide money market based on the single European currency and will offer a real-time gross settlement (RTGS) payment system (TARGET) of which the interlinking system will

⁷⁸EMI Changeover Scenario, *supra* note 29, at 20; *see also* Draft Council Regulation on the introduction of the euro, *supra* note 48, preamble (10), (13), art. 8(3).

⁷⁹Draft Council Regulation on the introduction of the euro, *supra* note 48, art. 8(1)-(2).

⁸⁰*Id.* art. 8(3).

⁸¹*Id.* preamble (13).

⁸²*See* European Commission (DG II), The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations 3 (Nov. 1997).

⁸³*See id.* 3-4.

⁸⁴*See id.*

⁸⁵*See* Draft Council Regulation on the introduction of the euro, *supra* note 48, preamble (13).

operate from the start in the euro unit; the national RTGS systems will also be capable of operating in the euro unit from the starting date of EMU.⁸⁶

The preamble to the EU Council regulation states that financial intermediaries are not obliged to make available payment facilities or products denominated in any particular unit of the euro.⁸⁷ In practice, however, financial institutions can be expected to establish conversion facilities for their customers to translate amounts from the euro unit to the national currency unit and vice-versa or to look to their national central banks for the provision of such conversion facilities.⁸⁸ The preamble to the EU Council regulation suggests that financial intermediaries might coordinate the introduction of payment facilities denominated in the euro unit which rely on a common technical infrastructure during the transitional period.⁸⁹

In summary, the euro unit may be used in credit transfers before the introduction of euro banknotes and coins and will therefore start to be used in scriptural (i.e., book-entry) non-cash form from January 1, 1999.⁹⁰ The significance of this development for the changeover to the single currency is highlighted in the European Commission's May 1995 Green Paper on the Practical Arrangements for the Introduction of the Single Currency, where it is noted that "the outstanding amount of sight deposits with banks represents a much larger quantity of money" than "the notes and coins issued by the monetary authorities", and that "[w]hile notes and coins are easily used between individuals as a means of payment, the growing automation of the various types of banking transactions... and of payments... has prompted banks to introduce increasingly sophisticated computerized processing and payment systems."⁹¹ It is therefore expected that the wholesale financial markets will largely change over to the euro unit at an early stage during the transitional period.⁹²

7. Euro and Foreign Exchange Markets

The euro will be the single currency of the participating member states on the international capital and foreign exchange markets as from January 1, 1999. It has been suggested that by permitting parties to discharge payments either in the euro unit or the national currency unit, forward foreign exchange trading between the national legal tenders during the transitional period that arises out of speculation that EMU may fall apart has been rendered commercially pointless.⁹³ This is because a contract for the purchase of the Deutsche mark legal tender on a forward basis at a different rate from its irrevocably fixed euro conversion rate could be legally discharged in the euro unit at its fixed Deutsche mark conversion rate if, at the time of delivery, the market valued the Deutsche mark more highly than its official euro conversion rate.⁹⁴

The EMI has emphasized the importance of the emergence of the euro as the single currency of the participating member states on the foreign exchange markets on January 1, 1999:

⁸⁶See European Monetary Institute, *supra* note 36, at 34-39, 93-96; EMI Changeover Scenario, *supra* note 29, at 2, 18-19; *see also* European Monetary Institute, Developments in EU Payment Systems in 1995 (Mar. 1996).

⁸⁷Draft Council Regulation on the introduction of the euro, *supra* note 48, preamble (13).

⁸⁸See European Commission (DG II), The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations 3 (Nov. 1997); *see also supra* p. 14.

⁸⁹*Id.* preamble (13); *see also* BANK OF ENGLAND, 3 PRACTICAL ISSUES ARISING FROM THE INTRODUCTION OF THE EURO 53 (Dec. 1996).

⁹⁰See EMI Changeover Scenario, *supra* note 29, at 13.

⁹¹European Commission, Green Paper on the Practical Arrangements for the Introduction of the Single Currency, COM(95)333 final at 24.

⁹²See EMI Changeover Scenario, *supra* note 29, at 3, 13.

⁹³See FINANCIAL LAW PANEL, ECONOMIC AND MONETARY UNION: THE RELATIONSHIP BETWEEN NATIONAL CURRENCIES AND THE EURO 10-12 (Nov. 1996).

⁹⁴See *id.*

It is worth underlining the fundamental change in nature which will take place at the start of Stage Three in the areas of money and foreign exchange rates for the participating Member States. Their bilateral exchange rates will no longer exist and will be replaced by irrevocably fixed conversion rates; their national currencies will cease to be foreign currencies in terms of one another. In economic terms, there will remain only one currency which can be expressed in different ways: either in terms of the European monetary unit or in terms of any of the national monetary units.... The national central banks involved in the foreign exchange market will accordingly change their market practice and quote third countries' currencies against the European currency only.⁹⁵

Thus, the preamble to the EU Council regulation notes that there will be no exchange rate risk either between the euro unit and the national currency units or between the national currency units during the transitional period, and that legislative provisions should be interpreted accordingly.⁹⁶ Financial institutions will not therefore be required to recognize exchange rate risk for capital adequacy purposes.⁹⁷

8. Bond Redenomination

Another feature of the EU Council regulation on the introduction of the euro that is designed to encourage an increased usage of the euro unit during the transitional period is that the regulation permits each participating member state to take measures which may be necessary in order to redenominate in the euro unit outstanding debt issued by that member state's general government that is denominated in its national currency unit and issued under its own law.⁹⁸ Thus, the German government may redenominate its DM-denominated sovereign debt governed by German law (i.e., German bunds). "Redenominate" shall mean changing the unit in which the amount of outstanding debt is stated from a national currency unit to the euro unit, but which does not have through the act of redenomination the effect of altering any other term of the debt, this being a matter subject to relevant national law.⁹⁹

Thus redenomination is defined narrowly as involving no more than a change in the stated amount of the debt from the relevant national currency unit to the euro unit. Upon such a change in the stated amount of the debt the resultant number may, when paid or accounted for, be rounded to the nearest euro cent,¹⁰⁰ in accordance with the EU Council regulations' rounding rules.¹⁰¹

If a member state has taken such a measure to redenominate its outstanding debt, other issuers of bonds and other forms of securitized debt negotiable in the capital markets and issuers of money market instruments may redenominate in the euro unit debt denominated in that member state's national currency unit unless redenomination is expressly excluded by the terms of the contract.¹⁰² Thus, issuers will be able to redenominate outstanding debt if the debt is denominated in a national currency unit of a member state which has redenominated part or all of its outstanding general government debt.¹⁰³ It is intended that private issuers should be able to redenominate such debt irrespective of the law which governs the issue, and the preamble to the regulation states that the provisions on redenomination should be such that

⁹⁵EMI Changeover Scenario, *supra* note 29, at 17, 19.

⁹⁶Draft Council Regulation on the introduction of the euro, *supra* note 48, preamble (6).

⁹⁷See FINANCIAL LAW PANEL, *supra* note 93, at 12-13.

⁹⁸Draft Council Regulation on the introduction of the euro, *supra* note 48, art. 8(4).

⁹⁹See Draft Council Regulation on the introduction of the euro, *supra* note 48, art. 1.

¹⁰⁰See European Commission (DG II), The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations 18-19 (Nov. 1997).

¹⁰¹Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, arts. 4-5, 1997 O.J. (L 162/1), discussed *supra* p. 17; see also The Impact of the Introduction of the Euro on Capital Markets: Communication from the Commission, II/338/97-EN-2 at 7 (1997); BANK OF ENGLAND, 4 PRACTICAL ISSUES ARISING FROM THE INTRODUCTION OF THE EURO 34 n. 11 (Apr. 1997).

¹⁰²See Draft Council Regulation on the introduction of the euro, *supra* note 48, art. 8(4).

¹⁰³See *id.* preamble (14).

they can also be applied in the jurisdictions of third countries.¹⁰⁴ Thus it is intended that a U.S. corporate issuer of bonds originally denominated in Deutsche marks that are governed by New York law should be able to redenominate its DM bonds into the euro unit as soon as the German government has redenominated any part of its general government debt.

It is important to emphasize that the act of redenomination does not have the effect of altering any other term of the debt, this being a matter subject to relevant national law.¹⁰⁵ Thus, as stated in the preamble to the regulation, the provisions on redenomination do not address the introduction of additional measures to amend the terms of outstanding debt to alter, among other things, the nominal amount of outstanding debt, these being matters subject to relevant national law.¹⁰⁶ It is therefore intended that a U.S. issuer of DM bonds governed by New York law would not be able to redenominate into the euro unit by rounding to the nearest euro unless permitted under the terms of its issue or any applicable provisions of New York law because such a redenomination would involve an alteration in the nominal amount of the debt.¹⁰⁷

9. Conversion of Organized Exchanges into Euro

Finally, the EU Council regulation on the introduction of the euro permits participating member states to take measures to enable securities and commodities exchanges, clearance and settlement systems and payment systems to change the unit of account of their operating procedures from a national currency unit to the euro unit.¹⁰⁸

D. Continuity of Contracts

The status of contracts denominated in the EU national currencies after the introduction of the single currency is addressed in the EU Council regulations.

1. Status of EU Regulations Outside the European Union

While the two regulations will, when adopted, only be directly applicable within the European Union, the preamble to one of the regulations notes that “the recognition of the monetary law of a state is a universally accepted principle” and that “the explicit confirmation of the principle of continuity should lead to the recognition of continuity of contracts and other legal instruments in the jurisdictions of third countries”.¹⁰⁹ As discussed in greater depth below, the State theory of money whereby the law of the state that issues a particular currency will determine how, in the case of a currency alteration, sums expressed in the former currency are to be converted into the existing one is widely accepted under U.S. law.¹¹⁰ Applying this theory to EMU, American courts will primarily look to the EU Council regulations to determine how obligations governed by the laws of U.S. jurisdictions and denominated in currencies affected by EMU are to be discharged in the aftermath of EMU.

2. Performance of Obligations During the Transitional Period

In addition to defining the monetary law provisions of the member states which have adopted the euro,¹¹¹ the regulation on the introduction of the euro also addresses the status of legal instruments during

¹⁰⁴*Id.* preamble (14); *see also infra* pp. 60-61.

¹⁰⁵*See id.* art. 1.

¹⁰⁶*Id.* preamble (14).

¹⁰⁷*See infra* pp. 142-43.

¹⁰⁸Draft Council Regulation on the introduction of the euro, *supra* note 48, art. 8(4).

¹⁰⁹Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (8), 1997 O.J. (L 162/1).

¹¹⁰*See infra* pp. 35-100.

¹¹¹*See supra* pp. 15-17.

the 3-year transitional period and thereafter.¹¹² “Legal instruments” are defined to include contracts, payment instruments other than banknotes and coins, and other instruments with legal effect, and the term “contract” is meant to include all types of contracts, irrespective of the way in which they are concluded.¹¹³

Where reference is made to a national currency unit in a legal instrument this reference shall, during the transitional period, be as valid as if reference were made to the euro unit according to the conversion rates.¹¹⁴ Thus, an obligation expressed in Deutsche marks will be valid notwithstanding the fact that the Deutsche mark has been substituted by the euro and survives during the transitional period as a mere expression or denomination of the euro.

It is further provided that the substitution of the euro for the currency of each participating member state shall not in itself have the effect of altering the denomination of legal instruments in existence on the date of substitution.¹¹⁵ Thus, an obligation denominated in Deutsche marks will continue to be denominated in Deutsche marks during the transitional period, notwithstanding the substitution of the Deutsche mark by the euro. This provision might also be interpreted as generally preventing the redenomination of legal instruments into third country currencies such as the U.S. dollar pursuant to contractual provisions permitting such redenomination in certain circumstances.¹¹⁶

The regulation provides that, subject to anything which parties may have agreed, acts to be performed under legal instruments stipulating the use of or denominated in a national currency unit shall be performed in that national currency unit and acts to be performed under legal instruments stipulating the use of or denominated in the euro unit shall be performed in the euro unit.¹¹⁷ Notwithstanding this provision, any amount denominated either in the euro unit or in the national currency unit of a given participating member state and payable within that member state by crediting an account of the creditor can be paid by the debtor either in the euro unit or in that national currency unit, and the amount paid shall be credited to the account of the creditor in the denomination of his account, with any conversion being effected at the irrevocably fixed conversion rates.¹¹⁸

3. Performance of Obligations After the Transitional Period

The regulation provides that where in legal instruments existing at the end of the transitional period reference is made to the national currency units, these references shall be read as references to the euro unit according to the respective conversion rates.¹¹⁹ Thus, all obligations will be performed in the euro unit after the introduction of euro tender at the end of the proposed three-year transitional period (i.e., at the end of 2001).

4. Principle of Continuity of Contracts

The regulation on certain provisions relating to the introduction of the euro contains additional provisions regarding the continuity of contracts. The regulation provides that the introduction of the euro

¹¹²Draft Council Regulation on the introduction of the euro, *supra* note 48, arts. 5-8, 14.

¹¹³*Id.* art. 1, preamble (7).

¹¹⁴*See id.* art. 6(2).

¹¹⁵*Id.* art. 7.

¹¹⁶*See infra* pp. 138-39.

¹¹⁷*Id.* art. 8(1)-(2).

¹¹⁸*Id.* art. 8(3), discussed *supra* pp. 18-20.

¹¹⁹*Id.* art. 14.

shall not have the effect of altering any term of a legal instrument or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate such an instrument, subject to anything which parties may have agreed.¹²⁰ As indicated in the preamble, this provision reflects the “generally accepted principle of law that the continuity of contracts and other legal instruments is not affected by the introduction of a new currency”.¹²¹ Thus, the doctrines of frustration and impossibility recognized under English or New York law could not be invoked to terminate or otherwise avoid contractual obligations in the aftermath of EMU.¹²²

In addition, the preamble notes that the principle of continuity of contracts “implies, in particular, that in the case of fixed interest rate instruments the introduction of the euro does not alter the nominal interest rate payable by the debtor.”¹²³ This will ensure the continuity of long-term fixed rate coupons negotiated on the basis of the prevailing interest rate climate linked to a particular national currency.¹²⁴ The continuity of floating interest rate obligations can also be reasonably expected under the continuity principle, with floating rate price sources for the euro replacing existing EU national currency interest rate sources that may disappear after EMU.¹²⁵ The provision that the introduction of the euro will not give a party the unilateral right to alter or terminate a legal instrument would also appear to be designed to prevent the invocation of contractual terms such as those contained in force majeure or similar clauses as a means of terminating or modifying contractual obligations after EMU.¹²⁶

5. Freedom of Contract

The continuity principle “is subject to anything which parties may have agreed”, reflecting the regulation’s insistence that “the principle of freedom of contract has to be respected.”¹²⁷ The preamble makes it clear that the continuity principle cannot be overcome by general language that might be interpreted as excusing performance or as giving a party the right to terminate a contract. Rather the agreement of the parties to override the principle of continuity must specifically relate to the eventuality of EMU because “the principle of continuity should be compatible with anything which parties might have agreed with reference to the introduction of the euro” (emphasis added).¹²⁸

6. Netting

One final issue relating to the implications of EMU for private contracts is that the regulation on the introduction of the euro provides that national legal provisions of participating member states which permit or impose netting, set-off or techniques with similar effects shall apply to monetary obligations, irrespective of their currency denomination, if that denomination is in the euro unit or in a national currency unit, with any conversion being effected at the conversion rates.¹²⁹

E. ERM II

¹²⁰Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 3, 1997 O.J. (L 162/1).

¹²¹*Id.* preamble (7).

¹²²For a discussion of the implications of these and other analogous doctrines for the continuity of contracts after EMU, *see infra* pp. 101-30.

¹²³Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (7), 1997 O.J. (L 162/1).

¹²⁴For a more detailed discussion of this issue, *see infra* pp. 127-28.

¹²⁵*See* Banque de France, *Can the Domestic Interbank Benchmark Indices be Maintained within the Euro Zone after the Transition to the Single Currency, or Must they be Adapted?* 3-4 (1997) (on file with author); *see infra* pp. 121-27.

¹²⁶*See* Letter from Allen & Overy, *City of London Joint Working Group on European Economic and Monetary Union*, to Helmut Wittelsberger and Jean-Pierre Fèvre, *European Commission* (June 17, 1996) (on file with author).

¹²⁷Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (7), art. 3, 1997 O.J. (L 162/1).

¹²⁸*Id.* preamble (7).

¹²⁹Draft Council Regulation on the introduction of the euro, *supra* note 48, art. 8(6).

In view of the participation of some but not all EU member states in EMU the European Council has adopted a resolution establishing the framework for a new exchange rate arrangement between the euro and the national currencies not participating in EMU.¹³⁰ Under this resolution the existing European Monetary System will be replaced by a new exchange rate mechanism (commonly referred to as ERM II) that will be established when EMU begins on January 1, 1999.¹³¹ ERM II will link currencies of member states outside the euro area to the euro which will be the center of the new mechanism.¹³² Participation in ERM II will be voluntary.¹³³

Under the new exchange-rate mechanism a central rate against the euro will be defined for each currency participating in the mechanism, and as with the bilateral central rates of currencies participating in the existing ERM there will be a relatively wide standard fluctuation band of plus or minus 15% around the central rates.¹³⁴ As in the existing ERM it will be possible to negotiate narrower fluctuation bands than the standard one.¹³⁵ Central bank intervention at the margins of the fluctuation band will in principle be automatic and unlimited, but the ECB and the central banks of other participants in the ERM could suspend intervention if this were to conflict with their primary objective of maintaining price stability.¹³⁶ Again, similar to the existing ERM, coordinated intra-marginal intervention will be possible in ERM II.¹³⁷ A very short-term financing facility to support the fluctuation bands will be available, and this facility will be determined broadly on the basis of the comparable facility used in the existing ERM.¹³⁸

The main contrast between ERM II and the existing ERM is that the fluctuation bands which the participating central banks are required to defend will be constructed around the euro rather than a series of bilateral exchange rates. Nonetheless, it will be possible for member states participating in ERM II to establish, on a bilateral basis, fluctuation bands between their currencies and intervention arrangements aimed at limiting excessive bilateral exchange rate oscillations.¹³⁹

Finally, it should be noted that ERM II is viewed by the European Commission as a purely transitional arrangement ahead of the participation of all EU member states in EMU.¹⁴⁰

F. Admission of Additional Member States to EMU

The Maastricht Treaty lays down detailed procedures for the admission of non-participating EU member states to the euro area after the launch of the single currency.¹⁴¹ At least once every two years, or at the request of a non-participating member state, the European Commission and the European Central

¹³⁰Resolution of the European Council on the establishment of an exchange-rate mechanism in the third stage of economic and monetary union, Amsterdam, 16 June 1997, 1997 O.J. (C 236/03); *see also* European Monetary Institute, *supra* note 36, at 24-25; Reinforced Convergence Procedures and a New Exchange Rate Mechanism in Stage Three of EMU: Communication from the Commission to the Council, COM(96)498 final.

¹³¹Resolution of the European Council on the establishment of an exchange-rate mechanism in the third stage of economic and monetary union, Amsterdam, 16 June 1997, 1997 O.J. (C 236/03).

¹³²*Id.*

¹³³*Id.* § 1.6.

¹³⁴*Id.* §§ 1.7, 2.1.

¹³⁵*Id.* §§ 1.8, 2.4.

¹³⁶*Id.* § 2.1.

¹³⁷*Id.* § 2.2.

¹³⁸*Id.* §§ 2.1, 2.6.

¹³⁹*See* European Monetary Institute, *supra* note 36, at 25.

¹⁴⁰*See* Reinforced Convergence Procedures and a New Exchange Rate Mechanism in Stage Three of EMU: Communication from the Commission to the Council, COM(96)498 final 1-2.

¹⁴¹EC TREATY, art. 109k(2).

Bank shall report to the Council on the progress made in the fulfillment by the non-participating member states of their obligations regarding the achievement of EMU.¹⁴²

Again, following a consultative process, the Council, meeting in the composition of the Heads of State or of Government, shall decide on the basis of the economic convergence criteria which non-participating member states fulfill the necessary conditions for the adoption of the single currency.¹⁴³

After the commencement of EMU the interests of the non-participating member states will be represented in the European Central Bank through a third decision-making body of the ECB to be known as the General Council whose membership will comprise the President and the Vice-President of the ECB and the governors of all the national central banks, including the central banks of countries initially outside the euro area.¹⁴⁴ The primary functions of the General Council relate to the preparations by non-participating member states to participate in EMU.¹⁴⁵ In addition, the General Council will contribute to certain advisory functions of the ECB, and must be informed of the decisions of the ECB's Governing Council.¹⁴⁶

¹⁴²*See id.*

¹⁴³*See id.*

¹⁴⁴*See id.* art. 109I(3); *id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, arts. 45-47.

¹⁴⁵*See id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, arts. 44, 47.

¹⁴⁶*See id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, art. 47.

III. GOVERNING LAW OF THE CONTRACT

This study analyzes the implications of EMU for the continuity of financial contracts governed by New York law and the laws of other U.S. jurisdictions. The first issue to be considered is the conflicts of law question of how to determine the governing law of the contract. State courts will follow the conflicts of law rules established by the forum state, while U.S. federal courts exercising their diversity jurisdiction over cases involving questions of state law will apply the choice of law rules of the forum state in which they sit to determine which body of substantive law will govern a contractual agreement.¹

A. Validity of Choice of Law Clauses

In most sophisticated international financial transactions the parties select the law that is to govern their rights and obligations. When New York law is selected as the governing law, the parties' choice of law will be enforced by the New York courts. Under Section 5-1401 of the New York General Obligations Law the parties to any contract entered into after 1984 involving an amount of \$250,000 or more may agree that the law of New York State shall govern their rights and duties whether or not such contract bears a reasonable relation to New York State.² Thus, the choice of New York law as the governing law in any large financial transaction must be respected regardless of whether the substance of the transaction or the parties involved in the transaction have any connections with New York.³ This rule is consistent with the deference that the New York courts generally accord to contractual choice of law clauses.⁴ Indeed, all American courts (state and federal) will in general enforce contractual choice of law clauses.⁵

There is, however, one important exception to the general enforceability of contractual choice of law clauses. If application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue, and which would be the state of the applicable law in the absence of an effective choice of law by the parties, then the law chosen by the parties will not be applied.⁶ While the EU member states have a materially greater interest than U.S. jurisdictions in the determination of disputes arising out of EMU,⁷ the application of the laws of a U.S. jurisdiction to such a case would not be contrary to the fundamental policy of any EU member states because the continuity of legal obligations governed by U.S. laws will be fully assured in accordance with the provisions of the EU Council regulations.⁸ In addition, it would

¹See *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496-97 (1941); *County Asphalt, Inc. v. Lewis Welding & Eng'g Corp.*, 323 F. Supp. 1300, 1303 (S.D.N.Y. 1970), *aff'd* 444 F.2d 372 (2d Cir. 1971).

²N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 1989).

³See, e.g., *Bank of Am. Nat. Trust & Sav. Ass'n v. Envas Venezolanos, S.A.*, 740 F. Supp. 260, 264-65 (S.D.N.Y. 1990), *aff'd* 923 F.2d 843 (2d Cir. 1990).

⁴See, e.g., *Wyatt v. Fulrath*, 211 N.E.2d 637, 639 (N.Y. 1965); *Haag v. Barnes*, 175 N.E.2d 441, 443-44 (N.Y. 1961); *Marine Midland Bank, N.A. v. United Missouri Bank, N.A.*, 643 N.Y.S.2d 528, 530 (N.Y. App. Div. 1996) (citations omitted); *Bossier Plaza Assoc. Ltd. P'ship v. Pierson*, 548 N.Y.S.2d 507, 507-08 (N.Y. App. Div. 1989) (citations omitted); *Gambar Enter. v. Kelly Serv's*, 418 N.Y.S.2d 818, 822 (N.Y. App. Div. 1979) (citations omitted); *Cargill, Inc. v. Charles Kowsky Resources, Inc.*, 949 F.2d 51, 55 (2d Cir. 1991) (citations omitted); *Woodling v. Garrett Corp.*, 813 F.2d 543, 551-52 (2d Cir. 1987); *Zerman v. Ball*, 735 F.2d 15, 19-20 (2d Cir. 1984) (citations omitted).

⁵See 16 AM. JUR. 2D, *Conflict of Laws* § 78 (1979 & Supp. 1997) (and the cases cited therein); *cf.* U.C.C. § 1-105(1), 1 U.L.A. 52 (1989).

⁶See, e.g., *Caribbean Wholesales and Sales Corp. v. U.S. JVC Corp.*, 1996 WL 140251 *2-3 (S.D.N.Y. 1996) (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1971)); *S. Leo Harmony, Inc. v. Binks Mfg.*, 597 F. Supp. 1014, 1024-25 (S.D.N.Y. 1984) (same), *aff'd* 762 F.2d 990 (2d Cir. 1985); *Southern Int'l Sales v. Potter & Brumfield Div.*, 410 F. Supp. 1339, 1341-43 (S.D.N.Y. 1976) (same); *Business Incentives Co. v. Sony Corp. of Am.*, 397 F. Supp. 63, 67 (S.D.N.Y. 1975) (same); *see also* 16 AM. JUR. 2D, *Conflict of Laws* § 78 (1979 & Supp. 1997) (and the cases cited therein).

⁷See Michael Gruson, *The Introduction of the Euro and its Implications for Obligations Denominated in Currencies Replaced by the Euro* 14-16 (June 2, 1997) (unpublished manuscript, on file with author).

⁸See *infra* pp. 35-100.

appear that this exception to the general enforceability of choice of law clauses may no longer be applicable to clauses specifying New York law as the governing law, in view of the passage of Section 5-1401 of the New York General Obligations Law.⁹ In light of this, contractual provisions designating the laws of New York or other U.S. jurisdictions as the governing law of a contract can be expected to be enforced in transactions affected by EMU.

Another exception to the general rule that choice of law clauses will in general be enforced by New York and American courts is that a choice of law clause stipulating a foreign law as the governing law will not prevail where such choice of law represents an affront to public policy in the forum state.¹⁰ A clause selecting the laws of an EU jurisdiction as the governing law would not conflict with the public policy of a U.S. jurisdiction because under U.S. law the continuity of all contractual obligations will be fully assured after EMU in accordance with the provisions of the EU Council regulations, regardless of what law governs the contract.¹¹

B. Governing Law in Absence of Choice of Law

In those contracts where there is no choice of law clause the analysis becomes more complicated. The current approaches taken by the New York courts hold that the law of the jurisdiction having the most significant relationship to the transaction and the parties will be applied,¹² and/or that the facts or contacts which obtain significance in defining state interests are those which relate to the purpose of the particular law in conflict.¹³ These approaches, known variously as the “significant contacts” and “governmental interest” theories, have attracted widespread support from American courts in modern times.¹⁴ Applying these tests under New York law courts have given consideration to the following factors:

- the policy considerations or purpose behind the law sought to be applied;¹⁵
- the place of the making of the contract, while not decisive, is “nevertheless to be given heavy weight in determining which jurisdiction has the most significant contacts with the matter in dispute”;¹⁶
- the location of the negotiations preceding the formation of the contract in question;¹⁷

⁹N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 1989).

¹⁰*See, e.g.,* Guaranty Mortgage Co. v. Z.I.D. Assoc., Inc., 506 F. Supp. 101, 107-08 (S.D.N.Y. 1980); Nakhleh v. Chem. Constr. Corp., 359 F. Supp. 357, 360 (S.D.N.Y. 1973) (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (2)(b) (1971)); *see also* 16 AM. JUR. 2D, *Conflict of Laws* § 78 (1979 & Supp. 1997) (and the cases cited therein).

¹¹*See infra* pp. 35-100.

¹²*See, e.g.,* Zurich Ins. Co. v. Shearson Lehman Hutton, Inc., 642 N.E.2d 1065, 1068-69 (N.Y. 1994) (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(1) (1971)); Haag, 175 N.E.2d at 443 (citation omitted).

¹³*See, e.g.,* Matter of Allstate Ins. Co. v. Stolarz, 613 N.E.2d 936, 938-39 (N.Y. 1993); J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda) Ltd., 333 N.E.2d 168, 172 (N.Y. 1975) (citing Intercontinental Planning, Ltd. v. Daystrom, Inc., 248 N.E.2d 576, 582 (N.Y. 1969) (citations omitted)); Kalb, Voorhis & Co. v. Am. Fin. Corp., 8 F.3d 130, 132 (2d Cir. 1993) (citing Daystrom); Wells Fargo Asia Ltd. v. Citibank, N.A., 936 F.2d 723, 726-27 (2d Cir. 1991) (quoting Daystrom).

¹⁴*See* 16 AM. JUR. 2D, *Conflict of Laws* §§ 83-84 (1979 & Supp. 1997) (and the cases cited therein); RESTATEMENT (SECOND) OF CONFLICT OF LAWS §188 (1971).

¹⁵*See* Zeevi, 333 N.E.2d at 172 (citing Daystrom, 248 N.E.2d at 582 (citations omitted)); Kalb, Voorhis, 8 F.3d at 132 (same); Wells Fargo, 936 F.2d at 726 (same).

¹⁶Haag, 175 N.E.2d at 443-44 (citation omitted); *see also* Zurich Ins., 642 N.E.2d at 1068 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS §188 (1971)); Anderson v. A/S Berge Sigval Bergesen, A/S, 287 N.Y.S.2d 712 (N.Y. App. Div. 1968), *aff'd* 242 N.E.2d 393 (N.Y. 1968); Bio-Systems, Inc. v. Biowaste Sys., Inc., 874 F.Supp. 48, 52 (E.D.N.Y. 1994); Van Kaulbach v. Keosian, 783 F. Supp. 170, 174 (S.D.N.Y. 1992).

- the place where the contract is to be performed or where the payment is to be made;¹⁸
- the domicile, business location and, if applicable, state of incorporation of the parties;¹⁹
- the location of the subject matter (i.e., the assets or securities) which form the basis of the litigation;²⁰
- the language in which the contract was written;²¹ and
- in the case of proceedings before the New York courts, New York’s policy interest in ensuring the application of New York law so that New York can maintain its position as an international financial capital.²²

It has been suggested that “New York law generally gives controlling effect to the law of the jurisdiction which, because of its relationship or contact with the occurrence or the parties, has the greatest concern with the specific issue in the litigation.”²³ In the absence of a choice of law provision in a contract, this test points to the application of the laws of the relevant EU member state whose currency forms the basis of a monetary obligation that may be litigated in the aftermath of EMU. EU member states would have a greater interest than the State of New York in the application of their laws to disputes concerning the legal implications of the substitution of their currencies by a single European currency.

By analogy, American courts have indicated that the U.S. has an overriding interest in the application of its monetary laws to debt obligations denominated in the U.S. dollar. In *Compañía de Inversiones v. Industrial Mortgage Bank of Finland*,²⁴ the New York Court of Appeals considered the decision to take the U.S. dollar off the gold standard in 1933, which was accompanied by a Congressional resolution abrogating “gold clauses” in private contracts which called for the repayment of debts in “gold coin of the United States” as opposed to paper dollars. The Congressional resolution permitted debts to be discharged, dollar for dollar, in legal tender coin or currency, rather than in the gold value of the dollar. It was held that Congressional regulation of “the kind and amount of the currency wherewith the obligation may be discharged” implicated “a matter of public policy in this jurisdiction.”²⁵ The court cited with approval the decision of a Dutch court to respect the U.S. Congressional resolution, holding that gold dollar bonds were not payable in the gold value of the bonds by virtue of the resolution.²⁶ The

¹⁷See *Zurich Ins.*, 642 N.E.2d at 1068 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS §188 (1971)); *Daystrom*, 248 N.E.2d at 583; *Fort Howard Paper Co. v. William D. Witter, Inc.*, 787 F.2d 784, 791 (2d Cir. 1986); *Hutner v. Greene*, 734 F.2d 896, 899 (2d Cir. 1984).

¹⁸See *Zurich Ins.*, 642 N.E.2d at 1068 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS §188 (1971)); *Anderson*, 287 N.Y.S.2d at 712; *Randy Knitwear, Inc. v. Am. Cyanamid Co.*, 180 N.Y.S.2d 471, 474 (N.Y. App. Div. 1958), *rev'd on other grounds* 163 N.E.2d 349 (N.Y. 1959); *Arkwright-Boston Mfr. Mut. Ins. Co. v. Calvert Fire Ins. Co.*, 887 F.2d 437, 439 (2d Cir. 1989).

¹⁹See *Zurich Ins.*, 642 N.E.2d at 1068 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS §188 (1971)); *Haag*, 175 N.E.2d at 444; *Crescent Oil and Shipping Services, Ltd. v. Philbro Energy, Inc.*, 929 F.2d 49, 52 (2d Cir. 1991); *Fort Howard*, 787 F.2d at 790; *Johansen v. Confederation Life Assoc.*, 447 F.2d 175, 179-80 (2d Cir. 1971).

²⁰See *Zurich Ins.*, 642 N.E.2d at 1068 (citing RESTATEMENT (SECOND) OF CONFLICT OF LAWS §188 (1971)); *Watts v. Swiss Bank Corp.*, 252 N.Y.S.2d 196, 198 (N.Y. Sup. Ct. 1964), *modified* 264 N.Y.S.2d 667 (N.Y. App. Div. 1965); *Bio-Systems*, 874 F. Supp. at 52.

²¹See *Watts*, 252 N.Y.S.2d at 198.

²²See *Allstate Ins.*, 613 N.E.2d at 939; *Zeevi*, 333 N.E.2d at 172; *Daystrom*, 248 N.E.2d at 582-83; *Wells Fargo*, 936 F.2d at 726 (citing *Zeevi*); *Hutner*, 734 F.2d at 899.

²³*Armstrong v. Rangaire Corp.*, 493 F. Supp. 390, 394 (S.D.N.Y. 1980) (emphasis added); *see also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188 (1971).

²⁴198 N.E. 617 (N.Y. 1935).

²⁵*Compañía de Inversiones*, 198 N.E. at 621.

²⁶*Id.*

implication here is that the New York courts would similarly recognize the monetary laws of the Netherlands as implicating Dutch public policy in a case involving a monetary obligation denominated in the Dutch currency.

In addition, New York courts have applied New York law as the governing law of the contract in several cases because the U.S. dollar was selected as the currency of repayment, thereby evincing the “trust” which the parties had placed “in [New York’s] policies.”²⁷ In one case the New York Court of Appeals applied English law because, among other things, the agreement spoke “in terms of English currency in providing for payments”.²⁸ In *Wells Fargo Asia Ltd. v. Citibank, N.A.*,²⁹ the U.S. Court of Appeals for the Second Circuit held that New York law applied to a dispute regarding a eurodollar deposit in a Philippine branch of a U.S. bank headquartered in New York. It was held that New York law should apply because “the transactions were denominated in United States dollars” and “Eurodollar transactions denominated in U.S. dollars customarily are cleared in New York.”³⁰

These cases, in conjunction with the strong policy considerations supporting the application of the laws of an EU jurisdiction to the resolution of legal issues arising in the aftermath of EMU, suggest that New York and other American courts would apply the laws of the relevant EU jurisdiction to resolve such issues in the absence of a specific choice of law provision in the relevant contractual documents.

²⁷See Zeevi, 333 N.E.2d at 173; see also Birger v. Tuner, 427 N.Y.S.2d 904, 908 (N.Y. Civ. Ct. 1980); United States v. Sonal, Inc., 573 F. Supp. 1126, 1127-28 (S.D.N.Y. 1983).

²⁸Auten v. Auten, 124 N.E.2d 99, 102 (N.Y. 1954).

²⁹936 F.2d 723, 726 (2d Cir. 1991).

³⁰Wells Fargo, 936 F.2d at 726.

IV. CONCEPT OF MONEY

A. Nature of Money - State or Federal Law?

The question of what is money is central to the legal analysis of EMU under New York law and the laws of other American jurisdictions. Because the common law inherited from England has been adopted as the basis of jurisprudence in all the states of the Union (with the exception of Louisiana, where the civil law prevails in civil matters),¹ this study will explore in detail the concept of money that has been articulated by the American courts. At common law American state courts (including the New York state courts) are generally required to follow the precedents established by courts of equal or higher rank, while decisions rendered by courts in other states and decisions of federal courts in cases involving questions of state law have persuasive authority.²

The question of what is money might be regarded as a mixed question of state and federal law. It triggers questions of contract interpretation under state law insofar as parties seek to understand the meaning of an obligation expressed in currencies like the Deutsche mark after EMU. Federal courts, acting on the basis of their jurisdiction over questions of federal law, have applied state law to the interpretation of contracts because “[t]he control of all types of contracts has been primarily a state function since the States came into being”,³ and “it is to state rather than federal law that private parties are likely to refer when formulating the terms of a contractual [agreement].”⁴

However, the federal courts have also held that “it is clear that federal law will control contracts between private parties if there is sufficient federal interest.”⁵ The question of what constitutes foreign money implicates questions of federal law insofar as the Federal government is vested with exclusive authority under the U.S. Constitution to conduct foreign relations with foreign nations.⁶ The introduction of the single European currency is a foreign affairs matter insofar as it implicates the monetary sovereignty of the European Union over the currencies of EU member states.⁷ This sovereignty extends to the use of EU currencies in transactions governed by the laws of American jurisdictions.⁸ In *Texas Industries, Inc. v. Radcliff Materials, Inc.*,⁹ the Supreme Court stated that “federal courts are free to develop [federal] common law in such narrow areas as those concerned with ... our relations with foreign nations”. In such cases the “international nature of the controversy makes it inappropriate for state law to control.”¹⁰

In *Banco Nacional de Cuba v. Sabbatino*,¹¹ the U.S. Supreme Court, in concluding that the scope of the act of state doctrine must be determined according to federal rather than state law, felt “constrained to make it clear that an issue concerned with a basic choice regarding the competence and function of the

¹See 15A AM. JUR. 2D, *Common Law* § 13 (1976) (and the cases cited therein).

²See 20 AM. JUR. 2D, *Courts* §§ 147-159, 164-171 (1995 & Supp. 1997) (and the cases cited therein).

³*Wilburn Boat Co. v. Fireman’s Ins. Co.*, 348 U.S. 310, 316 (1955).

⁴*Three Rivers Motor Co. v. Ford Motor Co.*, 522 F.2d 885, 891 (3d Cir. 1975).

⁵*United States v. Taylor*, 333 F.2d 633, 638 (5th Cir. 1964).

⁶See *infra* p. 215.

⁷See *infra* pp. 215, 220.

⁸See *infra* pp. 48, 53-57, 65-67, 69.

⁹451 U.S. 630, 641 (1981) (citations omitted).

¹⁰*Id.*

¹¹376 U.S. 398, 425 (1964).

Judiciary and the National Executive in ordering our relationships with other members of the international community must be treated exclusively as an aspect of federal law.” Thus, under the act of state doctrine contractual obligations whose situs are located in a foreign country are subject to the acts of a foreign sovereign government.¹² By analogy, the question of how the introduction of a new currency by a foreign country will affect contractual obligations denominated in the old currency and governed by the laws of U.S. jurisdictions implicates the relationship of the United States with that foreign country and should therefore be treated exclusively as a question of federal law.

The application of federal common law in this area would also be consistent with “[t]he desirability of a uniform rule” throughout the United States.¹³ Thus, it has been suggested that questions concerning foreign currency matters might be more properly treated as matters of federal common law,¹⁴ with the result that the decisions of the federal courts, and especially the U.S. Supreme Court, are of paramount importance.¹⁵ Interestingly, the U.S. Supreme Court held during the late 19th century that the question of whether bonds payable in currency of the United States were payable in gold coin or paper dollars implicated a question of federal rather than state law because of the Federal government’s constitutional authority to establish the currency of the United States.¹⁶

The question of what is money clearly has federal law aspects, and the decisions of the federal courts -- particularly the Supreme Court -- are precedents which state courts are obliged to follow. In addition, insofar as the question of what is money raises a question of federal common law, federal common law pre-empts conflicting state law, including state legislation.¹⁷ The Supreme Court has held, however, that in the absence of any conflict between state and federal law, the federal courts will refrain from the creation of a special federal rule.¹⁸ This study will therefore examine both federal and state law. Insofar as matters of contract law fall within the competence of the states, there is an emphasis in the study on New York law over and above the laws of other American states because of the overriding importance of New York law for international financial transactions affected by EMU.

B. State Theory of Money

Assuming that the law of a U.S. jurisdiction such as New York law has been selected by the parties as the governing law of the contract, the next question which must be considered is whether it is recognized under U.S. and New York law that the question of what a currency consists of is exclusively defined by the laws of the state issuing such currency. According to this legal theory of money, sometimes referred to as the State theory of money (so named after the work of G.F. Knapp),¹⁹ the essential attribute of money is that it is “a creature of the law” and “is regulated by the State”.²⁰ F.A. Mann explains this theory as follows in *The Legal Aspect of Money*:

¹²See *infra* pp. 74-78.

¹³Clearfield Trust Co. v. United States, 318 U.S. 363, 367 (1943).

¹⁴See Ronald A. Brand, *Restructuring the U.S. Approach to Judgments on Foreign Currency Liabilities: Building on the English Experience*, 11 YALE J. INT’L L. 139, 174 (1985); Suzanne R. Westerheim, *The Uniform Foreign-Money Claims Act: No Solution to an Old Problem*, 69 TEX. L. REV. 1203, 1216-20 (1991).

¹⁵See 20 AM. JUR. 2D, *Courts* §§ 170-171 (1995) (and the cases cited therein).

¹⁶Woodruff v. Mississippi, 162 U.S. 291, 301-04 (1896).

¹⁷See *Sabbatino*, 376 U.S. at 426-27; *Wilburn*, 348 U.S. at 314 (citation omitted); *Francis v. S. Pac. Co.*, 333 U.S. 445, 450 (1948).

¹⁸*O’Melveny & Myers v. FDIC*, 512 U.S. 79, 87-88 (1994) (citations omitted); *Boyle v. United Technologies Corp.*, 487 U.S. 500, 507-08 (1988).

¹⁹G. F. KNAPP, *STAATLICHE THEORIE DES GELDES* (4th ed. 1923), translated into English under the name *STATE THEORY OF MONEY* (1924).

²⁰F.A. MANN, *THE LEGAL ASPECT OF MONEY* 272 (5th ed. 1992).

As each State exercises these sovereign powers over its own currency, and as there is no State which would legislate with reference to another country's currency, it must be the law of the currency (*lex monetae*) which determines whether a thing is money and what nominal value is attributed to it. What 10,000 French francs consist of is exclusively defined by French law; there is no other law in the world which would explain the meaning of that denomination and which would lay down whether and for what nominal amount certain chattels are French legal tender. We therefore arrive at the rule that the law of the currency determines which things are legal tender of the currency referred to, to what extent they are legal tender, and how, in case of a currency alteration, sums expressed in the former currency are to be converted into the existing one.²¹

According to the State theory of money, the units of account referred to in a monetary obligation are defined by the recurrent link adopted by the state issuing the currency.²² The concept of a "recurrent link", first developed by Knapp,²³ holds that a linking is always effected between an old currency and a new currency by the rate of conversion which the state establishes for the payment of debts denominated with reference to the old standard.²⁴ This recurrent link must be universally applied irrespective of whether the contract is governed by the law of the country concerned.²⁵

Mann points out that the State theory of money is applicable to a monetary system which authorizes an international organization to issue money because the sovereign powers exercised by the supranational entity stem from a treaty between states granting the necessary power and authority.²⁶

Applied to EMU, the State theory of money would require American courts to hold that all monetary obligations denominated in existing EU currencies be discharged in the new euro currency at the conversion rates between the national currencies participating in EMU and the euro, as established by the Council of the European Union pursuant to the Maastricht Treaty. For example, the new currency — the euro — will, under French law, be the sole currency circulating in France, and monetary obligations created before the substitution of the French franc by the euro will therefore be capable of being discharged in the new currency at the specified conversion rates provided for in accordance with French law (which of course includes the Maastricht Treaty and other legally applicable measures adopted pursuant to the Treaty).

The implications of changes in a monetary system for legal obligations have been considered by American courts in a significant number of cases since American Independence. These cases involve changes to both the domestic and foreign monetary systems. This study will consider the historic precedents in chronological order. Overall, the precedents establish that there is widespread support for the State theory of money under U.S. law.

The State theory of money also has underpinnings in the U.S. Constitution and finds legislative expression in the definition of money in the Uniform Commercial Code (UCC) that has been incorporated into the laws of all 50 states of the United States. The U.S. Constitution and the UCC definition of money will be closely analyzed following the exposition of the relevant case law.²⁷

²¹*Id.*

²²*Id.*

²³G.F. KNAPP, STATE THEORY OF MONEY 21 (1924).

²⁴See MANN, *supra* note 20, at 46.

²⁵See *id.* at 267.

²⁶*Id.* at 20.

²⁷See *infra* pp. 80-85.

1. Assignats and the French Revolution

In 1790, during the French Revolution, the French Constituent Assembly issued paper notes not backed by specie called assignats that were made legal tender for the payment of debts. *Searight v. Calbraith*,²⁸ concerned an action between two U.S. citizens on a bill of exchange drawn in 1792 and payable in Paris for 150,000 livres tournois. The question was whether the contract called for payment in gold and silver coins up to the stated amount of livres tournois, or whether payment could be made in the depreciated paper assignats which passed as lawful money in France at the time of payment. A two judge circuit court took divergent positions on this point, with one judge appearing to reject the application of French law on the ground that the contract involved American citizens and the other judge moving closer to the State theory of money by holding that if the parties intended to refer to “the current money of France” then “the tender in assignats was lawfully made.”²⁹ It appears that the parties may have expressly intended that payment be made in specie because “livres tournois” was the medium identified, even though assignats had been made legal tender two years previously.³⁰ Overall the case is of historic interest but of limited precedential value in view of its lack of reasoned analysis.

2. U.S. Greenbacks and the American Civil War

The State theory of money has found favor with the U.S. Supreme Court on a number of occasions in American monetary history. The first important example of this arose out of the American Civil War. Because of the urgent need to raise capital to fight the war against the insurgent Southern forces, Congress authorized the issuance of paper money not backed by specie as legal tender.³¹ Unsurprisingly, this paper money was considered to have a lower commercial value than regular U.S. currency, and when debtors sought to discharge their debts using these “greenbacks” instead of U.S. gold dollars, creditors sued, challenging Congress’ right under the Constitution to issue the greenbacks.

In its 1870 decision, *Legal Tender Cases*,³² the Supreme Court held that Congress’ issuance of greenbacks was valid under its constitutional power “to coin Money”, and that contracts to pay money could be satisfied using the paper currency.

It was not a duty to pay gold or silver, or the kind of money recognized by law at the time when the contract was made, nor was it a duty to pay money of equal intrinsic value in the market.... [T]he obligation of a contract to pay money is to pay that which the law shall recognize as money when the payment is to be made Every contract for the payment of money, simply, is necessarily subject to the constitutional power of the government over the currency, whatever that power may be, and the obligation of the parties is, therefore, assumed with reference to that power.³³

In reaching this conclusion, the Court noted that the constitutional power of Congress to make particular notes a legal tender for the payment of all debts is “a power confessedly possessed by every independent sovereignty other than the United States” and that the constitutional power to coin money and regulate its value “was intended to confer upon Congress that general power over the [U.S.] currency which has always been an acknowledged attribute of sovereignty in every other civilized nation than our

²⁸4 U.S. (4 Dalles) 325 (1796).

²⁹*Searight*, 4 U.S. (4 Dalles) at 326-28 (Iredell and Peters JJ).

³⁰*Id.* at 325-27.

³¹See ARTHUR NUSSBAUM, MONEY IN THE LAW NATIONAL AND INTERNATIONAL 582-86 (1950).

³²79 U.S. (12 Wall.) 457 (1870).

³³*Legal Tender Cases*, 79 U.S. (12 Wall.) at 548-49; see also *Thompson v. Butler*, 95 U.S. (5 Otto) 694, 696-97 (1877); *Railroad Co. v. Johnson*, 82 U.S. (15 Wall.) 195 (1872) (citing *Legal Tender Cases*); *Dooley v. Smith*, 80 U.S. (13 Wall.) 604, 606-7 (1871) (same); *Faw v. Marsteller*, 6 U.S. (2 Cranch) 114, 116-25 (1804).

own”.³⁴ Thus, the Court acknowledged that a contract for the payment of foreign money is likewise subject to the constitutional power of the applicable foreign government over its currency.

In *Juilliard v. Greenman*,³⁵ another case arising out of the issuance of paper greenbacks during the Civil War, the Supreme Court held as follows:

A contract to pay a certain sum in money, without any stipulation as to the kind of money in which it shall be paid, may always be satisfied by payment of that sum in any currency which is lawful money at the place and time at which payment is to be made.

The Court was “irresistibly compelled” to this conclusion based on “the power to make the notes of the government a legal tender in payment of private debts being one of the powers belonging to sovereignty in other civilized nations”.³⁶ In particular, the Court stated that “Congress has the power to issue the obligations of the United States in such form, and to impress upon them such qualities as currency for the ... payment of debts, as accord with the usage of sovereign governments.”³⁷ The Court stated that this power “was a power universally understood to belong to sovereignty, in Europe and America, at the time of the framing and adoption of the Constitution of the United States.”³⁸ The Court noted that “[t]he governments of Europe, acting through the monarch or the legislature, according to the distribution of powers under their respective constitutions, had and have as sovereign a power of issuing paper money and of stamping coin.”³⁹ The Court also cited with approval an English case which “distinctly recognized” this power by granting an injunction to the Emperor of Austria, as King of Hungary, against the issue in England, without his license, of notes purporting to be public money of Hungary.⁴⁰

The decision of the Supreme Court in *Juilliard* demonstrates the Court’s acceptance that it lies within the sovereign powers of foreign nations to establish their currency and to stipulate what form of currency is acceptable for the payment of debts. It follows that U.S. courts will apply legislation enacted by a foreign power that provides for the alteration of its currency and the satisfaction of debts in its new currency.

Finally, in *Woodruff v. Mississippi*,⁴¹ it was held that bonds issued in 1871 when gold and silver coins and U.S. paper notes were in circulation that did not specify the particular kind of money in which payments be made constituted an “obligation . . . to pay what the law recognized as money when the payment was to be made.” The Supreme Court held that “[t]he bonds were, therefore, legally solvable in the money of the United States, whatever its description, and not in any particular kind of that money” (i.e., gold coin).⁴²

F.A. Mann has correctly cited the *Legal Tender Cases* in support of the State theory of money and as demonstrating that the State theory is the necessary consequence of the sovereign power or monopoly

³⁴Legal Tender Cases, 79 U.S. (12 Wall.) at 529, 545.

³⁵110 U.S. 421, 425-50, esp. at 449 (1883) (citations omitted).

³⁶*Juilliard*, 110 U.S. at 450.

³⁷*Id.* at 447.

³⁸*Id.*

³⁹*Id.*

⁴⁰*Id.* at 447 (citing *Austria v. Day*, 2 Giff. 628, 3 D.F.&J. 217).

⁴¹162 U.S. 291, 302 (1895).

⁴²*Id.*

over currency invariably established by modern constitutional law.⁴³ It has also been pointed out that while claims of “inherent sovereign powers” have on occasion been greeted with hostility by the U.S. Supreme Court, the tradition of fiat money reflected in the Legal Tender Cases has outlasted the gold standard and remains as valid today as it was in the late 19th century.⁴⁴ Thus the *Legal Tender Cases* were relied upon by the Supreme Court in the aftermath of the U.S. abandonment of the gold standard during the Great Depression of the 1930s.⁴⁵ The *Legal Tender Cases* have continued to be relied upon by American courts to this day in cases upholding the validity of paper dollar notes issued through the Federal Reserve System and not redeemable in specie.⁴⁶

3. Confederate Dollars and the American Civil War

An interesting refinement of the State theory of money can be found in the cases decided by the Supreme Court regarding the continuity of contracts following the collapse of the Confederate currency after the American Civil War. During the Civil War, the residents of the insurgent states entered into contracts with reference to the Confederate dollar as the standard of value. The value of the Confederate dollar in terms of its purchasing power fluctuated against the U.S. dollar throughout the Civil War, before completely collapsing after the defeat of the Confederate forces. The Confederate dollar notes were stated to be payable only “after the ratification of a treaty of peace between the Confederate States and the United States of America.”⁴⁷

In *Thorington v. Smith*,⁴⁸ decided after the War, the Supreme Court held that contracts made among residents of the Confederate states with reference to the Confederate currency were enforceable, and that the value of obligations created by such contracts was to be determined by the value of Confederate notes in lawful money of the United States. The Court held that although the Confederate notes were in themselves nullities because payment was contingent on a successful revolution, the notes “were used as money in nearly all the business transactions of many millions of people” and “must be regarded, therefore, as a currency, imposed on the community by irresistible force.”⁴⁹ The Court took the position that the inhabitants of the insurgent states “must be regarded as under the authority of the insurgent belligerent power actually established as the government of the country, and contracts made with them must be interpreted and enforced with reference to the condition of things created by the acts of the governing power.”⁵⁰ Thus the Court treated the Confederate dollar as a de facto foreign currency.

⁴³MANN, *supra* note 20, at 14 & n.66, 95 n.47; see also Phanor J. Eder, *Legal Theories of Money*, 20 CORNELL L.Q. 52, 69-70 (1934); George Nebolsine, *The Gold Clause in Private Contracts*, 42 YALE L.J. 1051, 1052-56 (1933); Arthur Nussbaum, *Comparative and International Aspects of American Gold Clause Abrogation*, 44 YALE L.J. 53, 54 (1934).

⁴⁴See Kenneth W. Dam, *The Legal Tender Cases*, SUP. CT. REV. 367, 394-96, 411-12 (1981).

⁴⁵See *infra* pp. 51-53.

⁴⁶See, e.g., *Foret v. Wilson*, 725 F.2d 254, 254-55 (5th Cir. 1984); *United States v. Ware*, 608 F.2d 400, 402-04 (10th Cir. 1979); *United States v. Anderson*, 584 F.2d 369, 374 (10th Cir. 1978); *United States v. Rifin*, 557 F.2d 1111, 1112-13 (8th Cir. 1978); *Mathes v. C.I.R.*, 576 F.2d 70, 71 (5th Cir. 1978); *Milam v. United States*, 524 F.2d 629, 630 (9th Cir. 1974); *Strickland v. A Mortgage Co.*, 179 B.R. 979, 980-81 (Bankr. N.D. Ga. 1995); *In re Walton*, 77 B.R. 617, 618-20 (Bankr. N.D. Ohio 1987); *Nixon v. Phillipoff*, 615 F. Supp. 890, 893-94 (N.D. Ind. 1985); *Bowser v. C.I.R.*, 41 T.C.M. (CCH) 275 (1980); see also *Howe v. United States*, 632 F. Supp. 700, 701 (D. Mass. 1986).

⁴⁷See *Thorington v. Smith*, 75 U.S. (8 Wall.) 1, 11 (1868).

⁴⁸75 U.S. (8 Wall.) 1, 7-14 (1869).

⁴⁹*Thorington*, 75 U.S. (8 Wall.) at 11.

⁵⁰*Id.* at 13; see also *Effinger v. Kenney*, 115 U.S. 566, 569-71 (1885) (citing *Thorington*); *Rives v. Duke*, 105 U.S. (15 Otto) 132, 140-41 (1881) (citations omitted); *Dugger v. Bocoock*, 104 U.S. (14 Otto) 596, 602-03 (1881) (citations omitted); *Cook v. Lillo*, 103 U.S. (13 Otto) 792, 792-93 (1880) (citing *Thorington*); *Bissell v. Heyward*, 96 U.S. (6 Otto) 580, 587 (1877) (citations omitted); *Stewart v. Salamon*, 94 U.S. (4 Otto) 434, 435 (1876) (citing *Thorington*); *Wilmington & Weldon R.R. Co. v. King*, 91 U.S. (1 Otto) 3, 3-4 (1875) (citations omitted); *The Confederate Note Case*, 86 U.S. (19 Wall.) 548, 555-57 (1873) (citing *Thorington*); *Planters' Bank v. Union Bank*, 83 U.S. (16 Wall.) 483, 499 (1872) (citing *Thorington*); *Hanauer v. Woodruff*, 82 U.S. (15 Wall.) 439, 442-49 (1872); *Delmas v. Ins. Co.*, 81 U.S. (14 Wall.) 661, 665 (1871) (citing *Thorington*).

The question of how contractual obligations denominated in Confederate dollars were to be valued in U.S. dollars was somewhat more complex, particularly in the case of long-term obligations. Traditionally, U.S. courts awarded damages with respect to a breach of a foreign currency contract in U.S. dollars based on the exchange rate prevailing between the foreign currency and the U.S. dollar at the date of breach.⁵¹ Thus in *Planters' Bank v. Union Bank*,⁵² the Supreme Court held that where a bank wrongfully failed to pay a depositor an amount in Confederate dollars deposited with the bank, the depositor was entitled to recover U.S. dollars equal to the value of the Confederate dollars at the date of demand rather than the earlier date of deposit. The Court insisted that “the risk of depreciation” in the value of the Confederate dollar “necessarily” lay with the depositor.⁵³

Pushed to its logical conclusions, this rule would require that obligations maturing after the collapse of the Confederacy would be virtually worthless because of the extreme depreciation in the value of the Confederate dollar that preceded the defeat of the Confederate forces. Consistent with the State theory of money, obligations denominated in Confederate dollars could be discharged in U.S. dollars at the rate of exchange prevailing between the worthless Confederate dollar and the U.S. dollar at the time of the defeat of the Confederacy and the re-introduction of the U.S. dollar as the currency of the vanquished Confederate states. This, of course, would have caused considerable hardship for creditors. In order to avoid such hardship the Supreme Court held in a long line of cases that Confederate creditors could recover an amount of U.S. dollars equal to the value of the Confederate dollar at the time and place of the contract rather than the time of maturity.⁵⁴

In *Effinger v. Kenney*,⁵⁵ the Supreme Court considered the question from the perspective of a Confederate dollar-denominated bond issued in March 1863 and payable in March 1865. At the date of the bond’s issue the purchasing power of the Confederate dollar was approximately one-third less than that of the U.S. dollar, whereas at the date of the bond’s maturity, when the Confederacy was in the throes of dissolution, the Confederate dollar was not worth more than one-twentieth of the U.S. dollar, and shortly thereafter the Confederate currency lost all appreciable value.⁵⁶ The Supreme Court stated that “[w]here a contract is payable in a specified currency, the rule is [] clear that such currency is demandable and receivable at the maturity of the contract, whatever change in its value by increase or depreciation may have taken place in the mean time.”⁵⁷ However, the Supreme Court held that this rule did not apply to the Confederate dollar because the Confederate notes were not recognized as lawful currency under U.S. law, but rather were “the promises of an insurgent and revolutionary organization.”⁵⁸ Because the Confederate dollars were not recognized as lawful currency, the Court held that the bondholder could recover the “exchangeable value of Confederate notes, in which the bond was payable, estimated at the time and place of its execution in lawful money of the United States.”⁵⁹ Any other rule “would be inconsistent with justice in determining the value of contracts thus payable, where they matured near the close or after the overthrow of the Confederacy.”⁶⁰

⁵¹See *infra* pp. 131-32.

⁵²83 U.S. (16 Wall.) 483, 500-03 (1872).

⁵³*Planters' Bank*, 83 U.S. (16 Wall.) at 503.

⁵⁴*Effinger*, 115 U.S. at 574-76; *Stewart*, 94 U.S. (4 Otto) at 436; *Wilmington*, 91 U.S. (1 Otto) at 4; *Confederate Note Case*, 86 U.S. (19 Wall.) at 557; *Thorington*, 75 U.S. (8 Wall.) at 14.

⁵⁵115 U.S. 566, 574-76 (1885).

⁵⁶*Effinger*, 115 U.S. at 574.

⁵⁷*Id.* at 575.

⁵⁸*Id.* at 575.

⁵⁹*Id.* at 575-6.

⁶⁰*Id.* at 576.

Professor Nussbaum, formerly of Columbia University, has cited the Confederate dollar cases to support the thesis that media of exchange not recognized by a state as money can acquire monetary status because of their widespread use by a particular community rather than because of their recognition under the laws of the issuing state.⁶¹ F.A. Mann has pointed out that Nussbaum's reliance on the Confederate dollar cases to support this proposition is misplaced because the monetary character of the Confederate currency was explained by the Supreme Court in *Thorington* on the ground that the Confederacy succeeded in establishing itself as the de facto government of the Confederate states.⁶²

Nussbaum and other commentators have pointed out that the conversion of Confederate dollar debts into U.S. dollars at the time of contracting effectively amounted to a judicial revaluation of such debts.⁶³ It appears that such revaluation was permitted by the Supreme Court because of the complete collapse of a currency issued by an illegal government not recognized by the United States.

It almost goes without saying that the collapse of the Confederate dollar is clearly distinguishable from the introduction of the single European currency. The introduction of the euro involves a highly organized plan by the European Union for an orderly transition to a new monetary regime.⁶⁴ While the Confederate dollar was issued by a revolutionary government not recognized by the United States, the euro will be issued by the European Central Bank on behalf of some of the United States' closest international allies. Indeed the official position of the United States with respect to EMU is that the U.S. regards EMU as "the latest step in the process of European integration" and "has long supported the broad objectives of European integration."⁶⁵

4. Conversion of the Puerto Rican Peso into the U.S. Dollar and Establishment of the Philippine Peso Following the Spanish-American War (1898)

The State theory of money was re-confirmed by the U.S. Supreme Court in cases arising out of the absorption of the Caribbean island of Puerto Rico as a U.S. possession and the U.S. annexation of the Philippine islands after the Spanish-American War of 1898.⁶⁶ At the outbreak of the 1898 War, the Puerto Rican gold peso was worth 40% less than the U.S. gold dollar. Following the War and cession of Puerto Rico, Congress passed a law for the conversion of the Puerto Rican peso into the U.S. dollar at the fixed exchange rate of one Puerto Rican peso for U.S.\$0.60.⁶⁷ The legislation provided for a three-month period between the passage of the legislation and the date Puerto Rican coins ceased to be used as legal tender; it also provided that "all debts owing on the date when this act shall take effect shall be payable in the coins of Puerto Rico now in circulation, or in the coins of the United States at the rate of exchange above named."⁶⁸

⁶¹NUSSBAUM, *supra* note 31, at 5-6.

⁶²MANN, *supra* note 20, at 23 n.111.

⁶³NUSSBAUM, *supra* note 31, at 112, 593; *see also* John P. Dawson and Frank E. Cooper, *The Effect of Inflation on Private Contracts: United States, 1861-1879*, 33 MICH. L. REV. 706, 747-53 (1935); Evsey S. Rashba, *Debts in Collapsed Foreign Currencies*, 54 YALE L.J. 1, 25-28 (1944).

⁶⁴*See supra* pp. 12-27.

⁶⁵Remarks by Deputy Treasury Secretary Lawrence H. Summers, EMU: An American View of Europe 1 (Apr. 30, 1997) (on file with U.S. Dept. of the Treasury, Office of Public Affairs, Index #1660).

⁶⁶*See* Succession of Serrales v. Esbri, 200 U.S. 103 (1906).

⁶⁷Law of April 12, 1900, ch. 191, § 11, 31 Stat. 77, 80 (1900) (eliminated) (An Act Temporarily to provide revenues and a civil government for Puerto Rico, and for other purposes).

⁶⁸*Id.*

In *Succession of Serrales v. Esbri*,⁶⁹ a contract made in 1894 called for payment to be made “in money that is in circulation or is accepted in the province, at the rate of one hundred centavos of the money in circulation for each peso”. The Supreme Court held that “a centavo” is equivalent to one hundredth of a Puerto Rican peso, not one hundredth of a U.S. dollar, and applied the conversion rate laid down in the Congressional legislation.⁷⁰ In arriving at this conclusion the Court held that “[t]he withdrawal of the coins of Puerto Rico in circulation at the time of the passage of the act of Congress, and provided for therein, did not take legal effect, so far as concerned debts then existing, except upon the condition that those debts might be solved in the coins of the United States, at the rate of exchange stated in the act.”⁷¹ The Court stated that “[t]his did not impair or change the obligation of any contract, and was but an exercise of power to fix the value of the coins which were to be withdrawn, and to state the rate of exchange at which existing debts might be paid in American money and as there was no contract to pay at any other rate, the act was valid and applied to this case.”⁷²

Succession of Serrales is important insofar as the Supreme Court held that the legislation introduced by Congress fixing the exchange rate at which the Puerto Rican peso was substituted for the U.S. dollar after the U.S. annexation of Puerto Rico, and providing for the payment of debts denominated in the Puerto Rican peso at the fixed exchange rate, derived its validity from Congress’ constitutional authority to establish and regulate the monetary system. It must follow, *a fortiori*, that U.S. courts will accept that a foreign country’s legislation specifying the rate of exchange at which a foreign currency is to be substituted for a new currency and providing for the discharge of debts in the old currency at such exchange rate is similarly derived from that country’s inherent sovereign powers with respect to the issuance and regulation of its currency.

In another Puerto Rican case the Supreme Court confirmed that where the character of money changes between the time the parties enter into a contract and the time fixed for performance under the contract, payments may be made in the money as so changed at the time of performance. Thus in *City of San Juan v. St. John’s Gas Co.*,⁷³ a case involving a Puerto Rican contract which called for payment in U.S. currency, the Supreme Court rejected the argument that the contract “required the payment to be made in foreign current money circulating in the island [of Puerto Rico] at the time the contract was made, instead of money of that character circulating at the time the payments were to be made. The general rule, under both the common and the civil law, is that in the absence of a stipulation to the contrary, the character of money which is current at the time fixed for performance of a contract is the medium in which payments may be made” (emphasis added).

Following the Spanish-American War the United States also annexed the Spanish colony of the Philippines. Congress passed legislation establishing the gold peso as the new unit of value of the local administration of the Philippines and providing for the coinage of a silver peso and various silver coins and further providing for the recognition of U.S. gold coins as legal tender in the Philippines at the rate of one dollar for two pesos.⁷⁴

In *Ling Su Fan v. United States*,⁷⁵ the Supreme Court upheld the validity of a local Philippine regulation prohibiting the exportation of Philippine silver coins from the islands, holding that the

⁶⁹200 U.S. 103 (1906).

⁷⁰*Succession of Serrales*, 200 U.S. at 110-13.

⁷¹*Id.* at 118.

⁷²*Id.*

⁷³195 U.S. 510, 519-20 (1904) (citations omitted).

⁷⁴Law of July 1, 1902, ch. 1369, §§76-79, 32 Stat. 691, 710 (eliminated) (An Act Temporarily to provide for the administration of the affairs of civil government in the Philippine Islands, and for other purposes); Law of March 2, 1903, ch. 980, §§ 1-4, 7, 32 Stat. 952, 952-54 (eliminated) (An Act to establish a standard of value and to provide for a coinage system in the Philippine Islands).

⁷⁵218 U.S. 302, 308-11 (1910).

regulation was derived from powers conferred on the Philippine administration by the U.S. Congress. In reaching this conclusion the Court noted that the power of Congress to coin money “is a prerogative of sovereignty.”⁷⁶ The Court held that there is attached to the ownership of Philippine silver coins affected by the regulation

those limitations which public policy may require by reason of their quality as a legal tender and as a medium of exchange. These limitations are due to the fact that public law gives to such coinage a value which does not attach as a mere consequence of intrinsic value. Their quality as a legal tender is an attribute of law aside from their bullion value. They bear, therefore, the impress of sovereign power which fixes value and authorizes their use in exchange.⁷⁷

The Supreme Court decision in *Ling Su Fan* recognizes that all money is a creature of law and is therefore subject to legal regulation by the sovereign power that authorizes the issuance of such money. Thus, F.A. Mann relies on *Ling Su Fan* as evidence of the support for the State theory of money under U.S. law.⁷⁸ This case has also been relied upon in modern cases involving foreign exchange regulations as establishing that a foreign country’s “[c]ontrol of the national currency and of foreign exchange is a necessary attribute of sovereignty”⁷⁹ or “an essential governmental function.”⁸⁰

5. Russian Rubles and the Bolshevik Revolution

In cases resulting from the collapse of the Russian ruble after the 1917 revolution the New York courts generally displayed a willingness to apply the State theory of money. There is, however, one authority where a court sought to avoid the harsh consequences of applying the State theory to debts denominated in the collapsed ruble.

At the outbreak of the First World War the Russian ruble was worth around U.S. \$0.514 and was exchangeable for gold. During and after the War the value of the ruble declined dramatically due to the suspension of its exchangeability for gold and the successive creation of several new paper ruble issues. On three separate occasions between 1922 and 1924 the Soviet government discontinued all existing legal tenders, replacing them with new ruble currencies which substituted the predecessor currencies at established conversion rates (10,000:1 in 1922, 100:1 in 1923 and 50,000:1 in 1924). By 1924 the Soviet government, having placed the Russian currency on a gold basis again, succeeded in stabilizing the value of the ruble near its old pre-War exchange rate of U.S.\$0.514. At the same time as these monetary alterations were taking place between 1922-1924, decrees were issued by the Soviet authorities providing that obligations expressed in the old currencies could be discharged at maturity in the new currencies at the specified conversion rates. The result of these currency alterations was that by 1924 one gold ruble was equivalent to a staggering 50 billion pre-Revolution rubles.⁸¹

⁷⁶*Ling Su Fan*, 218 U.S. at 310.

⁷⁷*Id.* at 310-11.

⁷⁸MANN, *supra* note 20, at 95-96 n.47.

⁷⁹*Naamloze Vennootschap Suiker-Fabriek Wono-Aseh v. Chase Nat. Bank of City of New York*, 111 F. Supp. 833, 845 (S.D.N.Y. 1953).

⁸⁰*French v. Banco Nacional de Cuba*, 242 N.E.2d 704, 715-16 (N.Y. 1968).

⁸¹For an account of the currency situation in Russia during these years, see *Dougherty v. Equitable Life Ins. Soc’y of United States*, 193 N.E. 897, 904-06 (N.Y. 1934).

The first New York decision addressing the legal basis of a Russian ruble obligation is *Reisfeld v. Jacobs*,⁸² a case involving an alleged breach of a foreign exchange contract involving the exchange of Imperial Russian rubles for U.S. dollars. The New York Supreme Court, Appellate Division, held that before the rubles could be considered money, the court “would have to take judicial notice that they were issued under the authority of and backed by the credit of a responsible government.”⁸³ In view of the fact that, with the collapse of Tsarist Russia, the Imperial rubles “were issued by a government now defunct” and, with the rise to power of the Bolsheviks in the 1917 revolution, “the United States at present has no relations with any government in Russia”, the court could not “take judicial notice that these notes are backed by the credit of a responsible government, or that they even pass current anywhere as money.”⁸⁴ This case established that the test of what is currency under New York law depends on whether the currency enjoys the full faith and credit of the government of the country that issues such currency. This test clearly requires the courts to look to the laws of the issuing country. Recognition of a foreign currency might be withheld where, as was the case with the Soviet Union, the United States does not recognize the government of the country in question or the country is in a state of such political chaos that is not possible to determine what its currency actually is. Clearly such considerations are irrelevant in the context of the highly organized plan for an orderly transition to EMU by some of the United States’ closest international allies.⁸⁵

In *Parker v. Hoppe*,⁸⁶ consideration was given to the depreciation of the Russian ruble prior to the monetary reforms of 1922-1924. The New York Court of Appeals confirmed the principle of the nominal continuity of obligations — the court would award 100,000 rubles where the amount owing under the contract was 100,000 rubles, regardless of the extent to which the purchasing power of the ruble and its value on the foreign exchange markets may have depreciated in the interim period.⁸⁷ In a subsequent decision clarifying this point, the court stated that “[t]he rubles in this case always remained, during the times in question, the money of Russia, under its different forms of government” and that “the ruble did not change its nature as money, nor was it debased in its intrinsic value. If a country creates a new monetary system, or by law debases its coinage by increasing the alloy, a different situation would arise.”⁸⁸ The court did not expand further on how obligations are to be discharged in the event of the establishment of a new monetary system and whether obligations are to be discharged in accordance with the recurrent link between the old currency and the new currency. Some light is shed on this point by the court’s observations regarding the then recent monetary change in the pound sterling as a result of the pound going off the gold standard.⁸⁹ The court noted with apparent approval that notwithstanding the depreciation of pound sterling following its break with the gold standard, English courts would only award “the same number of pounds” as were stated to be due under contracts entered into prior to the abandonment of the gold standard.⁹⁰ The decision by the U.K. to go off the gold standard in 1931 is generally recognized as one of the more significant events in the U.K.’s monetary history this century.⁹¹ The court’s apparent willingness to uphold the continuity of obligations in the event of such an important

⁸²176 N.Y.S. 223 (N.Y. App. Div. 1919).

⁸³*Reisfeld*, 176 N.Y.S. at 224.

⁸⁴*Id.*

⁸⁵*See supra* p. 42.

⁸⁶178 N.E. 550 (N.Y. 1931).

⁸⁷*Parker*, 178 N.E. at 551.

⁸⁸*Parker v. Hoppe*, 179 N.E. 770, 771-72 (N.Y. 1932).

⁸⁹*Id.* at 770 (citations omitted).

⁹⁰*Id.*

⁹¹*See generally* ROBERT GUTTMANN, *HOW CREDIT MONEY SHAPES THE ECONOMY: THE UNITED STATES IN A GLOBAL SYSTEM* 359-62 (1994).

change to a country's monetary system indicates that it would strive to do so in other situations. Clearly nominal continuity would not be possible where a country establishes a new monetary system, unless the rate of exchange between the old currency and the new currency is one for one. Thus, the only logical approach would be to establish continuity on the basis of the recurrent link at which the new currency substitutes the old one. It is, however, unclear from the court's decision whether it envisaged the application of the recurrent linking rule where a country creates a new monetary system.

While many of the Russian ruble cases that came before the New York courts involved obligations governed by Russian rather than New York law, the cases do shed light on the willingness of the New York courts to recognize the consequences of currency alterations for foreign currency obligations, regardless of governing law. The courts did not, however, always reach consistent conclusions in the Russian ruble cases.

The first case to consider the implications of the Soviet monetary reforms from 1922-1924 for obligations in the old ruble was *Re First Russian Insurance Co.*⁹² There the New York Court of Appeals permitted recovery on a debt on the basis of one old pre-war ruble equaling one new ruble. The court arrived at this conclusion on the ground that after the Soviet monetary reforms the new Soviet ruble "was again on a gold basis" and therefore was equal in value to the old pre-War Imperial gold ruble.⁹³ In effect the court treated the obligation undertaken before the First World War as calling for payment in gold rather than rubles, and so "where token rubles were paid in satisfaction of a debt, the number would have to be increased to the extent necessary to make the payment equivalent to one in gold."⁹⁴ Clearly the court did not attempt to follow the applicable provisions of Soviet law calling for the discharge of debts in the new rubles at the specified conversion rates, which would have all but extinguished pre-War ruble debts. Instead the court sought to accomplish an equitable result based on the real economic value of the old ruble at the time the debt was created. F.A. Mann has criticized this case as proceeding on wrong evidence.⁹⁵

First Russian was not followed in subsequent cases which declined to enforce a 1:1 conversion of old rubles into new rubles. These cases instead applied the recurrent link established under Soviet law.

In *Tillman v. Russo Asiatic Bank*,⁹⁶ it was argued that an obligation created in the ruble as it existed before the Soviet monetary reforms could be discharged in the new 1924 gold ruble on a ruble-for-ruble basis. The U.S. Court of Appeals for the Second Circuit held that the obligation was created under Russian law and that it had not been demonstrated that "the rubles which the [debtor] agreed to pay were the same currency that the Soviet decrees of 1922 and 1924 established as governmental currency or had anything in common with the latter except the name."⁹⁷ The court declined to apply *First Russian*, holding that its application was confined to the particular facts of its case.⁹⁸

Again in *Klochkov v. Petrogradski M.C. Bank*,⁹⁹ the New York Supreme Court, Appellate Division, held that old rubles deposited in a bank in Russia in 1919 "had become worthless" by 1924 and were not

⁹²175 N.E. 118, 119 (N.Y. 1931).

⁹³*First Russian*, 175 N.E. at 119.

⁹⁴*Id.*

⁹⁵MANN, *supra* note 20, at 274-75 n.9.

⁹⁶51 F.2d 1023 (2d Cir. 1931).

⁹⁷*Tillman*, 51 F.2d at 1025-26.

⁹⁸*Id.*

⁹⁹268 N.Y.S. 433, 434 (N.Y. App. Div. 1934), *aff'd* 195 N.E. 216 (N.Y. 1935).

payable “in gold currency, rouble for rouble.” Thus, the court followed the recurrent link established under Russian law.

In *Dougherty v. Equitable Life Assurance Society of United States*,¹⁰⁰ the New York Court of Appeals applied Russian law to determine the status of an obligation in Russian rubles created prior to the Bolshevik Revolution. It was held that “the 1924 gold rouble was never considered or made to be on a parity with the rouble of pre-existing obligations” because “with every shift in the currency there has been an established ratio, according to which pre-existing obligations could be paid in the new currency”.¹⁰¹ Thus, a strict application of the relevant provisions of Soviet law required that debts in old rubles needed only to be discharged in the new rubles at the specified conversion rates, all but extinguishing debts in the pre-War rouble. In arriving at this conclusion, the court stated that “with the crises which come to all nations at some time, debts must follow the ups and downs of the money market.”¹⁰² The court indicated that it was following a rule applicable not only to obligations governed by foreign law but also to any obligation denominated in a foreign currency, regardless of the governing law:

Where an entirely new standard of value is adopted by the government, the amount to be paid is found by giving such a sum in the new currency as shall be declared by law equal in value to the amount due in the old currency.¹⁰³

That the court intended this rule to be applicable to all obligations affected by currency alterations, and not just obligations governed by Russian law, is illustrated by its additional citation to the U.S. Supreme Court decision in *Succession of Serrales*, the case arising out of the substitution of the Puerto Rican peso for the U.S. dollar following the 1898 Spanish-American War.¹⁰⁴ *Dougherty* may therefore be cited for the broader proposition that an obligation denominated in a foreign currency must be discharged in any successor currency at the conversion rate established between the old and the new currencies under the laws of the relevant foreign jurisdiction. F.A. Mann correctly cites *Dougherty* as supporting the proposition that under U.S. law it is the law of the currency that determines how, in case of a currency alteration, sums expressed in a former currency are to be converted into the existing one.¹⁰⁵

Dougherty has been uniformly followed by the New York courts in subsequent cases involving Russian rouble obligations affected by the Soviet monetary reforms of 1922-1924.¹⁰⁶ Thus, in *Dougherty v. National City Bank of New York*,¹⁰⁷ the New York Supreme Court, citing the first *Dougherty* decision, held that imperial rubles deposited with a bank in 1917 could not be recovered because the imperial rouble had become worthless and could not be converted at par into the Soviet rouble which was “a new and different currency”, and the fact that the new rouble “happens to have the same name and statutory gold content” as the old pre-War Imperial rouble was “immaterial”.

The recurrent link between the old rubles and the new rubles was again applied in *Tillman v. National City Bank of New York*.¹⁰⁸ There the U.S. Court of Appeals for the Second Circuit, citing

¹⁰⁰193 N.E. 897, 898-99, 906-07 (N.Y. 1934).

¹⁰¹*Dougherty*, 193 N.E. at 906-07.

¹⁰²*Id.* at 906.

¹⁰³*Id.* at 907 (quoting 1 SEDGWICK ON DAMAGES §§ 268 and 269 (9th ed. 1912)).

¹⁰⁴*Id.* at 907.

¹⁰⁵MANN, *supra* note 20, at 274-75 n.9.

¹⁰⁶*See* Klochkov. Petrogradski M.C. Bank, 195 N.E. 216, 216-17 (N.Y. 1935); L.C. Smith & Bros. Typewriter Co. v. Credit Lyonnais, 194 N.E. 57, 58 (N.Y. 1934); *Dougherty v. Nat'l City Bank of New York*, 285 N.Y.S. 491, 510 (N.Y. Sup. Ct. 1935); *see also* *Tillman v. Nat'l City Bank of New York*, 118 F.2d 631, 635 (2d Cir. 1941).

¹⁰⁷285 N.Y.S. 491, 510-11 (N.Y. Sup. Ct. 1935).

¹⁰⁸118 F.2d 631, 635 (2d Cir. 1941).

Dougherty, held that rubles deposited with a bank in 1917 “were no equivalent for the other currencies of the same name” because “the decrees under which the later currencies were issued made no provision for paying the old obligations in the new currency, rouble for rouble, and [therefore] the old roubles in any exchange for current roubles were valueless.”¹⁰⁹

In conclusion, the Russian ruble cases, and particularly *Dougherty* and its progeny, provide support for the application of the recurrent linking rule whereby an obligation in an old currency will always be converted into the new currency at the conversion rate established by the state that issues such currency.¹¹⁰

6. Conversion of the Mark into the Reichsmark in Weimar Germany

The collapse of the old German mark in Weimar Germany also triggered a number of lawsuits before American courts. After the First World War the Weimar Republic experienced such a drastic depreciation in the value of its currency, the mark, that it was compelled to discontinue the currency in 1924, replacing the mark with the Reichsmark at a conversion rate of 1,000,000,000 marks to one Reichsmark. In the cases decided after the collapse of the Weimar mark the American courts reached inconsistent conclusions.

In *Matter of Lendle*,¹¹¹ a testator domiciled in the U.S. gave certain mark legacies to persons in Germany by a will made in 1920. The New York Court of Appeals held that to the testator’s mind “the normal mark must at all times have been the mark as he knew it before the World War”, and that the legatees were entitled to an amount of Reichsmarks corresponding to that amount of old marks which they were given by the will.¹¹² While the decision prevented the legacies from being wiped out, it does not sit easily with the court’s statement of principle that “[i]f at the time of a depreciated paper currency a testator provides in his will for legacies in dollars, the legacy is payable in any money that is legal tender at the time of his death”, regardless of whether “[t]he paper dollar may have shrunk in value or ... risen to a parity with gold, or a gold standard may have been established.”¹¹³

F.A. Mann has pointed out that although the decision in *Matter of Lendle* may perhaps be justified on the ground that the testator must have intended to equiparate marks for Reichsmarks, the material before the court suggested the opposite view.¹¹⁴ Arthur Nussbaum suggests that the failure to recast the mark debts into Reichsmark debts at the one trillion to one ratio was simply erroneous.¹¹⁵ The precedential value of this case is further limited insofar as the European monetary union entails an orderly transition to a new single currency. The collapse of the Weimar mark, on the other hand, arose out of a violent economic upheaval as a result of which the pre-existing legal tender had become utterly valueless.

The next case arising out of the collapse of the Weimar German currency is *Heine v. New York Life Insurance Co.*¹¹⁶ There the U.S. Court of Appeals for the Ninth Circuit held that certain insurance policies payable in marks were governed by German law.¹¹⁷ The court stated that the fact that the suit

¹⁰⁹*Id.* (citations omitted).

¹¹⁰See MANN, *supra* note 20, at 274-75 n.9 (citing *Tillman v. Russo Asiatic Bank*, *Klochkov*, *Dougherty*, *Tillman v. Nat’l City Bank of New York*, discussed *supra* pp. 47-49).

¹¹¹166 N.E. 182 (N.Y. 1929).

¹¹²*Matter of Lendle*, 166 N.E. at 183.

¹¹³*Id.*

¹¹⁴MANN, *supra* note 20, at 289 n.76.

¹¹⁵NUSSBAUM, *supra* note 31, at 187 n.69.

¹¹⁶50 F.2d 382 (9th Cir. 1931).

¹¹⁷*Heine*, 50 F.2d at 385-86.

might be entertained by U.S. courts would not confer “enlarged rights ... over the German law” on policy holders.¹¹⁸ The case is interesting for the reason that the court, in applying the recurrent link between the mark and the Reichsmark, cited an English case where it was held that an obligation to pay a certain sum of German Reichsmarks in a mortgage deed governed by English law was an obligation to pay whatever may be the legal tender at the time of repayment in the country where the Reichsmark circulates.¹¹⁹ By implication, an obligation in a foreign currency contract governed by New York law would also be payable in whatever passes as the lawful currency at the time of repayment in the country of issue.

7. Pound Sterling and the British Abandonment of the Gold Standard

Britain placed its currency on a gold standard during the early 18th century, and the pound sterling continued to be redeemable in gold until the outbreak of the First World War in 1914. After the War Britain returned to the gold standard, fixing the pound’s value at its pre-War gold parity in 1925. The pre-War parity proved unsustainable, and Britain was forced to abandon the gold standard in 1931, leading to a sharp depreciation of the pound against the U.S. dollar.¹²⁰

In *Booth & Co. v. Canadian Government Merchant Marine*,¹²¹ the U.S. Court of Appeals for the Second Circuit, citing the *Legal Tender Cases*,¹²² held that a duty under a bill of lading to pay freight in British sterling entered into prior to Britain’s abandonment of the gold standard “would be satisfied by the payment of the agreed number of pounds, regardless of their depreciation in the currency of other countries.” The court arrived at this conclusion notwithstanding the fact that “[w]hen the contract was entered into, Great Britain had not abandoned the gold standard, and the parties most probably believed that sterling would not suffer any depreciation in the rate of exchange.”¹²³ Again citing the *Legal Tender Cases*, the court stated that “there may be a difference between the expectations of the parties and the duties it imposes.”¹²⁴

This case recognizes that a foreign currency contract is necessarily subject to the power of a foreign government over its currency. Moreover, the fact that a monetary reform may have been unforeseeable at the time the contract was entered into is irrelevant since the contract imposes a duty to pay that which is recognized as lawful money in the country of issue at the time payment is to be made.

8. The Great Depression and the U.S. Departure from the Gold Standard

a. *The Gold Clause Cases*

The decisions of the U.S. Supreme Court in the *Gold Clause Cases*, decided after the U.S. abandoned the gold standard in response to the Great Depression in the early 1930s, re-confirmed the State theory of money and its implications for private contracts. The paper greenback currency not backed by specie that was issued during the American Civil War had been phased out by the end of the 1870s, firmly placing the U.S. dollar on a gold standard that brought monetary stability to the United

¹¹⁸*Id.* at 386 (citations omitted).

¹¹⁹*Id.* (citing *Chesterman’s Trust*, (1923) 2 Chancery 466 at 478-86).

¹²⁰For a description of these events see GUTTMANN, *supra* note 91, at 358-62; Kenneth W. Dam, *From the Gold Clause to the Gold Commission: A Half Century of American Monetary Law*, 50 U. CHI. L. REV. 504, 506, 509 (1983).

¹²¹63 F.2d 240, 241 (2d Cir. 1933) (citing *Legal Tender Cases*; *Deutsche Bank v. Humphrey*, 272 U.S. 517 (1926), discussed *infra* pp. 71-72).

¹²²*See supra* pp. 37-39.

¹²³*Booth*, 63 F. 2d at 241.

¹²⁴*Id.*

States for half a century.¹²⁵ The international monetary crisis that undermined one monetary system after another during the inter-War years reached the United States in 1933, resulting in a severe depletion of U.S. gold reserves and a decision by President Franklin D. Roosevelt to order the discontinuance of all payments in gold.¹²⁶ In June 1933 the U.S. Senate and House of Representatives passed a Joint Resolution providing that Federal Reserve notes constituted U.S. currency and legal tender for all debts, public and private.¹²⁷ The establishment of paper notes issued by the Federal Reserve as legal currency in the United States caused the U.S. dollar to depreciate, floating downwards until January 1934 when President Roosevelt fixed the gold weight of the dollar at 59.06% of its former gold parity.¹²⁸ While the dollar's value was again linked to gold, the paper notes issued by the Federal Reserve could no longer be redeemed in gold.¹²⁹ The issuance of paper currency as legal tender marked the end of the gold standard.¹³⁰

As the U.S. went off the gold standard, Congress abolished the “gold clauses” that were widely used in the financial markets which called for the repayment of debts in “gold coin of the United States” or an amount of U.S. dollars measured thereby.¹³¹ Because so many private financial obligations routinely contained a gold clause, Congress felt that the existence of such clauses obstructed its ability to regulate the value of the dollar and maintain the equal power of the dollar with dollar obligations in the financial markets, leading to the danger of a dual monetary system comprising gold dollar obligations and non-gold dollars.¹³²

In the *Gold Clause Cases*,¹³³ the Supreme Court upheld the power of Congress to abolish gold clauses in private contracts. The Court held that the gold clauses “were not contracts for payment in gold coin as a commodity, or in bullion, but were contracts for the payment of money.”¹³⁴ Relying on the *Legal Tender Cases*, the Court reiterated that “Congress may make Treasury notes legal tender in payment of debts previously contracted.”¹³⁵ Quoting the *Legal Tender Cases* the Court stated that “contracts must be understood as having been made in reference to the possible exercise of the rightful authority of the government”, and “no obligation of a contract ‘can extend to the defeat’ of that authority.”¹³⁶ To that extent contracts suffer from “a congenital infirmity.”¹³⁷ The Court repeated that the power over the currency is vested in Congress under the Constitution, and emphasized that Congress’

¹²⁵See Law of January 14, 1875, ch. 15, § 3, 18 Stat. 296 (repealed) (An Act to provide for the resumption of specie payments); Law of March 14, 1900, ch. 41, §§ 1, 2, 31 Stat. 45 (repealed) (“the dollar consisting of twenty-five and eight-tenths grains of gold nine-tenths fine . . . shall be the standard unit of value”) (An Act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes); see also NUSSBAUM, *supra* note 30, at 585, 594-97.

¹²⁶Exec. Order No. 6073 (1933); see also Dam, *supra* note 120, at 504, 509-14; NUSSBAUM, *supra* note 31, at 597-99.

¹²⁷Joint Resolution to assure uniform value to the coins and currencies of the United States, June 5, 1933, §§1(b), 2, 48 Stat. 112, 113 (repealed).

¹²⁸Proclamation No. 2072, 48 Stat. 1730, 1730-31 (1934); see also NUSSBAUM, *supra* note 31, at 600-01.

¹²⁹See 12 U.S.C.S. § 411 (1992).

¹³⁰See *Gajewski v. C.I.R.*, 67 T.C. 181, 193 (1976).

¹³¹Joint Resolution to assure uniform value to the coins and currencies of the United States, June 5, 1933, § 1(a), 48 Stat. 112, 113 (repealed).

¹³²See *Norman v. Baltimore & Ohio R.R. Co.*, 294 U.S. 240, 311-16 (1935).

¹³³*Norman*, 294 U.S. at 298-316; see also *Perry v. United States*, 294 U.S. 330 (1935); *Nortz v. United States*, 294 U.S. 317 (1935).

¹³⁴*Norman*, 294 U.S. at 302.

¹³⁵*Id.* at 302-03 (citing *Legal Tender Cases*).

¹³⁶*Id.* at 303-05 (quoting *Legal Tender Cases*).

¹³⁷*Id.* at 308.

authority over the currency “is derived from the aggregate of the powers granted to Congress” which are “appropriate to achieve the great objects for which the government was framed - a national government, with sovereign powers.”¹³⁸

In short, the *Gold Clause Cases* re-confirmed that the power to establish a monetary system is an inherent attribute of a sovereign state, and that every private contract for the payment of money is necessarily subject to that sovereign power. The *Gold Clauses Cases* continue to be relied upon in modern cases upholding the constitutional authority of Congress over the currency, including its power to authorize the issue of paper dollar notes by the Federal Reserve.¹³⁹ It has been emphasized that the power of Congress “to say what should be the medium of exchange, or money” is not derived from the provisions of the U.S. Constitution, but rather is an “inherent right” that is possessed by the United States “by virtue of its own sovereignty, even if it had not been mentioned in the organic law.”¹⁴⁰ Thus, “every person who enters into a contract is, in law, conclusively deemed to hold in contemplation the power of the Congress to alter and change the nature and so-called value of the medium of exchange or money of the nation.”¹⁴¹ It is a logical corollary of this that every contract denominated in a foreign currency is also necessarily subject to the sovereign power of a foreign state over its currency. Thus, in one case upholding Congress’ authority to alter the weight and fineness of the gold dollar, attention was drawn to “the numerous instances in history, from early times to the present, of such revaluation by practically every country in the world.”¹⁴²

This power of a sovereign over its currency extends to the use of the sovereign’s currency by non-nationals outside the sovereign’s jurisdiction in contracts governed by the laws of third countries. This point is well demonstrated by a New York case decided in the aftermath of the *Gold Clause Cases*.

In *Compañía de Inversiones Internacionales v. Industrial Mortgage Bank of Finland*,¹⁴³ a Finnish corporation issued bonds to a Colombian corporation denominated “in gold coin of the United States of America of the standard of law of the weight and fineness as it existed” at the time of issuance. New York law was the governing law of the contract.¹⁴⁴ The New York Court of Appeals held that the Congressional prohibition on the use of gold clauses in private contracts applied to foreign debtors as well as U.S. citizens since “to enforce gold clauses in foreign dollar bonds and not in domestic bonds would, in effect, be the equivalent of maintaining, in some degree at least, a dual monetary system.”¹⁴⁵ The court declined to enforce the gold clause, stating that in view of the important public policy of the United States implicated by the Congressional abolition of the gold clauses (i.e., “to establish a uniform currency, and parity between different kinds of currency, and to make that currency, dollar for dollar, legal tender for the payment of debts”), it was “immaterial whether the obligations of these bonds would otherwise be governed by some foreign law.”¹⁴⁶

¹³⁸*Id.* at 303 (quotations omitted).

¹³⁹*See, e.g.,* *Adams v. Burlington N. R.R. Co.*, 80 F.3d 1377, 1383 (9th Cir. 1996), *cert. den.* 117 S. Ct. 171 (1996); *Richardson v. State of Utah*, 36 F.3d 1005 (10th Cir. 1994); *Rudolph v. Steinhardt*, 721 F.2d 1324, 1329-30 (11th Cir. 1983); *United States v. Rickman*, 638 F.2d 182, 184 (10th Cir. 1980); *Southern Capital Corp. v. S. Pac. Co.*, 568 F.2d 590, 591-92 (8th Cir. 1978).

¹⁴⁰*Re Missouri Pac. Ry. Co.*, 7 F. Supp. 1, 5 (E.D. Mo. 1934).

¹⁴¹*Id.* at 12.

¹⁴²*Bakewell v. United States*, 28 F. Supp. 504, 505 (E.D. Mo. 1939), *aff’d* 110 F.2d 564 (8th Cir. 1940).

¹⁴³198 N.E. 617 (N.Y. 1935).

¹⁴⁴*Compañía de Inversiones*, 198 N.E. at 618.

¹⁴⁵*Id.* at 620.

¹⁴⁶*Id.* at 620-21.

Significantly, the court pointed out that “decisions in foreign jurisdictions have likewise affirmed the joint resolution as a defense in actions” brought to enforce gold dollar obligations based on gold clauses, and the court cited to court decisions in the Netherlands, Austria, Denmark, Germany and England refusing to enforce gold dollar obligations based on the U.S. Congress’ prohibition of the gold clause.¹⁴⁷ The court highlighted in particular a decision of the Dutch Court of Appeal at the Hague in *Amsterdam Stock Exchange Commission v. Bataafsche Petroleum Maatschappij*,¹⁴⁸ where the U.S. Congressional resolution was held to be a defense to an attempt to collect in Holland the gold value of U.S. dollar bonds issued by a Dutch corporation to Dutch bondholders.¹⁴⁹

Thus the Congressional resolution was applied notwithstanding the fact that the Netherlands appeared to have sufficient contacts for Dutch law to be the governing law of the contract.¹⁵⁰ The clear implication here is that the New York courts would similarly recognize and enforce the laws of foreign countries regulating private contractual relationships pursuant to the exercise of the sovereign power of a foreign country to establish and regulate its own monetary system. Such laws enacted by foreign jurisdictions would be enforced by the New York courts regardless of whether the contracts in question are governed by New York law and regardless of whether they involve U.S. contracting parties.

U.S. courts also accept that the constitutional power of a sovereign over its currency extends not only to the regulation of monetary obligations denominated in that sovereign’s currency in accordance with the recurrent link, but also to the regulation of private contractual obligations that are inextricably linked to such monetary obligations denominated in the sovereign’s currency. This point can be demonstrated by the decision of the U.S. Supreme Court in *Guaranty Trust Co. v. Henwood*.¹⁵¹ There an aggregate principal amount of \$100 million forty-year bonds denominated in U.S. gold dollars were issued in 1912. The bonds contained a multiple currency provision permitting the bondholders to elect to be paid in any one of four alternative foreign currencies (Pound sterling, Dutch guilders, German marks or French francs) in lieu of U.S. dollars at the exchange rate between each of those currencies and the dollar at the time of the issue of the bonds.¹⁵² Following the depreciation of the U.S. dollar after the break with the gold standard, bondholders asserted their option to be paid in Dutch guilders at this fixed exchange rate, resulting in a payment in guilders with a foreign exchange value in dollars greater than the face amount of the bonds. The Supreme Court held that the multi-currency payment option fell afoul of the Congressional resolution proscribing gold clauses because

the admitted purpose of the multiple currency provision supplementing the gold clause was the same as the gold clause itself, that is, to afford creditors of United States debtors on domestic money obligations contractual protection against possible depreciation of United States money. It was a plan . . . specifically designed to require debtors to pay 1912 gold dollars or fixed amounts in foreign currencies which were the exact equivalents of gold dollars in 1912.¹⁵³

Thus the Supreme Court held that “these promises [to pay] in alternative currencies were not separate and independent contracts or obligations, but were parts of one and the same monetary obligation of the debtor”, an obligation that was denominated in U.S. dollars.¹⁵⁴ Concluding that the bonds were

¹⁴⁷*Id.* at 621.

¹⁴⁸Court of Appeal at The Hague, Jan. 15, 1935.

¹⁴⁹*Compañia de Inversiones*, 198 N.E. at 621.

¹⁵⁰See NUSSBAUM, *supra* note 31, at 430-31.

¹⁵¹307 U.S. 247 (1939).

¹⁵²*Henwood.*, 307 U.S. at 249-50.

¹⁵³*Id.* at 257.

¹⁵⁴*Id.* at 255-56.

“dischargeable in the same United States legal tender which other creditors in this country must accept”, the Court reiterated that “contracts between private parties . . . [are] created subject not only to the exercise by Congress of its constitutional power to coin money, . . . but also to the full authority of the Congress in relation to the currency.”¹⁵⁵

This case is important because it establishes that ancillary obligations that are inextricably linked to monetary obligations denominated in a particular currency are subject to the power of a sovereign government over its currency. Thus, interest rate obligations linked to a particular currency are subject to regulation by the government of the country that issues the underlying currency. This is because interest rates are inextricably linked to monetary obligations.¹⁵⁶ As stated by the Supreme Court in *Henwood*,¹⁵⁷ “interest is not paid on commodities but on monetary obligations.” The intimate relationship between interest rates and money is amply demonstrated by the fact that on the foreign exchange markets the differential between the spot and forward exchange rates for any two currencies will be largely dictated by the different interest rates obtainable with respect to an investment in each currency.¹⁵⁸

In *Bethlehem Co. v. Zurich Insurance Co.*,¹⁵⁹ the Supreme Court took the logic of its *Henwood* decision one step further, holding that the Congressional resolution proscribing gold clauses also applied to the same bonds with a multiple currency option held by foreign corporations, some of whom had purchased the bonds in transactions subject to the laws of foreign countries. The court below had held that the Congressional resolution was not applicable to such bonds, relying on a decision by the U.S. Court of Appeals for the Second Circuit which applied the law of the place of performance of the contract (in this case non-American law) to the question of whether payment under such bonds would be inconsistent with the resolution.¹⁶⁰ Because the Congressional resolution was not known to the law of the place of performance, the court had concluded that it would have been an invasion of the prerogative of other countries to apply the Congressional resolution.¹⁶¹ The Supreme Court overturned this decision, rejecting the argument that the Congressional resolution was inapplicable to bonds not subject to the laws of the United States.¹⁶² The Supreme Court held that the multiple currency provisions in the bonds could not be enforced by U.S. courts “irrespective of their place of making.”¹⁶³ The Supreme Court held that in the absence of any international treaty between the United States and another country which provided otherwise, the Congressional resolution would be applied because “it is enough that [the] bonds are obligations payable in the money of the United States.”¹⁶⁴ The Supreme Court was unwilling to enforce gold clauses in contracts governed by foreign laws not just because it would be contrary to the public policy of the United States to do so, but simply because the contract involved “obligations payable in the money of the United States.”¹⁶⁵ As pointed out in a subsequent New York case, the Supreme Court in

¹⁵⁵*Id.* at 258-59 (quotations omitted).

¹⁵⁶See MANN, *supra* note 20, at 74 (one of the “principal characteristics” of “monetary obligations” is that “they are capable of carrying interest”); NUSSBAUM, *supra* note 31, at 342 (describing interest as “a pecuniary phenomenon”).

¹⁵⁷307 U.S. at 255.

¹⁵⁸See ALLAN M. LOOSIGAN, FOREIGN EXCHANGE FUTURES: A GUIDE TO INTERNATIONAL CURRENCY TRADING 61-63 (1981).

¹⁵⁹307 U.S. 265, 266-67 (1939).

¹⁶⁰*Zurich Gen. Accident & Liab. Ins. Co. v. Bethlehem Steel Co.*, 18 N.E.2d 673, 674 (N.Y. 1939) (following *Anglo-Continentale Treuhand, A.G. v. St. Louis Southwestern Ry. Co.*, 81 F.2d 11, 12-13 (2d Cir. 1936)).

¹⁶¹*Anglo-Continentale*, 81 F.2d at 12-13.

¹⁶²*Bethlehem*, 307 U.S. at 267.

¹⁶³*Id.*

¹⁶⁴*Id.*

¹⁶⁵*Id.*

Bethlehem “held that the obligation was subject to the will of Congress since it was a duty to pay in American money.”¹⁶⁶ Thus, the Supreme Court held that the monetary sovereignty of the United States over its currency extends to the regulation of monetary obligations contained in private contracts governed by the laws of foreign countries. This sovereignty extends to ancillary obligations that are inextricably linked to such monetary obligations. By analogy, the Court can also be reasonably expected to recognize the same exercise of sovereignty by foreign countries over monetary obligations denominated in the currencies of such foreign countries that are governed by the laws of American jurisdictions.

b. Implications of the Gold Clause Cases

In the *Gold Clause Cases* the U.S. courts asserted a broader sovereignty on the part of the United States over the U.S. dollar than has been recognized pursuant to the State theory of money by many foreign jurisdictions. In *Hellerman v. C.I.R.*,¹⁶⁷ it was noted that the *Gold Clause Cases* “further extended the power of Congress with respect to the currency.”¹⁶⁸ Mann suggests that the application of the law of the currency is confined to the determination of the character (*i.e.*, the definition) of foreign money, and that the effect of a currency change on the quantum of an obligation, including whether and under what circumstances redress against the effects of a currency change may be obtained, are questions of contract law to be determined in accordance with the governing law of the contract.¹⁶⁹ Thus, Mann argues that although the abrogation of a gold clause is a measure of monetary policy, the question of whether a gold clause is invalidated by legislation is purely a matter of contract law to be determined in accordance with the governing law of the contract rather than the law of the currency.¹⁷⁰ Both Mann and Nussbaum point out that it is the prevailing tendency in most foreign countries to submit the question of the effect of the abrogation of gold clauses to the governing law of the contract.¹⁷¹ Nonetheless, it appears that some foreign courts applied U.S. law as the law of the currency when enforcing the Congressional abrogation of the gold clause in the context of U.S. dollar contracts governed by foreign law.¹⁷²

This issue goes to the question of how to distinguish between the law of the currency and the governing law of the contract. According to the recurrent link, all monetary obligations denominated in the old currency must be discharged in the new currency at the conversion rate established by the law of the currency.¹⁷³ Thus, private contracts are necessarily subject to the application of the recurrent link established under the law of the currency. It is in this sense that the Supreme Court held in the *Legal Tender Cases*¹⁷⁴ that every contract for the payment of money is necessarily subject to the power of the government over the currency.¹⁷⁵ Legislation enacted by the state issuing the currency (e.g., German law in the case of the Deutsche mark) that provides for the continuity of all obligations in accordance with the

¹⁶⁶*South Am. Petroleum Corp. v. Colombian Petroleum Co.*, 31 N.Y.S.2d 771, 774 (N.Y. Sup. Ct. 1941).

¹⁶⁷77 T.C. 1361, 1365 (1981).

¹⁶⁸*See also* Laycock v. Kenney, 270 F.2d 580, 591 (9th Cir. 1959) (Congress’ “power over the monetary system ... is broader than mere regulation of the value of money”); John P. Dawson, *The Gold Clause Decisions*, 33 MICH. L. REV. 647, 676 (1935); Eder, *supra* note 43, at 66-68.

¹⁶⁹MANN, *supra* note 20, at 280, 287.

¹⁷⁰*Id.* at 299-300, 552-53.

¹⁷¹*Id.* at 299-300, 552 (citing to decisions of the highest courts of Austria, Belgium, Canada, Denmark, England, Germany and Sweden); NUSSBAUM, *supra* note 31, at 414-17, 422-23 (also citing to decisions of the highest courts of Hungary and Switzerland).

¹⁷²*See* NUSSBAUM, *supra* note 31, at 422 n.21, 430-31.

¹⁷³*See supra* pp. 35-36.

¹⁷⁴79 U.S. (12 Wall.) at 549.

¹⁷⁵*See also* Succession of Serrales, 200 U.S. at 118, discussed *supra* p. 43.

recurrent link forms part of the law of the currency and is applicable regardless of the governing law of the contract (e.g., New York law). Thus, the EU Council regulations providing for the continuity of all monetary obligations after EMU, including interest rate obligations, should be recognized by U.S. courts pursuant to the exercise of the monetary sovereignty of the European Union over the currencies of EU member states.

It appears that U.S. courts have defined the State theory of money even more expansively than this, permitting a country to exercise its monetary sovereignty so as to require not only the discharge of all monetary obligations in accordance with the recurrent link but also to alter or abrogate contractual rights in the aftermath of a currency change. Thus, in the *Gold Clause Cases* the Supreme Court and the New York Court of Appeals were willing to countenance the application of U.S. law as the law of the currency to invalidate gold clauses in contracts governed by foreign laws.¹⁷⁶

c. *Gold Clause Cases and EMU*

The expansive interpretation of the State theory of money enunciated in the *Gold Clause Cases* is relevant to the question of the application of certain provisions in the EU Council regulation relating to the performance of obligations during the proposed 3-year transitional period and the redenomination of outstanding bonds in transactions governed by the laws of U.S. jurisdictions.

With respect to the “no compulsion, no prohibition” principle, the general rule laid down by the EU Council regulation is that during the transitional period, prior to the introduction of euro banknotes, acts to be performed under legal instruments stipulating the use of or denominated in a national currency unit shall be performed in that national currency unit, while acts to be performed under legal instruments stipulating the use of or denominated in the euro unit shall be performed in that unit.¹⁷⁷ By way of exception to this general rule, any amount denominated either in the euro unit or in the national currency unit of a given participating member state and payable within that member state by crediting an account of the creditor can be paid by the debtor either in the euro unit or in that national currency unit.¹⁷⁸ The amount shall be credited to the account of the creditor in the denomination of his account, with any conversion being effected at the applicable conversion rate.¹⁷⁹

Under the narrow interpretation of the State theory of money it might be argued that an obligation originally denominated in an EU national currency such as the Deutsche mark that is governed by the laws of a U.S. jurisdiction and performable by way of credit transfer to a creditor’s account located in Germany may not be performed by the debtor by way of a payment in the euro unit in accordance with the applicable provisions of the EU regulation. The performance of obligations in the euro unit during the transitional period is not strictly necessary in order to facilitate the performance of obligations originally denominated in the EU national currencies. This is because such obligations may continue to be performed in the relevant national currency units until the introduction of euro banknotes. Therefore, the performance of obligations in the euro unit during the transitional period is not essential to the performance of obligations in accordance with the recurrent link. Rather, the payment by a debtor in the euro unit during the transitional period involves an alteration of the unit in which the obligation is performable that is not necessitated by the introduction of the single currency. This is so even though the amount must be credited to the account of the creditor in the denomination of his account at the applicable conversion rate.

¹⁷⁶See *Bethlehem*, 307 U.S. at 267; *Compañía de Inversiones*, 198 N.E. at 620-21.

¹⁷⁷Resolution of the European Council of 7 July 1997 on the legal framework for the introduction of the euro, Annex Draft Council Regulation on the introduction of the euro, 1997 O.J. (C 236/04), art. 8(3) [hereinafter Draft Council Regulation on the introduction of the euro].

¹⁷⁸See Draft Council Regulation on the introduction of the euro, *supra* note 177, art. 8(3), discussed *supra* pp. 18-20.

¹⁷⁹See *id.*

Moreover, the use of the euro unit in credit transfers does not affect the character or definition of the euro as the single currency. This is because bank money held on deposit at a financial institution is not money but rather represents indebtedness owed by a financial institution to a depositor for the amount deposited.¹⁸⁰ Thus, a funds transfer does not involve a transfer of money but rather entails a process whereby a creditor's bank becomes indebted to the creditor for the amount by which the indebtedness of the debtor's bank to the debtor is debited or reduced.¹⁸¹ On Mann's view, it might be argued that because the provisions of the EU Council regulation permitting credit transfers to be made in the euro unit do not affect the character or definition of the euro as a currency, these provisions do not form part of the law of the currency but rather relate to the law governing the performance of the contract. On this argument, the "no compulsion, no prohibition" provisions are inapplicable to transactions the performance of which are governed by the laws of a U.S. jurisdiction.

It is submitted however that under the broader interpretation of the State theory of money articulated in the *Gold Clause Cases* the "no compulsion, no prohibition" principle enshrined in the EU Council regulation is applicable to transactions governed by the laws of U.S. jurisdictions. Firstly, the monetary sovereignty of the European Union with respect to the currencies of EU member states extends to the regulation of ancillary obligations that are inextricably linked to monetary obligations denominated in the member states' currencies.¹⁸² The provisions of the EU Council regulation permitting obligations denominated in the member states' currencies that are performable by way of credit transfer to be paid in the euro unit involve the regulation of credit transfer obligations that are inextricably linked to underlying monetary obligations. Secondly, the alteration of the unit in which a debtor may perform a monetary obligation payable by way of credit transfer involves the alteration of a contractual obligation that is directly linked to the introduction of the euro. While the "no compulsion, no prohibition" principle is not strictly necessary in order to facilitate the performance of obligations in accordance with the recurrent link, it is an integral element in the changeover to the single currency. The conversion of the large stock of book-entry money on deposit with financial institutions into the euro unit during the transitional period is designed to play a vital role in the evolution of the euro as the single currency of the participating member states.¹⁸³ It is therefore submitted that the provisions of the EU regulation permitting obligations performable by credit transfer to be paid in the euro unit in accordance with the "no compulsion, no prohibition" principle are, under the logic of the *Gold Clause Cases*, applicable to obligations the performance of which are governed by the laws of U.S. jurisdictions.

The expansive interpretation of the State theory of money advanced in the *Gold Clause Cases* is also relevant to the question of the application to bonds issued under the laws of U.S. jurisdictions of the provisions of the EU Council regulation permitting the redenomination of outstanding debt. Under the EU Council regulation private issuers may during the transitional period redenominate in the euro unit outstanding debt denominated in the national currency unit of a member state that has redenominated all or part of its outstanding general government debt originally denominated in such national currency.¹⁸⁴ The EU Council regulation contemplates that this provision should be applicable in the jurisdictions of third countries such as the United States.¹⁸⁵ On a narrow view of the State theory of money it would seem difficult to argue that this provision is applicable to bonds issued under the laws of U.S. jurisdictions. The redenomination of bonds is not necessary in order to facilitate the performance of obligations after

¹⁸⁰See *Wheeling Steel Corp. v. Fox*, 298 U.S. 193, 213-14 (1936); *but see* *Vienna Park Properties v. United Postal Sav. Assoc.*, 976 F.2d 106, 116 (2d Cir. 1992) ("There is no question that ... funds held in [a bank] account ... are 'money' within [the UCC] definition"); Eder, *supra* note 43, at 68-69.

¹⁸¹WILLIAM D. HAWKLAND, UCC SERIES Prefatory Note (Art. 4A) at 1-7, esp. at 5-6 (Supp. 1996).

¹⁸²See *supra* pp. 54-56.

¹⁸³See *supra* pp. 19-20.

¹⁸⁴Draft Council Regulation on the introduction of the euro, *supra* note 177, art. 8(4), discussed *supra* pp. 21-22.

¹⁸⁵*Id.* preamble (14).

the introduction of the single currency. This is because during the transitional period it will be possible to perform contractual obligations denominated in the existing EU national currencies in the relevant national currency units or, if permitted under the “no compulsion, no prohibition” principle, in the euro unit by way of credit transfer.¹⁸⁶ Therefore, the redenomination of bonds is not necessary for the application of the recurrent link but rather involves an alteration of the unit in which the debt is stated that is not essential to the accomplishment of the changeover to the single currency. On Mann’s view, bond redenomination would therefore appear to involve a change to the terms of the contract that may only be accomplished in accordance with the governing law of the contract (i.e., New York law in the case of a eurobond governed by New York law).

Under the logic of the *Gold Clause Cases*, however, the provisions of the EU Council regulation on bond redenomination may be regarded as permitting an alteration of contractual terms that is closely related to the introduction of the euro. The provisions on bond redenomination may therefore be regarded as having been enacted pursuant to the monetary sovereignty of the European Union over EU national currencies. On this broader view of the State theory, issuers of bonds governed by New York law may rely on the EU Council regulation to redenominate outstanding bonds denominated in EU national currencies.

The expansive interpretation of the State theory suggested by the *Gold Clause Cases* could also be relevant to EMU if any EU member states introduce legislation revalorizing interest rates after EMU. It has been suggested that member states that have experienced high interest rates in recent years might legislate to revalorize coupons after EMU in order to alleviate any economic hardship that might be wrought upon the holders of long-term fixed rate obligations negotiated on the basis of a high interest rate climate.¹⁸⁷ While such hypothetical legislation might be primarily enacted for the protection of consumers (i.e., mortgagors), it could have important implications for financial markets.¹⁸⁸ On the broad view of the State theory of money articulated in the *Gold Clause Cases*, such legislation could be presented as an alteration of contractual rights effected pursuant to a state’s sovereign power over its currency in times of monetary change, analogous to the abrogation of the gold clause after the U.S. dollar was taken off the gold standard.

It is instructive to note that an English court adopting the narrower view of the State theory of money declined to apply German revalorization legislation to an insurance policy denominated in German marks and governed by English law where the German legislation sought to revalorize debts after the collapse of the Weimar German mark at a different rate from the rate at which the new Reichsmark substituted the old mark.¹⁸⁹ In view of the decision of the Supreme Court in *Bethlehem* and the decision of the New York Court of Appeals in *Compañía de Inversiones*, it appears that American courts have taken a broader view of the monetary sovereignty of a country over its currency.

9. Austro-German Anschluss (1938)

In March 1938 Germany annexed Austria, and immediately afterwards issued a decree introducing the German reichsmark as legal tender in Austria at the rate of one reichsmark to 1.5 Austrian schillings. In April 1938 Germany issued a decree providing for the cessation of the legal tender status of notes

¹⁸⁶See *id.* art. 8(3), discussed *supra* pp. 18-20.

¹⁸⁷See PARIBAS CAPITAL MARKETS, LEGAL IMPLICATIONS OF EUROPEAN MONETARY UNION 6-7 (1994).

¹⁸⁸See *id.*

¹⁸⁹See *Anderson v. Equitable Assurance Soc’y of the United States*, (1926) 134 L.T. 557 (C.A.); see also MANN, *supra* note 20, at 280-86.

issued by the Austrian National Bank and for the redemption of such notes in reichsmarks until the end of 1938 at the ratio of 3 schillings to 2 reichsmarks.¹⁹⁰

In *Oxford University Press, New York, Inc. v. United States*,¹⁹¹ the U.S. Customs Court considered the legal implications under U.S. customs legislation of these developments for the valuation of merchandise exported from Austria to the U.S. after the Anschluss. The collector was required to convert the appraisal value for merchandise denominated in Austrian schillings into U.S. dollars, and did so by converting the Austrian schilling amount into U.S. dollars on the basis of the 3:2 ratio between the schilling and the reichsmark.¹⁹² The Customs Court rejected the argument that there was no justification under the U.S. tariff law for “the conversion of foreign currency on the basis of an exchange rate adopted by foreign authorities”, holding that “the German decrees may be recognized under the doctrine of comity.”¹⁹³ In reaching this conclusion the court cited to the decision of the U.S. Supreme Court in *Hilton v. Guyot*,¹⁹⁴ where the doctrine of comity was defined as “the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.”

This case recognizes that foreign legislation providing for a monetary union such as occurred following the Austro-German Anschluss will be recognized under U.S. law. The same conclusion was reached in another customs case involving the exportation of merchandise after the Anschluss.¹⁹⁵

10. Japanese Military Currency Used in the Philippines During the Second World War

U.S. courts have recognized the application of the State theory of money to foreign currencies issued by belligerent occupants in the course of an international conflict. In *Aboitiz & Co. v. Price*,¹⁹⁶ the U.S. District Court for the District of Utah analyzed the legal status of military pass money issued by the Imperial Japanese government during the Japanese occupation of the Philippines during the Second World War. Under Japanese law the money, popularly known as “Mickey Mouse” money in the Philippines, was issued as legal tender for the payment of all debts at par with the pre-existing Philippine peso.¹⁹⁷ The court held that the Japanese war notes were a legal medium of exchange, and that “the power of a military occupant to issue a fiat currency for use in occupied territory is fully established and recognized by the United States, as well as in international law, and history, and practice.”¹⁹⁸ In reaching this conclusion, the court outlined the expansive nature of the power of a military government in occupied enemy territory to issue military currency. Citing with approval the study of a respected scholar, the court

¹⁹⁰For an account of these events see *Sabl v. Laenderbank Wien Aktiengesellschaft*, 33 N.Y.S.2d 764, 764-65 (N.Y. Sup. Ct. 1942); *Oxford Univ. Press, New York, Inc. v. United States*, 29 Cust. Ct. 191, 1952 WL 6769, *3 (Cust. Ct. 1952), *aff'd* 33 Cust. Ct. 479, 1954 WL 7554 (Cust. Ct. 1954).

¹⁹¹29 Cust. Ct. 191, 1952 WL 6769 (Cust. Ct. 1952), *aff'd* 33 Cust. Ct. 479, 1954 WL 7554 (Cust. Ct. 1954).

¹⁹²*Oxford Univ. Press*, 1952 WL 6769 at *6-7.

¹⁹³*Id.* at *8 (citing *Hilton v. Guyot*, 159 U.S. 113, 164 (1895)).

¹⁹⁴159 U.S. 113, 164 (1895).

¹⁹⁵*Klingerit, Inc. v. United States*, 14 Cust. Ct. 435, 1945 WL 4573 (Cust. Ct. 1945). For an interesting New York case involving an obligation contained in a contract governed by Austrian law entered into before the replacement of the schilling by the Reichsmark following the Anschluss, see *Sabl*, 33 N.Y.S.2d at 765-66, where it was held, in accordance with the relevant decrees issued after Germany's annexation of Austria, that an obligation in Austrian schillings would be converted into Reichsmarks at the 2:3 rate at which the Reichsmarks replaced the schilling. This case does not shed any light on how the obligation might have been treated if the contract had been governed by New York law.

¹⁹⁶99 F. Supp. 602 (D.Utah 1951).

¹⁹⁷*Aboitiz*, 99 F. Supp. at 606, 628-29.

¹⁹⁸*Id.* at 607-08, 612-15, esp. at 615.

stated that the occupant may exercise this power “in at least one of three ways”: (1) by reorganizing the local currency, including the creation of new types of currency or the supply of additional coverage for the currency (i.e., additional gold reserves); (2) by using the occupant’s own currency in the occupied region; or (3) by creating new types of money.¹⁹⁹ The court held that the belligerent occupant’s currency decrees were entitled to recognition because they were in the interests of the welfare of the inhabitants and “[g]reat inconvenience and disruption of most of the ordinary pursuits and business of society would have followed a failure to provide some medium of exchange.”²⁰⁰ The court took into account the extensive historic evidence demonstrating the existence of an occupant’s power to issue currency, alluding to the currency issued by the Continental Congress during the American War of Independence for use in British territory occupied by the colonial troops before the Declaration of Independence in 1776, the war currency issued by the rebel government of the Confederate states during the American Civil War, the occupation currencies issued by the United States and her allies in Italy, Germany and Austria towards the end of the Second World War, and innumerable occupation currencies issued by foreign powers going right back to the siege of Tyre in 1122.²⁰¹

The case is also interesting insofar as it reiterates that a foreign currency owes its monetary status to the fact that it is backed by a sovereign power. In *Aboitiz* an American prisoner of war had borrowed the Japanese war currency from a local bank, promising to repay in U.S. dollars at the rate of exchange of one U.S. dollar to two units of the Philippine military pass money.²⁰² The court rejected an argument that the contract was unenforceable because it involved the repayment of a loan of “Mickey Mouse” war money in “good hard American dollars,” emphasizing that the war notes “were guaranteed by the Japanese Imperial government” which stated in its proclamation that it took “full responsibility for their usage, having the correct amount to back them up.”²⁰³

The case also provides implicit support for the proposition that a debt denominated in an old foreign currency may be discharged in a new currency at the rate established for the conversion of the old currency into the new currency. In upholding the enforceability of the war currency loan, the court relied on a decision by the Supreme Court of the Philippines that a mortgage loan originally denominated in the pre-invasion Philippine peso had been validly discharged during the occupation by payment of the debt at par in the Japanese military fiat currency.²⁰⁴

Again, in *Bank of the Philippine Islands v. Rogers*,²⁰⁵ the U.S. District Court for the District of Columbia recognized that one of the rights that a belligerent occupant may exercise in an occupied country is that it “may regulate currency and may make the money it issues legal tender.” Thus, it was held that the Japanese military notes issued during the Japanese occupation of the Philippines in the Second World War were valid legal tender.²⁰⁶

These cases provide direct support for the application of the State theory of money under U.S. law. As explained by F.A. Mann, these cases reflect the principle that circulating media of exchange only constitute money in law if they are created by or with the authority of the state or such other supreme

¹⁹⁹*Id.* at 612-13 (citing ERNST HERMANN FEILCHENFELD, DIVISION OF INTERNATIONAL LAW, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE, THE INTERNATIONAL ECONOMIC LAW OF OCCUPATION para. 271 (1942)).

²⁰⁰*Id.* at 607-08, 612-14.

²⁰¹*Id.* at 614-15; *see also* NUSSBAUM, *supra* note 31, at 492-501.

²⁰²*Id.* at 605-07.

²⁰³*Id.* at 628-29.

²⁰⁴*Id.* at 613-14 (citing *Haw Pia v. China Banking Corp.*, *The Lawyers Journal* (Manila), 13 (1948), 173).

²⁰⁵165 F. Supp. 100, 107 (D.D.C. 1958) (citing *Aboitiz*).

²⁰⁶*Id.*

authority as may temporarily or de facto exercise the sovereign power of the state.²⁰⁷ In addition, Mann points out that *Aboitiz* supports the recurrent linking rule that a sum of money expressed and payable in the lawful currency of an occupied state may be discharged by the payment of so many military currency notes as, under the belligerent occupant's legal tender legislation, express the nominal value of the debt.²⁰⁸

11. Conversion of the German Reichsmark into the Deutsche Mark (1948)

U.S. courts have also had occasion to consider the legal status of obligations denominated in the former German Reichsmark after the introduction of the Deutsche mark as the currency of the Federal Republic of Germany in 1948. The Allied Commanders occupying the three western zones of the Federal Republic after the end of the Second World War issued an ordinance in 1948 converting the Reichsmark into the Deutsche mark at the rate of one Reichsmark for one Deutsche mark and converting Reichsmark debts generally at a rate of one Deutsche mark for ten Reichsmarks.²⁰⁹ In 1949 the American authorities in West Berlin issued a regulation providing for the conversion of all pre-occupation bank accounts (which had been blocked since the 1948 ordinance) at a rate of 20 Reichsmarks to one Deutsche mark.²¹⁰

In *Eisner v. United States*,²¹¹ the U.S. Court of Claims held that the task of the occupying powers "included the power to establish a rational monetary system." The court stated that "[t]he currency reform here in question was a sovereign act."²¹² Based on this, it was held that a U.S. citizen whose pre-occupation Reichsmark bank account in Berlin had been converted into a smaller amount of Deutsche marks by the currency reforms had no claim for recovery against the United States.²¹³

12. Chinese Monetary Reforms (1933-55)

A number of cases have come before American courts regarding the implications for private contracts of the Chinese monetary upheavals from 1933-55 and also regarding the legal status of the Chinese monetary system prior to these reforms. Before 1933 the Chinese monetary system was based around a number of regional units known as the tael (i.e., the Shanghai tael, the Chefoo tael, the Tien Tsin tael and various other taels).²¹⁴ The tael was a currency unit defined by reference to a specified weight in silver. Each regional tael was the only standard of value in that region and served as the sole currency in which all accounts were kept in the region. The tael was not issued as a coin by a governmental authority, but rather lumps of silver were melted down by private parties and presented to an official appointed by the financial community for certification as to their weight and fineness in terms of taels (e.g., as containing five taels and two-tenths, or three taels and one-seventh or whatever the case might be).

The U.S. courts recognized the monetary status of these silver coins, and in *Gordon v. Magone*,²¹⁵ the Circuit Court for the Southern District of New York held that "[i]t is not essential to a coin that ... it should bear the name or insignia of the sovereign" and that while the officer certifying the silver pieces

²⁰⁷MANN, *supra* note 20, at 19-20.

²⁰⁸*Id.* at 20 & n.97.

²⁰⁹*See id.* at 107-08; *Eisner v. United States*, 117 F. Supp. 197, 197-98 (U.S. Ct. Claims 1954).

²¹⁰*See Eisner*, 117 F. Supp. at 198-99.

²¹¹117 F. Supp. 197, 199 (U.S. Ct. Claims 1954).

²¹²*Eisner*, 117 F. Supp. at 199.

²¹³*Id.*

²¹⁴For a description of the pre-1933 Chinese monetary system, see *Gordon v. Magone*, 40 F. 747, 748-49 (C.C.S.D.N.Y. 1889).

²¹⁵40 F. 747, 749-50 (C.C.S.D.N.Y. 1889).

was “not directly an appointee of the government,... it [i.e., the government] seems to acquiesce in his discharging his functions.” The court noted that once certified, the silver pieces “circulate as the only money of account” and “being of a substance intrinsically valuable” are “as readily comparable with our standard as are the various gold and silver tokens of other countries.”²¹⁶ This case involves an interesting application of the State theory of money insofar as it holds that a medium of exchange can be legal currency where it is issued by private parties and circulates with the acquiescence of the government of the country of circulation.

In 1933 the Chinese government decided to establish a centralized monetary system. The government called in the regional taels and issued the silver dollar, a new currency whose value was also tied to the price of silver. In 1935 the Chinese Kuomintang Government issued a new paper currency not backed by silver, prohibiting the use of silver dollars or bullion for currency purposes and providing for the discharge of all contractual obligations expressed in terms of silver by the payment of paper notes in the nominal amount due (i.e., a 1:1 conversion). After the Second World War, the Government of the Republic of China introduced a new paper currency based upon the Gold Yuan which replaced the then heavily depreciated paper currency at the rate of 3 million dollars to 1 Gold Yuan. The Gold Yuan, in turn, rapidly depreciated, and after the Communists came to power two new currencies were introduced, successively replacing the pre-existing currency at conversion rates of 100,000:1 and 10,000:1, respectively, leaving the old currencies completely worthless.²¹⁷ In a majority of the cases that came before American courts following the collapse of the Chinese currency the State theory of money was applied. In one case, however, a contrary decision appears to have been reached.

Krenov v. West Coast Life Insurance Co.,²¹⁸ concerned an insurance policy whose benefits were payable in silver dollars “of the present weight and fineness” in 1933. The Supreme Court of Washington held that the policy did not call “for the payment of benefits in . . . silver dollars or their present equivalent in value”, but rather called “for the payment of premiums in the medium of exchange current at the time of each payment.”²¹⁹ The court stated that while the beneficiary would be harmed by the enforcement of the policy “as an ordinary insurance contract payable in the currency circulating legally at the time of payment”, this is “a type of loss which falls alike on all who deal in any given currency, and the risk of such loss is one normally incident to any transaction which involves a monetary investment.”²²⁰ Thus, while the insurance policy at issue may have been governed by Chinese law, the principle that foreign currency obligations must be satisfied in the currency legally circulating in the foreign country at the time of payment is applicable to all monetary transactions, regardless of governing law. This case supports the application of the State theory of money to foreign currency obligations.

Sternberg v. West Coast Life Insurance Co.,²²¹ was another case involving an insurance policy whose benefits were payable in a pre-1933 Shanghai silver currency “of the present weight and fineness.” The California District Court of Appeals refused to treat the policy “as a commodity contract for silver”, holding that the beneficiary could “recover only an amount equal to the cash surrender value of the policy in the current Chinese currency determined as of the date of requested payment.”²²² Relying on the *Legal Tender Cases* and the *Gold Clause Cases*, the court whole-heartedly endorsed the State theory of money:

²¹⁶Gordon, 40 F. at 750.

²¹⁷For a description of these events, see *Judah v. Delaware Trust Co.*, 378 A.2d 624, 627-28 (Del. 1977); *Sternberg v. W. Coast Life Ins. Co.*, 16 Cal. Rptr. 546, 547-48 (Cal. Dist. Ct. App. 1961).

²¹⁸292 P.2d 209 (Wash. 1956).

²¹⁹*Krenov*, 292 P.2d at 214.

²²⁰*Id.* at 213.

²²¹16 Cal. Rptr. 546 (Cal. Dist. Ct. App. 1961).

²²²*Sternberg*, 16 Cal. Rptr. at 548.

When parties name a specified currency for the payment of an obligation, they know that such a currency falls under the control of the government that issues it.... The pages of economic history are filled with the annals of fallen currencies of the past and with accounts of the rise and demise of media of exchange. Inherent in the idea of money itself lies the power of the sovereign to change its value.... Thus the courts have held that acceptance of a particular monetary symbol for the discharge of the debt constitutes an implied acceptance of the issuing government's control of the value of that symbol; the contract itself contains a 'congenital infirmity' equated to that control.²²³

The court rejected as irrelevant an argument based on California law being the applicable law as the place of performance, stating that the place of performance "cannot change the selected monetary media of payment."²²⁴ This case represents a comprehensive endorsement of the State theory of money as applied to foreign currency obligations.²²⁵

Finally, *Judah v. Delaware Trust Co.*,²²⁶ concerned preferred stock calling for the payment of dividends and the redemption price in a pre-1933 Shanghai local currency unit or, in the event that such currency unit ceased to be used or was substituted by another unit, in silver of the successor currency unit in an amount equal to the then current price of silver per currency unit. While the Supreme Court of Delaware accepted that the 1935 decree prohibited the use of silver for currency purposes, the court remanded the case to the lower court for a determination, *inter alia*, "whether the 1935 Decree is a revenue law not usually given extraterritorial effect."²²⁷ Whatever the impact of the 1935 decree on the state of the Chinese government's revenues, it is difficult to understand why the court failed to grasp that the decision to take the Chinese dollar off a silver standard was linked to the exercise of China's monetary sovereignty in the same way as the decision by the United States to take the dollar off the gold standard during the same period. It is submitted that the earlier cases regarding the implications of China's monetary reforms are to be preferred.

13. The Canadian Dollar and the Collapse of Bretton Woods (1970)

From the end of the Second World War until the early 1970s the international monetary system was based upon a system of near fixed exchange rates revolving around the official price of gold established for the U.S. dollar. This system, which was set up at the Bretton Woods conference towards the end of the War, depended for its stability on the convertibility of international dollars into gold. With the dollar glut in the late 1960s it became increasingly apparent that the United States would no longer be able to redeem international dollars in gold. The Bretton Woods system began to disintegrate, culminating in President Nixon's suspension of the dollar's convertibility in August 1971 and the advent of floating exchange rates.²²⁸ The Canadian government responded to the unraveling of Bretton Woods by removing

²²³*Id.* at 548-49 (quoting Gold Clause Cases).

²²⁴*Id.* at 550.

²²⁵This case has been cited by F.A. Mann as evidence of the application of the State theory of money under U.S. law. MANN, *supra* note 20, at 275 n.9.

²²⁶378 A.2d 624, 628-30 (Del. 1977).

²²⁷*Judah*, 378 A.2d at 631 (citations omitted).

²²⁸For a description of the operation of the Bretton Woods system, see NUSSBAUM, *supra* note 31, at 533-37. For a description of the collapse of Bretton Woods, see GUTTMANN, *supra* note 91, at 137-43. The implications of the collapse of Bretton Woods for the monetary limitations on liability contained in the Warsaw Convention for the Unification of Certain Rules Relating to International Transportation by Air, which were expressed in the French Poincaré gold franc current at the time the Warsaw Convention was opened for signature in 1929, were considered by the U.S. courts in a series of interesting cases. See *Franklin Mint Corp. v. Trans World Airlines, Inc.*, 690 F.2d 303, 307, 309-11 (2d Cir. 1982), *rev'd* 466 U.S. 243, 254-60 (1983); *Maschinenfabrik Kern A.G. v. Northwest Airlines, Inc.*, 562 F. Supp. 232,

the fixed par value of 0.925 Canadian dollars to U.S. \$1.00 in May 1970. As a result, the Canadian dollar appreciated against the U.S. dollar.²²⁹

In *ITT Arctic Services. v. United States*,²³⁰ a U.S. government contractor entered into a 3-year fixed price contract in 1969 with the U.S. Air Force under which it agreed to provide various services to Air Force operations in the Arctic Circle. Because the contractor was required under the terms of its agreement to hire Canadian labor and to pay such labor in Canadian dollars, the upward fluctuation in the Canadian dollar following its unpegging from the U.S. dollar necessitated the exchange of a greater number of U.S. dollars in order to meet the contractor's Canadian dollar obligations. The U.S. Court of Claims refused to allow the contractor to adjust the contract price based on a provision in the contract that permitted an adjustment to reflect labor cost increases required and approved by the Canadian government.²³¹ Citing the *Legal Tender Cases*, the Court stated that "in [fixed price contract] situations the payee party, absent a specific contract provision, assumes the risk of currency valuation changes."²³² In addition, the court stated that "[w]here one agrees to do, for a fixed sum, a thing possible to be performed, [one] will not be excused ... because unforeseen difficulties are encountered."²³³

The approach taken in this case was also adopted in a subsequent case enforcing a long-term contract notwithstanding the incurrence of increased costs as a result of the significant appreciation of the Swiss franc against the U.S. dollar following the collapse of Bretton Woods after the contract's execution in 1971.²³⁴

14. Exchange Control Regulations

That the State theory of money is accepted by the New York courts is demonstrated by several cases upholding the application of exchange control regulations imposed by foreign governments.

In *Eck v. N.V. Nederlansch Amerikaansche Stoomvaart Maatschappij*,²³⁵ the New York Supreme Court upheld the application of German exchange control regulations imposed during the Second World War to restrict the exchange of German reichsmarks for foreign currency to a contract payable in German reichsmarks. Rejecting an argument that German law was inapplicable because payment was to be made outside Germany, the court, citing the *Gold Clause Cases*, stated that "in currency legislation the policy of the sovereign governs the medium of payment, even though such payment is provided for outside the territorial jurisdiction of that sovereign."²³⁶ This case recognizes that monetary obligations are subject to the monetary sovereignty of the issuing state, regardless of what law governs the contract.

In *French v. Banco Nacional de Cuba*,²³⁷ a case concerning the validity of a Cuban exchange control regulation introduced after Fidel Castro's accession to power in 1959 to prevent the exchange of

237-40 (N.D. Ill. 1983); *In re Air Crash Disaster at Kimpo Int'l Airport, Korea on November 18, 1980*, 558 F. Supp 72, 73-75 (C.D. Cal. 1983); *In re Air Crash Disaster at Warsaw, Poland on March 14, 1980*, 535 F. Supp. 833, 839-44 (E.D.N.Y. 1982), *aff'd* 705 F.2d 85 (2d Cir. 1983); *Boehringer Mannheim Diagnostics, Inc. v. Pan Am. World Airways*, 531 F. Supp. 344, 349-54 (S.D. Tex. 1981), *rev'd* 737 F.2d 456, 457 (5th Cir. 1984).

²²⁹*See* *ITT Arctic Servs. v. United States*, 524 F.2d 680, 682 (Ct. Cl. 1975).

²³⁰524 F.2d 680 (Ct. Cl. 1975).

²³¹*ITT Arctic Servs.*, 524 F.2d at 684-91.

²³²*Id.* at 690 (citing *Legal Tender Cases*; *Deutsche Bank v. Humphrey*, 272 U.S. 517 (1926), discussed *infra* pp. 71-72).

²³³*Id.* at 691 (quoting *United States v. Spearin*, 248 U.S. 132, 136 (1918)).

²³⁴*Bernina Distribs., Inc. v. Bernina Sewing Mach.*, 646 F.2d 434, 437-40 (10th Cir. 1981).

²³⁵52 N.Y.S.2d 367, 369 (N.Y. App. Div. 1944).

²³⁶*Eck*, 52 N.Y.S.2d at 369 (citing *Gold Clause Cases*).

²³⁷242 N.E.2d 704, 710 (N.Y. 1968).

Cuban pesos into foreign currency, the New York Court of Appeals, citing the *Gold Clause Cases*, stated that “[a] currency regulation which alters either the value or the character of the money to be paid in satisfaction of contracts is not a ‘confiscation’ or ‘taking’”. Quoting F.A. Mann, the court stated that “[e]xpectations relating to the continuing intrinsic value of all currency or contractual terms such as the gold clause are, like favorable business conditions and goodwill, transient circumstances, subject to changes, and suffer from the ‘congenital infirmity’ that they may be changed by the competent legislator.”²³⁸

This language has been cited and relied upon in several more recent decisions upholding various exchange control regulations, including Mexican exchange controls introduced in response to the global debt crisis in the early 1980s.²³⁹

15. Principle of Monetary Nominalism

According to the principle of monetary nominalism a monetary obligation involves the payment of so much money as has a nominal value equal to the amount of the debt.²⁴⁰ Thus, an obligation to pay \$10 is discharged if the creditor receives what at the time of performance are \$10, regardless of the extent to which the intrinsic value or the functional value of the dollar may have changed in the meantime, either through an alteration in the metallic backing for the currency (e.g., when the dollar went off the gold standard) or a change in the dollar’s purchasing power through inflation, depreciation or devaluation.²⁴¹ The principle of monetary nominalism is closely related to the State theory of money and the recurrent link insofar as a change in the nature of money effected by the state such as taking a currency off the gold standard or devaluing a currency on the foreign exchange markets will not result in any change in the nominal amount of debts due under private contracts.²⁴²

The principle of monetary nominalism is widely accepted under U.S. law. Thus, in the *Legal Tender Cases*,²⁴³ the U.S. Supreme Court held that debts originally denominated in gold dollars could be validly discharged at their nominal value in paper dollars. Again, in *Effinger*,²⁴⁴ a Confederate dollar case, the Supreme Court stated that the normal rule is that “[w]here a contract is payable in a specified currency, the rule is ... clear that such currency is demandable and receivable at the maturity of the contract, whatever change in its value by increase or depreciation may have taken place in the mean time.” A striking application of the nominalistic principle occurred in *Bates v. United States*.²⁴⁵ There a taxpayer was assessed for capital gains based on a nominal gain realized on the sale of securities sold in 1935 that were purchased before the depreciation of the dollar following the abandonment of the gold standard. It was held by the U.S. Court of Appeals for the Seventh Circuit that a taxable gain had been realized because under the U.S. monetary system there could be no inequivalency of value, dollar for dollar, between dollars of “cost money” and dollars of “selling price money”.²⁴⁶ Again, in *Hellermann V.*

²³⁸French, 242 N.E.2d at 710-11 (quoting F.A. Mann, *Money in Public International Law*, 96 RECUEIL DES COURS 1, 90 (1959)).

²³⁹See *West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 831-32 (9th Cir. 1987) (Mexican regulations); *Braka v. Bancomer, S.A.*, 589 F. Supp. 1465, 1472-73 (S.D.N.Y. 1984), *aff’d* 762 F.2d 222 (2d Cir. 1985) (Mexican regulations); *Johansen v. Confederation Life Ass’n*, 312 F. Supp. 1056, 1064 (S.D.N.Y. 1970), *aff’d* 447 F.2d 175 (2d Cir. 1971) (Cuban regulations).

²⁴⁰See MANN, *supra* note 20, at 90.

²⁴¹*Id.* at 86-91.

²⁴²*Id.* at 92.

²⁴³79 U.S. at 548-59, discussed *supra* pp. 37-39.

²⁴⁴115 U.S. at 575, discussed *supra* p. 41.

²⁴⁵108 F.2d 407 (7th Cir. 1939).

²⁴⁶*Bates*, 108 F.2d at 409 (citing *Gold Clause Cases*).

C.I.R.,²⁴⁷ the U.S. Tax Court, relying on the *Legal Tender Cases* and the *Gold Clause Cases*, held that a nominal gain attributable solely to inflation is taxable income. Applying the principle of monetary nominalism, the court stated that “[d]ollars have constant legal value under the uniform monetary system created by Congress.”²⁴⁸ This case has been followed in subsequent tax rulings.²⁴⁹

The principle of monetary nominalism has also been applied by the Supreme Court in the context of sharp depreciations of foreign currencies. Thus in *Deutsche Bank v. Humphrey*,²⁵⁰ the Supreme Court, citing the *Legal Tender Cases*, held that a bank deposit of German marks

was and continued to be a liability in marks alone and was open to satisfaction by the payment of that number of marks, at any time, with whatever interest might have accrued, however much the mark might have fallen in value as compared with other things. An obligation in terms of the currency of a country takes the risk of currency fluctuations and whether creditor or debtor profits by the change the law takes no account of it. Obviously, in fact a dollar or a mark may have different values at different times but to the law that establishes it is always the same.

This case follows the principle of monetary nominalism and also recognizes that the nature of all money, including foreign money, is derived from the law that establishes such money.

The principle of monetary nominalism articulated in the *Legal Tender Cases* and *Deutsche Bank* has been repeatedly applied by American courts in cases involving foreign currencies, including the rapidly depreciating Russian, German and French currencies following the First World War,²⁵¹ the depreciating pound sterling following Britain’s abandonment of the gold standard in 1931,²⁵² the depreciating Italian currency during the Second World War,²⁵³ and the depreciating German currency after the Second World War.²⁵⁴

The principle of monetary nominalism has also been applied in the context of the more recent hyper-inflationary conditions experienced by many Latin-American economies. In *Tramontana v. S.A. Empresa de Viacao Aerea Rio Grandense*,²⁵⁵ the U.S. Court of Appeals for the D.C. Circuit held that where a person becomes entitled to 100,000 Brazilian cruzeiros which have, as a result of hyper-inflation

²⁴⁷77 T.C. 1361, 1364-66 (U.S. Tax Ct. 1981).

²⁴⁸Hellermann, 77 T.C. at 1366.

²⁴⁹See *Milkowski v. C.I.S.*, 46 T.C.M. (CCH) 732 (1983); *Collins v. C.I.S.*, 45 T.C.M. (CCH) 772 (1983) (“Gross income under the Internal Revenue Code is measured in United States dollars, without regard to the amount of goods a dollar will purchase in a particular taxable year”); *Spurgeon v. Franchise Tax Bd. of the State of California*, 206 Cal. Rptr. 636, 638-39 (Cal. Ct. App. 1984).

²⁵⁰272 U.S. 517, 519 (1926) (citing *Legal Tender Cases*; *Société des Hôtels le Touquet Paris-Plage v. Cummings*, (1922) 1 K.B. 451).

²⁵¹See *Parker v. Hoppe*, 178 N.E. 550, 551 (N.Y. 1931), *aff’d* 179 N.E. 770, 771-72 (N.Y. 1932) (court would award 100,000 rubles where the amount owing under the relevant contract was 100,000 rubles, regardless of the extent to which the purchasing power of the ruble and its value on the foreign exchange markets may have depreciated in the meantime); *Re James’ Will*, 161 N.E. 201, 202 (N.Y. 1928) (judgment in French francs would be satisfied by payment of “that certain number of francs without regard to their value” even though franc had fallen to half its value after judgment had been entered); *Re Illfelder’s Estate*, 240 N.Y.S. 413, 415-16 (N.Y. Surr. Ct. 1930), *aff’d* 249 N.Y.S. 903 (N.Y. App. Div. 1931) (bequest of 300,000 depreciating Weimar German marks).

²⁵²*Booth*, 63 F.2d at 241 (payment obligation in pound sterling “would be satisfied by the payment of the agreed number of pounds, regardless of their depreciation in the currency of other countries”).

²⁵³*Trans Am. Gen. Corp. v. Zumino*, 82 N.Y.S.2d 595, 602-4 (N.Y. Sup. Ct. 1948) (debt in the Italian lire as it depreciated from 1935-46).

²⁵⁴*Bonell v. Von Schultz*, 95 N.Y.S.2d 617, 619-20 (N.Y. Sup. Ct. 1950) (judgment for 10,000 Deutsche marks that depreciated after judgment).

²⁵⁵350 F.2d 468, 477 (D.C. Cir. 1965).

in Brazil, depreciated by more than 600 per cent, this would not “warrant a result different from that we would reach had the value of the cruzeiro in terms of the dollar remained unchanged.” The court emphasized that “an unpredictable and virtually immeasurable factor would be imported into the decisions of international conflict of laws cases if the otherwise applicable law were subject to being displaced because of the recent history of the relative values of the currencies involved.”²⁵⁶

Nominalism was again applied in the context of the appreciation of the Canadian dollar following its unpegging from the U.S. dollar during the disintegration of the Bretton Woods system of near fixed exchange rates. Thus, in *ITT Arctic Services*,²⁵⁷ where a U.S. government contractor sought to be relieved from a fixed price contract as a result of higher costs incurred following the Canadian dollar’s appreciation, the U.S. Court of Claims, citing the *Legal Tender Cases* and *Deutsche Bank*, held that in fixed price contracts “the payee party, absent a specific contrary contract provision, assumes the risk of currency valuation changes.”

Courts have supported the application of nominalism to foreign currencies because “when all jurisdictions ... share that philosophy and concept, we achieve uniformity of decision from one jurisdiction to the next and thus remove any incentive to forum shop.”²⁵⁸

Nominalism as applied to foreign currencies has acquired greater significance in recent years because of legislative reforms permitting American courts to award judgments in foreign currencies.²⁵⁹ Traditionally at common law American courts could only render judgment in U.S. dollars, and damages with respect to a breach of a foreign currency obligation that was governed by the laws of a U.S. jurisdiction would be converted from the relevant foreign currency into U.S. dollars based on the exchange rate prevailing on the date of breach of contract.²⁶⁰ The result of this was that there was no exchange rate risk with respect to the foreign currency between the date of breach and the date of judgment or satisfaction. An increasing number of state legislatures, including the New York, California and Illinois Legislatures, have passed legislation in recent years providing for the award and payment of judgments in foreign currencies.²⁶¹ Thus, in these jurisdictions the principle of nominalism will apply to all foreign currency obligations through to the date of judgment or payment, as the case may be.

There is one American decision that explicitly rejects the principle of monetary nominalism. In *Aluminum Co. of America v. Essex Group, Inc.*,²⁶² performance of a long-term service contract was held to have been rendered commercially impracticable where the price had been tied to a wholesale price index that completely underestimated the impact of inflation during the 1970s. In reaching this conclusion the U.S. District Court for the Western District of Pennsylvania criticized “as reprehensible the nominalist rule that a dollar’s a dollar no matter how small.”²⁶³ The court condemned “[t]he injustice of the nominalist position” as reflected in an English case, *Anderson v. Equitable Life Assurance Society*,²⁶⁴ where an insurance policy benefit for 60,000 marks was rendered worthless by German hyperinflation.²⁶⁵ Citing *F.A. Mann* and the experience of the American Civil War, the court stated that

²⁵⁶*Tramontana*, 350 F.2d at 477.

²⁵⁷524 F.2d at 690.

²⁵⁸*Pecaflor Constr., Inc. v. Landes*, 243 Cal. Rptr. 605, 607-8 (Cal. Ct. App. 1988).

²⁵⁹*See infra* pp. 130-32.

²⁶⁰*See infra* pp. 131-32.

²⁶¹*See infra* pp. 131-32.

²⁶²499 F. Supp. 53, 70-78 (1980).

²⁶³*Aluminum*, 499 F. Supp. at 77.

²⁶⁴42 T.L.R. 302 (1926).

²⁶⁵*Aluminum*, 499 F. Supp. at 77-78.

when “the problem [of serious sustained inflation] has arisen, here and abroad, courts and legislatures have repeatedly acted to relieve parties from great and unexpected losses.”²⁶⁶ The court concluded that it would reform (i.e., rewrite) the contract so as to prevent performance from being rendered commercially impracticable as a result of the unforeseen losses flowing from the draconian pricing formula.²⁶⁷

The suggestion that hyperinflation might render performance of a fixed price contract commercially impracticable is implicitly supported by *Publicker Industries Inc. v. Union Carbide Corp.*²⁶⁸ There is was held that a contract to supply ethanol at a fixed price had not been rendered impracticable by the dramatic price rise in ethanol that followed the energy crisis of the early 1970s. The District Court for the Eastern District of Pennsylvania held that “the mere fact that the cost of performance has doubled does not make performance impracticable”, and the court was “not aware of any cases where something less than a 100% cost increase has been held to make a seller’s performance ‘impracticable’”²⁶⁹ The implication here is that hyperinflationary conditions giving rise to inflation in excess of 100% might be sufficient to render performance impracticable.

Mann suggests that the *Aluminum* decision is a wholly isolated one and entirely out of favor.²⁷⁰ The *Aluminum* decision does, however, enjoy some academic support insofar as certain commentators have argued, based on decisions made by American courts during the American Civil War (including the Confederate dollar cases²⁷¹ and certain decisions handed down prior to the Supreme Court decisions in the *Legal Tender Cases*²⁷²), that in the event of an utter collapse of money American courts might not follow the nominalistic principle but rather adopt a revaluation device of some kind or develop other judicial relief.²⁷³ Nonetheless, even such commentators accept that a dramatic rise in prices would not of itself be enough²⁷⁴ and that the nominalistic concept of money should prevail except in emergency situations arising out of a monetary collapse.²⁷⁵ Moreover, American courts have not accorded relief to aggrieved parties in a significant number of cases arising out of the collapse or rapid depreciation of foreign currencies.²⁷⁶ The *Aluminum* decision would therefore appear to contradict the greater weight of established authority.

The courts do, however, sometimes take fluctuations in the value of money into account in calculating damages.²⁷⁷ In other respects, it has been suggested that American courts will in general only give consideration to the nominal value of money as laid down by legislation.²⁷⁸ In conclusion, therefore, the principle of monetary nominalism appears to be well established under U.S. law. Nominalism is

²⁶⁶*Id.* at 78 (citing F.A. MANN, *THE LEGAL ASPECT OF MONEY* (1938); ARTHUR LINTON CORBIN, 6 *CORBIN ON CONTRACTS* § 1360 (1962)).

²⁶⁷*Id.* at 78-80.

²⁶⁸17 U.C.C. Rep. Serv. 989 (E.D.Pa. 1975).

²⁶⁹*Id.*

²⁷⁰MANN, *supra* note 20, at 109 n.119.

²⁷¹*See supra* pp. 39-42.

²⁷²*See supra* pp. 37-39.

²⁷³*See* CORBIN, *supra* note 266, § 1360; Dawson & Cooper, *supra* note 63, at 893-98; Rashba, *supra* note 62, at 18-30.

²⁷⁴*See* Dawson & Cooper, *supra* note 63, at 894-95.

²⁷⁵*See* Rashba, *supra* note 63, at 29-30; *see also* CORBIN, *supra* note 266, § 1360.

²⁷⁶*See supra* pp. 48-49, 65-67.

²⁷⁷*See infra* pp. 132-34; *see also* Eder, *supra* note 43, at 65-66.

²⁷⁸*See* Eder, *supra* note 43, at 63.

consistent with the State theory of money and should therefore contribute to the continuity of contracts after EMU.

16. Comity and the Act of State Doctrine

The State theory of money may be properly regarded as flowing from the doctrine of comity.²⁷⁹ Comity has been judicially defined as “the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.”²⁸⁰ U.S. courts will not enforce foreign laws contrary to U.S. public policy by virtue of the doctrine of comity.²⁸¹

The State theory of money is also analogous to the act of state doctrine. The classic statement of the act of state doctrine is the Supreme Court’s formulation in *Underhill v. Hernandez*²⁸² that “[e]very sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in judgment on the acts of the government of another done, within its own territory.” Thus, in the context of government expropriations, the Supreme Court has stated that “the Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government, extant and recognized by this country at the time of suit, in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates customary international law.”²⁸³

Significantly, in *Steingut v. Guaranty Trust Co. of New York*,²⁸⁴ a case involving the depreciation of the Russian ruble by the Soviet government during the 1920s, the U.S. District Court for the Southern District of New York, citing the *Gold Clause Cases*, stated that the “pursuit of a policy of avowed monetary depreciation by a state is an act of state” and is “not subject to ... scrutiny” by American courts. In *Eisner*,²⁸⁵ it was held that the introduction of the Deutsche mark in substitution for the Reichsmark in Germany following the end of the Second World War “was a sovereign act.” In *Callejo v. Bancamer, S.A.*,²⁸⁶ the issuance of exchange control regulations “in response to a national monetary crisis” was recognized as an act of state because “the power to issue exchange control regulations is paradigmatically sovereign in nature.”²⁸⁷ Again, in *Grass v. Credito Mexicano, S.A.*,²⁸⁸ it was held that a “[foreign] government’s currency control decisions plainly are beyond inquiry by this court under the act of state doctrine.” Similarly, the establishment of a new currency by a country is also an act of state free from scrutiny by American courts. This is consistent with the general recognition under international law of the sovereignty of a state with respect to the regulation of its own currency.²⁸⁹

²⁷⁹See *supra* p. 62.

²⁸⁰*Hilton v. Guyot*, 159 U.S. 113, 164 (1895), *quoted in* *Société Nationale Industrielle Aerospatiale v. U.S. Dist. Court for the S. Dist. of Iowa*, 482 U.S. 522, 543-44 n.27 (1987).

²⁸¹See *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519, 589 (1839); *see also* *Sabbatino*, 376 U.S. at 409.

²⁸²168 U.S. 250, 252 (1897), *quoted in* *United States v. Pink*, 315 U.S. 203, 233 (1942); *see also* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 443 (1987).

²⁸³*Sabbatino*, 376 U.S. at 428; *see also* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 443 (1987).

²⁸⁴58 F. Supp. 623, 640 (S.D.N.Y. 1944) (citations omitted), *aff’d as modified* 161 F.2d 571 (2d Cir. 1947).

²⁸⁵117 F. Supp. at 199, discussed *supra* pp. 64-65.

²⁸⁶764 F.2d 1101, 1116 (5th Cir. 1985).

²⁸⁷See *also* *Riedel v. Bancam, S.A.* 792 F.2d 587, 592 (6th Cir. 1986) (following *Callejo*).

²⁸⁸797 F.2d 220, 222 (5th Cir. 1986) (citing *Callejo*).

²⁸⁹See *infra* p. 87.

Traditionally, the act of state doctrine has been regarded as resting upon notions of international comity,²⁹⁰ but in more recent times the major underpinning of the doctrine has been viewed as the policy of foreclosing court adjudications involving the legality of acts of foreign states on their own soil that might embarrass the Executive Branch of the Federal Government in the conduct of foreign relations.²⁹¹ In essence, the doctrine operates as a super-choice-of-law rule, requiring that foreign law be applied in certain circumstances even where the foreign law may be contrary to U.S. conceptions of public policy.²⁹² As a federal rule, the act of state doctrine supersedes conflicting state law, including conflicting state legislation.²⁹³

Under the act of state doctrine the sovereign act of a foreign state modifies a contractual obligation where the location or situs of the obligation is located inside the foreign sovereign's territory.²⁹⁴ Various tests have been proffered for a determination of the situs of an intangible obligation such as a debt. One test that has been adopted for determining the situs of an obligation for act of state purposes is whether the relevant act of state was able to come to complete fruition within the dominion of the acting state.²⁹⁵ This test has emphasized the place of payment of an obligation such as a debt.²⁹⁶

A more prevalent test holds that for purposes of the act of state doctrine a debt does not have its situs in a foreign state unless the state has the power to enforce or collect it, a power which is often stated to be dependent upon jurisdiction over the debtor or the debtor's assets.²⁹⁷ It has also been suggested under this test that when a debt or other obligation is not payable at all in the foreign state, the act of state doctrine is inapplicable because the foreign sovereign has no power to enforce or collect the debt.²⁹⁸

A third test is to fix the situs where the incidents of the debt, as a whole, place it.²⁹⁹ Under this more flexible test a wide variety of factors may be taken into account in order to determine whether the ties of the debt to the foreign country are sufficiently close that the U.S. courts would antagonize the foreign government by not recognizing its acts.³⁰⁰ This approach is consistent with the fact that the courts

²⁹⁰See, e.g., *First Nat'l City Bank v. Banco Nacional de Cuba*, 406 U.S. 759, 765 (1972); *Oetjen v. Cent. Leather Co.*, 246 U.S. 297, 303-04 (1918).

²⁹¹See, e.g., *Alfred Dunhill of London, Inc. v. Cuba*, 425 U.S. 682, 697 (1976); *First Nat'l*, 406 U.S. at 767-68; *Sabbatino*, 376 U.S. at 421-23, 427-28; see also *W.S. Kirkpatrick & Co., Inc. v. Evtl. Tectonics Corp., Int'l*, 493 U.S. 400, 404 (1990) (quoting *Oetjen* and *Sabbatino*); Margaret E. Tahyar, Note, *The Act of State Doctrine: Resolving Debt Situs Confusion*, 86 COLUM. L. REV. 594, 606-08 (1986).

²⁹²See *Callejo*, 764 F.2d at 1114 (citations omitted); see also RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 443 reporters' note 1 (1987).

²⁹³See *Sabbatino*, 376 U.S. at 426-27; *Republic of Iraq v. First Nat'l City Bank*, 353 F.2d 47, 50-51 (2d Cir. 1965).

²⁹⁴See *Bandes v. Harlow & Jones, Inc.*, 852 F.2d 661, 666-77 (2d Cir. 1988); *Trinh v. Citibank, N.A.*, 850 F.2d 1164, 1171-72 (6th Cir. 1988); *Tchacos Co., Ltd. v. Rockwell Int'l Corp.*, 766 F.2d 1333, 1337-38 (9th Cir. 1985); *Callejo*, 764 F.2d at 1123-24; *Braka v. Bancomer, S.N.C.*, 762 F.2d 222, 224 (2d Cir. 1985); *Allied Bank Int'l v. Banco Credito Agricola*, 757 F.2d 516, 521-22 (2d Cir. 1985); *Vishipco v. Chase Manhattan Bank, N.A.*, 660 F.2d 854, 862 (2d Cir. 1981); *Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co.*, 392 F.2d 706, 712-16 (5th Cir. 1968); *Drexel Burnham Lambert Group, Inc. v. Galadari*, 610 F. Supp. 114, 117-18 (S.D.N.Y. 1985), modified 777 F.2d 877, 881-82 (2d Cir. 1985); *Libra Bank Ltd. v. Banco Nacional de Costa Rica, S.A.*, 570 F. Supp. 870, 877-84 (S.D.N.Y. 1983); *Perez v. Chase Manhattan Bank, N.A.*, 463 N.E.2d 5, 8-9 (N.Y. 1984); *Weston Banking v. Turkiye Garanti Bankasi*, 442 N.E.2d 1195, 1199 (N.Y. 1982); *J. Zeevi & Sons Ltd. v. Grindlays Bank (Uganda) Ltd.*, 333 N.E.2d 168, 173-74 (N.Y. 1975).

²⁹⁵See *Braka*, 762 F.2d at 224-25 (citing *Allied*, 757 F.2d at 521-22 (citing *Tabacalera*, 392 F.2d at 715-16)); *Drexel*, 610 F. Supp. at 118, modified 777 F.2d at 881.

²⁹⁶*Id.*

²⁹⁷See *Bandes*, 852 F.2d at 667 (citing *Menendez v. Saks and Company*, 485 F.2d 1355, 1364 (2d Cir. 1973), *rev'd in part on other grounds sub nom.* *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976)); *Trinh*, 850 F.2d at 1172 (citing *Vishipco*, 660 F.2d at 862 (citing *Menendez*)); *Perez*, 463 N.E.2d at 8; *Weston Banking*, 442 N.E.2d at 1199 (citing *Zeevi*, 333 N.E.2d at 173-74).

²⁹⁸See *Perez*, 463 N.E.2d at 9.

²⁹⁹See *Callejo*, 764 F.2d at 1123; *Libra*, 570 F. Supp. at 881.

³⁰⁰See *Callejo*, 764 F.2d at 1123-24.

have in practice taken a wide variety of factors into account in determining debt situs,³⁰¹ including the place of payment,³⁰² the place of performance generally,³⁰³ the domicile, state of incorporation and/or place of business of the obligor,³⁰⁴ the place where the obligor's assets are located,³⁰⁵ the intent of the parties regarding the applicable law,³⁰⁶ the jurisdiction whose courts the parties have submitted to,³⁰⁷ the currency in which the payment is to be made,³⁰⁸ the place where the negotiations take place and/or the contract is entered into,³⁰⁹ the involvement of the American banking system in the transaction,³¹⁰ and a country's interest in maintaining a stable economy.³¹¹ Thus, while the governing law of the contract may provide an indication as to where the situs of the obligation is located, the governing law is not dispositive and an obligation that is expressly stated to be governed by the law of a particular state may find its situs in a different state.³¹²

The introduction of the euro is an act of state, and under the act of state doctrine the EU Council regulations relating to the introduction of the single currency are therefore applicable to all contractual obligations whose situs are located in EU member states.³¹³ Thus, the EU Council regulations may be applicable to obligations denominated in EU national currencies that involve obligors based in EU member states and/or payments that are to be discharged within EU member states.³¹⁴ The fact that such obligations may be stated to be governed by New York law would not necessarily preclude such an application of the act of state doctrine, particularly where the ties between the transaction and the EU member states are especially strong. Conversely, the act of state doctrine would not of itself trigger the application of the EU Council regulations where the nexus between the transaction and the EU member states is weak (e.g., a US\$/DM cross-currency swap between U.S. and Japanese counterparties).

Where the EU Council regulations are applicable to obligations whose situs are located in EU member states, such obligations will enjoy the benefit of all the applicable provisions of the EU Council regulations concerning the introduction of the euro. Thus, a eurobond whose interest and principal is

³⁰¹See Tahyar, *supra* note 291, at 601-05, 611-13.

³⁰²See Tchacosh, 766 F.2d at 1338; Callejo, 764 F.2d at 1123; Braka, 762 F.2d at 224-25; Allied, 757 F.2d at 521; Drexel Burnham Lambert Group, Inc. v. Comm. of Receivers for A.W. Galadari, 810 F. Supp. 1375, 1391 (S.D.N.Y. 1993), *modified* 12 F.3d 317 (2d Cir. 1993); Drexel, 610 F. Supp. at 118; Libra, 570 F. Supp. at 882; Perez, 463 N.E.2d at 8-9.

³⁰³See Tchacosh, 766 F.2d at 1338.

³⁰⁴See *supra* note 302.

³⁰⁵See Libra, 570 F. Supp. at 882; Weston Banking, 442 N.E.2d at 1199.

³⁰⁶See Tchacosh, 766 F.2d at 1338; Callejo, 764 F.2d at 1123; Drexel, 610 F. Supp. at 118; Libra, 570 F. Supp. at 881-82.

³⁰⁷See Allied, 757 F.2d at 521; Drexel, 610 F. Supp. at 118; Libra, 570 F. Supp. at 881; Weston Banking, 442 N.E.2d at 1199.

³⁰⁸See Allied, 757 F.2d at 521; Drexel, 610 F. Supp. at 118.

³⁰⁹See Allied, 757 F.2d at 521; Drexel, 810 F. Supp. at 1391; Drexel, 610 F. Supp. at 118.

³¹⁰See Callejo, 764 F.2d at 1123.

³¹¹See Allied, 757 F.2d at 522.

³¹²See Michael Gruson, *The Act of State Doctrine in Contract Cases*, 635 PLI/COMM 129, 150-51 (1992). It should be noted that there is older authority holding that the act of state doctrine does not allow "inquiry by a court in the United States as to the validity of ... contracts governed by the laws of [foreign] states". *New York Times Co. v. City of New York Comm'n on Human Rights*, 361 N.E.2d 963, 972 (N.Y. 1977).

³¹³See Michael Gruson, *The Introduction of the Euro and its Implications for Obligations Denominated in Currencies Replaced by the Euro* 12-13 (June 21, 1997) (unpublished manuscript, on file with author).

³¹⁴See also Alan H. Kaufman (Jones, Day, Reavis & Pogue), *Overview: the U.S. and European Legal Context of the Euro Currency* 7 (Oct. 23, 1997) (unpublished manuscript, on file with author).

payable in an EU member state would, by virtue of the act of state doctrine, be entitled to the full benefit of the EU Council regulation's provisions on bond redenomination during the transitional period.

More broadly, the act of state doctrine provides indirect support for the exercise of the monetary sovereignty of the European Union with respect to all contractual obligations denominated in EU national currencies, regardless of whether such transactions are governed by the laws of American jurisdictions.

17. Summary

To sum up, the State theory of money enjoys widespread support among U.S. courts. As previously stated,³¹⁵ the U.S. Supreme Court has held that the obligation of a contract to pay money is to pay that which the law shall recognize as money at the time the payment is to be made.³¹⁶ The U.S. Supreme Court has held that every contract for the payment of money is necessarily subject to the constitutional power of the government over the currency, whatever that power may be, and the obligation of the parties is therefore assumed with reference to that power.³¹⁷ This power has been recognized by the U.S. Supreme Court as an attribute of sovereignty both in Europe and America.³¹⁸ The U.S. Supreme Court has recognized that legislation fixing the conversion rate at which an old currency is substituted by a new currency and providing for the discharge of debts originally denominated in the old currency at the fixed conversion rate in the new currency is derived from this power of a sovereign government over its currency.³¹⁹ Both the U.S. Supreme Court and the New York Court of Appeals have recognized that the monetary sovereignty of a country over its currency extends to the use of the country's currency by non-nationals outside the country's jurisdiction in contracts governed by the laws of other countries.³²⁰ The U.S. Supreme Court has applied the State theory expansively, holding that the monetary sovereignty of a government over its currency extends not only to the regulation of monetary obligations contained in a private contract, but also to the regulation of ancillary contractual obligations that are inextricably linked to such monetary obligations.³²¹ Thus, the monetary sovereignty of a foreign government over its currency can be regarded as extending to the regulation of interest rate obligations.³²²

In a small number of cases resulting from the collapse of foreign currencies, American courts did not always strictly adhere to the State theory, sometimes seeking to revalorize contractual obligations denominated in collapsed currencies so as to ascribe a real economic value to such obligations.³²³ It appears that the State theory was not always applied in such cases because the currencies in question were not issued by a legitimate government (as in the case of the Southern Confederacy) or perhaps because of the harshness involved in strictly applying the State theory to obligations denominated in collapsed currencies.³²⁴ These cases have little or no relevance to the highly organized plan by some of the United States' closest international allies for an orderly transition to a single European currency. Moreover, the State theory of money has been generally applied by American courts to obligations denominated in

³¹⁵See *supra* Executive Summary.

³¹⁶See *supra* pp. 37-39, 42-44, 51-53.

³¹⁷See *supra* pp. 37-39, 51-57.

³¹⁸See *supra* p. 38.

³¹⁹See *supra* p. 43.

³²⁰See *supra* pp. 53-57.

³²¹See *supra* pp. 54-56.

³²²See *supra* pp. 55-56.

³²³See *supra* pp. 39-42, 47, 49-50, 67.

³²⁴*Id.*

collapsed currencies (including the Russian ruble and former Chinese currencies), notwithstanding any harshness involved.³²⁵

C. U.S. Constitution and the State Theory of Money

The State theory of money has constitutional underpinnings. Under the U.S. Constitution, Congress is vested with the power “To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures.”³²⁶ This clause draws a clear distinction between the powers of Congress with respect to the domestic currency on the one hand and foreign currencies on the other. While Congress’ powers with respect to the establishment of the U.S. currency are plenary,³²⁷ Congress’ powers with respect to foreign currencies are confined to the regulation of the value of foreign coin. Historically, the power to regulate the value of foreign coin was thought necessary because of the high circulation of foreign coins in the American colonies prior to the U.S. Declaration of Independence.³²⁸ Pursuant to this power Congress enacted legislation in 1793 providing for the recognition of foreign gold and silver coins as current money in the United States and establishing rates against the U.S. dollar at which British, French, Portuguese and Spanish coins would pass as legal tender for the payment of all debts.³²⁹ All of these foreign coins had been gradually phased out as legal tenders by 1857.³³⁰

Clearly, the Constitution does not permit the U.S. Congress to coin foreign money, since this is a sovereign power vested in the governments of foreign countries. Congress’ only power with respect to foreign currency relates to the regulation of the exchange rate of foreign currencies in terms of U.S. dollars. Thus, the U.S. Constitution implicitly recognizes that it is the law of the currency that determines what things are money in a foreign country. By logical extension, it is the law of the currency that must determine how, in case of a currency alteration, sums expressed in the former currency are to be converted into the new one.³³¹

In addition, the fact that the State theory of money has constitutional underpinnings provides further support for the proposition that the State theory of money is rooted in federal common law. In *Sabbatino*,³³² the Supreme Court concluded that the act of state doctrine “must be treated exclusively as an aspect of federal law” partly because the doctrine has “constitutional underpinnings.” By analogy, the State theory of money should also be treated as part of federal common law.

D. Legislative Adoption of State Theory: Uniform Commercial Code

1. UCC Definition of Money

Significantly, the State theory of money has also been endorsed by the Uniform Commercial Code (the “UCC”). The UCC is a code of laws governing various commercial transactions that has been

³²⁵See *supra* pp. 47-50, 65-67.

³²⁶U.S. CONST. art. I, § 8, cl. 5.

³²⁷See, e.g., Legal Tender Cases and Gold Clause Cases, discussed *supra* pp. 37-39, 51-53.

³²⁸See NUSSBAUM, *supra* note 31, at 556-58, 564-65, 569.

³²⁹Law of Feb. 9, 1793, ch. V, § 1, 1 Stat. 300 (eliminated) (An Act regulating foreign coins, and for other purposes).

³³⁰Law of Feb. 9, 1793, ch. V, § 2, 1 Stat. 300 (eliminated) (An Act regulating foreign coins, and for other purposes); Law of Feb. 21, 1857, ch. LVI, 11 Stat. 163 (eliminated) (An Act relating to Foreign Coins and to the Coinage of Cents at the Mint of the United States); NUSSBAUM, *supra* note 31, at 556-58, 561, 571-74, 576.

³³¹See *supra* pp. 35-36.

³³²376 U.S. at 421-27, esp. at 423-24, 427.

adopted in all 50 states of the United States (except Louisiana in part).³³³ The Code was adopted in New York State in 1962.³³⁴ It has been suggested that the Code, by comprehensively enacting a whole field of commercial law, thereby replacing the pre-Code common law constructed around judicial precedents, “displaces the legal method of the Anglo-American common law and substitutes the legal method of the civil law”, the legal system prevailing in most continental European jurisdictions.³³⁵ As a result many courts have utilized analogy to fill gaps, relying on the policies of the UCC rather than resorting to the common law for authoritative guidance.³³⁶ Nonetheless, the common law tradition is so deeply embedded in the American legal system that judicial precedents have inevitably been accorded significant weight in the interpretation of Code provisions.³³⁷

The definition of money adopted by the UCC is of great significance to the analysis of the legal implications of EMU under the laws of New York State and other U.S. jurisdictions. Section 1-201(24) of the UCC defines “money” as “a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency.”³³⁸ The New York version of section 1-201(24) of the UCC defines “money” in similar terms as “a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency except that it does not include rare or unusual coins used for numismatic purposes” which “shall be considered goods”.³³⁹ This definition of money as “a medium of exchange authorized or adopted by a domestic or foreign government” has been uniformly adopted in all 50 states of the United States, Washington D.C. and the U.S. territories of Guam and the Virgin Islands.³⁴⁰

The legislative history preceding the adoption of the UCC sheds considerable light on the intentions of the Code drafters with respect to the definition of money. The official comments, which were written

³³³See HAWKLAND, *supra* note 181, §§ 1-101:01-02 (Art. 1).

³³⁴N.Y. U.C.C. (McKinney 1993).

³³⁵Mitchell Franklin, *On the Legal Method of the Uniform Commercial Code*, 16 LAW & CONTEMP. PROBS. 330, 333 (1951); *see also* HAWKLAND, *supra* note 181, §§ 1-102:02-09 (Art. 1).

³³⁶See HAWKLAND, *supra* note 181, §§ 1-102:06-07; 1-102:10-11 (Art. 1).

³³⁷See *id.* § 1-102:08 (Art. 1).

³³⁸U.C.C § 1-201(24), 1 U.L.A. 65 (1989).

³³⁹N.Y. U.C.C. § 1-201(24) (McKinney 1993).

³⁴⁰ **Alabama:** ALA. CODE § 7-1-201(24) (1993); **Alaska:** ALASKA STAT. § 45.01.201(25) (Michie 1996); **Arizona:** ARIZ. REV. STAT. ANN. § 47-1201(24) (West 1988); **Arkansas:** ARK. CODE ANN. § 4-1-201(24) (Michie 1991); **California:** CAL. U.C.C. § 1201(24) (West 1964); **Colorado:** COLO. REV. STAT. ANN. § 4-1-201(24) (West 1996); **Connecticut:** CONN. GEN. STAT. ANN. § 42a-1-201(24) (West 1990); **Delaware:** DEL. CODE ANN. tit. 6, § 1-201(24) (1993); **District of Columbia:** D.C. CODE ANN. § 28-1-201(24) (1996); **Florida:** FLA. STAT. ANN. § 671.201(24) (West 1993); **Georgia:** GA. CODE ANN. § 11-1-201(24) (1994); **Guam:** 13 GUAM CODE ANN. § 1201(24) (1996); **Hawaii:** HAW. REV. STAT. § 490:1-201(24) (1993); **Idaho:** IDAHO CODE § 28-1-201(24) (1995); **Illinois:** ILL. ANN. STAT. ch. 810, para. 5/1-201(24) (West 1993); **Indiana:** IND. CODE ANN. § 26-1-1-201(24) (West 1995); **Iowa:** IOWA CODE ANN. § 554.1201(24) (West 1995); **Kansas:** KAN. STAT. ANN. § 84-1-201(24) (1996); **Kentucky:** KY. REV. STAT. ANN. § 355-1-201(24) (Michie 1996); **Louisiana:** LA. REV. STAT. ANN. § 10:1-201(24) (West 1993); **Maine:** ME. REV. STAT. ANN. tit. 11, § 1-201(24) (West 1995); **Maryland:** MD. CODE ANN., COM. LAW § 1-201(24) (1997); **Massachusetts:** MASS. ANN. LAWS ch. 106, § 1-201(24) (Law Co-op. 1984); **Michigan:** MICH. STAT. ANN. § 19.1201(24) (Callaghan 1990); **Minnesota:** MINN. STAT. ANN. § 336.1-201(24) (West 1966); **Mississippi:** MISS. CODE ANN. § 75-1-201(24) (1972); **Missouri:** MO. ANN. STAT. § 400.1-201 (West 1994); **Montana:** MONT. CODE ANN. § 30-1-201(24) (1995); **Nebraska:** NEB. REV. STAT. (U.C.C.) § 1-201(24) (1992); **Nevada:** NEV. REV. STAT. ANN. § 104.1201(24) (Michie 1994); **New Hampshire:** N.H. REV. STAT. ANN. § 382-A:1-201(24) (1994); **New Jersey:** N.J. STAT. ANN. § 12A:1-201(24) (West 1962); **New Mexico:** N.M. STAT. ANN. § 55-1-201(24) (Michie 1993); **New York:** N.Y. U.C.C. § 1-201(24) (McKinney 1993); **North Carolina:** N.C. GEN. STAT. § 25-1-201(24) (1995); **North Dakota:** N.D. CENT. CODE § 41-01-11(24) (1983); **Ohio:** OHIO REV. CODE ANN. § 1301.01(x) (Anderson 1993); **Oklahoma:** OKLA. STAT. ANN. tit. 12A, § 1-201(24) (West 1963); **Oregon:** OR. REV. STAT. § 71.201(24) (1995); **Pennsylvania:** 13 PA. CONS. STAT. ANN. § 1201 (West 1984); **Rhode Island:** R.I. GEN. LAWS § 6A-1-201(24) (1992); **South Carolina:** S.C. CODE ANN. § 36-1-201(24) (Law Co-op. 1977); **South Dakota:** S.D. CODIFIED LAWS § 57A-1-201(24) (Michie 1988); **Tennessee:** TENN. CODE ANN. § 47-1-201(24) (1996); **Texas:** TEX. BUS. & COM. CODE ANN. § 1.201(24) (West 1995); **Utah:** UTAH CODE ANN. § 70A-1-201(24) (1990); **Vermont:** VT. STAT. ANN. tit. 9A, § 1-201(24) (1994); **Virginia:** VA. CODE ANN. § 8.1-201(24) (Michie 1991); **Virgin Islands:** V.I. CODE ANN. tit. 11A, § 1-201(24) (1995); **Washington:** WASH. REV. CODE ANN. § 62A.1-201(24) (West 1995); **West Virginia:** W.VA. CODE § 46-1-201(24) (1993); **Wisconsin:** WIS. STAT. ANN. § 401.201(24) (West 1995); **Wyoming:** WYO. STAT. ANN. § 34.1-1-201(xxiv) (Michie 1991).

by the Code drafters and have been extensively utilized by the courts in construing the provisions of the UCC,³⁴¹ state as follows with respect to the definition of “money”: “The test adopted is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.”³⁴²

Further light is shed on the thinking of the Code drafters regarding the definition of money by the comments and notes to Tentative Draft No. 1 of the Code.³⁴³ In explaining why “francs, sterling, lira or other recognized currency of a foreign government” are included within the definition of money, the Code drafters noted in particular that the definition “adopts the view of such cases as *Incitti v. Ferrante*”.³⁴⁴ In this case a New Jersey court stated that “[m]oney is purely a legal institution; it is impossible without law.”³⁴⁵ Quoting Aristotle’s *Politica*, the court defined money as follows: “Money by itself is but a mere device. It has value only by law and not by nature. So that a change of convention between those that use it is sufficient to deprive it of its value and of its power to purchase our requirements.”³⁴⁶

The legislative history preceding New York’s adoption of the UCC also helps to clarify the concept of money embraced by the UCC. The New York Law Revision Committee, which reported to the New York State Legislature in 1956 on the changes that the enactment of the Uniform Commercial Code would make to New York law, noted that “[t]he Code definition test of governmental backing is in accord with a New York case involving the statute of frauds”, *Reisfeld v. Jacobs*,³⁴⁷ where “the court emphasized the necessity of money’s being issued under the authority of and backed by the credit of a responsible government”.³⁴⁸ The Commission concluded that it was “[t]his idea of governmental sanction” that “is carried over into the Code definition of money.”³⁴⁹ This interpretation of the Code definition of money was reiterated by the Commission on Uniform State Laws in its 1961 report to the New York State Legislature regarding the changes which the UCC would effect to New York law.³⁵⁰

It is therefore with much justification that commentators, including F.A. Mann and Arthur Nussbaum, have pointed to the UCC definition of money as evidence of the recognition of the State theory of money under American law.³⁵¹ The definition of money in the UCC defines foreign money to be whatever medium of exchange is circulating with the sanction and backing of the government in the foreign country in question. This clearly requires American courts to look to the laws of the relevant jurisdictions issuing foreign currencies when seeking to determine the legal nature of such currencies.

³⁴¹See HAWKLAND, *supra* note 181, § 1-101:10 (Art. 1).

³⁴²U.C.C. § 1-201(24), off. cmt. 24, 1 U.L.A. 72 (1989); *see also* U.C.C. § 3-107, off. cmt.1, 2 U.L.A. 314 (1991).

³⁴³See AMERICAN LAW INSTITUTE, COMMERCIAL CODE: COMMENTS AND NOTES TO TENTATIVE DRAFT NO.1- ARTICLE III 37-39 (1946).

³⁴⁴*Id.* at 39 (citing *Incitti v. Ferrante*, 175 A. 908 (Bergen Cty. Ct. 1933)).

³⁴⁵*Incitti*, 175 A. at 910 (quoting ARISTOTLE, POLITICA).

³⁴⁶*Id.*

³⁴⁷176 N.Y.S. 223, 224 (N.Y. App. Div. 1919), discussed *supra* pp. 45-46.

³⁴⁸STATE OF NEW YORK LAW REVISION COMMISSION, STUDY OF UNIFORM COMMERCIAL CODE: ARTICLE 3 - COMMERCIAL PAPER, 2 STATE OF NEW YORK LAW REVISION REPORT 789, 805 (1955).

³⁴⁹*Id.*

³⁵⁰COMMISSION ON UNIFORM STATE LAWS, NEW YORK ANNOTATIONS TO UNIFORM COMMERCIAL CODE AND REPORT OF COMMISSION ON UNIFORM STATE LAWS TO LEGISLATURE OF NEW YORK STATE 95-96 (1961) (“The Code definition requirement of governmental backing seems to accord with New York decisional law” (citing *Reisfeld*)).

³⁵¹MANN, *supra* note 20, at 14-15; NUSSBAUM, *supra* note 31, at 9 n.32.

2. Scope of UCC Definition of Money

The definition of money is relevant not only to the provisions of the UCC but is applicable for other legal purposes. Indeed, the UCC definition of money can be properly regarded as a general legislative definition of money which has been adopted by all 50 U.S. state legislatures, including the New York State Legislature. Thus Article 2 of the Code is applicable to transactions in “goods”. The term “goods” is in turn defined to exclude the money in which the price is to be paid in a contract of sale. It must follow that an obligation to deliver money in which such a price is to be paid is governed by some set of rules outside the UCC. These rules are of course contained in the general common law principles that form the law of contracts. It follows, *a fortiori*, that the definition of money in the UCC can be regarded as the applicable definition for common law purposes, as well as for purposes of the UCC.

The argument that the definition of money used in the UCC is a general legislative definition of money is further supported by the purposes and policies underlying the UCC. In keeping with the civil law spirit of the Code, Article 1 provides that the Code “shall be liberally construed and applied to promote its underlying purposes and policies.”³⁵² The “[u]nderlying purposes and policies” of the UCC are, *inter alia*, “to simplify, clarify and modernize the law governing commercial transactions” and “to make uniform the law among the various jurisdictions.”³⁵³ In this vein Official Comment 1 to Section 1-102 of the UCC states as follows:

Courts ... have recognized the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the Act. They have done the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the Act in general. They have implemented a statutory policy with liberal and useful remedies not provided in the statutory text.³⁵⁴

Clearly, this approach to statutory interpretation strongly suggests that the UCC definition of “money” would be regarded by U.S. courts as a general definition of money applicable for all legal purposes. This would simplify and clarify the law governing commercial transactions by confirming the uniform application of the State theory of money for all legal purposes and in all jurisdictions of the United States. This would also serve to modernize the law governing commercial transactions by ensuring that American law remains consistent with the widespread international acceptance of the State theory of money.³⁵⁵

3. The UCC Definition of Money and the Euro

The euro will be authorized or adopted by the EU Council (comprising representatives of the governments of the EU member states) as the single currency of the EU member states participating in EMU. The euro will be recognized under the EU Council regulation on the introduction of the euro as the single official currency of the participating EU member states beginning on January 1, 1999.³⁵⁶ Thus, the euro will be issued on behalf of participating member states under the authority of the European Central Bank.³⁵⁷ The euro will be adopted by the EU Council as the sole medium of exchange. Legally, the euro will therefore be a perfect substitute for the EU national currencies in accordance with the applicable provisions of the EU Council regulation which will be directly applicable in EU member states.

³⁵²U.C.C. § 1-102(1), 1 U.L.A. 12 (1989).

³⁵³*Id.* § 1-102(2).

³⁵⁴ U.C.C. § 1-102(1), off. cmt. 1, 1 U.L.A. 12-13 (1989) (citations omitted).

³⁵⁵*See infra* p. 87.

³⁵⁶*See supra* pp. 15-17.

³⁵⁷*See supra* p. 17.

E. Legislative Adoption of State Theory: Uniform Foreign-Money Claims Act

The State theory of money has also been expressly incorporated into the laws of the 20 U.S. jurisdictions (including California and Illinois) that have adopted the Uniform Foreign-Money Claims Act.³⁵⁸ Approved in 1989 by the National Conference of Commissioners on Uniform State Laws, the Act was designed to change and clarify the law regarding judgments or obligations denominated in a foreign currency. Section 12(a) of the Act contains a provision regarding the “effect of currency revalorizations” which provides as follows:

If, after an obligation is expressed or a loss is incurred in a foreign money, the country issuing or adopting that money substitutes a new money in place of that money, the obligation or the loss is treated as if expressed or incurred in the new money at the rate of conversion the issuing country establishes for the payment of like obligations or losses denominated in the former money.³⁵⁹

This provision has been included in the adopting legislation of all 20 adopting jurisdictions (19 states and the U.S. territory of the Virgin Islands).³⁶⁰ The Uniform Act defines foreign money in terms similar to the UCC as “a medium of exchange for the payment of obligations or a store of value authorized or adopted by a government or by inter-governmental agreement.”³⁶¹ The drafters’ comments to the Uniform Act shed further light on these provisions. Comment 1 to Section 12 of the Act notes that the provision relating to the effect of currency revalorization

refers to situations in which a country authorizes the issue of a new money to take the place of the old money at a stated ratio. An example is Brazil’s recent abolition of cruzeros for cruzados. The subsection mandates that foreign money claims should be subjected to the same ratio.³⁶²

Comment 2 to Section 12 further notes that:

The Act takes no position on the effect of money repudiations or revalorizations so drastic as to be, in effect, confiscations. Remedy, if any, for these is usually found through diplomatic channels. Equally, the Act takes no position on the effect of exchange control laws. The effect, if any, on obligations to pay is left to other law.³⁶³

The Chairman and Reporter of the drafting committee of the Uniform Foreign-Money Claims Act have equated the effect of the provision to Mann’s “recurrent linking”.³⁶⁴

³⁵⁸See UNIF. FOREIGN-MONEY CLAIMS ACT Refs & Annos, Table of Jurisdictions wherein Act has been adopted (West 1996).

³⁵⁹UNIF. FOREIGN-MONEY CLAIMS ACT § 12(a) (1989).

³⁶⁰**California:** CAL. CIVIL PROC. ACT § 676.12(a) (West Supp. 1997); **Colorado:** COLO. REV. STAT. ANN. § 13-62.1-112(a) (West Supp. 1995); **Connecticut:** CONN. GEN. STAT. ANN. § 50a-62(a) (West 1997); **Hawaii:** HAW. REV. STAT. § 658B-12(a) (1993); **Illinois:** ILL. ANN. STAT. Ch. 735 para. 5/12-642(a) (West 1992); **Minnesota:** MINN. STAT. ANN. § 548.51(a) (West Supp. 1997); **Montana:** MONT. CODE ANN. § 25-9-713(1) (1995); **Nevada:** NEV. REV. STAT. ANN. § 17-650(1) (Michie Supp. 1996); **New Jersey:** N.J. STAT. ANN. § 2A:49A-13(a) (West Supp. 1996); **New Mexico:** N.M. STAT. ANN. § 39-4C-13(A) (Michie 1991); **North Carolina:** N.C. GEN. STAT. § 1C-1831(a) (1995); **North Dakota:** N.D. CENT. CODE § 32-41-12 (1995); **Ohio:** OHIO REV. CODE ANN. § 2337.12(A) (Anderson 1995); **Oklahoma:** OKLA. STAT. ANN. tit. 12, § 729.13(A) (West Supp. 1997); **Oregon:** OR. REV. STAT. § 24-315(1) (1995); **Utah:** UTAH CODE ANN. § 78-22b-113(1) (1996); **Virginia:** VA. CODE ANN. § 8.01-465.25 (Michie 1992); **Virgin Islands:** V.I. CODE ANN. tit. 11, § 1542(a) (1995); **Washington:** WASH. REV. CODE ANN. § 6.44.120(1) (West 1995); **Wisconsin:** WIS. STAT. ANN. § 806.41(1) (West 1994).

³⁶¹UNIF. FOREIGN-MONEY CLAIMS ACT § 1(7) (1989).

³⁶²UNIF. FOREIGN-MONEY CLAIMS ACT § 12, cmt.1 (1989).

³⁶³UNIF. FOREIGN-MONEY CLAIMS ACT § 12, cmt.2 (1989).

³⁶⁴Fairfax Leary, Jr. and Howard T. Rosen, *The Uniform Foreign Money Claims Act*, 12 U. PA. J. INT’L BUS. L. 51, 79 n.129 (1991) (citing to F.A. MANN, *THE LEGAL ASPECT OF MONEY* 44 n.92 (4th ed. 1982)).

There can be no doubt that this provision of the Uniform Foreign-Money Claims Act expressly incorporates into obligations denominated in EU currencies the irrevocably fixed conversion rates at which the euro will be substituted for currencies participating in EMU. This provision applies to all obligations (including interest rate obligations) expressed in a foreign currency, and by necessary implication requires the full application of legislation enacted by the issuing countries with respect to the continuity of obligations in the aftermath of the substitution of the EU national currencies by the euro.

Interestingly, the Uniform Foreign-Money Claims Act will be applied by all courts sitting in the adopting jurisdictions regardless of the governing law of the contract. Section 2(b) of the Act provides that the Act applies to foreign-money issues even if other law applies under the conflict of laws rules of the state in which the court is located to other issues in the action or proceeding.³⁶⁵ Thus if legal proceedings are instigated before the courts of California or Illinois by or against a foreign exchange dealer in San Francisco or Chicago with respect to a contract governed by New York law, the courts of California and Illinois will be required to apply local law to foreign money issues covered by the Uniform Foreign Money Claims Act such as the rules regarding the treatment of foreign currency obligations after the substitution of a new currency for an old one by a foreign country.

F. State Theory of Money and International Law

1. State Theory and Customary International Law

The State theory of money is widely recognized under the laws of other countries.³⁶⁶ Indeed, the recognition of the theory is so universal that it appears to form part of customary international law. In the *Serbian and Brazilian Loans* cases the Permanent Court of International Justice held that even though French gold franc bonds issued by the governments of Brazil and Serbia were not governed by French law, this “does not prevent the currency in which payment must or may be made in France from being governed by French law.”³⁶⁷ This is because it is

a generally accepted principle that a State is entitled to regulate its own currency. The application of the laws of such State involves no difficulty so long as it does not affect the substance of the debt to be paid and does not conflict with the law governing such debt.³⁶⁸

The recognition of the State theory of money under customary international law and its widespread acceptance by foreign states should help to convince American courts that the State theory is universally recognized and forms part of U.S. law.³⁶⁹

2. U.S. International Claims Commission

³⁶⁵UNIF. FOREIGN-MONEY CLAIMS ACT, § 2(b) and cmt (1989).

³⁶⁶See MANN, *supra* note 20, at 272-77 (citing to decisions of the highest courts of Austria, Belgium, Czechoslovakia, Egypt, France, Germany, Greece, Hungary, Italy, Switzerland and the United Kingdom, as well as the United States).

³⁶⁷*Serbian Loans*, 1929 P.C.I.J. (ser. A) Nos. 20/21, at 44 (July 12); *Brazilian Fed. Loans*, 1929 P.C.I.J. (ser. A) No. 27, at 122-23 (July 12).

³⁶⁸*Id.*

³⁶⁹For an interesting discussion of the uncertain status of customary international law - the law of nations - as part of U.S. federal common law, see A.M. Weisburd, *State Courts, Federal Courts and International Cases*, 20 YALE J. INT'L L. 1, esp. at 28-48 (1995). See also *In re Estate of Ferdinand E. Marcos Human Rights Litig.*, 978 F.2d 493, 502 (9th Cir. 1992); *Filartiga v. Pena-Irala*, 630 F.2d 876, 886-87 (2d Cir. 1980) (citations omitted).

The State theory of money has also been applied by U.S. international claims tribunals established by Congress to resolve disputes under international law. The best example of this is the adoption of the State theory by the U.S. International Claims Commission which dealt with many international claims by the U.S. and its nationals against the United States' war-time allies after the Second World War. The Commission was established by Congress in 1940 to adjudicate claims against foreign governments arising out of nationalizations and other takings of property.³⁷⁰ The Commission adjudicated claims according to "the applicable principles of international law, justice and equity."³⁷¹ While the decisions of the Commission (and the successor U.S. Foreign Claims Commission) are not binding precedents, they are of legal interest insofar as they rely on the decisions of the U.S. Supreme Court in the *Legal Tender Cases* and the *Gold Clause Cases* in concluding that the State theory of money is generally recognized under international law. The Commission upheld the sovereign powers of a country over its currency in a number of different contexts.

a. Russian Roubles and the Bolshevik Revolution

The International Claims Commission held that losses sustained as a result of the conversion of the old Russian rouble into the new Soviet rouble at the rate of one 1924 Soviet rouble for 50 billion pre-1922 roubles did not give rise to a valid claim against the Soviet government under international law.³⁷² In *Zuk's Claim*,³⁷³ the Commission held that "[i]t is universally recognized that all matters pertaining to currency are inherently within the jurisdiction of the State." Quoting from the decision of the Permanent Court of International Justice in the *Serbian and Brazilian Loan Cases*, the Commission stated that "[i]t is indeed a generally accepted principle that a state is entitled to regulate its own currency."³⁷⁴ The Commission also relied on the "domestic law" of the United States, quoting from the U.S. Supreme Court in the *Legal Tender Cases*.³⁷⁵

b. Yugoslav Dinar and the Second World War

In 1945, the Yugoslav government passed legislation on the settlement of pre-War obligations denominated in the old Yugoslav dinar, providing for their settlement at the rate of 10 old Yugoslav dinars to one dinar of Democratic Federative Yugoslavia. In *Tabar's Claim*,³⁷⁶ the Foreign Claims Commission held that Yugoslavia had not violated international law "in providing, as part of the re-establishment of its monetary system, for the payment of obligations" at such rate. The Commission, citing the *Gold Clause Cases*, noted that "[o]ur own country abrogated contracts providing for payment in gold coin", and the Commission also quoted from the decision of the U.S. Supreme Court in *Deutsche Bank*.³⁷⁷

c. Hungarian Monetary Reforms (1925-1946)

In 1925 the Hungarian government introduced a new currency, the pengő, at a rate of one pengő for 12,500 units of the old currency, the korona. With the collapse of the pengő the Hungarian government

³⁷⁰International Claims Settlement Act of 1949, ch. 54, 64 Stat. 12 (1950) (current version at 22 U.S.C.S. §§ 1621-1627 (1982 & Supp. 1997)).

³⁷¹*Id.* § 4(a).

³⁷²*Zuk's Claim*, Int. L.R. 1958, 284.

³⁷³Int. L.R. 1958, 284 at 285.

³⁷⁴*Zuk's Claim*, Int. L.R. 1958, 284 at 285 (quoting *Serbian and Brazilian Loan Cases*, discussed *supra* p. 87).

³⁷⁵*Id.*; see also *supra* pp. 37-39.

³⁷⁶Int. L.R. 1953, 211 at 213.

³⁷⁷*Tabar's Claim*, Int. L.R. 1953, 211 at 212-13 (citing *Gold Clause Cases*, discussed *supra* pp. 51-57, and quoting *Deutsche Bank*, discussed *supra* pp. 71-72).

established a new currency in 1946, the forint, at a rate that completely destroyed the value of the pengő. Again the Foreign Claims Commission held that no claim existed against the Hungarian government for these monetary reforms.³⁷⁸

d. Romanian Lei and the Second World War

In 1947 the Romanian government introduced the stabilized lei for which one old lei could be exchanged at the rate of 20,000 to 1. The Foreign Claims Commission again held that the destruction of the economic value of obligations denominated in the old lei resulting from this monetary reform did not give rise to any claim against the Romanian government.³⁷⁹

The cases described in (a) to (d) above demonstrate that the State theory of money enunciated by the U.S. courts is fully consistent with the legal theory of money that is generally accepted under international law. Moreover, the State theory is also applied by the vast majority of foreign countries.³⁸⁰ The widespread international acceptance of the State theory helps to support the conclusion that the sovereign power of a state over its currency is universally recognized and that foreign currency contracts governed by the laws of U.S. jurisdictions are necessarily subject to the monetary sovereignty of foreign countries.

G. Euro as the Ideal Unit

Every modern monetary system is built upon what Nussbaum calls an “ideal unit” and upon a number of corporeal money types coordinated around this unit.³⁸¹ Thus in *Bates*,³⁸² the U.S. Court of Appeals for the Seventh Circuit noted that in the United States “[t]he standard unit of computation is the money dollar, an abstract or ideal unit of account.” The court noted that “[t]his standard unit of money has not changed in money value throughout the existence of our monetary system”, notwithstanding the fact that “[t]here have been changes from time to time in the form of the physical representatives of money.”³⁸³ Thus, the court recognized a distinction between money as the ideal unit of account and legal tender as the physical manifestations of such money. Because currencies are no longer convertible into gold or silver, this idea of money as an ideal or abstract unit provides the most adequate explanation of money to fit modern conditions.³⁸⁴ This ideal unit establishes the nominal value of money³⁸⁵ and thus provides the basis for the principle of monetary nominalism.³⁸⁶

Whether the unit around which the monetary system is built is actually represented by specific money is of no consequence. This point is clearly demonstrated by the decision of the Supreme Court in *Cramer v. Arthur*.³⁸⁷ There, duties payable on goods imported from Austria were assessed based on the value of the Austrian silver florin. Although there was evidence that the Austrian silver florin coin was no longer in circulation, the Supreme Court held that “the florin is the standard money of account of

³⁷⁸Endreny’s Claim, Int. L. R. 1958, 278; Chobady’s Claim, Int. L.R. 1958, 292.

³⁷⁹Muresan’s Claim, Int. L.R. 1958, 294.

³⁸⁰See *supra* p. 87.

³⁸¹NUSSBAUM, *supra* note 31, at 13-17, 115-16.

³⁸²108 F.2d at 408 (citing Legal Tender Cases).

³⁸³Bates, 108 F.2d at 408.

³⁸⁴See MANN, *supra* note 20, at 49.

³⁸⁵See Eder, *supra* note 43, at 61-63.

³⁸⁶See *supra* pp. 70-74.

³⁸⁷102 U.S. (12 Otto) 612 (1880).

Austria.”³⁸⁸ The Court stated that whether the florin was “represented by a corresponding coin of equal amount is of no consequence,” noting that “[i]t was only since the beginning of the present century that the pound sterling was thus represented” and that the pound’s “value was as fixed and certain before the sovereign was coined as since.”³⁸⁹

Also, in the *Legal Tender Cases*,³⁹⁰ the Supreme Court rejected the argument that the gold dollar constituted the standard of value in the U.S. monetary system, stating that “the gold or silver thing we call a dollar is, in no sense, a standard of a dollar. It is a representative of it. There might never have been a piece of money of the denomination of a dollar.”

Thus, the existence of a distinct unit of account with reference to which all money is denominated is a characteristic feature of all monetary systems.³⁹¹ A legal tender is only money in law insofar as it represents the embodiment of this ideal unit of account - its fraction or multiple.³⁹² While coins or notes represent decimal fractions or multiples of the ideal unit in most monetary systems, Nussbaum has noted that irregular features frequently appear during the infancy of a new monetary system.³⁹³

After the introduction of the single currency on January 1, 1999 the euro will be the ideal unit around which EU national legal tenders will be coordinated. The fact that the euro will not be represented by a corresponding note or coin of equal value until the introduction of euro notes and coins at the end of the transitional period is of no consequence. The euro will be the single currency of the EU member states and the national legal tenders will be mere denominations of the euro that will be valued in terms of the euro at the irrevocably fixed conversion rates.

This point is also supported by the UCC definition of money. The UCC definition of money defines money broadly as “a medium of exchange”.³⁹⁴ The official comments to the UCC confirm that this definition “rejects the narrow view of some early cases that ‘money’ is limited to legal tender. Legal tender acts do no more than designate a particular kind of money which the obligee will be required to accept in discharge of an obligation.”³⁹⁵

Indeed, the Code drafters also pointed out in their notes and comments to Tentative Draft No. 1 of the Code that this “is illustrated by the fact that until 1933 Federal Reserve notes, . . . although issued under the authority of an act of Congress, were not legal tender in the United States.”³⁹⁶

The legal distinction between currency and legal tender is also confirmed by the legislative history preceding the adoption of the UCC in New York when the view was expressed by the New York Law Revision Committee and the Commission on Uniform State Laws that the Code definition of money reflects the concept of money articulated by the New York courts at common law, as evidenced by *Reisfeld v. Jacobs*.³⁹⁷ In *Reisfeld*,³⁹⁸ it was noted that “the word ‘money’ may be used in a strict sense as

³⁸⁸Cramer, 102 U.S. at 613, 616.

³⁸⁹*Id.* at 616.

³⁹⁰79 U.S. (12 Wall.) at 553.

³⁹¹See MANN, *supra* note 20, at 23.

³⁹²See *id.* at 24, 44.

³⁹³NUSSBAUM, *supra* note 31, at 116.

³⁹⁴U.C.C. § 1-201(24), 1 U.L.A. 65 (1989).

³⁹⁵U.C.C. § 3-107, off. cmt. 1, 2 U.L.A. 314 (1991); *see also* U.C.C. § 1-201 (24), off. cmt. 24, 1 U.L.A. 72 (1989).

³⁹⁶AMERICAN LAW INSTITUTE, *supra* note 343, at 39.

³⁹⁷STATE OF NEW YORK LAW REVISION COMMISSION, *supra* note 348, at 805; COMMISSION ON UNIFORM STATE LAWS, *supra* note 350, at 95-96.

denoting only ‘legal tender in payment of a debt’, or it may be used broadly to denote any token of value.” What confers monetary status on a token of value is not the form of such token (i.e., legal tender notes or some other medium of exchange) but rather whether the token is “issued under the authority of a responsible government.”³⁹⁹ The pivotal issue is not whether the medium of exchange constitutes legal tender, but whether a government has recognized the medium as part of its official currency.⁴⁰⁰ In this sense, money is ultimately a creature of law which may be altered or redefined by the sovereign issuer.

Clearly, the euro will be used as a medium of exchange prior to the introduction of euro notes and coins no later than 2002. Before the introduction of euro legal tender the euro will be the single currency of which the national legal tenders will be denominations or expressions.⁴⁰¹ The fact that euro notes will not exist does not affect the legal status of the euro as money because the UCC rejects the narrow view that money is limited to legal tender. During the three-year transitional period preceding the introduction of euro tender the EU Council regulation on the introduction of the euro will designate particular kinds of money as legal tender (e.g., the Deutsche mark will be legal tender within the territorial limits of Germany, the French franc within the territorial limits of France, etc.). All of these national legal tenders will be mere expressions of the sole medium of exchange used in the participating EU member states during the transitional period – the euro.⁴⁰² Thus, each transaction involving the use of a national legal tender as a medium of exchange is in reality a transaction involving the use of the euro as a medium of exchange. Each national legal tender will have an unchangeable countervalue in terms of the euro during the transitional period.⁴⁰³ There will be no foreign exchange rate risk between the national legal tenders.⁴⁰⁴ Thus, the euro will be the only medium of exchange in the participating EU member states during the transitional period.

H. Foreign Currencies as Commodities

In this section the classification of foreign currency as a commodity will be examined. In particular, this section will consider whether the euro will be regarded as the same commodity as the existing EU national currencies from a legal perspective.

1. Commodity Theory of Foreign

Foreign currencies have long been classified as commodities under New York law.⁴⁰⁵ Two strands of thinking can be discerned in the classification of foreign money as a commodity. According to one line of authority, foreign currencies are only to be regarded as commodities where they are purchased and sold in foreign exchange transactions.⁴⁰⁶ This approach draws a sharp distinction between the use of

³⁹⁸176 N.Y.S. at 224 (citations omitted).

³⁹⁹Reisfeld, 176 N.Y.S. at 224.

⁴⁰⁰See HAWKLAND, *supra* note 181, § 3-107:02 (Art. 3).

⁴⁰¹See *supra* pp. 15-17.

⁴⁰²See *id.*

⁴⁰³See *id.*

⁴⁰⁴See *supra* pp. 20-21.

⁴⁰⁵See *Kerr S.S. Co. v. Chartered Bank of India, Australia and China*, 54 N.E.2d 813, 816 (N.Y. 1944) (citing *Richard v. Am. Bank*, 170 N.E. 532, 535 (N.Y. 1930)); *Kantor v. Aristo Hosiery Co., Inc.*, 226 N.Y.S. 582, 584 (N.Y. App. Div. 1928), *aff'd* 162 N.E. 553 (N.Y. 1928); *Webber v. Am. Union Bank*, 217 N.Y.S. 833, 836 (N.Y. Sup. Ct. 1926), *rev'd on other grounds* 222 N.Y.S. 359 (N.Y. App. Div. 1927); *Reisfeld*, 176 N.Y.S. at 224; *Petkus v. Letuvos Ukio Bankas*, 204 N.Y.S. 726, 729 (N.Y. Sup. Ct. 1924); *DeBiase v. Commercial Union Ins. Co. of New York*, 278 N.Y.S.2d 145, 147-48 (N.Y. Civ. Ct. 1967), *aff'd* 286 N.Y.S.2d 502 (N.Y. 1967); *Vishipco Line v. Chase Manhattan Bank, N.A.*, 754 F.2d 452, 455 (2d Cir. 1985) (citing *Richard and Kantor*); *cf.* *Equitable Trust Co. v. Keene*, 183 N.Y.S. 699, 700-1 (N.Y. Sup. Ct. 1920), *aff'd* 186 N.Y.S. 468, 468-70 (N.Y. App. Div. 1921), *rev'd* 133 N.E. 894, 894-95 (N.Y. 1922).

⁴⁰⁶See *Henwood*, 307 U.S. at 255-56; *Kerr*, 54 N.E.2d at 816 (citing *Richard*, 170 N.E. at 535); *Webber*, 217 N.Y.S. at 836; *Reisfeld*, 176 N.Y.S. at 224.

foreign currency as a commodity on its barter and sale in the foreign exchange markets and the use of foreign currency as a medium of payment for the discharge of debts (i.e., in loan transactions and bond issues).

Thus in *Henwood*,⁴⁰⁷ a “gold clause” case involving a bond which permitted repayment in any one of five different currencies,⁴⁰⁸ the Supreme Court stated that “[t]he foreign currencies promised were not bartered for as commodities, but their function was that of money to be paid in countries in which they were legal tender”. Again in *Webber v. American Union Bank*,⁴⁰⁹ it was emphasized that “[f]oreign money in this country, on its barter and sale, is generally treated as a commodity, though it may be treated as money having a monetary value fixed by the exchange value.” According to these cases, a foreign currency’s status as a commodity depends entirely on the use to which such currency is put (i.e., whether it is used in foreign exchange transactions or whether it is used to discharge a debt in a loan or a commercial transaction).

According to a second strand of thinking, foreign currency is generally treated as a commodity in the United States, regardless of the kind of transaction in which it is used.⁴¹⁰ Thus, it was held in *Vishipco Line v. Chase Manhattan Bank, N.A.*,⁴¹¹ that “in actions brought to recover sums expressed in foreign money, the obligation—whether characterized as an unpaid debt or a breach of contract—is treated as a promise to deliver a commodity.” Again in *Kantor v. Aristo Hosiery Co.*,⁴¹² it was stated that “[t]he obligation to deliver pounds sterling in return for hosiery is essentially the same as the obligation . . . to deliver francs in return for dollars.” To hold otherwise “is to lose sight of the economic fact that foreign currency is a commodity.”⁴¹³ The Supreme Court stated in one of the Confederate dollar cases that the Confederate dollar was a commodity.⁴¹⁴ In *Barreda v. Milmo National Bank*,⁴¹⁵ the Texas Court of Civil Appeals held that Mexican dollars deposited at a bank in a border town on the U.S. side of the Mexican border “were not in fact and truth money, but a commodity varying and fluctuating in value as often and as disastrously as the price of cotton or wheat.” According to these cases a foreign currency is a commodity purely because it is not the domestic currency of the United States.

The idea that foreign currency is only treated as a commodity when used in foreign exchange transactions appears to have found favor with the drafters of the Uniform Commercial Code. Article 2-102 of the Code specifically limits the applicability of Article 2 “to transactions in goods”.⁴¹⁶ “Goods” in turn have been defined by the Code as “all things . . . which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action.”⁴¹⁷ At first blush it might appear, in view of this exclusion of the money in which the price is to be paid from the definition of goods, that foreign currencies are not goods/commodities for

⁴⁰⁷307 U.S. at 255-56.

⁴⁰⁸See *supra* pp. 54-56.

⁴⁰⁹217 N.Y.S. 833, 836 (N.Y. App. Div. 1926), *rev'd on other grounds* 222 N.Y.S. 359 (1924).

⁴¹⁰See *Vishipco*, 754 F.2d at 455 (citing *Kantor*, 226 N.Y.S. at 584); *Petkus*, 204 N.Y.S. at 729; *see also DeBiase*, 278 N.Y.S.2d at 147-48.

⁴¹¹754 F.2d 452, 455 (2d Cir. 1985) (citing *Richard* and *Kantor*).

⁴¹²226 N.Y.S. 582, 584 (N.Y. App. Div. 1928), *aff'd* 162 N.E. 553 (N.Y. 1928).

⁴¹³*Kantor*, 226 N.Y.S. at 584.

⁴¹⁴*Planters' Bank*, 83 U.S. (16 Wall.) at 502; *but see Bissell*, 96 U.S. at 587.

⁴¹⁵241 S.W. 743, 745, 748-49 (Tex. Civ. App. 1922).

⁴¹⁶U.C.C. § 2-102, 1 U.L.A. 172 (1989).

⁴¹⁷U.C.C. § 2-105(l), 1 U.L.A. 198-99 (1989).

purposes of the UCC. However, Official Comment 1 to Section 2-105 of the UCC states that “[t]he exclusion of ‘money in which the price is to be paid’ from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. ‘Goods’ is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment.”⁴¹⁸ Official Comment 1 to Section 2-105 thus contemplates a distinction between the use of foreign currency as a commodity and the use of foreign currency as a medium of payment. Relying on this comment the New York courts held without argument in a series of decisions that the UCC is applicable to foreign exchange transactions.⁴¹⁹ This view has been reiterated in *Re Koreag, Controle et Revision S.A.*⁴²⁰ Invoking Official Comment 1 to Section 2-105, the U.S. Court of Appeals for the Second Circuit stated that money is excluded from the UCC’s definition of “goods” “only when it is used as the medium of exchange. In a currency exchange contract, however, the money is not the medium of exchange, but rather the object of exchange.”⁴²¹

If we try to unravel the logic of Official Comment 1 and the cases decided thereunder, the UCC appears to be applicable to foreign exchange transactions such as FX forwards, cross-currency swaps and currency options. An FX forward is an agreement by one party to deliver a specified amount in one currency on a specific date in the future against delivery of a specified amount in another currency.⁴²² A cross currency swap is a bilateral agreement in which each of the parties promises to make periodic payments to the other in two different currencies, which amounts are calculated as one would calculate interest on a debt obligation.⁴²³ A currency option is an arrangement whereby the seller of the option, in exchange for the payment of a fee, grants the purchaser of the option the right to buy a specified amount of a given currency at a specified “strike” price expressed in another currency -- a currency call option -- or the right to require the seller of the option to buy a specified amount of a given currency at a specified strike price in another currency -- a currency put option.⁴²⁴

With respect to interest rate swaps, the better view appears to be that they remain subject to the application of the common law and are not governed by the UCC.⁴²⁵ This is consistent with the Supreme Court’s view that “[i]nterest is not paid on commodities but on monetary obligations”,⁴²⁶ and that “interest must follow the character of the principal.”⁴²⁷ Similarly, payments under interest rate swaps are made on notional principal amounts and the interest payments must follow the notional character of the principal amounts.

⁴¹⁸U.C.C. § 2-105, off. cmt. 1, 1 U.L.A. 199 (1989).

⁴¹⁹*See Intershoe, Inc. v. Bankers Trust Co.*, 571 N.E.2d 641, 644 (N.Y. 1991); *Saboundjian v. Bank Audi (USA)*, 556 N.Y.S.2d 258, 261 n.2 (N.Y. App. Div. 1990); *Compania Sud-Americana de Vapores, S.A. v. IJB Schroder Bank & Trust Co.*, 785 F. Supp. 411, 431 n.19 (S.D.N.Y. 1992) (citing *Intershoe*); *cf. United Equities Co. v. First Nat’l City Bank*, 383 N.Y.S.2d 6, 9-13 (N.Y. App. Div. 1976), *aff’d* 395 N.Y.S.2d 640 (N.Y. 1977); *see also Berman v. Dean Witter & Co., Inc.*, 119 Cal. Rptr. 130, 133-34 (Cal. Ct. App. 1975).

⁴²⁰961 F.2d 341 (2d Cir. 1992). This case is also cited (without further discussion) in *United States v. BCCI Holdings (Luxembourg), S.A.*, 833 F. Supp. 22, 28 n.6 (D.D.C. 1993), *aff’d* 48 F.3d 551 (D.C. Cir. 1995).

⁴²¹*Koreag*, 961 F.2d at 355.

⁴²²*See ANTHONY C. GOOCH AND LINDA B. KLEIN, DOCUMENTATION FOR DERIVATIVES* 242 (1993).

⁴²³*See id.* at 199.

⁴²⁴*See id.* at 248.

⁴²⁵*See Daniel P. Cunningham et al., Interest Rate and Currency Swaps and Related Transactions*, 815 PLI/CORP 511, 523 (1993). A question arises with respect to the classification of so-called ‘diff’ or ‘differential’ swaps which are interest rate swaps based on the differential between interest rates in two different currencies. Such swaps arguably involve the exchange of money. For a description of differential swaps, *see GOOCH & KLEIN, supra* note 422, at 187 n.99.

⁴²⁶*Henwood*, 307 U.S. at 255.

⁴²⁷*Confederate Note Case*, 86 U.S. (19 Wall.) at 560; *see also NUSSBAUM, supra* note 31, at 342; *MANN, supra* note 20, at 74.

Eurobond and loan transactions involving debt obligations to make payments in foreign currencies clearly fall into the category of transactions where money is not the object of exchange but rather the medium of exchange. This would mean that the legal principles governing the performance of such transactions can be found in the common law rather than the UCC.

The rulings that foreign exchange contracts are covered by the UCC have aroused considerable academic controversy and have been subjected to serious criticism.⁴²⁸ An examination of these criticisms is outside the scope of this study. Suffice it to note that there is some doubt regarding the applicability of the UCC to foreign exchange transactions. Nonetheless, there has been some support for the application of the UCC in this context⁴²⁹ and even among the critics there has been general agreement that UCC provisions should be applied by analogy to foreign exchange transactions where appropriate.⁴³⁰ In view of the decisions of the New York courts regarding the application of the UCC to foreign exchange transactions,⁴³¹ it would be prudent for the purposes of this study to assume that the UCC is applicable to all foreign exchange transactions and that foreign currencies are therefore to be treated as commodities when used in currency swaps, currency options and FX forwards.

2. Implications of Commodity Theory of Foreign Money

The notion that foreign currencies are commodities has been relied upon by courts to undermine the State theory of money. Thus, in *Matter of Lendle*,⁴³² the case where a bequest in old German marks was held to be a bequest in the same number of new Weimar Reichsmarks, notwithstanding the fact that a different conversion rate was established under German law for the conversion of old marks into Reichsmarks, the New York Court of Appeals held that the marks were “to be regarded, not as a measure of value, but as a commodity to be satisfied in kind.”⁴³³

It might be argued that the Deutsche mark is a different commodity from the euro because the Deutsche mark is issued by the Deutsche Bundesbank whereas the euro will be issued by or under the authority of the newly established European Central Bank. Also, it might be argued that the Deutsche mark is a different commodity from the euro because the value of the euro will be affected by different economic considerations from the value of the Deutsche mark. Foreign currencies have been compared to commodities insofar as their value fluctuates on the international currency markets. “In other countries [money] is a commodity bought and sold in the market and its value fluctuates in the market like that of other commodities.”⁴³⁴ Thus it has been stated that “[i]n New York and elsewhere, foreign money ... is a commodity of fluctuating market value dependent upon the principles of supply and demand.”⁴³⁵ If foreign currencies are like other commodities in that their value fluctuates on the open market according to the laws of supply and demand, then a currency like the Deutsche mark can be viewed as a commodity

⁴²⁸See Thomas C. Baxter and James H. Freis, Jr., *Resolving Funds Transfer Disputes Related to Currency Exchange Transactions: What Law Governs?* COMM. L. ANN. 297, 323-39 (1995); Raj Bhala, *A Pragmatic Strategy for the Scope of Sales Law, the Statute of Frauds and the Global Currency Bazaar*, 72 DENV. U. L. REV. 1, 11-18 (1994); Michael Latham Manire, *Foreign Exchange Sales and the Law of Contracts: A Case for Analogy to the Uniform Commercial Code*, 35 VAND. L. REV. 1173, 1188-93 (1982); Stephen C. Veltri, *Should Foreign Exchange Be ‘Foreign’ to Article Two of the Uniform Commercial Code?*, 27 CORNELL INT’L L. J. 343, 351-64 (1994).

⁴²⁹See Tobias M.C. Asser, *Foreign Exchange Contracts and the Applicability of Article 2 of the UCC*, 113 BANKING L.J. 578, 593-600 (1996).

⁴³⁰See Bhala, *supra* note 428, at 23-52; Manire, *supra* note 428, at 1193-1209; Veltri, *supra* note 428, at 361-64.

⁴³¹See *supra* pp. 93-94.

⁴³²166 N.E. 182 (N.Y. 1929) (citations omitted), discussed *supra* pp. 49-50.

⁴³³See also *Re Wirth’s Estate*, 132 N.Y.S.2d 98, 99-100 (N.Y. Surr. Ct. 1954) (discussing *Matter of Lendle*); *Matter of Illfelder*, 240 N.Y.S. 413, 416 (N.Y. Surr. Ct. 1930), *aff’d* 249 N.Y.S. 903 (N.Y. App. Div. 1931) (same).

⁴³⁴Richard, 170 N.E. at 535.

⁴³⁵DeBiase, 278 N.Y.S.2d at 147-48 (citing Richard).

whose value fluctuates on the currency markets according to the supply of and demand for Deutsche marks. The supply of and demand for Deutsche marks is in turn influenced by economic factors such as the monetary policy pursued by the Deutsche Bundesbank, the use of the Deutsche mark as an international reserve currency, Germany's balance of payments and the overall performance of the German economy, actual and perceived. On this analysis of the Deutsche mark as a commodity, the new euro could be classified as a fundamentally different commodity from the Deutsche mark. The supply of and demand for the euro will be influenced by the monetary policy adopted by the new European Central Bank, the economic performance of the single European economy underpinning the new currency and the confidence of the international markets in the new currency. The new currency will be issued by or under the authority of the new European Central Bank which will define and implement the monetary policy of all EU member states participating in EMU, while national central banks like the Bundesbank will lose their power to direct monetary policy.⁴³⁶

Interesting as these theories might be, foreign money is defined under the Uniform Commercial Code as a medium of exchange authorized or adopted by the government of a foreign country. This definition is applicable to foreign currency both when used as a commodity and therefore subject to the sale of goods provisions in Article 2 of the Code, and also when foreign currency is otherwise used as a medium of payment and therefore exempt from the provisions of Article 2 of the Code. The fact that foreign currency may be used as a commodity does not in any way alter its definition or essential attributes. This point is amply demonstrated by the UCC itself, by the Official Comments to the Code and by the case law. Article 2 of the Code does not exclude all money from its application, but only "the money in which the price is to be paid."⁴³⁷ Thus, when money is used to purchase anything other than money Article 2 does not apply, but when money is used to purchase money it is used as a commodity and Article 2 applies. The definition of money is the same regardless of whether it is subject to regulation by the Code. The main significance of money being treated as a commodity is that it is thereby subject to regulation by the UCC, which could have practical consequences for issues such as the level of damages to be awarded for a breach of contract. Regard may be had to the depreciation of a currency in calculating the level of damages to be awarded for a breach of a foreign exchange contract under the UCC, whereas it appears that such depreciation may not be considered when calculating damages for breach of a foreign currency debt obligation at common law.⁴³⁸

That the treatment of a foreign currency as a commodity in foreign exchange transactions has no bearing on the definition or essential characteristics of foreign currency is further demonstrated by the Official Comments to the Code. The Comments clearly state that foreign currency "which is included in the definition of money" may be the subject of a sales transaction when treated as a commodity.⁴³⁹ Thus the definition of money remains unchanged—it is the legal regime to which the money is subject that is affected by its treatment as a commodity. This point is also implicitly accepted in *Koreag*,⁴⁴⁰ where the court focused on the use to which the currency is put in concluding that foreign exchange transactions involve the sale of goods. The only situation where the use of money as a commodity may influence a court's view of that money's definition and essential attributes concerns the sale of legal tender coins having an appreciated numismatic value.⁴⁴¹

⁴³⁶See generally Kaufman, *supra* note 314, at 8.

⁴³⁷U.C.C. § 2-105(1), 1 U.L.A. 198-99 (1989).

⁴³⁸See NUSSBAUM, *supra* note 31, at 319-20; Paul H. Vishny, *Money and International Transactions*, C395 A.L.I.-A.B.A. 631, 633 (1989); see *infra* pp. 132-34.

⁴³⁹U.C.C. § 2-105, off. cmt. 1, 1 U.L.A. 199 (1989).

⁴⁴⁰961 F.2d at 355.

⁴⁴¹See *Re Midas Coin Co.*, 264 F. Supp. 193, 197 (E.D. Mo. 1967).

The UCC definition of foreign money recognizes that the essential characteristics of a foreign currency, whether used as a commodity or as a medium of payment, are delineated by the laws of the state issuing such currency. Since the EU Council regulations (which are directly applicable in EU member states such as Germany) will recognize the euro as the successor currency to EU national currencies like the Deutsche mark, the euro should be treated as both the same commodity and the same medium of payment as the Deutsche mark in accordance with the applicable provisions of EU law. Thus, in accordance with the State theory of money, all foreign currency transactions that are governed by the laws of U.S. jurisdictions are subject to the monetary sovereignty of the governments of foreign countries. This analysis ensures that the definition of foreign money will be consistently applied, regardless of whether foreign money is being used as a commodity or as a medium of exchange. To quote the Supreme Court in *Holyoke Power Co. v. Paper Co.*,⁴⁴² “[t]he fact is of little moment that currency is characterized as a commodity in the verbiage of the covenant as long as it is currency. Weasel words will not avail to defeat the triumph of intention when once the words are read in the setting of the whole transaction.”⁴⁴³ Thus in *Brown v. Perera*,⁴⁴⁴ it was held that

foreign money in its nature and inherent qualities is not different from domestic money. Whether it is received under sanction of a legal tender statute, or in border transactions, or by certain merchants in accordance with a special practice, or by money changers in exchange for American money at prevailing rates, it is received, not as an article useful or valuable in itself, but merely as a token or representative of value issued by a responsible government.

Another variation on the State theory of money would be to argue that the commodity we call the Deutsche mark underwent a fundamental alteration at the time of the signing of the Maastricht Treaty by the then 12 member states of the European Economic Community in 1992. From Maastricht onwards the Deutsche mark became a currency that was capable of being transformed into a single European currency at the time and in the manner contemplated by the Treaty. The fact that the Treaty provides for a gradual and phased introduction of the single currency would bolster this argument that existing EU national currencies are gradually converging into a single currency. First of all, the interest rates, inflation rates and debt ratios of countries seeking to participate in EMU begin to converge in an effort to comply with the Treaty’s economic convergence criteria. Several months before the commencement of EMU the EU Council decides which currencies will participate in EMU. EMU then starts on January 1, 1999 with the irrevocable fixing of the conversion rates of currencies participating in EMU, at which point the euro becomes a currency in its own right. While the euro is the single currency of the participating member states, the old national currencies survive as legal tenders that are denominations of the single currency. Finally, after a period lasting no longer than three years from the irrevocable fixing of conversion rates, the national tenders are withdrawn from circulation altogether and replaced by new euro bank notes and coins.⁴⁴⁵ This phased introduction of the single currency will make it difficult for a litigant to pin-point any single moment in the changeover to the single currency where there is such a fundamental alteration in the nature of the currencies participating in EMU as to cause the euro to be classified as an altogether different currency from the participating national currencies. If key economic indicators in the countries participating in EMU converge in the manner contemplated by Maastricht and a smooth “Glidepath” to EMU is reasonably assured, it will be extremely difficult to argue that the euro is a different commodity from existing national currencies. While the Deutsche mark, for example, will have ceased to exist in law as a currency in its own right after the fixing of conversion rates, the fact that it will survive as a legal tender will also make it difficult on a practical level to persuade the courts that the mark is a fundamentally different commodity/ currency from the euro.

⁴⁴²300 U.S. 324, 336 (1936) (citation omitted).

⁴⁴³See also *Legal Tender Cases*, 79 U.S. (12 Wall.) at 549.

⁴⁴⁴176 N.Y.S. 215, 218 (N.Y. App. Div. 1918).

⁴⁴⁵See *supra* pp. 11-27.

The statements by the New York courts regarding currencies being like other commodities with fluctuating market values are not dispositive in any respect and may be viewed as descriptive of how the foreign exchange markets work in practice. The fact that the values of foreign currencies fluctuate on the open market says nothing about the legal definition of such currencies. Whether they fluctuate or not, the legal definition of a particular currency is laid down by the laws of the issuing state.

I. Conclusion

F.A. Mann has pointed out that the State theory of money is firmly established under U.S. law.⁴⁴⁶ This is borne out by the fact that the State theory of money has been accepted by federal and state courts.⁴⁴⁷ The State theory of money has constitutional underpinnings insofar as the U.S. Constitution implicitly recognizes that the power to establish foreign currencies is vested in foreign countries.⁴⁴⁸ Moreover, the State theory has been incorporated into the laws of every U.S. jurisdiction by virtue of the Uniform Commercial Code which defines money as the medium of exchange that has been authorized or adopted as currency by the government of a country.⁴⁴⁹ Deviations from the State theory have only been permitted in a small number of cases involving the complete collapse of foreign currencies.⁴⁵⁰ While the legal classification of foreign currency can differ depending on whether foreign money is being used as a commodity or as a medium of payment, this does not in any way affect the inherent quality of foreign currency as money.⁴⁵¹ The legal definition of foreign currency as the medium of exchange authorized or adopted by a foreign government is applicable regardless of whether foreign currency is used as a commodity on the foreign exchange markets or as a medium of payment on the debt markets.⁴⁵²

Applying the State theory of money to EMU, the euro will be recognized by the governments of the EU member states as the circulating medium of exchange and official currency of EU member states participating in EMU. Obligations denominated in EU national currencies participating in EMU that are governed by New York law or the laws of other U.S. jurisdictions are subject to the sovereign powers of the European Union over the currencies of EU member states. These sovereign powers extend to the substitution of EU national currencies for the euro at the irrevocably fixed conversion rates established by the Council. These powers also include the enactment of legislation by the EU Council providing for the continuity of obligations denominated in or by reference to EU currencies and ancillary interest rates in the aftermath of the introduction of the single currency. In view of the broad view that has been taken by U.S. courts with respect to the monetary sovereignty of a state over its currency, strong arguments can also be made that additional provisions in the EU legislation permitting credit transfers to be made in, and bonds to be redenominated into, the euro unit prior to the introduction of euro banknotes are also applicable to transactions governed by U.S. laws.⁴⁵³

⁴⁴⁶MANN, *supra* note 20, at 14-15.

⁴⁴⁷*See supra* pp. 35-78.

⁴⁴⁸*See supra* pp. 80-81.

⁴⁴⁹*See supra* pp. 81-85.

⁴⁵⁰*See supra* pp. 39-42, 47, 49-50, 67.

⁴⁵¹*See supra* pp. 92-99.

⁴⁵²*See supra* pp. 96-98.

⁴⁵³*See supra* pp. 58-61.

V. CONTRACT LAW

The acceptance by American courts of the State theory of money would ensure the continuity of contracts denominated in EU national currencies after EMU. Nonetheless, it is necessary to consider the possible application of various legal doctrines that might be invoked in an effort to terminate or otherwise discharge contractual obligations by virtue of the occurrence of EMU. The three main doctrines that could be relevant here are the doctrine of commercial impracticability (which is applicable under the Uniform Commercial Code) and the common law doctrines of impossibility and frustration.

A. *Uniform Commercial Code*

1. Doctrine of Commercial Impracticability

Article 2 of the Uniform Commercial Code governs transactions in goods, including transactions involving the exchange of foreign currency.¹ The doctrine of commercial impracticability is contained in Article 2, Section 615 of the UCC, which is captioned *Excuse by Failure of Presupposed Conditions*, and provides in relevant part as follows:

Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

- (a) Delay in delivery or non-delivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.²

Section 2-615 of the UCC has been uniformly adopted in all adopting jurisdictions.³ There is a three-step test to determine the applicability of the Section: “(1) a contingency has occurred; (2) the contingency has made performance impracticable; and (3) the nonoccurrence of that contingency was a basic assumption upon which the contract was made.”⁴

Official Comment 1 to Section 2-615 states that “[t]his section excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting.”⁵ In the context of EMU, the question which arises is whether the continued existence of the currency in which a contractual obligation may be denominated is a basic assumption on which a contract is made, and whether the disappearance of the currency of the contract renders performance impracticable. This study will consider these issues in some detail below.

It should also be noted that Section 2-615, by its terms, is only available for a “seller”. Official Comment 9 to Section 2-615 states, however, that “where the buyer’s contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption . . . the reason of the present section may well apply.”⁶ One commentator notes that given the language of Official Comment 9, “in proper circumstances . . . buyers, too, could use this excuse” (*i.e.*, of impracticability

¹U.C.C. § 2-102, 1 U.L.A. 172 (1989); *see supra*. pp. 93-94.

²U.C.C. § 2-615, 1B U.L.A. 195 (1989).

³WILLIAM D. HAWKLAND, UCC SERIES § 2-615 (Art. 2) (Supp. 1996).

⁴Waldinger Corp. v. CRS Group Eng’rs, Inc., 775 F.2d 781, 786 (7th Cir. 1985) (citations omitted), quoted in Cliffstar Corp. v. Riverbend Prods., Inc., 750 F. Supp. 81, 84 (W.D.N.Y. 1990); *see also* HAWKLAND, *supra* note 3, § 2-615:06 (Art. 2).

⁵U.C.C. § 2-615, off. cmt. 1, 1B U.L.A. 195 (1989).

⁶U.C.C. § 2-615, off. cmt. 9, 1B U.L.A. 196-97 (1989).

under Section 2-615).⁷ Even if the provision is applicable only to sellers, foreign exchange contracts present a unique situation insofar as “a participant in such [a currency] exchange is both a seller with respect to the currency it is delivering, and a buyer with respect to the currency it is receiving.”⁸ This raises the question of which seller should bear the risk. It would appear logically that the seller of the currency being converted into euros is the “seller” to which Section 2-615 refers. Alternatively, this appears to be an example of one particular situation in which Section 2-615 is applicable to both buyers and sellers.

2. Commercial Impracticability and the UCC Definition of Money

The definition of foreign money in the UCC requires that consideration be given to whether the euro will be circulating as the medium of exchange with the sanction of the governments of the EU member states participating in EMU.⁹ Since the EU Council regulations, which are directly applicable in EU member states such as France and Germany, will define the euro to be legally identical to the Deutsche mark and the French franc, respectively, the doctrine of commercial impracticability would be unavailable. Performance as agreed can be accomplished by delivery of the good — in this case by delivery of the medium of exchange or currency that is circulating in Germany and France with the sanction of the governments of Germany and France, the euro.

Notwithstanding the availability of the euro it might still be argued that performance as agreed has been rendered commercially impracticable for other reasons.¹⁰ In support of this argument it might be suggested that while the law of the currency applies to the definition of foreign money in accordance with the State theory of money, the question of whether the introduction of the euro can operate to discharge contractual obligations is a question of contract law to be resolved in accordance with the governing law of the contract.¹¹ Indeed, F.A. Mann appears to implicitly support this argument by suggesting that there is no reason to assume that a serious and sudden depreciation of a currency can never be regarded as a supervening change of circumstances within the scope of doctrines such as commercial impracticability.¹² Mann believes that forceful arguments to this effect can be made where a currency collapses so completely as to render the currency worthless, thereby destroying the consideration altogether.¹³ Thus, some American commentators have argued, based on decisions made by American courts during the American Civil War (including the Confederate dollar cases¹⁴ and certain decisions handed down before the decisions of the Supreme Court in the *Legal Tender Cases*¹⁵), that in the event of an utter collapse of money American courts would adopt a revaluation device or develop some judicial relief on the ground of unforeseen monetary changes.¹⁶ It has been suggested that this argument is particularly forceful with respect to long-term obligations.¹⁷ Moreover, in one isolated case a U.S. court has actually held that the

⁷HAWKLAND, *supra* note 3, § 2-615:05 (Art. 2); *see also* Northern Indiana Pub. Serv. Co. v. Carbon County Coal Co., 799 F.2d 265, 276-77 (7th Cir. 1986); Lawrence v. Elmore Bean Warehouse, Inc., 702 P.2d 930, 932 (Idaho App. 1985) (“the provisions [of section 2-615] are applicable to buyers so long as there is compliance with the statutory requirements”) (citations omitted).

⁸*See* Re Koreag Controle et Revision, S.A., 961 F.2d 341, 355 (2d Cir. 1992).

⁹*See supra* pp. 81-85.

¹⁰*See infra* pp. 111-14

¹¹*See* F.A. MANN, THE LEGAL ASPECT OF MONEY 117-18, 287 (5th ed. 1992).

¹²*Id.* at 118-19.

¹³*Id.* at 295-96.

¹⁴*See supra* pp. 39-42.

¹⁵*See supra* pp. 37-39.

¹⁶*See* ARTHUR LINTON CORBIN, 6 CORBIN ON CONTRACTS § 1360 (1962); John P. Dawson and Frank E. Cooper, *The Effect of Inflation on Private Contracts: United States, 1861-1879*, 33 MICH. L. REV. 852, 893-98 (1935); Evsey S. Rashba, *Debts in Collapsed Foreign Currencies*, 54 YALE L.J. 1, 18-30 (1944).

¹⁷CORBIN, *supra* note 16, § 1360.

impact of inflation can render performance commercially impracticable under a long-term contract with a price tied to an index that underestimated the impact of inflation.¹⁸

It is submitted, however, that the invocation of the doctrine of commercial impracticability is inconsistent with the State theory of money as reflected in the UCC and articulated by American courts. The State theory of money requires that every contract for the payment of foreign money is necessarily subject to the monetary sovereignty of a foreign country over its currency.¹⁹ This sovereignty includes the power to introduce a new currency in substitution for an old currency, and to specify the conversion rate at which the substitution will take place and monetary obligations will be discharged.²⁰ Thus, American courts can be expected to recognize the EU Council regulations providing for the continuity of monetary obligations after EMU as an exercise of the monetary sovereignty of the European Union over the currencies of EU member states. Indeed, American courts have defined the State theory more expansively than is necessary for the recognition of the provisions of the EU Council regulations ensuring the continuity of contracts after EMU, permitting a country not only to require the discharge of monetary obligations in accordance with the recurrent link but also to alter or abrogate contractual rights in the aftermath of a currency change.²¹ In either case, the State theory of money as articulated by American courts prevents the invocation of contractual doctrines such as commercial impracticability as a means of excusing obligations after EMU in contravention of the applicable provisions of the EU Council regulations.

In addition, Mann's suggestion that the collapse of a currency and concomitant destruction of the consideration may render performance impracticable is not supported by various American authorities involving the collapse of currencies such as the Russian ruble and successive Chinese currencies. Indeed, in these cases it was held that monetary obligations are afflicted with the "congenital infirmity" that they are subject to the issuing government's control over its currency.²² In any case, arguments based on the collapse of foreign currencies have no relevance to the highly organized plans of the European Union for an orderly transition to a single European currency. Finally, the isolated U.S. case that permitted a reformation of a monetary obligation the performance of which had been rendered commercially impracticable based on a fall in the real value of the U.S. dollar appears to contradict established authority.²³

That the State theory of money prevents parties from raising doctrines like commercial impracticability in order to excuse performance is also supported by the case law. As previously noted, the doctrine of commercial impracticability excuses performance rendered impracticable by unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting.²⁴ As discussed in some detail below,²⁵ the unforeseeability of a contingency is an integral element in the doctrine of commercial impracticability. The Supreme Court has made it clear, however, that the fact that a monetary change may have been unforeseeable at the time of contracting will not excuse performance under a contract for the payment of money.

Thus, in the *Legal Tender Cases*,²⁶ where obligations originally denominated in gold dollars were held to be dischargeable in paper dollars, the Court stated as follows:

¹⁸Aluminum Co. of America v. Essex Group, Inc., 499 F. Supp. 53, 70-78 (W.D. Pa. 1980), discussed *supra* pp. 72-73.

¹⁹See *supra* pp. 35-100.

²⁰See *supra* pp. 37-39, 42-44, 48-49, 61-68.

²¹See *supra* pp. 51-58.

²²See *supra* pp. 48-49, 65-67.

²³See *supra* pp. 73-74.

²⁴See *supra* p. 101.

²⁵See *infra* pp. 105-07.

²⁶79 U.S. (12 Wall.) 457, 548 (1870).

The expectation of the creditor and the anticipation of the debtor may have been that the contract would be discharged by the payment of coined metals, but neither the expectation of one party to the contract respecting its fruits, nor the anticipation of the other constitutes its obligation. There is a well-recognized distinction between the expectation of the parties to a contract and the duty imposed by it [T]he obligation of a contract to pay money is to pay that which the law shall recognize as money when the payment is to be made.

This language has been relied upon in a subsequent case upholding the continuity of a payment obligation following the British abandonment of the gold standard.²⁷ Again, the appreciation of the Canadian dollar following its unpegging from the U.S. dollar during the collapse of Bretton Woods, even though giving rise to “unforeseen difficulties”, did not excuse performance under a fixed price contract.²⁸ These cases make it clear that doctrines permitting contracts to be terminated or otherwise discharged due to the occurrence of unforeseeable events may not be invoked based on a change in a country’s monetary system.

Even assuming for the purpose of argument that the doctrine of commercial impracticability can be invoked after EMU it is still unlikely that the performance of contracts affected by EMU would be rendered impracticable by the introduction of the euro. It is to this subject that this study will now turn.

3. Concept of Foreseeability

Section 2-615 of the UCC excuses performance if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made. The foreseeability of a contingency is an essential element in the doctrine of commercial impracticability, and the Official Comments to the Code repeatedly emphasize that the doctrine may not be invoked to excuse performance where the contingency was foreseeable.

- Official Comment 1 to Section 2-615 states that the section is concerned with instances where “performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting.”²⁹
- Official Comment 4 states that “[i]ncreased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance.”³⁰
- Official Comment 8 states that the excuse from performance provided by Section 2-615 does “not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances.”³¹

Consistent with this, courts have stated that “[i]f a contingency is foreseeable, it and its consequences are taken outside the scope of U.C.C. § 2-615, because the party disadvantaged by fruition of the contingency might have protected himself in his contract.”³² The excuse on which commercial

²⁷Booth & Co. v. Canadian Gov’t Merchant Marine, 63 F.2d 240, 241 (2d Cir. 1933).

²⁸ITT Arctic Servs. v. United States, 524 F.2d 680, 691 (Ct. Cl. 1975) (citation omitted).

²⁹U.C.C. § 2-615, off. cmt. 1, 1B U.L.A. 195 (1989).

³⁰U.C.C. § 2-615, off. cmt. 4, 1B U.L.A. 195-96 (1989).

³¹U.C.C. § 2-615, off. cmt. 8, 1B U.L.A. 196 (1989), citing *Madeirense do Brasil, S.A. v. Stulman-Emrick Lumber Co.*, 147 F.2d 399 (2d Cir. 1945).

³² *Eastern Air Lines v. Gulf Oil Corp.*, 415 F. Supp. 429, 441 (S.D. Fla. 1975) (citation omitted), *quoted in Cliffstar*, 750 F. Supp. at 84; *see also Moyer v. City of Little Falls*, 510 N.Y.S.2d 813, 814-15 (N.Y. Sup. Ct. 1986).

impracticability is based, however, must be “due to factors beyond the party’s control.”³³ A New York case affirms that the UCC “reflects the common law standard of impracticability” and suggests that “[t]he foreseeability requirement does not entail contemplation of a specific contingency; rather it is sufficient that the contingency that eventually occurred could have been foreseen as a real possibility that would affect performance.”³⁴ The common law standard will be considered in more depth below when we consider the common law doctrines of frustration and impossibility.³⁵

American courts will take a broad view of the foreseeability of international political and economic developments. This point is demonstrated by several decisions upholding commercial contracts following the eruption of the oil crisis during the 1970s. In *Eastern Air Lines v. Gulf Oil Corp.*,³⁶ it was argued that a long-term contract to supply jet fuel from 1972 to 1977 at a controlled price had been rendered commercially impracticable by the eruption of the oil crisis in 1973, which led to a 400% increase in the price of foreign oil during the period from September 1973 to January 1974 alone. The U.S. District Court for the Southern District of Florida held that “the events associated with the so-called energy crises were reasonably foreseeable at the time the contract was executed” in June 1972, and in reaching this conclusion the court highlighted “the volatility of the Middle East situation” (e.g., the interruption in the flow of Mid-East oil during the 1967 “Six-Day War”, Libya’s nationalization of its oil industry during the same period and the formation of OPEC in 1970 for the avowed purpose of raising oil prices).³⁷ The court stated that “[e]ven without the extensive evidence present in the record, the court would be justified in taking judicial notice of the fact that oil has been used as a political weapon with increasing success by the oil-producing nations for many years, and Gulf was well aware and assumed the risk that the OPEC nations would do exactly what they have done.”³⁸

In *Publicker Industries Inc. v. Union Carbide Corp.*,³⁹ the U.S. District Court for the Eastern District of Pennsylvania held that a three-year contract entered into in 1972 for the supply of ethanol, the major cost component of which is natural gas, had not been rendered commercially impracticable by a near doubling in costs due to the energy crisis. It was argued that at the time of the contract it was completely unforeseeable that the oil producing nations would bring about such exorbitant price increases. The court agreed, however, with the contention that “because the oil producing nations had joined together in 1971 to effect a 25% price increase, further price increases of the same kind were not unforeseeable at the time of the contact.”⁴⁰

Again, in *Helms Construction & Development Co. v. State of Nevada*,⁴¹ the Supreme Court of Nevada held that the performance of contracts entered into in 1972 had not been rendered commercially impracticable by the dramatic increase in the cost of petroleum-based products following the imposition of the oil embargo by the Arab nations. “The Arab oil embargo, although perhaps not within the contemplation of the parties, [was] ‘reasonably foreseeable.’”⁴²

Another line of cases touching upon the foreseeability of geopolitical events arose out of the closure of the Suez Canal by the Egyptian government in late 1956. In *Glidden Co. v. Hellenic Lines Ltd.*,⁴³ it was

³³ *Roth Steel Prods. v. Sharon Steel Corp.*, 705 F.2d 134, 149-50 (6th Cir 1983) (citation omitted), *quoted in* *Cliffstar*, 750 F. Supp. at 85.

³⁴ *Bende and Sons, Inc. v. Crown Recreation, Inc.*, 548 F. Supp. 1018, 1022 (E.D.N.Y. 1982), *aff’d* 722 F.2d 727 (2d Cir. 1983).

³⁵ *See infra* pp. 115-28.

³⁶ 415 F. Supp. 429 (S.D.Fla. 1975).

³⁷ *Eastern Air Lines*, 415 F. Supp. at 433-34, 441.

³⁸ *Id.* at 441-42.

³⁹ 17 U.C.C. Rep. 989 (E.D. Pa. 1975).

⁴⁰ *Id.*

⁴¹ 634 P.2d 1224, 1224-25 (Nev. 1981).

⁴² *Helms*, 634 P.2d at 1225 (quoting *Eastern Airlines*).

⁴³ 275 F.2d 253, 254-56 (2d Cir. 1960).

argued that shipping contracts for the transportation of goods from India to the east coast of the United States had been frustrated by the closure of the canal because the alternative routes – via the Cape of Good Hope or the Panama Canal – were not economically feasible. The U.S. Court of Appeals for the Second Circuit held that performance of the charter parties had not been frustrated because at the time of the negotiations leading to their signing “the Egyptian government had already nationalized the Suez Canal and the possibility of war in the Sinai Peninsula and the closing of the Canal were discussed in the public press and were recognized by the parties.”⁴⁴

Again, in *Transatlantic Financing Corp. v. United States*,⁴⁵ the U.S. Court of Appeals for the D.C. Circuit held that a shipping contract entered into after the canal’s nationalization in early 1956 had not been rendered commercially impracticable by its subsequent closure, the court assuming “that the parties were aware, as were most commercial men with interests affected by the Suez situation, that the Canal might become a dangerous area.”⁴⁶

In conclusion, American courts can be expected to take an expansive view of the foreseeability of international political and economic developments.

4. Foreseeability of EMU

While the occurrence of EMU is undoubtedly “beyond a party’s control” in a contract between two private parties, its long-standing foreseeability would appear to preclude the availability of the UCC doctrine of commercial impracticability. At the very latest, EMU became a foreseeable event when the Maastricht Treaty came into force in November 1993, or earlier when the Treaty was signed by the heads of state and government of the then 12 member states of the European Community in February 1992, at which time the world was put on notice that the member states intended to establish a monetary union.⁴⁷ Strong arguments can also be made that EMU became foreseeable earlier still when it was decided at the Madrid summit meeting of the European Council in 1989 to launch the first stage of EMU or when it was decided at the Hanover summit in June 1988 to commission the Delors report on monetary union.⁴⁸ It can also be argued that some form of monetary union has long been a goal of the European Community, going right back to the publication of the Werner Report in 1970 and the establishment of an exchange rate mechanism and later the European Monetary System in response to the collapse of Bretton Woods during the 1970s.⁴⁹

More broadly, in view of the widespread acceptance of the State theory of money and the fact that all countries have, at various times in history, changed their currencies, it may be argued that all manner of currency alterations are generally foreseeable. Parties may therefore be said to assume the risk of a currency alteration when they enter into a contract.

It is possible that arguments might be advanced that EMU was not foreseeable, perhaps even after the Maastricht Treaty came into effect. Such arguments might emphasize the high degree of skepticism that has permeated the financial markets regarding the EMU project, especially in the aftermath of the ERM currency crisis in 1993 and the related teething pains involved in shepherding the passage of the Maastricht Treaty through the EU member states.⁵⁰ It might also be pointed out that by year-end 1996 a

⁴⁴Glidden, 275 F.2d at 257.

⁴⁵363 F.2d 312, 314, 318 (D.C. Cir. 1966) (citation omitted).

⁴⁶See also *American Trading and Prod. Corp. v. Shell Int’l Marine Ltd.*, 453 F.2d 939, 942-43 (2d Cir. 1972).

⁴⁷See *supra* pp. 10-11.

⁴⁸See *supra* pp. 9-10; but see Memorandum from Daniel P. Cunningham, R. Brent Jones, Patricia L. Hogan, *Cravath Swaine & Moore*, for Financial Markets Lawyers Group, International Swaps and Derivatives Association, PSA The Bond Market Trade Association and Securities Industry Association, Economic and Monetary Union and Continuity of Contract Under New York Law 33-34 (Apr. 10, 1997) (on file with author).

⁴⁹See *supra* pp. 8-9; see also European Commission (DG II), *The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations 10-11* (Nov. 1997); Michael Gruson, *The Introduction of the Euro and its Implications for Obligations Denominated in Currencies Replaced by the Euro 21* (June 2, 1997) (unpublished manuscript, on file with author).

⁵⁰See *supra* p. 10.

majority of the member states did not appear to satisfy all of the Maastricht Treaty's economic convergence criteria.⁵¹ Furthermore, there can be no certainty as to which member states will qualify for EMU until the decision is finally made by the European Council, currently expected to take place in May 1998.

It is submitted, however, that the fact that considerable skepticism may have pervaded international financial markets is irrelevant. A prudent court would refuse to accept that EMU was unforeseeable after the political decision had been made to proceed with EMU and the Maastricht Treaty had been signed. It is not necessary to show that EMU may have appeared implausible in the financial markets, particularly in the United States. U.S. courts take a broad view of the concept of foreseeability when considering the application of the UCC doctrine of commercial impracticability, especially in the context of the foreseeability of international political and economic developments.⁵² Thus, in order to demonstrate the foreseeability of EMU it is not necessary to show that its occurrence was probable, but rather that the occurrence of EMU was a real possibility.⁵³ It is submitted that the decision by the heads of state and government to launch the first stage of EMU in 1989 placed the global financial markets on notice that EMU had become a real possibility. In addition, the introduction of a new currency by *any* country is arguably always a real possibility in view of the experiences of history and the long line of currencies that have come and gone in so many countries.

Another factor to be borne in mind is that it is possible for parties to include provisions in their contracts guarding against the possibility of EMU. The case law makes it clear that the failure to include such provisions counts against the party suffering from the event in question, who could have included protective clauses in the relevant contract.⁵⁴ In this regard it is instructive to note that a large number of U.S. issuers and counterparties have taken account of EMU in their legal documents since the Maastricht Treaty came into force in late 1993.⁵⁵

5. Expansive View of Commercial Impracticability

There is a line of authority that has taken an expansive view of the doctrine of commercial impracticability, suggesting that there may be circumstances where Section 2-615 of the UCC may be invoked notwithstanding the foreseeability of the contingency in question.

In *Transatlantic Financing*,⁵⁶ the court stated that in any attempt to define impossibility or impracticability, "[t]he doctrine ultimately represents the ever-shifting line, drawn by courts hopefully responsive to commercial practices and mores, at which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance." While the need to deviate from the normal shipping route due to the closure of the Suez Canal may have been foreseeable, the court stated as follows with respect to the concept of foreseeability:

Foreseeability or even recognition of a risk does not necessarily prove its allocation . . . Parties to a contract are not always able to provide for all the possibilities of which they are aware, sometimes because they cannot agree, often simply because they are too busy. Moreover, that some abnormal risk was contemplated is probative but does not necessarily establish an allocation of the risk of the contingency which actually occurs.⁵⁷

⁵¹See European Commission, Report on Convergence in the European Union in 1996, COM(96)560 final at 5, 72-75; European Monetary Institute, Progress Towards Convergence 1996 II-III (1996).

⁵²See *supra* pp. 106-07.

⁵³See *supra* p. 106.

⁵⁴See *supra* pp. 105-06, *infra* pp. 116-17, 119-20.

⁵⁵See *infra* pp. 139-45, 160-61, 179-81.

⁵⁶363 F.2d at 315.

⁵⁷*Transatlantic Fin.*, 363 F.2d at 318 (citations omitted).

In *Aluminum Co. of America v. Essex Group, Inc.*,⁵⁸ it was stated that this

approach is more in keeping with the spirit and purpose of the Uniform Commercial Code than is the strict approach. . . . Courts must decide the point at which the community's interest in predictable contract enforcement shall yield to the fact that enforcement of a particular contract would be commercially senseless and unjust.⁵⁹

This more expansive view of commercial impracticability has been echoed by certain commentators who have argued that the basic problem in every discharge case is to decide who should bear the loss resulting from an event that has rendered performance by one party uneconomical⁶⁰ and that "the case for excuse, at bottom, rests on notions of justice".⁶¹ This broad view of the doctrine of commercial impracticability cannot, however, remove foreseeability as an element of impracticability. Taken together, the case law and the Official Comments to Section 2-615 of the UCC demonstrate that foreseeability of a contingency is an integral element in the doctrine of commercial impracticability. The long-standing foreseeability of EMU should preclude the availability of the doctrine as excusing performance under the vast majority of contracts denominated in EU currencies. Moreover, it would be unjust as a general matter to excuse performance based on EMU. Exchange rates and currency values are subject to the vagaries of all kinds of macroeconomic and political factors. These factors fall into the category of risks which all contracting parties must be taken to have assumed from the outset.

In addition, courts are generally slow to relieve parties from the terms of their bargains, particularly when the parties obtain exactly what was contracted for. This is demonstrated by one case arising out of the introduction of Japanese exchange control regulations after the collapse of Bretton Woods. In *United Equities Co. v. First National City Bank*,⁶² the parties entered into a six month forward contract in April 1971 for the purchase of Japanese yen with U.S. dollars at a pre-determined rate with settlement taking place in October 1971. President Nixon announced in August 1971 that U.S. dollars would no longer be convertible into gold. This announcement caused the Japanese government to impose various currency and foreign exchange regulations which had the effect of severely restricting the ability of non-Japanese residents to hold yen bank accounts. Because the yen purchaser was unable to make satisfactory arrangements to obtain delivery of the yen on the maturity date as a result of these regulations, the seller liquidated the account by offsetting the contract price of the April contract against the spot or market price of the yen on the maturity date and crediting the difference to the yen purchaser's account in U.S. dollars, the yen purchaser realizing a profit as a result of the dollar's depreciation following the demonetization of gold. The yen purchaser was not satisfied with his profit, however, arguing that he had a right to delayed delivery of the yen for a three-month period under a force majeure clause in the contract because the contract had been frustrated. The New York Supreme Court, Appellate Division, held that there had been no frustration of the reasonable expectations of the parties because the yen purchaser had received and the yen seller had paid "exactly what the parties had contracted for, the profit due to the increased value of the Yen on October 14, 1971."⁶³ The court emphasized that there can be no frustration of the expectations of the parties where the yen purchaser "has realized and been paid the full benefit and profit contracted for."⁶⁴ The court arrived at this conclusion notwithstanding the fact that the yen purchaser did not in fact obtain the yen but rather the U.S. dollar equivalent of the yen on the maturity date, thereby depriving the purchaser of the opportunity to hold the yen beyond the maturity date for

⁵⁸499 F. Supp. 53, 76 (W.D. Pa. 1980).

⁵⁹See also *Maple Farms, Inc. v. City Sch. Dist. of the City of Elmira*, 352 N.Y.S.2d 784, 789-90 (N.Y. Sup. Ct. 1974); *Asphalt Int'l, Inc. v. Enter. Shipping Corp., S.A.*, 667 F.2d 261, 265-66 (2d Cir. 1981).

⁶⁰Richard A. Posner and Andrew W. Rosenfield, *Impossibility and Related Doctrines in Contract Law*, 6 J. LEGAL STUD. 83, 86 (1977).

⁶¹HAWKLAND, *supra* note 3, § 2-615:08 (Art. 2).

⁶²383 N.Y.S.2d 6 (N.Y. App. Div. 1976).

⁶³*United Equities*, 383 N.Y.S.2d at 10.

⁶⁴*Id.* at 12.

investment purposes.⁶⁵ This case demonstrates that the courts will not lightly treat performance under a foreign exchange contract as frustrated or commercially impracticable due to the introduction of exchange controls. The case also demonstrates that parties will be held to the terms of their agreement, especially where they have obtained what has been contracted for (i.e., the lawful currency of the country designated in the contract).

6. Commercial Impracticability and Certain Swap Transactions

This study will next consider several kinds of transactions whose performance might be argued to have been rendered commercially impracticable after EMU.

a. Cross Currency Interest Rate Swaps

Because so many U.S. counterparties select New York law as the governing law for their swap contracts,⁶⁶ New York law is the governing law for a large number of cross currency interest rate swaps that involve obligations to make payments in two EU currencies both of which are eligible to participate in EMU (e.g., a Deutsche mark/French franc swap). If each of the currencies underlying such a swap were to merge into the single currency the swap contract would be transformed into an obligation by one party to make net payments to its counterparty for the remaining life of the contract, transforming the swap into an obligation akin to an annuity. In such a scenario it would be arguable that the survival of the two separate currencies underlying the swap, together with the independent interest rate climates associated with such currencies, was a basic assumption upon which the contract was made and against which the swap was actually designed to hedge. Notwithstanding the foreseeability of EMU, it might not be equitable to insist on performance because the basic purpose of such a swap would arguably be undermined by the occurrence of EMU. As stated by ISDA to the European Commission, “[t]he swap derives its purpose from the fact that (a) currencies may fluctuate in value as against each other, and (b) different interest rates apply to different currencies. Neither of these reasons would continue to apply following conversion of the underlying currencies to a single currency.”⁶⁷

Moreover, a cross currency swap between two participating currencies could be subjected to different tax treatment after EMU. The tax implications of EMU for certain derivative transactions such as cross-currency swaps involving two participating currencies is currently being examined by the financial markets as there is a concern in certain jurisdictions that the removal of any currency risk between participating currencies upon the fixing of conversion rates may cause profits to be capable of recognition earlier than would otherwise be the case.⁶⁸ Under the U.S. income tax regulations the general rule is that gains, profits and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible in a different year in accordance with the taxpayer’s method of accounting.⁶⁹ Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.⁷⁰ Clearly a strong argument can be made that upon the irrevocable fixing of conversion rates all the events have occurred which fix the right to receive a readily determinable amount of income under a cross-currency swap between two currencies both of which have been irrevocably converted into the single currency. The outcome of the contract can be calculated with certainty and the exchange difference may be realized for a determinable amount of

⁶⁵See *id.* at 11.

⁶⁶See *supra* pp. 3-5.

⁶⁷Letter from Gay H. Evans, Chairman, *International Swaps and Derivatives Association*, to John F. Mogg, Director General, DG XV, *European Commission* 2-3 (Nov. 1, 1995) (on file with author); see also LONDON INVESTMENT BANKING ASSOCIATION, *THE PRACTICAL IMPLICATIONS OF CONVERTING LONDON’S CAPITAL MARKETS TO A SINGLE CURRENCY* para. 31 (Oct. 1995); FINANCIAL LAW PANEL, *RESPONSE TO THE EUROPEAN COMMISSION’S GREEN PAPER DATED 31 MAY 1995 ON THE PRACTICAL ARRANGEMENTS FOR THE INTRODUCTION OF THE SINGLE CURRENCY* 7-8 (Oct. 1995).

⁶⁸See BANK OF ENGLAND, *2 PRACTICAL ISSUES ARISING FROM THE INTRODUCTION OF THE EURO* 34-35 (Sept. 1996).

⁶⁹TREAS. REG. §1.451-1 (as amended in 1993).

⁷⁰See *id.*

money that only changes because of the time value of money. The tax exempt treatment of foreign exchange gains under a cross-currency swap might be regarded as a basic assumption of the contract. It does not appear that this issue has been considered yet by the U.S. tax authorities.⁷¹

b. Currency Options

With respect to currency options involving two participating currencies, ISDA has noted as follows:

The commercial essence of the contract is the unpredictable volatility of currency exchange rates - the value of the contract to the optionholder derives from the possibility that, by the exercise date, the currency the optionholder is entitled to receive will be worth more than the deliverable currency. If both currencies are converted into a single currency then the exchange rate between them is effectively frozen. The optionholder loses the volatility from which the option value derives.⁷²

In addition, the income tax treatment of such currency options might be affected by the irrevocable fixing of the conversion rates because, as with cross currency swaps between two participating currencies, the outcome of the contract can be predicted with certainty from the moment the rates have been fixed.

c. Continuity of Currency Swaps and Options

Strong arguments can be made that, assuming currency swaps are not subjected to different tax treatment after EMU, performance of all relevant currency swaps and options should be required because each party will obtain exactly what they have contracted for. The irrevocable fixing of conversion rates and the merger of the two currencies underlying the swap or option was one of the risks assumed by the parties at the time they entered into the transaction. Moreover, there is no guarantee, even today, that particular member states will satisfy the necessary conditions for adoption of the single currency. Also, in view of the continuing importance of the nation state in European politics, there has been speculation in the financial markets that member states initially participating in EMU might subsequently withdraw and re-establish their national currencies which would then float against the euro. The belief (however irrational) that this might occur would provide a rationale for cross currency swap transactions between participating currencies after the introduction of the single currency, particularly during the transitional period when the national legal tenders will still be in circulation and a withdrawal from EMU might still be believed possible. For all of these reasons it is submitted that the irrevocable fixing of conversion rates should not be viewed as rendering the performance of such currency swaps or options commercially impracticable. In this regard, it is instructive to note that several English lawyers considering this issue from the perspective of the common law doctrine of frustration have arrived at the same conclusion.⁷³

Perhaps most important of all, the EU Council regulation on certain provisions relating to the introduction of the euro provides that the introduction of the euro will not have the effect of altering any term of a legal instrument (which would of course include a swap contract) or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate a legal instrument, subject to anything which the parties may have agreed with reference to the introduction of the euro.⁷⁴ The Preamble to this regulation makes it clear that the EU authorities anticipate that this provision will be recognized in non-EU jurisdictions as part of “the monetary law” of the European Union, that “the recognition of the monetary law of a state is a universally accepted principle”; and that

⁷¹See Simon Boughey, *The EMU Threat*, I DERIVATIVES STRATEGY, No. 10, Oct. 1996, at 29.

⁷²Letter from Gay H. Evans, Chairman, *International Swaps and Derivatives Association*, to John F. Mogg, Director General, DG XV, *European Commission* 3 (Nov. 1, 1995) (on file with author).

⁷³See CHARLES PROCTOR AND GILLES THIEFFRY, NORTON ROSE, EMU—BUSINESS AS USUAL IN FINANCIAL MARKETS: A LEGAL ANALYSIS OF THE IMPACT OF EMU ON FINANCIAL OBLIGATIONS 9 (1996); PARIBAS CAPITAL MARKETS, LEGAL IMPLICATIONS OF EUROPEAN MONETARY UNION 6 (1994); see also European Commission (DG II), *The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations* 11-12 (Nov. 1997).

⁷⁴Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (7), art. 3, 1997 O.J. (L 162/1); see *supra* pp. 24-25.

“the explicit confirmation of the principle of continuity should lead to the recognition of continuity of contracts and other legal instruments in the jurisdictions of third countries”.⁷⁵ Clearly this provision prevents the invocation of doctrines like commercial impracticability to excuse performance under currency swap or option contracts involving two currencies participating in EMU. With respect to swaps and options that are governed by New York law, the sovereign power of the European Union to establish a new monetary system permits the EU Council to enact legislation stipulating the manner in which monetary obligations contained in currency contracts are to be discharged after EMU.⁷⁶ In the absence of U.S. federal legislation to the contrary, all swaps and options governed by New York law and denominated in EU currencies are necessarily subject to the sovereign powers of the European Union in this respect.

7. Increased Cost of Performance

Official Comment 4 to Section 2-615 of the UCC states that “[i]ncreased cost alone does not excuse performance unless the rise is due to some unforeseen contingency which alters the essential nature of the performance, and a rise or a collapse in the market is not in itself a justification for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover.”⁷⁷ Thus, the fact that performance has been rendered costly should not in general afford an excuse from performance.⁷⁸

8. Expiry of Exclusive Source of Supply

Official Comment 5 to Section 2-615 of the UCC states that the doctrine of commercial impracticability is available “[w]here a particular source of supply is exclusive under the agreement and fails through casualty”, or “where a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of contracting.”⁷⁹ Official Comment 5 further states that “[i]n the case of failure of production by an agreed source for causes beyond the seller’s control, the seller should, if possible, be excused since production by an agreed source is without more a basic assumption of the contract.”⁸⁰ Applied to EMU, the somewhat aggressive argument might be made that the Deutsche Bundesbank, for example, provides the exclusive source of the supply of the Deutsche mark commodity and that the continued issuance by the Bundesbank or some other German governmental authority of the German currency is without more a basic assumption on which the contract was made. If Germany transfers its sovereign powers to issue currency and to implement and define monetary policy to a new supranational European Central Bank, the exclusive source of the supply of the Deutsche mark will have expired.

This argument is inconsistent with the concept of money adopted by the UCC. The definition of money does not require that money be issued by a particular government, but rather that it be authorized or adopted by a government as its medium of exchange.⁸¹ The EU Council will adopt the euro as the currency of participating EU member states. Moreover, national central banks such as the Deutsche Bundesbank will issue the new currency under the authority of the European Central Bank and will continue to influence the direction of monetary policy through their participation in the decision-making process of the European Central Bank.⁸² To that extent it would be inaccurate to suggest that national central banks like the Bundesbank will cease to provide a source of supply for the new currency. In any

⁷⁵Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro , preamble (8), 1997 O.J. (L 162/1).

⁷⁶See *supra* pp. 35-100.

⁷⁷U.C.C. § 2-615, off. cmt. 4, 1B U.L.A. 195-96 (1989).

⁷⁸See also Moyer, 510 N.Y.S.2d at 814-15; Publicker, 17 U.C.C. Rep. at 989; Aluminum, 499 F. Supp. at 70-78, discussed *supra* pp. 73-74.

⁷⁹U.C.C. § 2-615, off. cmt. 5, 1B U.L.A. 196 (1989).

⁸⁰*Id.*

⁸¹See *supra* pp. 81-85.

⁸²See *supra* pp. 81-85.

case, it appears counter-intuitive to suggest that a central bank's issuance of currency provides the source of supply for the production of a commodity within the meaning of Section 2-615 of the UCC.

9. Compliance with Applicable Foreign Governmental Regulations

Section 2-615 of the UCC excuses performance if performance as agreed has been made impracticable by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.⁸³ Official Comment 10 states that "governmental interference cannot excuse unless it truly 'supervenes' in such a manner as to be beyond the seller's assumption of risk."⁸⁴ The EU Council regulations confirming the continuity of contracts after EMU will not hinder performance but will actually facilitate the performance of contracts. This is another factor that would prevent any party from raising the doctrine of commercial impracticability as excusing performance under swap and foreign exchange contracts.

10. Substituted Performance

Section 2-614(1) of the Code provides that "[w]here without fault of either party . . . the agreed manner of delivery . . . becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted."⁸⁵ Section 2-614(2) of the Code provides that "[i]f the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent."⁸⁶ If there was any doubt regarding the legal continuity between the euro and the national currencies participating in EMU, these provisions would clearly facilitate the discharge of obligations in the euro as a commercially reasonable substitute and substantial equivalent for the pre-existing national currencies.

B. Doctrine of Impossibility

There are many financial obligations denominated in EU currencies that are not governed by the Uniform Commercial Code, particularly payment obligations under interest rate swaps, Eurobonds, international loans and cross-border commercial transactions. The legal implications of EMU for such contracts must be considered under common law doctrines such as the doctrines of impossibility and frustration, and in the case of many cross-border commercial transactions under the U.N. Convention for the International Sale of Goods.

1. Contours of Doctrine of Impossibility

Under the doctrine of impossibility nonperformance of a contract is typically excused "only when the destruction of the subject matter of the contract or the means of performance renders performance objectively impossible."⁸⁷ Thus, performance is excused where performance becomes impossible because of a change in the law or action taken by the government.⁸⁸ The doctrine is available in the event of the destruction of the subject matter of the contract: "[i]n the absence of an express contract provision, if the act to be performed is necessarily dependent on the continued existence of a specific thing, the perishing of that thing before time for performance, without the fault of the promisor, will excuse a

⁸³U.C.C. § 2-615, 1B U.L.A. 195 (1989).

⁸⁴U.C.C. § 2-615, off. cmt. 10, 1B U.L.A. 197 (1989); *see* *Maple Farms*, 352 N.Y.S.2d at 789-90; *Harriscom Svenska, AB v. Harris Corp.*, 3 F.3d 576, 580 (2d Cir 1993).

⁸⁵U.C.C. § 2-614(1), 1B U.L.A. 193 (1989).

⁸⁶*Id.*

⁸⁷22A N.Y. JUR. 2D, *Contracts* § 384 (1996) (citing *Kel Kim Corp. v. Cent. Mkts., Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987); *Inter-Power of New York Inc. v. Niagara Mohawk Power Corp.*, 617 N.Y.S.2d 562, 564 (N.Y. App. Div. 1994), *modified* 630 N.Y.S.2d 584 (N.Y. App. Div. 1995)); *see also* *J.J. Cassone Bakery, Inc. v. Consol. Edison Co. of New York, Inc.*, 638 N.Y.S.2d 898, 903 (N.Y. Sup. Ct. 1996); 17A AM. JUR. 2D, *Contracts* §§ 673, 675-76 (1991) (and the cases cited therein).

⁸⁸*See* 22A N.Y. JUR., *Contracts* § 399 (1996); 17A AM. JUR. 2D, *Contracts* § 673 (1991) (and the cases cited therein).

breach of the contract [T]he contingency which has arisen is treated as one about which no bargain at all was made.”⁸⁹ It has been suggested that the question of whether a contract is dependent on the continued existence of a given thing “must be gathered from the intention of the parties as expressed in the instrument as a whole.”⁹⁰ It is important to emphasize that “where impossibility or difficulty of performance is occasioned only by financial difficulty or economic hardship, even to the extent of insolvency or bankruptcy, performance of a contract is not excused.”⁹¹

A court may consider that there is, given the nature of a specific contract, an implied condition of impossibility by which a party will be relieved from his or her unqualified obligation when it inherently appears from the contract to have been known to the parties and contemplated by them when it was made that its fulfillment would be dependent upon the continuance of or existence at the time for performance of certain things or conditions essential to its execution.⁹²

Foreseeability is a consideration in determining whether the defense of impossibility applies. The excuse of impossibility of performance must be the result of an unanticipated event that could not be foreseen or protected against in the contract.⁹³ This principle has been repeatedly reiterated by the New York courts.⁹⁴ The prevailing view in other American jurisdictions seems to be that where the event which causes the impossibility might have been anticipated and guarded against in the contract, an unqualified undertaking is to be construed as an absolute contract to perform the things which subsequently become impossible or to pay damages for their non-performance.⁹⁵

Common law courts have traditionally been slow to relieve a party of obligations entered into by contract and have traditionally been wary of excuses proffered after the fact. This has led over the years to a strict standard of foreseeability. One explanation is typical:

It is clear that a person who makes an absolute promise to pay may not be excused from performance because of the happening of a contingency which destroys the value of the stipulated consideration for such payment where inference is reasonable that an express condition so providing would have been inserted in the contract had the parties so intended. Where the promisor has knowingly chosen to make an absolute promise, he may not afterwards claim relief because subsequent events show that the choice was ill-advised. The test seems to be whether the event...was or might have been guarded against.⁹⁶

Parties are meant to be hard bargainers and to think about possible contingencies preventing performance before they sign a contract. One court denying that a governmental change of policy was

⁸⁹22A N.Y. JUR., *Contracts* §§ 391, 394 (1996) (citing *Nitro Powder Co. v. Agency of Canadian Car & Foundry Co.*, 135 N.E. 507, 508 (N.Y. 1922); *Lorillard v. Clyde*, 37 N.E. 489, 491 (N.Y. 1894); *W.K. Ewing Co. v. New York State Teachers' Retirement Sys.*, 218 N.Y.S.2d 253, 255 (N.Y. App. Div. 1961), *aff'd* 181 N.E.2d 628 (N.Y. 1962); *Port Aux Quilles Lumber Co. v. Meigs Pulp Wood Co.*, 198 N.Y.S. 563, 565 (N.Y. App. Div. 1923); *Freund v. Zephyr Laundry Mach. Co.*, 39 N.Y.S.2d 250, 254 (N.Y. Sup. Ct. 1942), *aff'd* 41 N.Y.S.2d 909 (N.Y. App. Div. 1943)).

⁹⁰*Neumann v. S. Bay Pontiac Motors*, 145 N.Y.S.2d 633, 635 (N.Y. Co. Ct. 1955) (citation omitted).

⁹¹407 E. 61st Garage v. Savoy Fifth Ave. Corp., 244 N.E.2d 37, 41 (N.Y. 1968); *Bank of Am. v. Envasas Venezolanos, S.A.*, 740 F. Supp. 260, 267 (S.D.N.Y. 1990) (citing 407 E. 61st St. Garage), *aff'd* 923 F.2d 843 (2d Cir. 1990); *Rivas Paniagua, Inc. v. World Airways, Inc.*, 673 F. Supp. 708, 713 (S.D.N.Y. 1987) (same).

⁹²See *J.J. Cassone Bakery*, 638 N.Y.S.2d at 903; 22A N.Y. JUR., *Contracts* § 386 (1996) (citing *Stewart v. Stone*, 28 N.E. 595, 596 (N.Y. 1891)); 17A AM. JUR. 2D, *Contracts* § 677 (1991) (and the cases cited therein).

⁹³See 22A N.Y. JUR., *Contracts* § 384 (1996) (citing *Kel Kim*, 519 N.E.2d at 296; *Inter-Power of New York*, 617 N.Y.S.2d at 564); see also 17A AM. JUR. 2D, *Contracts* § 678 (1991) (and the cases cited therein).

⁹⁴See, e.g., *Kel Kim*, 519 N.E.2d at 296 (citations omitted); *Ogdensburg Urban Renewal Agency v. Moroney*, 345 N.Y.S.2d 169, 171 (N.Y. App. Div. 1973) (citations omitted); *J.J. Cassone Bakery*, 638 N.Y.S.2d at 903 (citations omitted); *Bank of Am.*, 740 F. Supp. at 267 (citing *VJK Prods., Inc. v. Friedman/Meyer Prods., Inc.*, 565 F. Supp. 916, 920 (S.D.N.Y. 1983)(citations omitted)).

⁹⁵See, e.g., 17A AM. JUR. 2D, *Contracts* § 678 (1991) (and the cases cited therein).

⁹⁶*Raner v. Goldberg*, 155 N.E. 733, 733 (N.Y. 1927).

foreseeable noted that both parties to a contract “were surely aware that theirs is a business subject to governmental approval and regulation.”⁹⁷

2. Impossibility and EMU

Applying the doctrine of impossibility to EMU, it might be argued that the performance of a financial contract denominated in an existing EU national currency has been rendered impossible where that currency disappears and is replaced by a new single European currency. Thus, one commentator has suggested that if the currency promised is wholly withdrawn from circulation by government action so that it is no longer a medium of exchange, the case should be regarded as one in impossibility of performance by act of the law.⁹⁸ On this argument, the contract is necessarily dependent on the continued existence of the currency in which the obligation was denominated, and the introduction of the euro by the governments of the countries participating in EMU may render performance impossible by destroying the subject matter of the contract. A variation of this theory would be to argue that the continued existence of separate European national currencies was an implied condition of the contract, and the contract was therefore dependent upon the continuance of a monetary system in Europe that is linked to the nation state.⁹⁹

This argument would not persuade American courts to disturb the continuity of European currency contracts. In accordance with the State theory of money, the subject-matter of the contract is not a particular national currency issued by a particular government but rather whatever money passes as lawful currency at the time and place of payment. This is firmly established at common law and under the UCC.¹⁰⁰ Thus, the subject-matter of the contract will be the euro substituted for the national currencies at the irrevocably fixed conversion rates. Commentators like Mann and Nussbaum agree that it can never be impossible to perform monetary obligations because monetary obligations are indestructible.¹⁰¹ In the event of the extinction of a currency the recurrent link, connecting the new currency with the old currency, will always define the amount payable.¹⁰²

An additional reason why the defense of impossibility will not be open to litigants after EMU is that the defense is only available where performance is rendered impossible by the occurrence of an unanticipated event. As previously discussed,¹⁰³ EMU has long been a goal of the European Community and has been foreseeable since the decision to commission the Delors Report at the European Council summit in Hanover in June 1988, followed by the decision in 1989 to launch the first stage of EMU. At the very latest EMU became foreseeable after the signing of the Maastricht Treaty in early 1992. More broadly, in view of the widespread acceptance of the State theory of money and the long history of currency changes, a compelling argument can be made that the introduction of a new currency by a country is always inherently foreseeable. In addition, the standard of foreseeability is explicitly based on whether the parties could or should have allocated risks in their contract.¹⁰⁴ The long-standing preparations by the financial markets for EMU, including the decision by many operators in the financial markets to revise legal documentation in anticipation of EMU, will provide ample evidence for American courts that the risks arising out of the introduction of the single European currency could have been guarded against in financial transactions.¹⁰⁵

⁹⁷In re M&M Transp. Co., 13 B.R. 861, 871 (Bankr. S.D.N.Y. 1981).

⁹⁸CORBIN, *supra* note 16, § 1360 n.45.

⁹⁹See generally Alan H. Kaufman (Jones, Day, Reavis & Pogue), Overview: the U.S. and European Legal Context of the Euro Currency 7 (Oct. 23, 1997) (unpublished manuscript, on file with author).

¹⁰⁰See *supra* pp. 35-100.

¹⁰¹MANN, *supra* note 11, at 67, 278; ARTHUR NUSSBAUM, MONEY IN THE LAW NATIONAL AND INTERNATIONAL 144-46 (1950).

¹⁰²See *id.*

¹⁰³See *supra* pp. 8-11, 107-09.

¹⁰⁴See *supra* pp. 105-06, 116-17, *infra* pp. 119-20.

¹⁰⁵See *infra* pp. 139-45, 160-61, 179-81.

C. Doctrine of Frustration

1. Contours of Doctrine of Frustration

The common law doctrine of frustration stems from a series of English cases known as the “coronation cases”. Purchasers of tickets to a British coronation parade in 1902 sought their money back when the parade was delayed because of the monarch’s illness, arguing that their purpose in contracting was “frustrated” because the object of the contract was to see the parade. Beginning with *Krell v. Henry*,¹⁰⁶ English courts accepted this doctrine, holding that “the coronation procession was the foundation of this contract” and that “the object of the contract was frustrated by the non-happening of the coronation and its procession on the days proclaimed”. American courts adopted the doctrine of frustration of purpose soon thereafter.¹⁰⁷

It has been held that in order to establish the defense of frustration, “the inducing circumstance which no longer exists must be ‘the foundation of the contract’.”¹⁰⁸ Again, it has been stated that “frustration of purpose refers to a situation where an unforeseen event has occurred, which, in the context of the entire transaction, destroys the underlying reasons for performing the contract, even though performance is possible, thus operating to discharge a party’s duties of performance.”¹⁰⁹ The concept of the “underlying reasons” for performance may be stated differently using another term from contract law: the “benefit of the bargain.” Thus the doctrine of frustration

focuses on events which materially affect the consideration received by one party for his performance. Both parties can perform but, as a result of unforeseeable events, performance by party X would no longer give party Y what induced him to make the bargain in the first place. Thus frustrated, Y may rescind the contract.¹¹⁰

The application of the doctrine of frustration is narrow. “Discharge under this doctrine has been limited to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party.”¹¹¹ The courts have repeatedly emphasized that the supervening event must be one which was not foreseeable by the parties and therefore could not have been guarded against in the contract.¹¹² Indeed it has been suggested that it is this factor “more than any other upon which New York cases have generally focused, i.e., whether or not the supervening event was within the contemplation of the parties and might have been guarded against.”¹¹³ There appears to be general agreement under the laws of all American jurisdictions that the common law doctrine of frustration does not apply where the risk of the event that has supervened to cause the alleged frustration was reasonably foreseeable and could have been anticipated by the parties by making provision therefor in the contract.¹¹⁴ It has also been emphasized that the doctrine of frustration does “not permit a party to abrogate a contract, unilaterally,

¹⁰⁶[1903] K.B. 740 at 751, 754 (C.A).

¹⁰⁷See 17A AM. JUR. 2D, *Contracts* § 666 (1991) (and the cases cited therein).

¹⁰⁸*Pettinelli Elec. Co. v. Bd. of Educ. of New York City*, 391 N.Y.S.2d 118, 119 (N.Y. App. Div. 1977) (quoting *Krell*), *aff’d* 372 N.E.2d 799 (N.Y. 1977); *see also* *Raner*, 155 N.E. at 734.

¹⁰⁹*Re Agosta*, 472 N.Y.S.2d 528, 532 (N.Y. Sup. Ct. 1983) (citations omitted), *aff’d as modified* 484 N.Y.S.2d 644 (N.Y. App. Div. 1985), *aff’d* 482 N.E.2d 1216 (N.Y. 1985), *quoted in* *Bank of Am.*, 740 F. Supp. at 266.

¹¹⁰*United States v. Gen. Douglas MacArthur Senior Village, Inc.*, 508 F.2d 377, 381 (2d Cir. 1974).

¹¹¹*MacArthur Senior Village*, 508 F.2d at 381 (citations omitted).

¹¹²*See, e.g.*, *Frenchman & Sweet Inc. v. Philco*, 249 N.Y.S.2d 611, 613 (N.Y. App. Div. 1964); *Re Agosta*, 472 N.Y.S.2d at 532 (citations omitted); *Bank of Am.*, 740 F. Supp. at 921 (citing *VJK Prods.*, 565 F. Supp. at 921); *In re M&M Transp. Co.*, 13 B.R. 861, 870 (Bankr. S.D.N.Y. 1981) (citations omitted); *see also* 17A AM. JUR. 2D, *Contracts* § 668 (1991) (and the cases cited therein).

¹¹³*In re M&M*, 13 B.R. at 870 (citations omitted).

¹¹⁴*See, e.g.*, 17A AM. JUR. 2D, *Contracts* § 668 (1991) (and the cases cited therein).

merely upon a showing that it would be financially disadvantageous to perform it; were the rules otherwise, they would place in jeopardy all commercial contracts.”¹¹⁵

A more expansive view of the doctrine of frustration has been advanced in one case where it was stated that “New York, to a large extent, follows the principle of commercial frustration, as outlined in the Restatement (Second) of Contracts, § 285” which, like the doctrine of commercial impracticability under the Uniform Commercial Code, speaks of a contract being frustrated “by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made”.¹¹⁶ Working from this premise, the court characterized the doctrine of frustration as a way for courts to allocate risk not allocated between the parties in their contract.

Essentially, the principle of commercial frustration affords a means by which courts allocate risk in order to decide who is to bear the burden of any event not provided for by the parties’ agreement. And, although the courts have attempted to outline its components, it actually involves the balancing of interests in light of the facts involved and society’s customs and mores. The basic test is whether the parties contracted on a basic assumption that a particular contingency would not occur.¹¹⁷

A contract may be frustrated by unforeseen government orders.¹¹⁸ The applicability of the doctrine of frustration has been examined in the context of the introduction of exchange control regulations. In *United Equities*, a forward contract for the purchase of yen with dollars was discharged by payment of the U.S. dollar equivalent of the yen owing under the contract on the maturity date.¹¹⁹ Although payment of the yen had been prevented by the introduction of supervening exchange control regulations, it was held that payment of the U.S. dollar equivalent value of the yen did not frustrate “the reasonable expectations of the parties” because the purchaser of yen received and the seller paid “exactly what the parties had contracted for, the profit due to the increased value of the yen” on the maturity date.¹²⁰

In *Bank of America v. Envases Venezolanos, S.A.*,¹²¹ a Venezuelan company entered into an agreement with an American bank for the restructuring of certain loans made by the American bank to enable the Venezuelan company to make repayments through the Venezuelan Central Bank at a favorable exchange rate under a scheme established by the Central Bank to subsidize Venezuelan companies with foreign currency debts. It was held that the revocation of this scheme by the Central Bank did not frustrate the purpose of the loan restructuring agreement because the agreement contemplated the possibility of a change in the applicable Venezuelan currency regulations.¹²²

2. Frustration and EMU

In view of the requirement that the frustrating event be unforeseeable, there are few transactions that could be dischargeable under the common law doctrine of frustration after EMU.¹²³ In any case, in accordance with the State theory of money all obligations denominated in EU currencies must be discharged in the single currency in accordance with the applicable provisions of the EU Council regulations.¹²⁴ The financial obligations which are most likely to be relevant in the context of the

¹¹⁵407 E. 61st St. Garage, 244 N.E.2d at 42, *quoted in* Bank of Am., 740 F. Supp. at 266; *see also* 17A AM. JUR. 2D., *Contracts* § 669 (1991) (and the cases cited therein).

¹¹⁶In re M&M, 13 B.R. at 869 (citing RESTATEMENT (SECOND) OF CONTRACTS § 285 (Tentative Draft No. 9, 1974)).

¹¹⁷*Id.* (citing MURRAY ON CONTRACTS § 202 (1974)).

¹¹⁸*See, e.g.*, *Gunze Silk Corp. v. Charles Rudolph Corp. of N.Y.*, 43 N.Y.S.2d 175, 175-76 (N.Y. App. Div. 1943).

¹¹⁹*See supra* pp. 110-11.

¹²⁰*United Equities*, 383 N.Y.S.2d at 10.

¹²¹740 F. Supp. 260 (S.D.N.Y. 1990).

¹²²*Bank of Am.*, 740 F. Supp. at 265-267.

¹²³*See supra* pp. 8-11, 105-09.

¹²⁴*See supra* pp. 35-100.

doctrine of frustration concern interest rate obligations. It might be argued that the fundamental purpose underlying interest rate obligations has been undermined as a result of the overhaul of the existing system of interest rates linked to separate European national currencies. This argument must be considered from the perspective of both fixed and floating interest rates.

a. Floating Interest Rate Obligations

There are many rate swaps governed by New York law involving floating interest rates that are linked to existing EU national currencies. A rate swap is a bilateral agreement in which each of the parties promises to make periodic payments in the same currency to the other, calculated as one would calculate interest payments on the principal amount of a debt obligation using fixed to floating interest rate bases or floating to floating bases (i.e., basis swaps).¹²⁵ In addition, there may also be floating rate obligations linked to debt obligations denominated in EU national currencies that are governed by New York law. Following the introduction of the single currency, price sources relating to specific national currencies may disappear or be substantially modified and may be replaced with new price sources relating to the single currency. In addition, existing panels of banks in particular countries that quote national currency rates may cease to quote any rates after EMU and may instead be replaced by a single pricing panel drawn from throughout the euro area to provide euro rate quotations.¹²⁶

i. Frustration and Floating Rates

In the context of the doctrine of frustration, the question arises whether the possible disappearance of a price source and/or related pricing panel for a floating interest rate linked to an existing national currency would either destroy the underlying reasons for performing a contract or undermine a basic assumption upon which a contract is made.¹²⁷

There is older common law authority supporting the proposition that contracts may be frustrated where the price source for the contract has become unavailable. In *Interstate Plywood Sales Co. v. Interstate Container Corp.*,¹²⁸ a supply contract containing an option to purchase certain quantities of plywood provided that plywood would be sold at “Market price”, which was defined as “the published market price” for five specified mills. The five-mill pricing formula became unworkable shortly after the contract was executed because some of the listed mills went out of business, and others did not publish prices.¹²⁹ It was held that “[p]rice is an essential contractual element: it cannot be supplied by the court, and when the price cannot be determined in the manner in which the parties intended, the contract is unenforceable.”¹³⁰ Again in *Louisville Soap Co. v. Taylor*,¹³¹ the parties to a contract were relieved of their obligations where the price of goods sold was to be determined by the official closing price of a Board of Trade on the day an order was received and there were no closing prices during the last part of the contract period. In *Turman Oil Co. v. Sapulpa Ref. Co.*,¹³² a contract for the sale of oil at a price determined by a particular company terminated when the company began to post several prices depending upon the grade of oil.

¹²⁵See ANTHONY C. GOOCH AND LINDA B. KLEIN, DOCUMENTATION FOR DERIVATIVES 183, 185 (1993).

¹²⁶The Impact of the Introduction of the Euro on Capital Markets: Communication from the Commission, II/338/97-EN-2 at 30-31 (1997); Banque de France, Can the Domestic Interbank Benchmark Indices be Maintained within the Euro Zone after the Transition to the Single Currency, or must they be Adapted? (1997) (on file with author); INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., EFFECT OF EMU ON PRICE SOURCES 1-3 (June 1997).

¹²⁷This issue has long been a subject of concern in London financial circles. LONDON INVESTMENT BANKING ASSOCIATION, *supra* note 67, at para. 82.

¹²⁸331 F.2d 449 (9th Cir. 1964).

¹²⁹*Interstate Plywood*, 331 F.2d at 450.

¹³⁰*Id.* at 452-53 (citations omitted).

¹³¹279 F. 470, 476-79 (6th Cir. 1922).

¹³²254 P. 84, 84-87 (Okla. 1926).

Taken together, these cases clearly indicate that the disappearance of price sources for floating rates linked to national currencies might be regarded as destroying the underlying reasons for performing a contract.¹³³ However, insofar as these cases involved contracts for the sale of goods, they have been supplanted by Section 2-305(1) of the Uniform Commercial Code. Section 2-305(1) of the UCC provides that where the price in a contract of sale is not settled because “the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded”, then “[i]n such a case the price is a reasonable price at the time of delivery.”¹³⁴ In *North Central Airlines v. Continental Oil Co.*,¹³⁵ the parties entered into a long-term contract for the purchase and supply of aviation fuel with the price to be determined using a benchmark price for particular crude oil posted in a periodic bulletin. It was held that when the U.S. Government introduced a two-tier pricing system for new and old oil in response to the 1970s oil crisis, the agreed standard failed because there were then two prices posted, and the contract would instead have to be enforced through the substitution by the court of a reasonable price in the absence of the old price source.¹³⁶ This case has been followed in subsequent decisions holding that courts should admit evidence to determine a reasonable price when a pricing clause is ambiguous.¹³⁷ While the UCC is inapplicable to interest rate swaps, it can be reasonably expected that its provisions would be applied by analogy by American courts so as to substitute a reasonable price source for existing interest rate price sources after EMU.¹³⁸

There is also older common law authority supporting the proposition that courts should construe a pricing term in a contract reasonably so as to substitute an equivalent price where the price source unexpectedly disappears. In *Nevada Half Moon Mining Co. v. Combined Metals Reduction Co.*,¹³⁹ the parties entered into a contract for the assignment of certain mining claims with an agreement that the assignor would be paid an annual 2½% royalty on returns (profits) resulting from the sale of ores mined from the property. It was held that when the U.S. Government introduced ceilings on certain minerals and paid subsidies to the mining company for ores produced from the property, the assignor was entitled to royalty payments on the subsidies even though they were not provided for in the contract. Cautioning that “a contract should not be so narrowly or technically interpreted as to frustrate its obvious design or so loosely construed as to relieve a party of an obligation or liability fairly within its scope or spirit”, the court held that the subsidy payments “were the equivalent of returns from the production and processing of ores extracted from the premises within the scope of the contract.”¹⁴⁰

By analogy, successor price sources for euro interest rates that are established after EMU should be regarded by American courts as legally equivalent to the pre-existing national currency rate sources that they replace. In this regard market operators have recognized that the disappearance of existing price sources for national currency rates may be seen as a natural consequence of the move to a unified euro money market.¹⁴¹ Since the emergence of euro rates is an inevitable consequence of the changeover to the single currency, successor rates established for the euro should be recognized as reasonable substitutes for existing rates linked to EU national currencies. This interpretation will ensure that parties are not relieved of obligations within the scope and spirit of applicable floating rate contracts. This approach is also consistent with the principle that “[a] contract should be construed, if possible, so as to sustain it

¹³³See Memorandum from Daniel P. Cunningham, R. Brent Jones and Patricia L. Hogan, *Cravath Swaine & Moore*, for Financial Markets Lawyers Group, International Swaps and Derivatives Association, PSA the Bond Market Trade Association and Securities Industry Association, Economic and Monetary Union and Continuity of Contract Under New York Law 35-36 (Apr. 10, 1997) (on file with author).

¹³⁴U.C.C. § 2-305(1), 1A U.L.A. 47 (1989).

¹³⁵574 F.2d 582 (D.C. Cir 1978).

¹³⁶*North Cent. Airlines*, 574 F.2d at 592-93.

¹³⁷See *MGPC, Inc. v. Canadian Hidrogas Resources, Inc.*, 725 F.2d 1376, 1379 (Temp. Emer. Ct. App. 1983); *Dawn Enter. v. Luna*, 399 N.W.2d 303, 307-08 (N.D. 1987).

¹³⁸See *supra* pp. 83-84.

¹³⁹176 F.2d 73 (10th Cir. 1949).

¹⁴⁰*Nevada Half Moon*, 176 F.2d at 75-76 (citation omitted).

¹⁴¹See *Banque de France*, *supra* note 126, at 3-4; INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *supra* note 126, at 1.

rather than convert it into something . . . unenforceable.”¹⁴² In this regard it is instructive to note that certain English lawyers who have analyzed this issue under the common law doctrines of frustration and impossibility have concluded that there should be no difficulty substituting euro price sources for existing national currency price sources.¹⁴³

While the introduction of new price sources should not, in and of itself, affect the continuity of contracts, questions may still arise as to the appropriate price source to employ following EMU.¹⁴⁴ It has been suggested that while the replacement of a national rate calculated from national bank quotes by a euro rate calculated from national bank sources would pose minimal legal uncertainties, the replacement of a national rate by an international rate calculated from the quotes of banks in various countries could lead a court to conclude that the new euro rate is not a comparable successor rate.¹⁴⁵ It is submitted, however, that when a national rate is completely abolished and replaced by a successor rate calculated for the EMU-zone as a whole, American courts could be reasonably expected to construe the contract by substituting the EMU-zone successor rate, thereby sustaining the contract rather than rendering it unenforceable.

ii. State Theory of Money and Continuity of Floating Rate Obligations

The strongest argument for the continuity of floating rate obligations after EMU is based on the State theory of money. The EU Council regulation on certain provisions relating to the introduction of the euro establishes the “generally accepted principle of law that the continuity of contracts and other legal instruments is not affected by the introduction of a new currency”, and provides that the introduction of the euro shall not have the effect of altering any term of a legal instrument or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate a legal instrument, subject to anything which the parties may have agreed with reference to the introduction of the euro.¹⁴⁶ The principle of the continuity of contracts clearly implies that vanishing national rate price sources should be replaced by successor euro rate price sources. Thus, market operators have suggested that the recognition of successor rates may follow from the fact that the EU Council regulation provides that the terms of contracts are not to be affected by the changeover to the single currency.¹⁴⁷

The preamble to the regulation notes that “the recognition of the monetary law of a state is a universally accepted principle” and that “the explicit confirmation of continuity should lead to the recognition of continuity of contracts . . . in the jurisdictions of third countries”.¹⁴⁸ Because the replacement of national rate price sources by euro rate price sources would be a direct consequence of the introduction of the single currency, the establishment of successor euro rate price sources should be recognized under the laws of U.S. jurisdictions as flowing from the exercise of the monetary sovereignty of the European Union over the currencies of EU member states.¹⁴⁹ This monetary sovereignty extends to the regulation of all monetary obligations contained in private contracts, including interest rate

¹⁴²Gulf Oil Corp. v. Fed. Power Comm’n, 563 F.2d 588, 595 (3d Cir. 1977) (citations omitted).

¹⁴³See PROCTOR & THIEFFRY, NORTON ROSE, *supra* note 73, at 9; PARIBAS CAPITAL MARKETS, *supra* note 73, at 6 (1994); *see also* European Commission (DG II), The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations 10 (Nov. 1997).

¹⁴⁴See INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., EMU AND PRICE SOURCES: MARKET PREFERENCES AND LEGAL ISSUES 2-3 (Aug. 1997).

¹⁴⁵*Id.*

¹⁴⁶Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (7), art. 3, 1997 O.J. (L 162/1).

¹⁴⁷See Banque de France, *supra* note 126, at 3-4; INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *supra* note 126, at 4.

¹⁴⁸Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (8), 1997 O.J. (L 162/1).

¹⁴⁹See *supra* pp. 35-100.

obligations.¹⁵⁰ Thus, the continuity of floating rate obligations in accordance with the provisions of the applicable EU Council regulation should be recognized under U.S. law.

iii. ISDA Standard Form and Floating Rates

The plain and unambiguous terms of the ISDA standard form, under which the vast majority of rate swaps governed by New York law are documented, make specific provision for the substitution of euro rate sources for existing EU national currency rate sources. Take for example the floating rates for the Italian lire specified in the 1991 ISDA standard form definitions.¹⁵¹ Most of the rates for deposits in the Italian lire are the rates which appear on designated pages of the Reuters Screen or Telerate.¹⁵² The ISDA form defines the “Reuters Screen” to mean, when used in connection with any designated page and any relevant floating rate, the display page so designated on the Reuter Monitor Money Rates Service, or such other page as may replace that page or that service for the purpose of displaying rates or prices comparable to such floating rate.¹⁵³ Telerate is similarly defined to mean the display page so designated on the Dow Jones Telerate Service, or such other page as may replace that page or that service, or such other service as may be nominated as the information vendor, for the purpose of displaying rates or prices comparable to the relevant floating rate.¹⁵⁴ Thus, if after EMU a lire rate source is replaced by a successor euro rate source that is expressly designated as such by the relevant screen service provider, the successor rate should be regarded as a comparable rate under the ISDA form. ISDA has indicated that it is unlikely that a change in currency reference would, in this respect, be controversial given that the euro is the designated successor to euro area national currencies.¹⁵⁵

ISDA has suggested, however, that a court might be persuaded that an international rate calculated from the quotes of banks in different countries that is designated by a screen provider as a successor rate for pre-existing national rates is not a legally comparable rate where national euro rates continue to be quoted elsewhere.¹⁵⁶ As against that the Banque de France has argued that maintaining a purely national panel of bank quotes for euro rates might not be consistent with the logic of introducing a single currency for several different countries.¹⁵⁷ It is submitted that the arguments on both sides of this debate are evenly balanced and that both national and transnational panels of price sources selected by screen providers after EMU would therefore provide comparable rates to pre-existing national rates. Thus, the selection of either a national or an international price source by the relevant screen provider should not raise any legal difficulties.

In the unlikely event that successor rates do not appear on Reuters or Telerate pages for the applicable reset date, or in the event that the rate designated by the screen service provider is not deemed to be legally comparable to a pre-existing national rate, the ISDA form provides that the rate will be determined as follows:

- in the case of London interbank rates (LIBOR), on the basis of the rates for Italian lire deposits offered by reference banks to prime banks in the London interbank market or, in the absence of

¹⁵⁰*See id.*

¹⁵¹INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., 1991 ISDA DEFINITIONS Article 7.1(k) (1991) [hereinafter 1991 ISDA DEFINITIONS].

¹⁵²ITL-LIBOR-ITFX (Reuters Screen ITFX Page), ITL-LIBOR-ITFY (Reuters Screen ITFY Page), ITL-LIBOR-BBA (Telerate Page 3740), ITL-LIBOR-ILIR (Reuters Screen ILIR Page), ITL-MIBOR-Full Period Average (Reuters Screen ATIA Page), ITL-MIBOR-Preceding Days Average (Reuters Screen ATIA Page), ITL-MIBOR-ATIA (Reuters Screen ATIA Page), 1991 ISDA DEFINITIONS, *supra* note 151, Section 7.1(k).

¹⁵³1991 ISDA DEFINITIONS, *supra* note 151, Section 7.3(c).

¹⁵⁴*Id.* Section 7.3(d).

¹⁵⁵INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *supra* note 126, at 4; *see also* The Impact of the Introduction of the Euro on Capital Markets: Communication from the Commission, II/338/97-EN-2 at 30 (1997).

¹⁵⁶INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *supra* note 144, at 2-3.

¹⁵⁷*See* Banque de France, *supra* note 126, at 1-6.

available quotations, on the basis of the rates quoted by major banks in Rome for Italian lire loans to leading European banks; and

- in the case of most Milan interbank rates (MIBOR), on the basis of the rates for Italian lire deposits offered to prime banks in the Milan interbank market, as published in a particular Italian publication, or in the absence of such publication on the same basis as LIBOR rates.¹⁵⁸

Thus, the ISDA form provides that if Italy participates in EMU, obligations based on lire rates can be calculated on the basis of comparable rates for euros that appear on the specified Reuters or Telerate replacement pages, or alternatively that are quoted by banks in the London or Milan interbank markets.¹⁵⁹ So long as Reuters and Telerate continue to provide such designated screen pages the price source for a particular floating rate initially linked to the lire will not disappear but rather will be supplanted by a comparable rate linked to the euro. In any event, it is certain that substitute quotations for euro deposits will be available from banks in the London and Milan interbank markets.

A similar approach can be taken with respect to floating rates linked to other EU currencies, so that rates may be calculated on the basis of the applicable screen pages or alternatively on the basis of the rates offered on the London interbank market or the interbank market in the financial center of the relevant country (e.g., a Deutsche mark deposit rate could be calculated by reference to the euro deposit rate offered in the London or the Frankfurt interbank market, a Dutch guilder rate by reference to the London or the Amsterdam interbank market, etc.).¹⁶⁰ Performance of interest rate swaps documented under the ISDA form will not therefore be frustrated.

ISDA has noted that “[w]hile in most cases the courts are likely to be willing to substitute an alternative price source which is substantially similar, they may be reluctant to do so in cases where the whole purpose of the contract is the difference between the price source selected by the parties.”¹⁶¹ Thus, a so-called differential swap between two floating rates linked to two separate currencies participating in EMU might be rendered purposeless where the single currency leads to the creation of a unified interest rate throughout the euro area.¹⁶²

b. Fixed Interest Rate Obligations

Concerns have been expressed regarding the implications of EMU for long-term fixed interest rate obligations negotiated on the basis of prevailing rates for a particular national currency.¹⁶³ The economic repercussions for some holders of such long-term fixed interest rate obligations could be particularly severe if the euro is a hard currency with associated low interest rates.¹⁶⁴ It is submitted, however, that the overhaul of the prevailing interest rate climates associated with individual national currencies would not destroy the underlying reasons for performing a contract, or undermine a basic assumption of a contract. Interest rates are subject to the vagaries of all kinds of economic and political developments, and adjustments in the interest rate climate arising out of EMU should be regarded no differently from the frequent interest rate changes that are so commonplace in the contemporary global economy. Moreover,

¹⁵⁸1991 ISDA DEFINITIONS, *supra* note 151, Section 7.1(k).

¹⁵⁹INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *supra* note 126, at 4.

¹⁶⁰Section 7.1 of the 1991 ISDA Definitions identifies the price sources for floating rates linked to the Belgian franc (Section 7.1(b)), the Danish krone (Section 7.1(d)), the Deutsche mark (Section 7.1(e)), the Dutch guilder (Section 7.1(f)), the Finnish markka (Section 7.1(h)), the French franc (Section 7.1(i)), the Luxembourg franc (Section 7.1(l)), the Spanish peseta (Section 7.1(o)), Pound sterling (Section 7.1(p)) and the Swedish krona (Section 7.1(q)). 1991 ISDA DEFINITIONS, *supra* note 151, Section 7.1.

¹⁶¹Letter from Gay H. Evans, Chairman, *International Swaps and Derivatives Association, Inc.*, to John F. Mogg, Director General, DG XV, *European Commission* 3 (Nov. 1, 1995) (on file with author).

¹⁶²For a description of ‘diff’ swaps, see GOOCH & KLEIN, *supra* note 125, at 187 n.99.

¹⁶³See, e.g., Francesco Mazzaferro, *On the Continuity of Contracts in the Process of the European Monetary Union*, VI DE PECUNIA-REVUE DU CEPIME, No. 1, 123, 136-37, 140-41 (Mai 1994); PARIBAS CAPITAL MARKETS, *supra* note 73, at 6; FINANCIAL LAW PANEL, *supra* note 67, at 8-9.

¹⁶⁴See Mazzaferro, *supra* note 163, at 136, 140-41.

the convergence criterion on long-term interest rates should ensure that in the run-up to EMU the interest rates of participating countries will progressively converge. This position has been supported by some English lawyers analyzing this issue from the perspective of the common law doctrine of frustration,¹⁶⁵ as well as the European Commission.¹⁶⁶

Moreover, the EU Council regulation on certain provisions relating to the introduction of the euro provides that the introduction of the euro shall not have the effect of altering any term of a legal instrument or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate a legal instrument, subject to anything which the parties may have agreed with reference to the introduction of the euro.¹⁶⁷ The preamble to the regulation notes that this principle of the continuity of contracts “implies in particular that in the case of fixed interest rate instruments the introduction of the euro does not alter the nominal interest rate payable by the debtor.”¹⁶⁸ The preamble to the EU regulation also indicates that non-EU jurisdictions will recognize the continuity principle as emanating from the exercise by the European Union of its monetary sovereignty over the currencies of EU member states.¹⁶⁹ This legislative provision would be recognized under the laws of U.S. jurisdictions as resulting from the exercise of the sovereign power of the European Union to establish a new monetary system.¹⁷⁰ This sovereign power extends to the regulation of all monetary obligations, including interest rate obligations, in the aftermath of the establishment of a new currency.¹⁷¹

D. International Sale of Goods Convention

The United Nations Convention on Contracts for the International Sale of Goods,¹⁷² applicable in the United States and over 50 other signatory states as of January 1996, is relevant to payment obligations contained in international trade transactions involving the import and export of goods to and from the United States and nine member states of the European Union (including four of the five most populous EU member states - France, Germany, Italy and Spain but not the United Kingdom).¹⁷³ The Convention applies to contracts of sale of goods between parties whose places of business are in different states when the states are contracting states or when the rules of private international law lead to the application of the law of a contracting state.¹⁷⁴ The Convention does not apply to sales of stocks, shares, investment securities, negotiable instruments or money, and therefore excludes debt securities and transactions requiring the payment of money by both parties (e.g., cross currency swaps and interest rate swaps).¹⁷⁵ The distinction which the Uniform Commercial Code has drawn between money as a commodity (i.e., where money is used as the object of exchange) and money as a medium of payment¹⁷⁶ appears to have been expressly rejected by the drafters of the Convention so as to exclude foreign exchange transactions from the Convention’s coverage.¹⁷⁷ The Convention’s application to American law governed transactions

¹⁶⁵See FINANCIAL LAW PANEL, *supra* note 67, at 8; PARIBAS CAPITAL MARKETS, *supra* note 73, at 6-7.

¹⁶⁶European Commission, Green Paper on the Practical Arrangements for the Introduction of the Single Currency, COM(95)333 final at 58.

¹⁶⁷Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, preamble (7), art. 3, 1997 O.J. (L.162/1).

¹⁶⁸*Id.* preamble (7).

¹⁶⁹*Id.* preamble (8).

¹⁷⁰See *supra* pp. 35-100.

¹⁷¹See *id.*

¹⁷²United Nations Convention on Contracts for the International Sale of Goods, 19 I.L.M. 671 (1980) [hereinafter U.N. International Sale of Goods Convention].

¹⁷³See CENTRE FOR COMPARATIVE AND FOREIGN LAW STUDIES, UNILEX INTERNATIONAL CASE LAW AND BIBLIOGRAPHY ON THE UN CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS B.1 (Michael Bonell ed., Dec. 1995).

¹⁷⁴U.N. International Sale of Goods Convention, *supra* note 172, art. 1(1).

¹⁷⁵*Id.* art. 2(d).

¹⁷⁶See *supra* pp. 93-95.

¹⁷⁷See JOHN HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION 100-01 (2d ed. 1991); Memorandum from Daniel P. Cunningham and Patricia L. Hogan, *Cravath, Swaine & Moore*, for the International Swaps and

would therefore appear to be confined to cross-border transactions between parties with places of business in different countries involving the payment of money by one party in exchange for the physical delivery of commodities by the other party.¹⁷⁸

Under Article 79(1) of the U.N. Convention, a party is not liable for a failure to perform any obligation if such party proves that the failure was due to an impediment beyond such party's control and that such party could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided such impediment or its consequences.¹⁷⁹ While the U.N. Convention offers no guidance on what is meant by an "impediment" and while there is no international consensus on the matter,¹⁸⁰ it is submitted that EMU does not present an impediment to the due performance of international sale of goods transactions governed by the U.N. Convention. Contracts governed by the U.N. Convention involve the delivery of goods in exchange for the payment of money. In the interpretation of the Convention, courts in contracting states (including, of course, U.S. courts) are expressly required to have regard to the international character of the Convention and to the need to promote uniformity in its application and the observance of good faith in international trade.¹⁸¹ The State theory of money which characterizes money as whatever passes as lawful currency at the time and place of payment has been recognized as part of customary international law.¹⁸² In addition, the State theory of money enjoys widespread international recognition in countries that are parties to the U.N. Convention.¹⁸³ Monetary obligations contained in cross-border trade transactions governed by the Convention must therefore be interpreted in accordance with the State theory of money applicable under U.S. law, international law and the laws of other contracting states. Such monetary obligations must therefore be discharged in euro in accordance with the applicable provisions of the EU Council regulations.

Furthermore, a strong argument can be made that foreseeability is an important element in the concept of an impediment beyond a party's control. Thus, Article 79(1) of the U.N. Convention specifically provides that this excuse from performance is not available where the party could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract.¹⁸⁴ The reasonable expectations of a party to a contract may be ascertained by a consideration of what was foreseeable at the time a contract was entered into. It is inevitable that American courts will emphasize the importance of foreseeability when interpreting Article 79(1) of the U.N. Convention, consistent with the UCC doctrine of commercial impracticability and the common law doctrines of frustration and impossibility.¹⁸⁵ In this regard the chairman of the Article's drafting party has acknowledged that there is bound to be a point at which each attempt at unifying some areas of international trade law stops short and the governing law of the contract takes over.¹⁸⁶ As discussed at a

Derivatives Association, The United Nations Convention on Contracts for the International Sale of Goods 4-10 (Nov. 27, 1996) (on file with author).

¹⁷⁸See U.N. International Sale of Goods Convention, *supra* note 172, art. 1(1); Memorandum from Daniel P. Cunningham and Patricia L. Hogan, *Cravath, Swaine & Moore*, for the International Swaps and Derivatives Association, The United Nations Convention on Contracts for the International Sale of Goods 10-14 (Nov. 27, 1996) (on file with author).

¹⁷⁹U.N. International Sale of Goods Convention, *supra* note 172, art. 79(1).

¹⁸⁰See, e.g., HONNOLD, *supra* note 177, at 542-44; A.H. HUDSON, EXEMPTIONS AND IMPOSSIBILITY UNDER THE VIENNA CONVENTION, reprinted in FORCE MAJEURE AND FRUSTRATION OF CONTRACT 175, 178-79 (Ewan McKendrick ed., 1991); BARRY NICHOLAS, IMPRACTICABILITY AND IMPOSSIBILITY IN THE U.N. CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, reprinted in INTERNATIONAL SALES: THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS § 5-02[1] (Nina M. Galston & Hans Smit eds., 1984); Memorandum from Daniel P. Cunningham and Patricia L. Hogan, *Cravath, Swaine & Moore*, for the International Swaps and Derivatives Association, The United Nations Convention on Contracts for the International Sale of Goods 15-23 (Nov. 27 1996) (on file with author).

¹⁸¹U.N. International Sale of Goods Convention, *supra* note 172, art. 7(1).

¹⁸²See Serbian Loans, 1929 P.C.I.J. (ser. A) Nos. 20/21, at 44 (July 12); Brazilian Fed. Loans, 1929 P.C.I.J. (ser. A) No. 27, at 122-23 (July 12), discussed *supra* p. 87.

¹⁸³See, e.g., MANN, *supra* note 11, at 273-75.

¹⁸⁴U.N. International Sale of Goods Convention, *supra* note 172, art. 79(1).

¹⁸⁵See *supra* pp. 105-07, 116-17, 119-20.

¹⁸⁶Barry Nicholas, *Force Majeure and Frustration*, 27 AM. J. COMP. L. 231, 244 (1979).

number of points throughout this study, EMU has been a long-standing goal of the European Community and the financial markets have been in a position to take account of its legal implications in their contracts since as far back as the decision to launch the first stage of EMU in 1989.¹⁸⁷ In any case, currency alterations have been so commonplace in history that they may properly be regarded as inherently foreseeable events.

In conclusion, the continuity of payment obligations contained in international commercial transactions governed by the U.N. Convention would not face any obstacles in the aftermath of EMU.

E. Damages

Any attempt by a contracting party to raise EMU as excusing performance of an obligation denominated in an EU national currency would constitute a breach of contract triggering a right on the part of the wronged party to recover damages. This raises questions as to whether American courts may award damages in a foreign currency or U.S. dollars, and if they may make awards in U.S. dollars how the foreign currency is to be translated into dollars. More generally, where damages are awarded for a breach of a foreign currency contract it is also necessary to consider how damages are to be measured.

1. Foreign Currency Awards

It has been suggested that the questions of whether damages may be awarded in a foreign currency or in U.S. dollars and of how to convert damages with respect to a breach of a foreign currency obligation into U.S. dollars are issues that fall more naturally within the province of the Federal government.¹⁸⁸ Nonetheless, a large number of state legislatures have enacted legislation in this area over the past few years.¹⁸⁹ Federal courts exercising their diversity jurisdiction over cases involving questions of state law (e.g., private contracts) apply state law to resolve this issue, and state law treats this issue under its conflict of law rules either as a procedural issue to be resolved in accordance with the law of the forum state (i.e., the state in which the court is located),¹⁹⁰ or as a substantive issue to be resolved in accordance with the governing law of the contract.¹⁹¹

Broadly speaking, state law follows three different approaches to the question of damages for breach of a foreign currency obligation.

a. New York: Judgment Date Rule

First, under the New York Judiciary Law it is provided that in any case in which the cause of action is based upon an obligation denominated in a foreign currency the court will render judgment in the foreign currency of the underlying obligation (i.e., in euros after EMU), and will convert such judgment into U.S. currency at the rate of exchange prevailing on the date of entry of the judgment.¹⁹² Thus, New York law follows a “judgment-date rule” which values the foreign currency at the date of judgment.

b. Payment Date Rule

¹⁸⁷See *supra* pp. 8-11, 107-09, 118, 121.

¹⁸⁸See Ronald A. Brand, *Restructuring the U.S. Approach to Judgments on Foreign Currency Liabilities: Building on the English Experience*, 11 YALE J. INT'L L. 139, 174 (1985); Suzanne R. Westerheim, *The Uniform Foreign-Money Claims Act: No Solution to an Old Problem*, 69 TEX. L. REV. 1203, 1216-20 (1991).

¹⁸⁹See N.Y. JUD. LAW, § 27(b) (McKinney Supp. 1997); UNIF. FOREIGN-MONEY CLAIMS ACT (1989) (enacted in 20 U.S. jurisdictions, including California and Illinois).

¹⁹⁰See, e.g., *Matter of Oil Spill by the Amoco Cadiz*, 954 F.2d 1279, 1329-30 (7th Cir. 1992) (citations omitted); *Ingersoll Milling Mach. Co. v. Granger*, 833 F.2d 680, 692 (7th Cir. 1987); UNIF. FOREIGN-MONEY CLAIMS ACT § 2(b) and cmt.

¹⁹¹See, e.g., *AGFA-GEVAERT, A.G. v. A.B. Dick Co.*, 879 F.2d 1518, 1524-25 (7th Cir. 1989) (citations omitted); *Competex, S.A. v. Labow*, 783 F.2d 333, 334 (2d Cir. 1986) (citing *Vishipco Line v. Chase Manhattan Bank, N.A.*, 660 F.2d 854, 865-66 (2d Cir. 1981) (citation omitted)); *Nikimiha Sec. Ltd. v. Trend Group Ltd.*, 646 F. Supp. 1211, 1228-29. (E.D. Pa. 1986) (citing *Vishipco*).

¹⁹²N.Y. JUD. LAW, § 27(b) (McKinney Supp. 1997).

Secondly, the 20 jurisdictions (including California and Illinois) that have adopted the Uniform Foreign Money Claims Act follow a “payment-date rule”, providing that a judgment or award on a claim upon a foreign money obligation must be stated in an amount of the foreign money of the claim, and the judgment is payable in that foreign money or, at the debtor’s option, in U.S. dollars at the spot exchange rate on the date immediately preceding payment.¹⁹³

c. Common Law

Finally, all other U.S. states follow the common law. The traditional position at common law is that American courts may only render judgments in U.S. dollars.¹⁹⁴ However, in recent years American courts, following principles of common law, have shown a greater willingness to enter judgment in whatever currency the parties have selected for their dealings.¹⁹⁵ To the extent that the common law has traditionally permitted awards to be made only in U.S. dollars, courts have also held that if the payment of foreign currency is to be made in the United States and the payment obligation is subject to American law, the foreign currency will be valued at the date set for performance, but that if the payment obligation arises in the country of the foreign currency and is subject to foreign law, then the currency will be valued as of the date of judgment because such a valuation represents all that would have been obtained from a foreign tribunal at judgment.¹⁹⁶ This partial “breach-date rule” will of course become obsolete as courts begin to render judgment in foreign currencies. It can also be reasonably expected that an increasing number of states will adopt the payment-date rule in the Uniform Foreign-Money Claims Act over the coming years.¹⁹⁷

2. Measure of Damages

The general view accepted under the conflict of law rules of most American states (including New York State) is that the elements and measure of damages are matters of substance rather than procedure and therefore fall to be determined under the governing law of the contract rather than the law of the forum state.¹⁹⁸ Because New York law is selected as the governing law for so many sophisticated financial transactions, it must follow that U.S. courts will mostly look to the law of damages of New York State to determine the measure and elements of damages in such financial transactions. In currency swaps, FX forwards and currency options, where money is treated as a commodity, damages will be measured in accordance with the applicable provisions of the UCC. In all other contracts for the payment of foreign money, which will consist of debt obligations for specific amounts of principal and/or interest, damages will be measured in accordance with the general principles accepted under New York State law.

¹⁹³UNIF. FOREIGN-MONEY CLAIMS ACT, § 7(a)-(b) (1989).

¹⁹⁴*See, e.g.*, *Vishipco Line v. Chase Manhattan Bank, N.A.*, 754 F.2d 452, 455 (2d Cir. 1985) (citation omitted); *Jamaica Nutrition Holdings v. United Shipping*, 643 F.2d 376, 379 n.5 (5th Cir. 1981) (citation omitted); *International Silk Guild v. Rogers*, 262 F.2d 219, 224 (D.C. Cir. 1958) (citing *Shaw, Savill, Albion & Co. v. The Fredericksburg*, 189 F.2d 952, 954 (2d Cir. 1951) (citation omitted)).

¹⁹⁵*See Amoco Cadiz*, 954 F.2d at 1327-28; *Competex*, 783 F.2d at 337; *Mitsui & Co., Ltd. v. Oceantrawl Corp.*, 906 F. Supp. 202, 203-04 (S.D.N.Y. 1995); *see also* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 823(1) (1986).

¹⁹⁶*See, e.g.*, *Zimmerman v. Sutherland*, 274 U.S. 253, 255-56 (1927) (discussing *Deutsche Bank v. Humphrey*, 272 U.S. 517, 518-19 (1926); *Hicks v. Guinness*, 269 U.S. 71, 80-81 (1925)); *In re Good Hope Chem. Corp.*, 747 F.2d 806, 809-12 (1st Cir. 1984) (same); *Jamaica Nutrition*, 643 F.2d at 379-81 (same).

¹⁹⁷Of the 20 jurisdictions that have adopted the Uniform Foreign-Money Claims Act since its approval by the National Commissioners on Uniform State Laws in 1989, five jurisdictions adopted the Uniform Act during 1989-90, nine jurisdictions during 1991-92 and a further six jurisdictions during 1993-95. *See* Unif. Foreign-Money Claims Act Refs. & Annos, Table of Jurisdictions Wherein Act has been adopted (West. 1996).

¹⁹⁸*See, e.g.*, *Smith v. Onyx Oil and Chem. Co.*, 218 F.2d 104, 110 (3d Cir. 1955); *Transit Bus Sales v. Kalamazoo Coaches, Inc.*, 145 F.2d 804, 807 (6th Cir. 1944); *Skyline Steel Corp. v. A.J. Dupuis Co.*, 648 F. Supp. 360, 374 (E.D. Mich. 1986) (citing *Transit Bus Sales*); *Carriage Bags, Ltd. v. Aerolinas Argentinas*, 521 F. Supp. 1363, 1366-67 (D. Colo. 1981); 16 AM. JUR. 2D, *Conflict of Laws* § 138 (1979 & Supp. 1997) (and cases cited therein); 36 N.Y. JUR. 2D, *Damages* § 3 (1984); *cf.* *Travelers Ins. v. Liljeberg Enter., Inc.*, 7 F.3d 1203, 1208-09 (5th Cir. 1993). *But see* *Lincoln v. NCR Corp.*, 772 F.2d 315, 320 (7th Cir. 1985) (citation omitted); *Automated Med. Lab. v. Armour Pharm.*, 629 F.2d 1118, 1122 n.3 (5th Cir. 1980) (citation omitted).

Under the UCC, various remedies are accorded to sellers and buyers of goods (i.e., currencies in transactions involving the use of money as a commodity).¹⁹⁹ Where a buyer wrongfully rejects a currency sold to him, then the aggrieved seller may either resell the currency and recover damages for the difference between the resale price and the contract price, or alternatively recover damages measured by the difference between the market price at the time and place for tender of the currency and the unpaid contract price.²⁰⁰ Similarly, where a seller wrongfully fails to deliver a currency, the buyer may choose to “cover” by purchasing the currency elsewhere and recovering damages for the difference between the cost of cover and the contract price, or alternatively recover damages for the difference between the market price at the time when the buyer learned of the breach and the contract price.²⁰¹ Both buyers and sellers may also recover incidental damages, which include any commercially reasonable charges, expenses or commissions resulting from the breach.²⁰²

In addition, buyers and sellers are also entitled to a measure of lost profits. In the case of an aggrieved seller, where the measure of damages between the market price at the time for tender and the unpaid contract price is inadequate to put the seller in as good a position as performance would have done, then the seller can recover the profit which would have been made from full performance by the buyer.²⁰³ In the case of an aggrieved buyer, recovery of consequential damages is allowed, i.e. recovery is allowed for losses resulting from general or particular requirements and needs which the seller had reason to know of at the time of contracting and which could not reasonably be prevented by cover or otherwise.²⁰⁴

In the context of currency swaps, options and FX forwards after EMU, the aggrieved seller would be any party entitled to sell euros at the favorable exchange rate specified in the contract and the aggrieved buyer would be any party entitled to purchase euros at the favorable exchange rate specified in the contract. Basically, the UCC permits recovery of damages based on the difference between the contract price for the currency and the market exchange rate of the currency at the time of breach.²⁰⁵ The UCC also allows for recovery of consequential damages (e.g., loss of profits), permitting the courts to consider the extent to which profits may have been lost due to ancillary developments on the currency markets. Given that both parties are treated as buyers and sellers in a foreign exchange transaction,²⁰⁶ it is questionable whether the courts would attribute much significance to the different wordings in the UCC with respect to the damages remedies for buyers and sellers in the case of lost profits.

In the case of debt obligations, the measure of damages for breach of a contract to pay money at a stipulated time is generally the sum agreed to be paid with legal interest thereon from the date of maturity to compensate the creditor for the temporary loss of the use of his money.²⁰⁷ Where one contracts to pay a principal sum at a future date with interest, or alternatively an amount of interest based on a notional principal amount, the interest prior to default is payable by virtue of the contract, and after default the

¹⁹⁹U.C.C. §§ 2-701-25, 1B U.L.A. 217-646 (1989). This discussion will only focus on those remedies that are most relevant in the context of foreign exchange transactions. The relevant provisions of the New York Uniform Commercial Code mirror those of the UCC. N.Y. U.C.C. §§ 2-701-25 (McKinney 1993).

²⁰⁰See U.C.C. §§ 2-703, 2-706, 2-708, 1B U.L.A. 232, 249, 265 (1989).

²⁰¹See U.C.C. §§ 2-711, 2-712, 2-713, 1B U.L.A. 321-22, 344, 358 (1989).

²⁰²See U.C.C. §§ 2-706, 2-708, 2-710, 2-712, 2-713, 2-715, 1B U.L.A. 249, 265, 313, 344, 358, 417 (1989).

²⁰³See U.C.C. § 2-708(2), 1B U.L.A. 265 (1989).

²⁰⁴See U.C.C. §§ 712, 713, 715(2), 1B U.L.A. 344, 358, 417 (1989).

²⁰⁵This measure of damages for breach of a foreign exchange contract was also allowed by the New York courts at common law. See, e.g., *Richard v. Am. Union Bank*, 170 N.E. 532, 535-36 (N.Y. 1930).

²⁰⁶*Koreag*, 961 F.2d at 355.

²⁰⁷See *Avalon Const. Corp. v. Kirch Holding Co.*, 175 N.E. 651, 652 (N.Y. 1931); 36 N.Y. JUR. 2D, *Damages* § 45 (1984).

interest should be computed as damages for breach of the contract according to the rate prescribed by law and not according to the rate prescribed in the contract if that is more or less.²⁰⁸

Under the New York Civil Practice Law and Rules interest will in general be recovered upon a sum awarded because of a breach of contract at a rate of 9% per annum from the earliest ascertainable date the cause of action existed.²⁰⁹ While many jurisdictions (including New York State) take the position that such prejudgment interest is an element of damages and that rules for prejudgment interest are therefore to be found in the law defining the elements of damages (in most cases the governing law of the contract),²¹⁰ other jurisdictions treat prejudgment interest as a procedural matter to be resolved in accordance with the law of the forum state.²¹¹

Two final issues regarding the measure of damages for breach of a contract to pay foreign money should be mentioned. First, it has been suggested that prejudgment interest on a foreign currency obligation should be computed based on the rate prevailing in the country issuing the money of judgment, consistent with the practice of certain foreign common law jurisdictions.²¹² In the absence of available precedent, it must be presumed that the New York statutory rules regarding the award of prejudgment interest apply both to foreign and domestic money, especially since the statutory 9% rate in New York does not bear any necessary relationship to the prevailing interest rates for borrowed money in U.S. dollars.

A final issue relating to the measure of damages for a breach of contract to pay a foreign currency debt is whether damages may be awarded for losses incurred as a result of exchange rate fluctuations after the time of breach and prior to judgment. The traditional rule is that damages for delay in payment under a debt are provided for in the allowance of prejudgment interest, which is in the nature of damages for withholding money that is due.²¹³ This rule has been applied so as to deny damages for losses suffered by reason of the dollar's devaluation against a foreign currency between the time a contract was breached and the time of judgment.²¹⁴ It has been suggested that this rule is no longer appropriate in a world of free floating exchange rates, and that American courts should follow the example of other common law jurisdictions and allow recovery for damages resulting from reasonably foreseeable losses arising out of exchange rate fluctuations.²¹⁵ Again, in the apparent absence of supporting precedent it may be presumed that prejudgment interest is the only form of compensation available under New York law as compensation for the temporary loss of the use of foreign money.

In the case of foreign currency obligations governed by the laws of American jurisdictions other than New York, the legal principles pertaining to the measure of damages to be awarded will be similar to those applicable under New York law. The UCC has been adopted throughout the United States and its provisions relating to the measure of damages for foreign exchange transactions are generally applicable.²¹⁶ It also appears that the measure of damages for breach of a promise to pay a debt is, in

²⁰⁸See *Metropolitan Sav. Bank v. Tuttle*, 49 N.E.2d 983, 984 (N.Y. 1943) (citation omitted); *Title Guarantee & Trust Co. v. 2846 Briggs Avenue*, 29 N.E.2d 66, 68-69 (N.Y. 1940); *Marine Midland Bank, N.A. v. 281 Groton Corp.*, 530 N.Y.S.2d 366, 367 (N.Y. App. Div. 1988) (citing *Metropolitan Sav. Bank*); 36 N.Y. JUR. 2D, *Damages* § 45 (1984).

²⁰⁹N.Y. C.P.L.R. §§ 5001, 5002, 5003, 5004 (McKinney 1992 & Supp. 1997).

²¹⁰See *Travelers Ins.*, 7 F.3d at 1208-09; *American Home Assurance Co. v. Dykema, Gossett, et al.*, 811 F.2d 1077, 1088-89 (7th Cir. 1987) (citations omitted); *Entron, Inc. v. Affiliated FM Ins. Co.*, 749 F.2d 127, 131 (2d Cir. 1984) (citations omitted); *Marine Midland Bank v. Kilbane*, 573 F. Supp. 469, 471 (D. Md. 1983).

²¹¹See *Yohannon v. Keene Corp.*, 924 F.2d 1255, 1263-67 (3d Cir. 1991); *F.E. Myers Co. v. Pipe Maintenance Servs., Inc.*, 599 F. Supp. 697, 704 (D. Del. 1984).

²¹²See Brand, *supra* note 188, at 166-168, 183, 189; Ronald A. Brand, *Exchange Loss Damages and the Uniform Foreign-Money Claims Act: The Emperor Hasn't All His Clothes*, 23 LAW & POL'Y INT'L BUS. 1, 9 (1992); Westerheim, *supra* note 188, at 1225-26.

²¹³See *O'Rourke Eng'g Constr. Co. v. City of New York*, 241 N.Y.S. 613, 619-20 (N.Y. App. Div. 1930) (citing *Loudon v. Taxing Dist.*, 104 U.S. 771, 774 (1881)); *Meinrath v. Singer Co.*, 87 F.R.D. 422, 426 (S.D.N.Y. 1980) (same).

²¹⁴See *Meinrath*, 87 F.R.D. at 427-29 esp. at 429; see also *Deutsche Bank*, 272 U.S. at 519.

²¹⁵See Brand, *supra* note 212, at 45-47.

²¹⁶See HAWKLAND, *supra* note 3, §§ 2-701-725 (Art. 2) for a description of current variations to these sections of the UCC in certain states.

most jurisdictions outside New York, the amount of such debt with legal interest thereon from the time of maturity.²¹⁷ The amount of prejudgment interest payable will of course vary from jurisdiction to jurisdiction.

²¹⁷See 22 AM. JUR. 2D, *Damages* § 90 (1988) (and the cases cited therein).

VI. LEGAL DOCUMENTATION

Many financial transactions contain currency definitions and other contract clauses which are relevant to the analysis of the legal implications of EMU under the laws of U.S. jurisdictions. We will consider the meaning of these clauses in this section.

A. “Lawful Currency”: Definition of Money

Many legal documents, including, significantly, the standard form documentation of the International Swaps and Derivatives Association, define currencies as the “lawful” currencies of the relevant country of issue.¹ Thus, the Deutsche mark is defined in the ISDA standard form as “the lawful currency of the Federal Republic of Germany”, the French franc as “the lawful currency of the Republic of France”, the Dutch guilder as “the lawful currency of the Kingdom of the Netherlands”, and so on.²

The use of the word “lawful” here is significant as it implies that American courts, when considering, for example, what is meant by the term “Deutsche mark” in an ISDA swap contract, should look directly to the laws of Germany for guidance. German law includes the provisions of the Maastricht Treaty and all regulations adopted by the EU Council thereunder.³ After January 1, 1999 the Deutsche mark will be substituted by the euro in accordance with the Maastricht Treaty and the relevant EU Council regulations and the euro will thereafter be recognized under German law as the lawful currency of Germany.⁴ Obligations under ISDA swap contracts that are denominated in Deutsche marks can therefore be discharged in euro after 1999. In view of the fact that euro banknotes will not be introduced until 2002 (at the latest), obligations originally denominated in Deutsche marks may continue to be discharged during the three-year transitional period in Deutsche marks, which will survive as a subdivision or denomination of the euro and a legal tender in the territorial limits of Germany.⁵ Thus, the lawful currency of Germany during the transitional period will be the euro, of which the Deutsche mark is an expression.

It might also be argued, however, that the fact that the ‘lawful currency’ formula establishes separate definitions for various European currencies implies that these definitions refer only to distinct national currencies and cannot be interpreted to embrace a single European currency. Moreover, even if it is accepted that the euro is the lawful currency of Germany, arguments might still be advanced for terminating or otherwise discharging contractual obligations after EMU on the ground that performance has been rendered commercially impracticable or has been frustrated by virtue of the introduction of the single currency. It is submitted, however, that such arguments would not persuade American courts. Swap contracts denominated in EU currencies are subject to the monetary sovereignty of the European Union over the currencies of EU member states, a sovereignty that extends to the enactment of legislation by the EU Council regarding the discharge of contractual obligations in the aftermath of the establishment of a new monetary system.⁶ This is bolstered by the fact that the ‘lawful currency’ formula directs the courts to the law of the country issuing the currency for a determination of the currency’s legal character.

B. Legal Tender Clauses

¹INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION INC., 1991 ISDA DEFINITIONS Section 1.5 (1991) [hereinafter 1991 ISDA DEFINITIONS]; INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., 1992 ISDA FX AND CURRENCY OPTION DEFINITIONS Section 3.2 (1992) [hereinafter 1992 ISDA FX AND CURRENCY OPTION DEFINITIONS].

²1991 ISDA DEFINITIONS, *supra* note 1, Section 1.5(e), (f) and (i); 1992 ISDA FX AND CURRENCY OPTION DEFINITIONS, *supra* note 1, Section 3.2(f), (g) and (j).

³For a discussion regarding the supremacy of European Community law (including Council regulations) over national law, see T.C. HARTLEY, THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW 206-10, 234-36 (3d ed. 1994).

⁴See *supra* pp. 12-17.

⁵See *id.*

⁶See *supra* pp. 35-100, 102-05, 117-18.

Many Eurobonds contain clauses calling for payment in a national currency such as French francs or “such coin or currency of the Republic of France as at the time of payment shall be legal tender for the payment of public or private debts.” This kind of clause ensures the continuity of the payment obligation after the introduction of the single currency. Because the euro will be a currency but not a legal tender during the three-year transitional period, the legal tender clause may only permit discharge in the national currency tenders until euro banknotes are introduced and replace the national banknotes.

C. Force Majeure and Impossibility Clauses

Like the doctrine of commercial impracticability, a force majeure clause in a contract excuses nonperformance when circumstances beyond the control of the parties prevent performance.⁷ Many debt instruments contain clauses calling for the discharge of debts in U.S. dollars where the currency in which the debt is denominated “is no longer available for making payments due to the imposition of exchange controls or other circumstances beyond the party’s control.”

It has been held that the term “conditions beyond control” is a term which “has by repeated use assumed an indisputable connotation” and “refers to an unforeseeable act of God or other extraordinary cause which could not reasonably be anticipated by the parties.”⁸ Contractual force majeure clauses excusing performance due to circumstances beyond the control of the parties provide a narrow defense at common law because they do not apply when the event preventing performance could have been foreseen or guarded against in the contract.⁹ Ordinarily, only if the force majeure clause specifically includes the event that actually prevents a party’s performance will that party be excused.¹⁰ The principle of interpretation applicable to force majeure clauses containing an enumeration of specific causes of relief followed by a general catch-all provision relieving a party from liability where performance has been prevented due to other causes beyond the control of such party is that the general words are not given an expansive meaning but are confined to things of the same kind or nature as the particular matters mentioned (the principle of *ejusdem generis*).¹¹

Applying the above force majeure clause to EMU, the U.S. dollar repayment provision would not be triggered after EMU for a number of reasons:

- First, EMU has been long foreseeable and such force majeure clauses do not apply to foreseeable events. In any case, all currency alterations may be regarded as inherently foreseeable events.
- Second, the general catch-all provision in this clause – “other circumstances beyond the party’s control” – is confined to matters similar to the imposition of exchange controls. It is not intended that the introduction of the single currency will involve the imposition of any exchange controls or similar restrictions on foreign exchange transactions.¹²
- Third, the clause would not be triggered after EMU because the currency of the contract – the euro in substitution for the national currency in which the debt was originally denominated – will still be available for making payments. This is consistent with the State theory of money.¹³ The clause is not designed to cover monetary alterations but rather situations where

⁷See *Harriscom Svenska, AB v. Harris Corp.*, 3 F.3d 576, 580 (2d Cir. 1993); see also 22A N.Y. JUR. 2D, *Contracts* § 385 (1996).

⁸*Vernon Lumber Corp. v. Harcen Constr. Co.*, 60 F. Supp. 555, 558 (E.D.N.Y. 1945), *aff’d* 155 F.2d 348 (2d Cir. 1946).

⁹See *Kel Kim Corp. v. Cent. Mkts., Inc.*, 519 N.E.2d 295, 296 (N.Y. 1987).

¹⁰See *id.* at 296 (citations omitted).

¹¹See *id.* at 296-97; 22A N.Y. JUR. 2D, *Contracts* § 385 (1996).

¹²See *infra* p. 186.

¹³See European Commission (DG II), *The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations* 10 (Nov. 1997); see also *supra* pp. 102-05.

the obligor is unable to gain access to the currency in which its obligation is denominated, either because of exchange controls or some similar factor beyond the obligor's control.

One clause contained in many debt instruments governed by New York law that could cause interpretive difficulties in the aftermath of EMU is a clause which permits obligations to be satisfied in U.S. dollars where the foreign currency in question "is no longer used by the government of the country issuing, or authority sponsoring, such currency." This language appears to trigger the U.S. dollar payment provision where the government of the relevant country is no longer issuing the currency in question. After the introduction of the single currency the exclusive power to authorize the issuance of currency will be vested in the newly-established European Central Bank. National central banks will be part of the European System of Central Banks and will issue currency under the authority of the European Central Bank.¹⁴ If the governments of the EU member states no longer enjoy the exclusive authority to issue currency in their own right, the clause calling for payment in U.S. dollars could be triggered.

Strong arguments can be made against triggering the U.S. dollar payment provision after EMU. The EU member states, through their national central banks' representation in the European Central Bank, will continue to exercise the power to issue currency after EMU.¹⁵ It can also be argued, based on the State theory of money, that the currency of the contract – the euro in substitution for, e.g., the Deutsche mark – is the currency that is used by the governments of the participating member states after EMU, and therefore is the currency in which the obligation should be satisfied. As against this, however, it might be argued that the provision is actually designed to prevent the application of the State theory.

Perhaps the most compelling factor in the legal interpretation of this impossibility clause is that the continuity principle enshrined in the EU Council regulations is designed to prevent the invocation of general contractual provisions that do not specifically refer to EMU as a means of modifying contractual obligations after the introduction of the single currency.¹⁶ In accordance with the State theory of money the EU Council regulations may be regarded as an expression of the monetary sovereignty of the European Union over the currencies of EU member states, and the regulations would therefore be applicable to contracts governed by the laws of U.S. jurisdictions that contain such force majeure or impossibility clauses. Since force majeure and impossibility clauses are general clauses that do not specifically contemplate the introduction of the euro, such clauses would not be triggered by EMU under the EU Council regulations. In the case of impossibility clauses objection might be made that the EU Council regulations alter the terms of the contract insofar as such impossibility clauses are actually designed to prevent the application of the State theory of money. However, such an alteration of contractual terms could be justified under the expansive view of the State theory of money articulated in the *Gold Clause Cases*.¹⁷

D. EMU Continuity Clauses

As a result of the uncertain implications of EMU for certain force majeure and impossibility clauses, as well as possible uncertainty for the continuity of contracts under New York law, a number of issuers of debt instruments operating under New York law began in March 1995 to adopt specific language ensuring that their obligations would enjoy the full benefit of all EU Council regulations and ancillary legislation dealing with the changeover to the single currency.¹⁸ Most of these clauses follow a similar pattern and provide as follows:

¹⁴See *supra* p. 17.

¹⁵*Id.*

¹⁶See *supra* pp. 24-25.

¹⁷See *supra* pp. 57-61.

¹⁸See, e.g., MORGAN STANLEY GROUP INC., GLOBAL MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Mar. 29, 1995) (on file with Securities and Exchange Commission), GLOBAL MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (May 1, 1996) (on file with Securities and Exchange Commission), GLOBAL MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Feb. 21, 1997) (on file with Securities and Exchange Commission); McDONALDS CORPORATION, DM BONDS DUE 2000 OFFERING CIRCULAR (June 8, 1995) (on file with Luxembourg Stock Exchange), DM BONDS DUE 2001 OFFERING CIRCULAR (May 17, 1996) (on file with Luxembourg Stock Exchange), FRENCH FRANC BONDS

If, pursuant to the Treaty establishing the European Community, as amended by the Treaty on European Union (the “Treaty”), some or all of the currencies of the 15 member states of the European Union are substituted by a new single European currency (such new currency to be named the “euro”), the payment of principal of, or interest on, Notes denominated or payable in such currencies shall be effected in euro in conformity with legally applicable measures adopted pursuant to, or by virtue of, the Treaty.¹⁹

The clause is designed to ensure that all EU Council regulations (i.e., measures adopted “pursuant to” the Treaty) and ancillary legislation adopted by the EU member states (i.e., measures adopted “by virtue of” the Treaty) relating to EMU are applicable to debt instruments governed by New York law and maturing after 1999. Such contractual *dépacage* (i.e., an agreement that different laws apply to different parts of a contract) is expressly authorized under Section 5-1401 of the New York General Obligations Law which provides that the parties to a contract may agree that the law of New York State shall govern their rights and duties “in whole or in part.”²⁰

Under the above EMU continuity clause payments will be made in euro after the euro substitutes the national currencies in 1999. In accordance with the “no compulsion, no prohibition” principle enshrined in the EU Council regulation on the introduction of the euro, this clause ensures that payments may be performed in certain circumstances either in the national currency unit or the euro unit during the transitional period

The approach taken by the above clause serves the need for uniformity in the increasingly integrated international capital markets by placing parties contracting under New York law in the same legal position with respect to the implications of EMU as parties contracting under the laws of EU jurisdictions, thereby ensuring the continuity of contracts in accordance with the EU Council’s regulations on the introduction of the euro. In addition, the incorporation of the EU Council regulations into the terms and conditions of the bonds ensures that parties contracting under New York law enjoy the benefit of any ancillary legislation that may be enacted in the aftermath of EMU (e.g., legislation revalorizing interest rates in particular member states).²¹

E. ISDA EMU Continuity Clause

DUE 2006 OFFERING CIRCULAR (July 22, 1996) (on file with Luxembourg Stock Exchange), DM BONDS DUE 2002 OFFERING CIRCULAR (Feb. 13, 1997) (on file with Luxembourg Stock Exchange); AT&T CAPITAL CORPORATION, MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Oct. 19, 1995) (on file with Securities and Exchange Commission); PITNEY BOWES CREDIT CORPORATION, MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Nov. 10, 1995) (on file with Securities and Exchange Commission); DONALDSON, LUFKIN & JENRETTE, MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Feb. 9, 1996) (on file with Securities and Exchange Commission), MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Apr. 8, 1997) (on file with Securities and Exchange Commission); GENERAL SIGNAL CORPORATION, MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Apr. 30, 1996) (on file with Securities and Exchange Commission); MASSACHUSETTS INSTITUTE OF TECHNOLOGY, MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (May 8, 1996) (on file with Securities and Exchange Commission); GMAC INTERNATIONAL FINANCE B.V., GMAC AUSTRALIA (FINANCE) LIMITED AND GENERAL MOTORS ACCEPTANCE CORPORATION OF CANADA, LIMITED, EURO MEDIUM-TERM NOTE PROGRAM OFFERING CIRCULAR (May 23, 1996) (on file with London Stock Exchange), EURO MEDIUM-TERM NOTE PROGRAM OFFERING Circular (May 23, 1997) (on file with London Stock Exchange); PRUDENTIAL FUNDING CORPORATION, EURO MEDIUM-TERM NOTE PROGRAMME OFFERING CIRCULAR (May 29, 1996) (on file with Luxembourg Stock Exchange); AMERICAN INTERNATIONAL GROUP, INC., MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (June 11, 1996) (on file with Securities and Exchange Commission); REPUBLIC OF ITALY, PRIVATIZATION EXCHANGEABLE LIRA NOTES DUE 2001 PROSPECTUS SUPPLEMENT (June 21, 1996) (on file with Securities and Exchange Commission); GENERAL ELECTRIC CAPITAL CORPORATION, GE CAPITAL AUSTRALIA LIMITED AND GENERAL ELECTRIC CAPITAL CANADA INC., EURO MEDIUM-TERM NOTES OFFERING CIRCULAR (July 2, 1996) (on file with Luxembourg Stock Exchange); PHILIP MORRIS CAPITAL CORPORATION, FRENCH FRANC BONDS DUE 2006 OFFERING CIRCULAR (July 9, 1996) (on file with Luxembourg Stock Exchange); DAIMLER-BENZ NORTH AMERICA CORPORATION, DAIMLER-BENZ CANADA INC. AND DAIMLER-BENZ INTERNATIONAL FINANCE B.V., MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Sept. 13, 1996) (on file with Securities and Exchange Commission); COMPANIA ENERGETICA DE SAO PAULO, EURO MEDIUM-TERM NOTE PROGRAM OFFERING CIRCULAR (May 21, 1997) (on file with Luxembourg Stock Exchange).

¹⁹See Memorandum from Niall Lenihan, Draft Recommendation of Wall Street Committee on the Transition to the European Monetary Union (July 11, 1996) (on file with author).

²⁰N.Y. GEN. OBLIG. LAW § 5-1401 (McKinney 1989); see also *Corporation Venezolano de Fomento v. Vintero Sales Corp.*, 629 F.2d 786, 794-95 & n.8 (2d Cir. 1980).

²¹See Michael Gruson, *The Introduction of the Euro and its Implications for Obligations Denominated in Currencies Replaced by the Euro* 25-27 (June 2, 1997) (unpublished manuscript, on file with author); see also Alan H. Kaufman (Jones, Day, Reavis & Pogue), *Overview: the U.S. and European Legal Context of the Euro Currency* 4 (Oct. 23, 1997) (unpublished manuscript, on file with author).

In July 1997 ISDA adopted an EMU continuity provision for use in ISDA master agreements which confirms that EMU will not affect the continuity of contracts or give any party the unilateral right to walk away from, or modify the terms of, any transaction governed by an ISDA master agreement unless otherwise expressly agreed by the parties.²² The ISDA EMU continuity provision thus provides in relevant part as follows:

(a) The parties confirm that, except as provided in subsection (b) below, the occurrence or non-occurrence of an event associated with economic and monetary union in the European Community will not have the effect of altering any term of, or discharging or excusing performance under, the Agreement or any Transaction, give a party the right unilaterally to alter or terminate the Agreement or any Transaction or, in and of itself, give rise to an Event of Default, Termination Event or otherwise be the basis for the effective designation of an Early Termination Date.

“An event associated with economic and monetary union in the European Community” includes, without limitation, each (and any combination) of the following:

- (i) the introduction of, changeover to or operation of a single or unified European currency (whether known as the euro or otherwise);
- (ii) the fixing of conversion rates between a member state’s currency and the new currency or between the currencies of member states;
- (iii) ...;
- (iv) the introduction of that new currency as lawful currency in a member state;
- (v) the withdrawal from legal tender of any currency that, before the introduction of the new currency, was lawful currency in one of the member states; or
- (vi) the disappearance or replacement of a relevant rate option or other price source for the ... national currency of any member state, or the failure of the agreed sponsor (or a successor sponsor) to publish or display a relevant rate, index, price, page or screen.

(b) Any agreement between the parties that amends or overrides the provisions of this Section in respect of any Transaction will be effective if it is in writing and expressly refers to this Section or to European monetary union or to an event associated with economic and monetary union in the European Community ...²³

The ISDA EMU continuity provision is designed to be consistent with the EU Council regulations on the introduction of the euro.²⁴ In essence, the provision spells out the detailed implications of the continuity principle contained in the EU Council regulation on certain provisions relating to the introduction of the euro, while at the same time preserving the parties’ freedom of contract in a manner that is consistent with the EU Council regulation.²⁵

F. Bond Redenomination Provisions

As previously discussed, the provisions of the EU Council regulation on the introduction of the euro permitting the redenomination of bonds should be recognized as applicable to bonds governed by New York law.²⁶ It must be emphasized that the EU Council regulation contemplates a narrow form of redenomination which involves no more than changing the unit in which the amount of outstanding debt is stated from a national currency unit to the euro unit, but which does not have the effect of altering any

²²INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., EMU CONTINUITY PROVISION (July 1997).

²³*Id.*

²⁴*Id.*

²⁵*See supra* pp. 24-25.

²⁶*See supra* pp. 60-61.

other term of the debt.²⁷ Additional measures to amend the terms of outstanding debt, including an alteration in the nominal amount of such debt, may only be accomplished in accordance with the governing law of the contract.²⁸

Under New York law or the law of any other U.S. jurisdiction, an issuer would only be able to alter the nominal amount of outstanding bonds (i.e., renominalize) if so permitted under the terms and conditions of the bonds. Under standard form indentures and fiscal agency agreements used in many debt transactions governed by New York law it is provided that the principal amount of any outstanding note issued under an indenture or fiscal agency agreement shall not be reduced without the consent of the holder of each outstanding note affected thereby.²⁹ Other provisions modifying the rights of the noteholders may be added to the indenture or fiscal agency agreement with the consent of the holders of not less than 66 2/3% in principal amount of the outstanding notes, except that provisions which do not adversely affect the interests of the noteholders may typically be added to the indenture or fiscal agency agreement without the consent of the noteholders.³⁰

There is a widespread international consensus that a renominalization of outstanding debt by rounding the amount of such debt downwards to the nearest euro would constitute a reduction in the principal amount of the debt that could not be accomplished without the consent of the bondholders.³¹ Notwithstanding the fact that the amounts involved may be quite trifling (particularly in the case of debt issues represented by a global certificate), and that any such renominalization would be accompanied by cash compensation for the bondholders with respect to the truncated amounts, strong concerns have been expressed that because such renominalization would alter the economic value of the securities and the liquidity of the issue the rights of bondholders should not be limited in any way.³² Thus bonds governed by New York law may only be renominalized by rounding downwards to the nearest euro if this is explicitly provided for in the terms and conditions of the issue, and the first eurobond issued by a North American corporation under New York law that makes provision for the possibility of such renominalization was issued in June 1997.³³

It may remain possible for issuers to renominalize under a one-euro method without the consent of the bondholders by rounding upwards to the nearest euro, since this would not adversely affect the interests of the bondholders. Alternatively, issuers operating under U.S. laws may be able to rely on the provisions of the EU Council regulation to redenominate into the euro unit by rounding to the nearest euro cent.³⁴ It has been suggested, however, that issuers should obtain bondholders' consent for almost any redenomination because of the impact that a redenomination would have on the liquidity of the issue and on investors generally.³⁵ It is difficult to conceive how an upward redenomination to the nearest euro

²⁷See Resolution of the European Council of 7 July 1997 on the legal framework for the introduction of the euro, Annex Draft Council Regulation on the introduction of the euro, 1997 O.J. (C 236/04), art. 1 [hereinafter Draft Council Regulation on the introduction of the euro].

²⁸See Draft Council Regulation on the introduction of the euro, *supra* note 27, preamble (14).

²⁹See AMERICAN BAR FOUNDATION, COMMENTARIES ON MODEL DEBENTURE INDENTURE PROVISIONS 1965, MODEL DEBENTURE INDENTURE PROVISIONS (ALL REGISTERED ISSUES) 1967, AND CERTAIN NEGOTIABLE PROVISIONS 303-6 (1986).

³⁰See *id.*

³¹See European Commission, Communication from the Commission: The Impact of the Introduction of the Euro on Capital Markets II/338/97-EN-2 at 7 (1997); BANK OF ENGLAND, 4 PRACTICAL ISSUES ARISING FROM THE INTRODUCTION OF THE EURO 26, 34 (Apr. 1997); Bundesverband deutscher Banken, EMU-Conversion to a single currency in the securities industry: 1-cent method vs. 1-euro method (Mar. 24, 1997) (on file with author).

³²See European Commission, Communication from the Commission: The Impact of the Introduction of the Euro on Capital Markets: Communication from the Commission, II/338/97-EN-2 at 7 (1997); BANK OF ENGLAND, *supra* note 31, at 26-36; Bundesverband deutscher Banken, *supra* note 31.

³³See GENERAL MOTORS ACCEPTANCE CORPORATION OF CANADA, LIMITED, DM BONDS DUE 2002 PRICING SUPPLEMENT (June 11, 1997) (on file with London Stock Exchange); GENERAL MOTORS ACCEPTANCE CORPORATION, DM750,000,000 AND £300,000,000 GLOBAL FLOATING RATE NOTES PROSPECTUS SUPPLEMENT (September 11, 1997) (on file with Securities and Exchange Commission); see also BANK OF ENGLAND, *supra* note 31, at 35-36.

³⁴See *supra* pp. 21-22, 60-61.

³⁵BANK OF ENGLAND, *supra* note 31, at 35.

or a redenomination to the nearest cent³⁶ could adversely affect the interests of bondholders, particularly if the redenomination follows an across-the-board redenomination by the benchmark sovereign issuer,³⁷ thereby creating an increasingly liquid bond market in the euro unit.

³⁶See *supra* pp. 21-22.

³⁷See Council Regulation (EC) No 1103/97 of 17 June 1997 on the introduction of the euro, art. 8(4), 1997 O.J. (L 162/1), discussed *supra* pp. 21-22.

G. Consolidation Clauses

Beginning in 1997 a number of international issuers have adopted contractual provisions providing for a simultaneous redenomination in the euro unit and consolidation of two or more bond issues denominated in different EU national currencies or the ECU.³⁸ These so-called “parallel” or “tributary” bonds which will be consolidated into a single fungible issue denominated in the euro unit after EMU have common basic features such as an identical coupon and maturity.³⁹

H. Reconventioning

With the switch to the single currency the question has arisen whether harmonized market conventions should be adopted for eurobonds and money market instruments denominated in the euro. Such harmonized conventions would cover such matters as a day-count basis for the calculation of accrued interest, particularly for callable bonds (i.e., actual/365 or 30/360), a definition of business days, coupon frequency (i.e., annual, semi-annual, quarterly), the details of how reference rates are fixed and ex-dividend periods.⁴⁰

There is a general consensus that new harmonized conventions adopted for the euro area will not be applied to existing legacy contracts.⁴¹ Nonetheless, issuers adopting contractual clauses permitting bond redenomination are also introducing contractual provisions that would permit the adoption of new conventions upon such redenomination.⁴² The implications of such reconventioning clauses for potential hedging mismatches with respect to underlying derivative instruments require careful consideration.⁴³

I. U.S. Securities Disclosure Requirements

In order to meet the disclosure requirements of the U.S. securities laws, and in particular the disclosure of known trends and uncertainties, an increasing number of corporate issuers registering their securities with the U.S. Securities and Exchange Commission have made disclosures regarding how the introduction of the euro might affect their business operations.⁴⁴

³⁸See BANK OF ENGLAND, *supra* note 31, at 53.

³⁹See *id.*

⁴⁰See European Commission, Communication from the Commission: The Impact of the Introduction of the Euro on Capital Markets: Communication from the Commission, II/338/97-EN-2 at 14-17, 29 (1997); BANK OF ENGLAND, *supra* note 31, at 38-45; ACI-The Financial Market Association, Cedel Bank, Morgan Guaranty Trust Company of New York as Operator of the Euroclear System (Euroclear), International Paying Agents Association, International Primary Market Association, International Securities Association, International Swaps and Derivatives Association, Joint Statement on Market Conventions for the Euro (May 29, 1997) (on file with author).

⁴¹See *id.*

⁴²See, e.g., GENERAL MOTORS ACCEPTANCE CORPORATION OF CANADA, LIMITED, DM BONDS DUE 2002 PRICING SUPPLEMENT (June 11, 1997) (on file with London Stock Exchange).

⁴³See ACI-The Financial Market Association, Cedel Bank, Morgan Guaranty Trust Company of New York as Operator of the Euroclear System (Euroclear), International Paying Agents Association, International Primary Market Association, International Securities Association, International Swaps and Derivatives Association, Joint Statement on Market Conventions for the Euro (May 29, 1997) (on file with author).

⁴⁴See Gary T. Johnson and Steven D. Guynn (Jones, Day, Reavis & Pogue), The Transition to the Euro and the U.S. Capital Markets 2-4 (Oct. 23, 1997) (unpublished manuscript, on file with author).

VII. THE LEGAL STATUS OF THE ECU

This study has so far considered the legal implications of EMU for obligations denominated in EU national currencies (e.g., the Deutsche mark, the French franc) that are governed by the laws of U.S. jurisdictions. The study will next consider the legal status of obligations denominated in the ECU, a basket of currencies comprising specified amounts of 12 of the 15 EU national currencies. Many financial obligations denominated in the ECU are governed by New York law.¹ In view of the proposed replacement of references to the ECU basket in legal instruments by references to the euro at the rate of one euro for one ECU, it is necessary to consider whether ECU obligations governed by the laws of U.S. jurisdictions will be transformed into euro obligations on a 1:1 basis after EMU. This question will be analyzed in several stages.

- First, the study will consider the nature of the ECU. In particular, the study will seek to explain the important distinction between the “official” ECU of the European Community and the “private” ECU used in financial transactions.
- Second, the study will outline the role played by the ECU in the process of European monetary integration.
- Third, the study will explore the legal status of the ECU under the laws of U.S. jurisdictions.
- Fourth, the study will consider the relevance of the act of state doctrine for ECU obligations.
- Fifth, the study will examine the import of recent legislation enacted in New York and Illinois to ensure the continuity of ECU contracts after EMU.
- Sixth, the study will analyze the implications of various contractual definitions and clauses used by the financial markets to define obligations denominated in the ECU.

A. The Official ECU of the European Community

The term ECU encompasses both the “official” ECU and the “private” ECU. The official ECU is a reserve asset issued by the European Monetary Institute that may be used as a means of settlement for the payment of debts between the central banks of the countries participating in the European Monetary System.² The private ECU has no direct link with the official ECU. The private ECU was first created by the financial markets against the EU national currencies underlying the ECU and is used in a wide variety of private financial transactions.³ The official ECU may only be used by central banks, whereas the private ECU is traded through a separate clearing system established by the financial markets.⁴

1. Composition of the Official ECU

Known in English as the European Currency Unit and in French as the *écu* (so named after a long line of French coins of like name used from medieval times until the French revolution),⁵ the official ECU was created in 1978 in connection with the establishment of the European Monetary System (EMS).⁶ The official ECU was originally defined as the sum of fixed amounts of the currencies of the

¹See *infra* p. 152.

²See *infra* pp. 148-50.

³See *infra* pp. 152-56.

⁴See *infra* pp. 148-50, 154-55.

⁵See SUE MOORE, *THE ECU AS A COIN*, in *ECU: THE CURRENCY OF EUROPE* 242-45 (Christopher Johnson ed., 1991) [hereinafter *ECU*].

⁶The European Council Resolution establishing the EMS provided that the value of the ECU would be identical to the value of the EUA (European Unit of Account), a unit of account created by the European Economic Community in 1975 as a means of calculating

then nine member states of the European Economic Community (3.66 Belgian francs, plus 0.217 Danish krone, plus 0.286 Dutch guilder, plus 1.15 French francs, plus 0.828 German marks, plus 0.00759 Irish pound, plus 109 Italian lire, plus 0.14 Luxembourg francs, plus 0.0885 Pound sterling).⁷ The essential characteristic of the ECU basket is that the percentage composition of the ECU basket in terms of national currencies continually changes as the market values of its component national currencies fluctuate. This is because the ECU basket comprises fixed sums of national currencies, and not fixed percentages of national currencies. The weightings attributed to the currencies in this currency basket were originally supposed to reflect the underlying strength of the respective European economies based on GDP, participation in intra-Community trade, etc.⁸

The Resolution of the European Council on the establishment of the EMS permits revisions to be made to the composition of the official ECU, but provides that such revisions “will, by themselves, not modify the external value of the ECU.”⁹ Maintaining the external value of the ECU means that immediately following any revision the value of the revised ECU against the U.S. dollar or any other currency will be identical to the value of the ECU against such currency immediately prior to such revision.¹⁰ This ensures a 1:1 continuity from one old ECU basket to one new ECU basket.

To date there have been two revisions to the composition of the ECU. The first revision to the ECU took place in 1984 after Greece joined the European Economic Community and the composition of the ECU basket was revised to include the Greek drachma while the weightings of three of the other currencies included in the basket were altered.¹¹ The second revision to the ECU took place in 1989 after Spain and Portugal joined the European Economic Community and the composition of the basket was revised to include the Spanish peseta and the Portuguese escudo and the weightings of the existing 10 currencies included in the basket were altered.¹² These revisions did not in themselves modify the external value of the ECU so that both immediately before and immediately after each revision the exchange rate between the ECU and the U.S. dollar remained unchanged. Thus the ECU was revised on each occasion so that one old ECU basket was transformed into one new ECU basket at a 1:1 rate.

The ECU is currently defined as the sum of the following amounts of the following components:

| | | | |
|---------|----------------|----------|-----------------------------------|
| 0.6242 | German mark | 0.130 | Luxembourg franc |
| 0.08784 | Pound sterling | 0.1976 | Danish krone |
| 1.332 | French francs | 0.008552 | Irish pound |
| 151.8 | Italian lire | 1.440 | Greek drachmas |
| 0.2198 | Dutch Guilder | 6.885 | Spanish pesetas |
| 3.301 | Belgian francs | 1.393 | Portuguese escudos. ¹³ |

development aid under the first Lomé Convention. Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters (Dec. 5, 1978), art. 2.1, E.C. Bulletin 1978 No. 12 point 1.1.11, *reprinted in* Monetary Committee of the European Community, Compendium of Community Monetary Texts 45 (1989) [hereinafter 1989 Monetary Compendium]; *see also* JOHN A. USHER, *THE LAW OF MONEY AND FINANCIAL SERVICES IN THE EUROPEAN COMMUNITY* 129-32 (1994).

⁷Council Regulation 3180/78 of 18 December 1978 changing the value of the unit of account used by the European Monetary Cooperation Fund, art. 1, 1978 O.J. (L 379/1).

⁸*See* CHRIS SUNT, *LEGAL ASPECTS OF THE ECU* 5, 8 (1989); DANIEL GROS, *THE DEVELOPMENT OF THE ECU*, *in* ECU, *supra* note 5, at 13-14; DANIEL GROS AND NIELS THYGESEN, *EUROPEAN MONETARY INTEGRATION* 204-5 (1992).

⁹Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters, Dec. 5, 1978, art. 2.3, E.C. Bulletin 1978 No. 12 point 1.1.11, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 45.

¹⁰*See* SUNT, *supra* note 8, at 7-8.

¹¹The ECU was re-defined as the sum of 3.71 Belgian francs, plus 0.219 Danish krone, plus 0.256 Dutch guilder, plus 1.31 French francs, 0.719 German mark, plus 1.15 Greek drachmas, plus 140 Italian lire, plus 0.00871 Irish pound, plus 0.14 Luxembourg franc, plus 0.0878 Pound sterling. Council Regulation 2626/84 of 15 September 1984 amending Article 1 of Council Regulation 3180/78 changing the value of the unit of account used by the European Monetary Cooperation Fund, art. 1, 1984 O.J. (L 247/1).

¹²Council Regulation 1971/89 of 19 June 1989 amending Article 1 of Regulation 3180/78 changing the value of the unit of account used by the European Monetary Cooperation Fund, art. 1, 1989 O.J. (L 189/1).

¹³Council Regulation 3320/94 of 22 December 1994 on the consolidation of the existing Community legislation on the definition of the ecu following the entry into force of the Treaty on European Union, art. 1, 1994 O.J. (L 350/27).

The Maastricht Treaty provides that from January 1, 1994 the currency composition of the ECU basket shall not be changed.¹⁴ This freezing of the ECU basket in 1994 effectively precluded the Austrian, Finnish and Swedish currencies from forming part of the ECU basket at any time prior to EMU, notwithstanding the fact that these three currencies may participate in EMU if their countries satisfy the necessary conditions for the adoption of the single currency. The absence of these currencies is due to the fact that Austria, Finland and Sweden only joined the EU and acceded to the Maastricht Treaty in January 1995, after the Treaty had entered into force.¹⁵

2. Monetary Nature of the Official ECU

The official ECU has acquired the characteristics of a genuine currency separate and apart from its component currencies as a result of its usage in the European Monetary System. Under the Maastricht Treaty, ECUs are issued by the European Monetary Institute as successor to the former European Monetary Cooperation Fund (EMCF), which acted as the issuer of the ECU from the inception of the EMS until the Fund's tasks were taken over by the EMI upon the establishment of the EMI on January 1, 1994.¹⁶ The Statute of the EMI empowers the EMI to issue ECUs against monetary reserves received by the EMI from the national central banks for the purpose of implementing the March 1979 agreement between the central banks of the EEC member states laying down the operating procedures for the European Monetary System.¹⁷ The ECUs so issued may be used by the EMI and the national central banks as a means of settlement and for transactions between them and the EMI.¹⁸ Prior to January 1, 1994 the European Monetary Co-operation Fund was empowered in similar terms to issue ECUs against the receipt of monetary reserves from the monetary authorities of the member states.¹⁹

Under the EMS operating procedures agreed between the central banks in March 1979, each central bank participating in the ERM contributes to the EMI 20% of its gold holdings and gross dollar reserves against which it is credited with a corresponding amount of ECUs issued by the EMI.²⁰ The contributions of gold and dollars by the central banks take the form of revolving swaps.²¹ Thus each central bank, against receipt of the ECUs, enters into a three-month forward contract with the EMI for the repurchase of the gold and dollar reserves that it has just transferred to the EMI in exchange for the ECUs thereby issued.²² Upon the maturity of this swap arrangement each central bank will re-contribute 20% of its then-outstanding gold and dollar reserves to the EMI in return for a new equivalent amount of ECU and will simultaneously enter into a new three-month forward contract for the re-purchase of the reserves in exchange for the new amount of ECU issued, and so on.²³ Because fluctuations are not taken into account by the EMI, the exchange rate risk passes to the central banks.²⁴ Because the stock of official ECUs held by the central banks fluctuates with changes in the ECU values of the central banks' dollar and gold reserves, ECU creation is necessarily dependent on factors outside the control of the EMI and the EMS central banks (i.e., the conditions of the dollar foreign exchange markets and the London gold

¹⁴EC TREATY, arts. 109g and 109e(1).

¹⁵See *supra* pp. 2, 10-11.

¹⁶EC TREATY, art. 109f(2); *id.* Protocol (No 4) on the Statute of the European Monetary Institute, arts. 4.1,6.

¹⁷*Id.* Protocol (No 4) on the Statute of the European Monetary Institute, art. 6.2.

¹⁸See *id.*

¹⁹See Council Regulation 3181/78 of 18 December 1978 relating to the European Monetary System, art.1, 1978 O.J. (L 379/2).

²⁰Agreement of 13 March 1979 between the central banks of the Member States of the European Economic Community laying down operating procedures for the European Monetary System, art. 17.1, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 50.

²¹See *id.* art. 17.3.

²²See Ralph J. Mehnert, *The European Currency Unit - The ECU - Currency for the United States of Europe*, 23 GEO. WASH. J. INT'L L. & ECON. 349, 376-77 (1989-90).

²³See Agreement of 13 March 1979 between the central banks of the Member States of the European Economic Community laying down operating procedures for the European Monetary System, as amended, arts. 17.3, 17.6, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 50; Mehnert, *supra* note 22, at 376-77.

²⁴See Mehnert, *supra* note 22, at 376; Susan B. Shulman, *A Rapid or Evolutionary Approach: The EEC's Adoption of the ECU as a Common Currency*, 12 N.W. J. INT'L L. & BUS. 390, 394-95 (1991).

fixings).²⁵ It has been noted that in view of the three-month revolving swap arrangements neither the EMI nor the central banks have free access to the dollar and gold reserves, which have been legally transferred to the EMI but which are automatically subject to a three-month repurchase contract reverting ownership of the reserves to the central banks.²⁶ In practice, the dollar and gold reserves are not physically transferred to the EMI but rather are held by the national central banks in trust on behalf of the EMI.²⁷

The result of these arrangements is that a significant portion of the reserve assets of EMS central banks comprise ECU reserves. The ECU serves as a means of settlement between the EMS central banks, and a creditor central bank is obliged to accept settlement by means of ECUs of an amount up to 50% of its claim against a debtor central bank, unless the creditor bank is itself a net debtor in ECU in which case it is obliged to accept full settlement in ECUs.²⁸ Significantly, the EMI may grant to the monetary authorities of third countries and to international monetary institutions the status of “other holders” of ECU, and the first non-EU institutions that were permitted to hold the ECU were the Bank for International Settlements and the Swiss National Bank.²⁹

3. Additional Functions of the ECU in the EMS

The ECU performs several additional functions in the European Monetary System. First, in the exchange rate mechanism of the EMS, the central exchange rates of the participating currencies which form the basis of the bands within which currencies may float are expressed in ECU.³⁰ This choice of the ECU as denominator (numéraire) for the exchange rate mechanism fulfills a purely accounting function.³¹

The second function performed by the ECU in the EMS is as the reference against which the so-called divergence indicator operates.³² The divergence indicator establishes a threshold of divergence which is the point at which a currency’s market value against the ECU diverges from its central rate against the ECU by more than 75% of the maximum spread of divergence permitted under the fluctuation bands for each currency.³³ When a currency crosses its threshold of divergence there is a presumption that the authorities concerned will intervene on the currency markets or adopt other corrective measures.³⁴ Unlike the obligation of the central banks to intervene in support of the bilateral exchange rate bands of the EMS, intervention is at the discretion of the central banks when the divergence threshold is crossed.³⁵

²⁵See Mehnert, *supra* note 22, at 377-78; SUNT, *supra* note 8, at 17-18.

²⁶See Mehnert, *supra* note 22, at 379-80.

²⁷See *id.* at 377 n.98; SUNT, *supra* note 8, at 17-18.

²⁸See Agreement of 13 March 1979 between the central banks of the Member States of the European Economic Community laying down operating procedures for the European Monetary System, as amended, arts. 16, 18, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 50; Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters (Dec. 5, 1978), art. 2(d), E.C. Bulletin 1978 No. 12 point 1.1.11, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 45; *see also* SUNT, *supra* note 8, at 16-17.

²⁹See EC TREATY, Protocol (No 4) on the Statute of the European Monetary Institute, art. 6.3; J.V. Louis and E. de Lhoneux, *The Development of the Use of the ECU: Legal Aspects*, 28 COMMON MKT. L. REV. 335, 336 (1991).

³⁰See Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters (Dec. 5, 1978), art. 2.2(a), E.C. Bulletin 1978 No. 12 point 1.1.11, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 45.

³¹See GROS, *supra* note 8, *in* ECU, *supra* note 5, at 13, 17; PIERRE JAILLET AND THIERRY VISSOL, THE ECU AND EUROPEAN ECONOMIC AND MONETARY UNION, *in* ECU, *supra* note 5, at 25, 26; USHER, *supra* note 6, at 143.

³²See Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters (Dec. 5, 1978), art. 2.2(a), E.C. Bulletin 1978 No. 12 point 1.1.11, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 45.

³³See *id.* art. 3.5; Agreement of 13 March 1979 between the central banks of the Member States of the European Economic Community laying down operating procedures for the European Monetary System, as amended, art. 3, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 50.

³⁴See Resolution of the European Council on the establishment of the European Monetary System (EMS) and related matters (Dec. 5, 1978), art. 3.6, E.C. Bulletin (1978) No. 12 point 1.1.11, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 45.

³⁵See Mehnert, *supra* note 22, at 363-64; Richard Myrus, *From Bretton Woods to Brussels: A Legal Analysis of the Exchange-Rate Arrangements of the International Monetary Fund and the European Community*, 62 FORDHAM L. REV. 2095, 2112 (1994).

The divergence indicator is essentially an early-warning system, identifying any currency that diverges from the average of the other currencies (i.e., the ECU) before the gap grows too large.³⁶

The third function performed by the ECU in the EMS is that of the denominator for operations in both the intervention and the credit mechanism—in other words it denominates the creditor and debtor balances resulting from obligations to intervene in EMS currencies.³⁷

4. Use of the ECU in the EC Budget

In addition to its role in the European Monetary System, the ECU has served other functions in the European Community. The ECU has been used for many years as the unit of account of the EC and the general EC budget has been drafted in terms of ECU since the early 1980s.³⁸ Notwithstanding the use of the ECU as the unit of account for the EC budget, the Community has devised a mechanism that seeks to introduce monetary stability for the EC budget by converting budgetary operations for each month into national currencies.³⁹ Despite the application of this system, movements in the purchasing power of the EC budget still occur.⁴⁰ Since January 1988 the ECU has been used not only as a unit of account but also as a means of payment in the execution of the EC budget, accounting for 44% of total budgetary expenditures in 1995.⁴¹

B. The Private ECU

1. Use of the Private ECU in the International Financial Markets

The so-called “private ECU” has proved popular on the financial markets and is quoted daily in the currency markets. Since the early 1980s the private ECU has been widely used to measure obligations in many swap and bond transactions and international loans.⁴² Although initially quite a modest market, the ECU market took off in the mid 1980s with the amount of ECU bond issues increasing from 4.9 billion ECU in 1984 to 12.1 billion ECU in 1985.⁴³ As of the end of September 1995 the total estimated stock of ECU bonds amounted to ECU 119.1 billion, outstanding short-term paper totaled ECU 11.7 billion and net ECU bank lending is estimated to have reached ECU 56.9 billion.⁴⁴ The ECU is estimated to have accounted for 2.1% of global foreign exchange market turnover in April 1995 and the ECU’s share in the total outstanding volume of currency swaps and interest rate swaps in all currencies for year-end 1994 was 3.0% and 1.9%, respectively.⁴⁵ In terms of aggregate amounts of assets and liabilities, the ECU ranked third among EU currencies in the international banking market, behind the Deutsche mark and the Pound sterling.⁴⁶ The share of non-European ECU bond issuers, mainly in the U.S. and Japan, ranged

³⁶See Kathryn M. Conway, *The ECU: Prospects for a Monetary Union in the European Economic Community*, 21 LAW & POL’Y INT’L BUS. 273, 274 n.12 (1989); see also SUNT, *supra* note 8, at 13-14; John H. Works, *The European Currency Unit: The Increasing Significance of the European Monetary System’s Currency Cocktail*, 41 BUS. LAW. 483, 494-96 (1986).

³⁷See Resolution of the European Council on the establishment of the European Monetary System and related matters (Dec. 5 1978), art. 2.2(c), E.C. Bulletin 1978 No. 12 point 1.1.11, *reprinted in* 1989 Monetary Compendium, *supra* note 6, at 45. For a discussion of the operation of the financing facilities underlying this system, see USHER, *supra* note 6, at 144-46; SUNT, *supra* note 8, at 14-16.

³⁸See USHER, *supra* note 6, at 120-21; Louis & de Lhoneux, *supra* note 29, at 341.

³⁹See Christopher Bovis, *Legal Aspects of the European Union’s Public Finances: The Budget and the Communities’ Own Resources System*, 28 INT’L LAW. 743, 750-51 (1994).

⁴⁰See *id.* at 751.

⁴¹See European Monetary Institute, *Recent Developments in the Use of the Private ECU: Statistical Survey 19* (Mar. 1996).

⁴²See *Removing the Legal Obstacles to the Use of the ECU: White Paper from the Commission for the Council*, SEC(92) 2472 final at 4-6 (Dec. 1992) [hereinafter *Removing the Legal Obstacles to the Use of the ECU*].

⁴³European Monetary Institute, *supra* note 41, Table 4.1; GROS, *supra* note 8, in ECU, *supra* note 5, at 13, 18-20.

⁴⁴European Monetary Institute, *supra* note 41, at 2.

⁴⁵See *id.* at 9-10.

⁴⁶See *id.* at 4.

from 2.5% to 9.2% of the ECU bond market in the five years from 1991 to 1995.⁴⁷ An ECU futures and options market also appears to have developed in the United States, with the ECU being listed on a number of commodities exchanges.⁴⁸

While the ECU is widely used in the financial markets, it is not yet an important vehicle for current transactions and it is not widely used as a unit of account in non-financial transactions.⁴⁹ The ECU has not yet developed as a legal tender.

New York law is likely to be the governing law for a significant portion of ECU swap contracts in view of the preference of U.S. counterparties to select New York law as the governing law of their contracts.⁵⁰ New York law is also likely to be the governing law for most ECU bonds issued by U.S. corporations.

2. Private ECU: Creation of the Financial Markets

It is important to understand that the private ECU is a creation of the financial markets and has no formal link with the so-called official ECU that is issued by the European Monetary Institute and is used in the European Monetary System.⁵¹ Private ECUs were initially created by Belgian commercial banks in the late 1970s against the deposit by the European Economic Community of sums of money in the component currencies of the official ECU.⁵² The value of the private ECUs so created were ensured by the banks issuing a guarantee that the ECUs could be converted into the component currencies.⁵³ The private ECU is therefore not officially issued by any central banking institution.⁵⁴ Thus, assets in private ECUs cannot be converted into official ECUs because private ECUs are created by commercial banks against national currencies, independently from the supply of official ECUs that are created against dollar and gold reserves and are only capable of being held by monetary authorities.⁵⁵ At bottom, the private ECU has traditionally been regarded as a creature of contract that exists purely as a matter of agreement between contracting parties.⁵⁶

3. Development of the Private ECU as a Quasi-Currency

During the 1980s the private ECU began to acquire certain characteristics more closely associated with a currency in its own right than a basket of separate currencies. What started out as a one-way ECU deposit market quickly developed into a two-way deposit and loan market as banks sought out ECU

⁴⁷See *id.* Table 4.2.

⁴⁸See J. Trevor Brown, *The private ECU and Composite Currencies*, INT'L BUS. LAW. 203 (1990); Mehnert, *supra* note 22, at 394; SUNT, *supra* note 8, at 96-97.

⁴⁹See European Monetary Institute, *supra* note 41, at 13-14.

⁵⁰See *supra* pp. 3-4.

⁵¹There is an extensive literature discussing the distinction between the official ECU and the private ECU. See, e.g., J.T. BROWN AND A.M. SHEA, CLIFFORD CHANCE, THE LEGAL CONTEXT, in ECU, *supra* note 5, at 167-72; Marlo Giovanoli, *The Role of the Bank for International Settlements in International Monetary Cooperation and its Tasks Relating to the European Currency Unit*, 23 INT'L LAW. 841, 858-59 (1989); GROS, *supra* note 8, in ECU, *supra* note 5, at 13, 16-18; Louis & de Lhoneux, *supra* note 29, at 336-39; Mehnert, *supra* note 22, at 386-405; Shulman, *supra* note 24, at 402-03; SUNT, *supra* note 8, at 25, 47; USHER, *supra* note 6, at 135-36.

⁵²See SUNT, *supra* note 8, at 25, 27; Mehnert, *supra* note 22, at 390.

⁵³See Shulman, *supra* note 24, at 402.

⁵⁴See BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 167, 170; Louis & de Lhoneux, *supra* note 29, at 337; SUNT, *supra* note 8, at 25.

⁵⁵See Giovanoli, *supra* note 51, at 858-59.

⁵⁶See BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 167-68, 170, 172; GROS, *supra* note 8, in ECU, *supra* note 5, at 13, 18; Shulman, *supra* note 24, at 402; SUNT, *supra* note 8, at 25, 47.

borrowers in order to avoid having to unbundle the ECU basket into its component parts.⁵⁷ Perhaps the most significant development facilitating the expansion of the private ECU market was the adoption of the “open basket” definition of the private ECU. The “open basket” definition of the private ECU expressly defines the private ECU by reference to the official ECU, denoting that a change in the composition of the official ECU will result in a parallel change in the composition of the underlying private ECU obligation.⁵⁸ A “closed basket” on the other hand would define the private ECU obligation by reference to the official ECU on the date the contract was made.⁵⁹ The development of the open basket was crucial to the emergence of a unified, liquid private ECU market because the continued usage by the financial markets of the closed basket definition would have resulted in the creation of different types of private ECU obligations, causing confusion in the marketplace.⁶⁰ In fact the private ECU market boomed from the moment that the “open basket” formula became widely used,⁶¹ and in practice the formula was rapidly accepted in most, if not all, cases.⁶²

It has been suggested that the adoption of the open basket definition caused the private ECU to shift conceptually from being a “basket of currencies” to a “basket-currency.”⁶³ Two developments in particular attest to the private ECU’s emergence as a quasi-currency during this time. Firstly, the acceptance of the “open basket” formula greatly enhanced the direct settlement of private ECUs in ECUs rather than the component currencies.⁶⁴ Initially ECU transactions were settled either in a third currency or in the full basket of component currencies, leading to high transaction costs associated with bundling and unbundling the component currencies.⁶⁵ In 1986 a comprehensive same-day private ECU settlement system started functioning, with the ECU Banking Association (EBA) managing the system, SWIFT (Society for Worldwide Financial Telecommunication) providing a payment transmission mechanism and a netting center which produces the balances of each bank vis-à-vis the others, and the Bank for International Settlements (BIS) acting as agent for the clearing banks.⁶⁶ In 1988 the ECU clearing system decided that component currencies would no longer be deliverable against the basket.⁶⁷ In 1995 the average daily turnover in the system was ECU 46.8 billion, and it was expected that by early 1997 there would be 48 clearing banks participating in the system.⁶⁸ While the development of the ECU clearing system has greatly encouraged the use of the ECU as a basket currency separate and apart from the underlying component currencies, the system is structured so that neither the BIS nor the EBA perform the function of a lender of last resort.⁶⁹ Thus the BIS does not grant credits or loans in ECU, thereby effecting the creation of ECU, and neither the BIS nor SWIFT are exposed to any responsibility for losses or damage arising out of the clearing of ECU transactions.⁷⁰ The absence of a lender of last resort means that there is systemic risk in the ECU clearing system (i.e., the failure by one bank to meet its liabilities

⁵⁷See SUNT, *supra* note 8, at 27, 89.

⁵⁸See Shulman, *supra* note 24, at 403; SUNT, *supra* note 8, at 28-29.

⁵⁹See Shulman, *supra* note 24, at 402-03.

⁶⁰See BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 167, 172; GROS, *supra* note 8, in ECU, *supra* note 5, at 13, 18.

⁶¹See SUNT, *supra* note 8, at 29.

⁶²See Brown, *supra* note 48, at 207-08; GROS & THYGESEN, *supra* note 8, at 209; Louis & de Lhoneux, *supra* note 29, at 337; SUNT, *supra* note 8, at 29, 48.

⁶³See BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 167, 172; SUNT, *supra* note 8, at 29.

⁶⁴See BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, at 167, 172-73.

⁶⁵See MALCOLM LEVITT, THE ECU CLEARING SYSTEM, in ECU, *supra* note 5, at 152; SUNT, *supra* note 8, at 82.

⁶⁶See Giovanoli, *supra* note 51, at 861-64; LEVITT, *supra* note 65, in ECU, *supra* note 5, at 152-56; SUNT, *supra* note 8, at 82-86.

⁶⁷See European Monetary Institute, *supra* note 41, at 17.

⁶⁸See *id.* at 14.

⁶⁹See BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 167, 171-72; Giovanoli, *supra* note 51, at 863; LEVITT, *supra* note 65, in ECU, *supra* note 5, at 152, 153; Louis & de Lhoneux, *supra* note 29, at 337; SUNT, *supra* note 8, at 86; Works, *supra* note 36, at 507.

⁷⁰See BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 167, 171-72; SUNT, *supra* note 8, at 86.

would have repercussions throughout the system).⁷¹ This provides a significant contrast with the role of a central bank as lender of last resort in a domestic clearing system.

A second development precipitated by the use of the “open basket” formula and the resulting usage of the ECU as a quasi-currency in its own right is that the ECU’s market value became determined by the supply and demand for ECU as such and was no longer determined by the supply and demand for the component currencies.⁷² Similarly the interest rate for the ECU became a negotiated rate rather than a computed rate based on the weighted interest rates of the component currencies (the so-called theoretical yield).⁷³ The transaction cost of arbitrage operations in ECU through bundling and unbundling the ECU are sufficiently high to ensure some independence for ECU market rates.⁷⁴ However, the extent of the divergence between the market value of the private ECU and its theoretical value based on the currencies comprising the basket has at times been so pronounced that commentators have concluded that the divergence cannot be explained purely in terms of the arbitrage cost.⁷⁵

Thus, in 1989 actual ECU yields rose above the theoretical ECU yield as markets anticipated a revision in the composition of the ECU basket to include the high-yielding Spanish peseta and Portuguese escudo, whose incorporation into the basket implied an increase in the weight of currencies with higher interest rates.⁷⁶ Again in late 1995 and early 1996 there was an unprecedented spread in terms of both magnitude and persistence between the market and theoretical ECU exchange rates, fluctuating between 150 and 320 basis points.⁷⁷ The spread is thought to have reflected uncertainty regarding which countries will participate in EMU and legal uncertainties concerning the continuity of private ECU contracts after EMU.⁷⁸ The return to narrower exchange rate spreads as 1996 progressed is thought to have reflected a more general increase in optimism in financial markets about the likelihood of EMU, as well as ongoing work to prepare the legal framework for the use of the euro.⁷⁹ The only conclusion that can be drawn from this is that the ECU and its underlying basket are not the same thing and that the private ECU has acquired an independent identity as a quasi-currency based on the role played by the ECU in the process of European monetary integration.⁸⁰

4. Government Support for the Private ECU Market

While there is no official issuer of the private ECU and no monetary authority that plays the role of a lender of last resort with respect to the private ECU market, the institutions and member states of the European Union have played an important role in fostering the development of the private ECU. In order to facilitate the progressive usage of the private ECU in transactions within their borders, all member states had accorded the ECU the status of a foreign currency - either *de jure* or *de facto* - prior to the signing of the Maastricht Treaty.⁸¹ Since the coming into operation of the Maastricht Treaty, the European Monetary Institute has been charged with a supervisory role with respect to the private ECU market and is required to facilitate the use of the ECU and oversee its development, including the smooth

⁷¹See LEVITT, *supra* note 65, in ECU, *supra* note 5, at 152, 154-55.

⁷²See SUNT, *supra* note 8, at 29-30.

⁷³See *id.* at 30.

⁷⁴See GROS, *supra* note 8, in ECU, *supra* note 5, at 13, 22; Louis & de Lhoneux, *supra* note 29, at 353.

⁷⁵See GROS & THYGESEN, *supra* note 8, at 221; ALFRED STEINHERR AND ÉRIC PEREE, EUROPEAN INVESTMENT BANK, INVESTMENT IN ECU, in ECU, *supra* note 5, at 111-23, esp. at 122-23.

⁷⁶See JENNIFER SCHOFIELD, DEUTSCHE BANK, ECU BOND MARKETS AND THEIR OPERATIONS, in ECU, *supra* note 5, at 37, 48-49.

⁷⁷See European Monetary Institute, *supra* note 41, at 11.

⁷⁸See European Monetary Institute, Progress Towards Convergence 1996 58 (Nov. 1996); European Monetary Institute, *supra* note 41, at 11-12.

⁷⁹See European Monetary Institute, *supra* note 78, at 58.

⁸⁰See GROS & THYGESEN, *supra* note 8, at 214-25, esp. at 216, 222.

⁸¹See Removing the Legal Obstacles to the Use of the ECU, *supra* note 42, at 11-13, 20, ann. II, 5-6; see also BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 170; Conway, *supra* note 36, at 277; Louis & de Lhoneux, *supra* note 29, at 338, 344; Shulman, *supra* note 24, at 403-04; SUNT, *supra* note 8, at 27, 58-64.

functioning of the ECU clearing system.⁸² The EMI sees its role with respect to the smooth functioning of the ECU clearing system as ensuring that ECU clearing operations do not pose unacceptable systemic risks to the ECU market.⁸³ The EMI's supervisory role over the private ECU market is acquiring greater significance as EMU approaches and preparations are made for the private ECU market to be subsumed into the new euro market.

The governments of the EU member states have in practice played an important role in providing liquidity to the private ECU market through their large shares of ECU bond and commercial paper issues.⁸⁴ Thus, in 1995 84% of new ECU bond issues were placed by EU governments and an additional 4% by EU supranational institutions (i.e., the European Community and the European Investment Bank).⁸⁵ EU sovereigns and supnationals have accounted for over 50% of new ECU bond issues in every year since 1987.⁸⁶ Government funding of the ECU market has long been regarded by the financial markets as a political support mechanism to accelerate progress towards EMU through the development of a liquid ECU market that will be subsumed by the single currency.⁸⁷

C. 1:1 Replacement of the ECU Basket by the Euro

1. Emergence of the ECU as a Predecessor to the Single European Currency

The 1989 Delors Report, whose proposed three-stage process to EMU is largely reflected in the Maastricht Treaty, first recognized that the ECU has the potential to be developed into the single European currency.⁸⁸ Following the publication of the Delors Report an intense and highly publicized debate took place within the European Community between advocates of the introduction of a single European currency that would substitute national currencies and proponents of a dual currency approach. The dual currency approach found expression in the so-called "hard ECU" proposal developed by the United Kingdom which envisaged the introduction of the ECU as a dual currency to be issued by a European Monetary Fund and available on demand in lieu of national currencies, leaving it to market forces to dictate the usage of the hard ECU or the various national currencies.⁸⁹ The debate was won by the single currency theorists, and all doubt on the matter was dispelled by the declaration by the European Council in Rome in October 1990 that "the Community will have a single currency - a strong and stable ECU - which will be an expression and identity of its unity."⁹⁰ The debate served to focus the attention of the financial markets on the private ECU, and it is clear that, even before the Maastricht Treaty had been drafted, the prospect that the ECU might one day become the currency of Europe had attracted considerable interest in the private ECU market, with financial investors inside and outside the European Community willing to take a strategic position in the private ECU.⁹¹ This demonstrates that the fortunes of the private ECU market have long been wedded to the process of European monetary integration.⁹²

⁸²EC TREATY, art. 109f(2); *id.* Protocol (No 4) on the Statute of the European Monetary Institute, art. 4.1.

⁸³See European Monetary Institute, *supra* note 41, at 15.

⁸⁴See *ECU Forex: Analysing the Delta of the ECU*, BANQUE NATIONALE DE PARIS FIXED INCOME RESEARCH, Apr. 9, 1996; THIEFFRY PORTE AND JAMES O'BRIEN, MORGAN STANLEY, THE US AND THE ECU, *in* ECU, *supra* note 5, at 234, 236-37.

⁸⁵See European Monetary Institute, *supra* note 41, at 6, Table 4.1.

⁸⁶*Id.* Table 4.1.

⁸⁷See JENNIFER SCHOFIELD, DEUTSCHE BANK, *supra* note 76, *in* ECU, *supra* note 5, at 37, 38, 50; GRAHAM BISHOP, SALOMON BROTHERS, USERS OF ECU BOND MARKETS, *in* ECU, *supra* note 5, at 52-53.

⁸⁸Committee for the Study of Economic and Monetary Union, Report on Economic and Monetary Union in the European Community paras. 45-46 (1989) [hereinafter Delors Report].

⁸⁹See Shulman, *supra* note 24, at 390-91, 411-23; PAUL RICHARDS, THE U.K. PROPOSALS FOR AN EVOLUTIONARY APPROACH TO MONETARY UNION, *in* ECU, *supra* note 5, at 187-97.

⁹⁰European Council Rome Presidency Conclusions, Oct. 27-28, 1990, *quoted in* Removing the Legal Obstacles to the Use of the ECU, *supra* note 42, at 2; *see also* Delors Report, *supra* note 88, para. 47.

⁹¹See GROS, *supra* note 8, *in* ECU, *supra* note 5, at 13, 21-23; WILLIAM LEDWARD ET AL, INVESTORS IN ECU: THE CASE OF JAPAN, *in* ECU, *supra* note 5, at 124, 137; DOMINIQUE RAMBURE, ECU BANKING ASSOCIATION, ECU BANKING AND SHORT-TERM MARKETS, *in* ECU, *supra* note 5, at 62, 69; NEIL ROGERS, UBS, THE ECU FUTURES MARKET, *in* ECU, *supra* note 5, at 85; JENNIFER SCHOFIELD, DEUTSCHE

2. Maastricht Treaty and the 1:1 Replacement of References to the ECU Basket

Under the Maastricht Treaty it is provided that from January 1, 1994 the currency composition of the ECU basket will not be changed.⁹³ The Treaty further provides that at the starting date of EMU the Council will, acting with the unanimity of member states participating in EMU, adopt the conversion rates at which their currencies will be irrevocably fixed and at which irrevocably fixed rate the ECU will be substituted for these currencies, and the ECU will become a currency in its own right.⁹⁴ The Treaty provides that this measure (i.e., the irrevocable fixing of conversion rates) shall not by itself modify the external value of the ECU.⁹⁵ This means that the ECU basket will become a currency in its own right at the rate of one ECU basket to one unit of the single currency. The Treaty further provides that the Council will, acting according to the same procedure, also take the other measures necessary for the rapid introduction of the ECU as the single currency of the participating member states.⁹⁶

That the introduction of the ECU as a currency in its own right will not modify the external value of the ECU means that the exchange rate between the ECU basket and the currencies of non-EU countries such as the U.S. dollar or the Japanese yen prior to EMU will be identical to the exchange rate between the new euro currency and third country currencies at the moment the euro comes into existence. Immediately after its introduction as a currency in its own right the euro will, of course, be subject to the normal exchange rate fluctuations of the international currency markets. The Treaty implies, however, that the initial exchange rate of the euro will be linked to the exchange rate values of the twelve currencies forming the basis of the existing ECU basket. It should be noted that if, as can be reasonably expected, not all of the EU member states satisfy the preconditions to monetary union, the initial exchange rate of the euro could be influenced by the exchange rates of currencies not participating in EMU.

Since the Maastricht Treaty entered into force in November 1993 the institutions of the European Community have repeatedly confirmed that the Maastricht Treaty requires that obligations denominated in ECU become obligations denominated in the single currency at the rate of one ECU to one unit of the single currency. In April 1994, the European Commission issued a recommendation concerning the legal treatment of the ECU and of contracts denominated in ECU in view of the introduction of the single European currency, noting that Article 109I(4) of the Treaty “explains... that the decision regarding the conversion rates shall by itself not modify the external value of the ECU” and that “this means that one ECU in its current composition of a basket of component currencies will be exchanged, at the due time and in accordance with the procedures described in the Treaty, for one ECU in its new composition of a currency in its own right at a 1:1 conversion rate”.⁹⁷ Based on this, the Commission recommended that all parties to contracts denominated in ECU ensure that “every obligation to pay a sum in the ECU basket will be converted into an obligation to pay the same sum in ECU as single currency.”⁹⁸

In May 1995 the European Commission published its *Green Paper on the Practical Arrangements for the Introduction of the Single Currency*, which re-confirmed as follows:

As the transformation of the ECU from a basket currency into a currency in its own right will not by itself modify the external value of the ECU, the Treaty establishes that the conversion

BANK, *supra* note 76, in ECU, *supra* note 5, at 37, 38, 44; see also JIM DURRANT, PARIBAS CAPITAL MARKETS, THE ECU SWAPS AND OPTIONS MARKET, in ECU, *supra* note 5, at 83-84.

⁹²See GROS & THYGESEN, *supra* note 8, at 214-25.

⁹³EC TREATY, arts. 109g and 109e(1).

⁹⁴*Id.* art. 109I(4).

⁹⁵*Id.*

⁹⁶*Id.*

⁹⁷Commission Recommendation 94/284 of April 19, 1994 concerning the legal treatment of the ECU and of contracts denominated in ECU in view of the introduction of the single European currency, preamble, 1994 O.J. (L 121/43).

⁹⁸*Id.* at A, Tit. 3, § 4 & ann., § 4.

rate of the basket ECU into the ECU [single currency] will be 1:1. As a consequence, the unilateral decision of a contracting party to apply a different conversion rate should be considered as a violation of the terms of the contract.⁹⁹

The Presidency Conclusions of the Madrid European Council of December 1995 contained two important points regarding the conversion of the ECU basket into the single currency.¹⁰⁰ First, the Presidency Conclusions specified that the single currency's name would be the "euro" and that "the specific name euro will be used instead of the generic term 'ECU' used by the Treaty to refer to the European currency unit."¹⁰¹ Second, the Presidency Conclusions stated that upon monetary union "the official ECU basket will cease to exist" and confirmed that "[i]n the case of contracts denominated by reference to the official ECU basket of the European Community, in accordance with the Treaty, substitution by the euro will be at the 1:1 rate, subject to the particular terms of individual contracts."¹⁰² Thus, obligations denominated in the official ECU will be transformed into obligations denominated in euro at the rate of one ECU for one euro.

3. EU Council Regulations and the Continuity of ECU Contracts

The EU Council regulation on certain provisions relating to the introduction of the euro makes provision for contracts denominated in ECU.¹⁰³ The regulation provides that every reference in a legal instrument to the ECU, as referred to in Article 109g of the Treaty and as defined in Council Regulation (EC) No. 3320/94 (i.e., the regulation which defines the current composition of the ECU basket),¹⁰⁴ is replaced by a reference to the euro at a rate of one euro to one ECU.¹⁰⁵ This provision confirms the 1:1 transformation of ECU obligations into euro obligations as from January 1, 1999. As stated in the Preamble, this "confirm[s] that the principle of continuity of contracts and other legal instruments shall apply... between the ECU as referred to in Article 109g of the Treaty and as defined in the Council Regulation (EC) No. 3320/94 and the euro."¹⁰⁶

It is important to note that the continuity principle only applies to the ECU as defined in Council Regulation (EC) No. 3320/94. There are, however, many different contractual definitions of the ECU in the marketplace, a number of which do not refer to Council Regulation (EC) No. 3320/94.¹⁰⁷ The EU Council regulation overcomes this potential problem by providing that "[r]eferences in a legal instrument to the ECU without such a definition shall be presumed... to be references to the ECU as referred to in Article 109g EC and as defined in Council Regulation (EC) No. 3320/94."¹⁰⁸ This presumption is "rebuttable taking into account the intentions of the parties."¹⁰⁹ Thus, where an ECU obligation is not defined by reference to Council Regulation (EC) No. 3320/94 it is open to a party to argue that the parties intended to contract with reference to the basket of currencies underlying the ECU rather than the official

⁹⁹European Commission, Green Paper on the Practical Arrangements for the Introduction of the Single Currency, COM(95)333 final at 58.

¹⁰⁰European Council Madrid Presidency Conclusions, The Scenario for the Changeover to the Single Currency, para. 2 & ann. I, para. 10 (Dec. 1995).

¹⁰¹*Id.* para. 2.

¹⁰²*Id.* ann. I, para. 10.

¹⁰³Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 2, 1997 O.J. (L 162/1).

¹⁰⁴*See supra* pp. 147-48.

¹⁰⁵Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 2(1), 1997 O.J. (L 162/1).

¹⁰⁶*Id.* preamble (7).

¹⁰⁷*See* Letter from Allen & Overy, *City of London Joint Working Group on European Economic and Monetary Union*, to Helmut Wittelsberger and Jean-Pierre Fèvre, *European Commission* (June 17, 1996) (on file with author).

¹⁰⁸Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 2(1), 1997 O.J. (L 162/1).

¹⁰⁹*Id.*

ECU that will be transformed into a currency in its own right on January 1, 1999. This intention might be demonstrated by evidence that the parties chose to denominate their obligations in ECU because of the anticipated stability of the countervailing exchange rate fluctuations of a basket of currencies as opposed to the more uncertain fortunes of an individual currency like the Deutsche mark or the French franc. However, the City of London Joint Working Group on EMU Legislation has conducted investigations into this issue and has concluded “that even where, in older bond issues for example, a fixed basket ECU was used, the intention was to follow the official ECU for pricing, trading and settlement purposes.”¹¹⁰

4. 1:1 Replacement: Response of the U.S. and International Financial Markets

This wealth of legal provisions and official pronouncements regarding the 1:1 replacement of references to the ECU basket by references to the single currency in ECU contracts is mirrored by concurrent developments in the financial markets on both sides of the Atlantic. In June 1994, the European Commission published an analysis of the reaction of the ECU bond markets to the entry into force of the Maastricht Treaty in November 1993.¹¹¹ Based on a representative sample of 18 of the 33 ECU bonds issued on the bond markets during the period from November 1993 to June 1994, including a number of ECU bond issues governed by New York law, the Commission concluded that “[t]here is a positive trend towards the acceptance in the markets of stating explicitly continuity rules between the ECU basket and the future single currency in eurobond contracts.”¹¹² The first market participant to amend the documentation of its ECU bonds was the European Community itself in its capacity as an issuer. Beginning in November 1993, immediately following the entry into force of the Maastricht Treaty, the Community inserted new language in its ECU bond and loan documentation “to ensure that, in any case, the nominal continuity of obligations to pay a sum of ECUs is guaranteed throughout the process leading to full monetary union.”¹¹³

The preparations of the international financial markets for the 1:1 replacement were also assisted by the establishment in April 1993 by the European Commission and the ECU Banking Association of an ad hoc working group on the legal definition of the ECU.¹¹⁴ Arising out of this process IPMA (the International Primary Market Association) and ISDA released a joint statement in December 1995 recommending a standard definition of the ECU for use in terms and conditions of securities and derivatives contracts which was “designed to take into account the entry into force of the Treaty on European Union and the second stage of European Monetary Union.”¹¹⁵ In the meantime a number of U.S. ECU bond issuers had, beginning in 1994, already started to follow the market trend towards the inclusion of specific language in their ECU bond obligations ensuring that ECU bonds became single currency bonds after EMU.¹¹⁶ In July 1996 IPMA and ISDA put out for comment an updated version of the standard definition of the ECU which was designed to “reflect the current decision of the European

¹¹⁰Memorandum from the City of London Joint Working Group on EMU Legislation for the European Commission, Directorate General II, attaching Comments on Legal Framework for the use of the euro 1 (July 12, 1996) (on file with author).

¹¹¹European Commission (DGII), Analysis of Explicit Rules of Continuity Contained in ECU Bond Prospectuses Issued Since 1.11.1993, FM-1994 06se (June 1994).

¹¹²*Id.*

¹¹³European Commission, Explanatory note concerning new clauses in the prospectuses of loans and bonds of the European Communities (94/C 130/05), 1994 O.J. (C 130/6).

¹¹⁴The author was pleased to represent the law firm of Davis Polk & Wardwell, New York City, in the deliberations of this working group which held its last meeting in June 1995.

¹¹⁵INTERNATIONAL PRIMARY MARKET ASSOCIATION AND INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION INC., JOINT STATEMENT ON THE LEGAL DEFINITION OF THE ECU (Nov. 1995), and IPMA Press Release (Dec. 8, 1995) (on file with author).

¹¹⁶*See, e.g.*, PHILIP MORRIS CAPITAL CORPORATION, ECU NOTES DUE 1998 OFFERING CIRCULAR (Oct. 17, 1994) (on file with Luxembourg Stock Exchange); MORGAN STANLEY GROUP, INC., GLOBAL MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Mar. 29, 1995) (on file with Securities and Exchange Commission); PITNEY BOWES CREDIT CORPORATION, MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Nov. 10, 1995) (on file with Securities and Exchange Commission).

Council on the name euro and 1:1 conversion.”¹¹⁷ Following a period of consultation this updated definition of the ECU was adopted in September 1996.¹¹⁸

D. Legal Status of the ECU

As has already been noted, the proposed EU Council regulation containing certain provisions relating to the introduction of the euro provides that as of January 1, 1999 every reference in a legal instrument to the ECU, as referred to in Article 109g of the Treaty and as defined in Council Regulation 3320/94, will be replaced by a reference to the euro at a rate of one euro to one ECU.¹¹⁹ In addition, the regulation also provides that references to the ECU without such a definition will be presumed to be references to the ECU as referred to in Article 109g of the Treaty and as defined in Council Regulation 3320/94, but this presumption is rebuttable taking into account the intentions of the parties.¹²⁰

The U.K. Financial Law Panel has suggested that the status of such legislation compelling private ECU obligors to pay euros is problematical and that it is not clear why an American court should order an ECU payer to make payments in euro simply because legislation enacted by the EU Council requires this.¹²¹ The basis of the Financial Law Panel’s concern is that the ECU is not a currency, but rather a formula which produces a value in terms of the currencies of the EU member states (i.e., the basket of currencies), and that the rules of law which apply when a country changes its currency for another might have no application.¹²² The concern that the international obligation to recognize the currencies of other states cannot apply to obligations expressed in ECU because the ECU is not a currency in the true sense has been voiced by other commentators considering the legal implications of EMU.¹²³ The Financial Law Panel appears to suggest as an alternative that private ECU obligations could be discharged in a recomposed ECU basket after EMU (such a basket would consist of a large euro component calculated by reference to the conversion rates between the participating currencies that are in the basket and the euro together with the existing national currency components for those currencies not participating in EMU).¹²⁴ This argument raises the question whether private ECU obligations are recognized as obligations denominated in a lawful currency under New York law and the laws of other U.S. jurisdictions, in which case the provisions of EC law requiring a 1:1 conversion of private ECU obligations into euro would be automatically applied by American courts.

1. Revised UCC Definition of Money and the ECU

The official ECU of the European Community is recognized as a lawful currency in the 43 U.S. jurisdictions (including California and Illinois) that have adopted the revised UCC definition of “money”. The definition of money contained in Section 2-105(24) of the Uniform Commercial Code was revised in 1990 so as to define “money” as follows: “Money is a medium of exchange authorized or adopted by a

¹¹⁷INTERNATIONAL PRIMARY MARKET ASSOCIATION AND INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., DRAFT JOINT STATEMENT ON THE LEGAL DEFINITION OF THE ECU (July 1996), and IPMA Press Release (July 31, 1996) (on file with author).

¹¹⁸ INTERNATIONAL PRIMARY MARKET ASSOCIATION AND INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., JOINT STATEMENT ON THE LEGAL DEFINITION OF THE ECU (Sept. 1996), and IPMA Press Release (Sept. 6, 1996) (on file with author).

¹¹⁹Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 2, 1997 O.J. (L 162/1).

¹²⁰*Id.*

¹²¹FINANCIAL LAW PANEL, EVIDENCE TO SUB-COMMITTEE A OF THE U.K. HOUSE OF LORDS SELECT COMMITTEE ON THE EUROPEAN COMMUNITIES 12 (Jan. 1996).

¹²²*Id.*; FINANCIAL LAW PANEL, THE NEED FOR THE ECU: SUPPLEMENTAL RESPONSE TO THE EUROPEAN COMMISSION’S GREEN PAPER ON THE PRACTICAL ARRANGEMENTS FOR THE INTRODUCTION OF THE SINGLE CURRENCY 2 (Dec. 1995).

¹²³*See, e.g.*, CHARLES PROCTOR AND GILLES THIEFFRY, NORTON ROSE, EMU – BUSINESS AS USUAL IN FINANCIAL MARKETS: A LEGAL ANALYSIS OF THE IMPACT OF EMU ON FINANCIAL OBLIGATIONS 10 (1996).

¹²⁴FINANCIAL LAW PANEL, *supra* note 122, at 6.

domestic or foreign government as a part of its currency and *includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations.*¹²⁵

The significance of this amendment is that it broadened the definition of money to include the monetary units of intergovernmental organizations such as the European Community's ECU and the IMF's Special Drawing Right (SDR). This revised definition of money has been adopted in 42 of the 50 states and the District of Columbia.¹²⁶ In these jurisdictions the ECU is therefore recognized as a medium of exchange and monetary unit of account established by the European Community. Thus, in accordance with Official Comment 24 to the Code,¹²⁷ the ECU used in the European Monetary System is recognized as an official currency of the European Community based on its recognition and sanction as such by the institutions and member states of the European Community. The official ECU will be regarded as a creature of European Community law in these jurisdictions and the 1:1 replacement of references to the official ECU by references to the euro will be recognized in accordance with the applicable provisions of EC law. Obligations denominated in the official ECU that are governed by the laws of these jurisdictions will therefore automatically become obligations denominated in euro after EMU.

2. Uniform Foreign-Money Claims Act and the ECU

The official ECU is also recognized as a lawful currency under the laws of the 20 U.S. jurisdictions (including California and Illinois) that have adopted the Uniform Foreign-Money Claims Act. The Uniform Foreign-Money Claims Act defines foreign money as "a medium of exchange for the payment of obligations or a store of value authorized or adopted by a government or by inter-governmental agreement."¹²⁸ This definition of foreign money has been uniformly adopted in all 20 enacting jurisdictions.¹²⁹ The drafters' comments to the Act confirm that the ECU falls within the definition of foreign money:

¹²⁵U.C.C. § 1-201(24), 1 U.L.A. 65 (1989) (emphasis added).

¹²⁶**Alabama:** ALA. CODE § 7-1-201(24) (Supp. 1996); **Alaska:** ALASKA STAT. § 45.01.201(25) (Michie 1996); **Arizona:** ARIZ. REV. STAT. ANN. § 47-1201(24) (West Supp. 1996); **Arkansas:** ARK. CODE ANN. § 4-1-201(24) (Michie 1991); **California:** CAL. U.C.C. § 1201(24) (West Supp. 1997); **Colorado:** COLO. REV. STAT. ANN. § 4-1-201(24) (West Supp. 1997); **Connecticut:** CONN. GEN. STAT. ANN. § 42a-1-201(24) (West 1996); **Delaware:** DEL. CODE ANN. tit. 6, § 1-201(24) (Supp. 1996); **District of Columbia:** D.C. CODE ANN. § 28-1-201(24) (1996); **Florida:** FLA. STAT. ANN. § 671.201(24) (West 1993); **Georgia:** GA. CODE ANN. § 11-1-201(24) (Supp. 1996); **Hawaii:** HAW. REV. STAT. § 490:1-201(24) (1993); **Idaho:** IDAHO CODE § 28-1-201(24) (1995); **Illinois:** ILL. ANN. STAT. ch. 810, para. 5/1-201(24) (West 1993); **Indiana:** IND. CODE ANN. § 26-1-1-201(24) (West 1995); **Iowa:** IOWA CODE ANN. § 554.1201(24) (West 1995); **Louisiana:** LA. REV. STAT. ANN. § 10:1-201(24) (West 1993); **Maine:** ME. REV. STAT. ANN. tit. 11, § 1-201(24) (West 1995); **Maryland:** MD. CODE ANN., COM. LAW § 1-201(24) (1997); **Michigan:** MICH. STAT. ANN. § 19.1201(24) (Callaghan Supp. 1997); **Minnesota:** MINN. STAT. ANN. § 336.1-201(24) (West Supp. 1997); **Mississippi:** MISS. CODE ANN. § 75-1-201(24) (Supp. 1996); **Missouri:** MO. ANN. STAT. § 400.1-201 (West 1994); **Nebraska:** NEB. REV. STAT. (U.C.C.) § 1-201(24) (1992); **Nevada:** NEV. REV. STAT. ANN. § 104.1201(24) (Michie 1994); **New Hampshire:** N.H. REV. STAT. ANN. § 382-A:1-201(24) (1994); **New Jersey:** N.J. STAT. ANN. § 12A:1-201(24) (West Supp. 1996); **New Mexico:** N.M. STAT. ANN. § 55-1-201(24) (Michie 1993); **North Carolina:** N.C. GEN. STAT. § 25-1-201(24) (1995); **Ohio:** OHIO REV. CODE ANN. § 1301.01(x) (Anderson Supp. 1996); **Oklahoma:** OKLA. STAT. ANN. tit. 12A, § 1-201(24) (West Supp. 1997); **Oregon:** OR. REV. STAT. § 71.2010(24) (1995); **Pennsylvania:** 13 PA. CONS. STAT. ANN. § 1201 (West Supp. 1996); **South Dakota:** S.D. CODIFIED LAWS § 57A-1-201(24) (Michie Supp. 1996); **Texas:** TEX. BUS. & COM. CODE ANN. § 1.201(24) (West 1995); **Vermont:** VT. STAT. ANN. tit. 9A, § 1-201(24) (1994); **Virginia:** VA. CODE ANN. § 8.1-201(24) (Michie Supp. 1996); **Washington:** WASH. REV. CODE ANN. § 62A.1-201(24) (West 1995); **West Virginia:** W.VA. CODE § 46-1-201(24) (1993); **Wyoming:** WYO. STAT. ANN. § 34.1-1-201(xxiv) (Michie 1991). The revised definition was adopted with minor variations in three jurisdictions: North Dakota ("Money" means a medium of exchange authorized or adopted by a domestic or foreign government or by an international organization"), Montana and Utah ("Money" means a medium of exchange authorized or adopted by a domestic or foreign government or intergovernmental organization"). **Montana:** MONT. CODE ANN. § 30-1-201(24) (1995); **North Dakota:** N.D. CENT. CODE § 41-01-11(24) (Supp. 1995); **Utah:** UTAH CODE ANN. § 70A-1-201(24) (Supp. 1996).

¹²⁷ U.C.C. § 1-201, off. cmt. 24, 1 U.L.A. 72 (1989), discussed *supra* pp. 81-85.

¹²⁸ UNIF. FOREIGN-MONEY CLAIMS ACT § 1(7) (1989).

¹²⁹ **California:** CAL. CIVIL PROC. ACT § 676.1(7) (West Supp. 1997.); **Colorado:** COLO. REV. STAT. ANN. §§ 13-62.1-101(7) (West Supp. 1995); **Connecticut:** CONN. GEN. STAT. ANN. § 50a-51(7) (West 1997); **Hawaii:** HAW. REV. STAT. § 658B-1 (1993); **Illinois:** ILL. ANN. STAT. Ch. 735 para. 5/12-631(7) (West 1992); **Minnesota:** MINN. STAT. ANN. § 548.40(7) (West Supp. 1997); **Montana:** MONT. CODE ANN. § 25-9-701(7) (1995); **Nevada:** NEV. REV. STAT. ANN. § 17.500 (Michie Supp. 1996); **New Jersey:** N.J. STAT. ANN. § 2a-49a-2 (West Supp. 1996); **New Mexico:** N.M. STAT. ANN. § 39-4C-2(G) (Michie 1991); **North Carolina:** N.C. GEN. STAT. § 1C-1820(7) (1995); **North Dakota:** N.D. CENT. CODE § 32-41-01(7) (1995); **Ohio:** OHIO REV. CODE ANN. § 2337.01(G) (Anderson 1995); **Oklahoma:** OKLA. STAT. ANN. tit. 12, § 729.2(7) (West Supp. 1997); **Oregon:** OR. REV. STAT. § 24-260(7) (1995); **Utah:** UTAH CODE ANN. § 78-22b-102(6) (1996); **Virginia:** VA. CODE ANN. § 801-465.14 (Michie 1992); **Virgin Islands:** V.I. CODE ANN. tit. 11, § 1531(6) (1995); **Washington:** WASH. REV. CODE ANN. § 6.44.010(7) (West 1995); **Wisconsin:** WIS. STAT. ANN. § 806.30(6) (West 1994).

The definition includes composite currencies such as European Currency Units created by agreement of the governments that are members of the European Monetary System or the Special Drawing Rights created under the auspices of the International Monetary Fund. These are “stores of value” used to determine the quantity of payment in some international transactions.¹³⁰

The significance of this is that the official ECU will again be regarded as a creature of European Community law in these jurisdictions and the 1:1 replacement of all references to the official ECU by references to the euro will be acknowledged by these jurisdictions in accordance with the applicable provisions of EC law. Indeed, the 1:1 transformation of private ECU obligations denominated in the official ECU into obligations denominated in euro is expressly required under the provisions of the Uniform Foreign-Money Claims Act. Section 12 of the Act provides that if, after an obligation is expressed in a foreign money, the country issuing or adopting that money substitutes a new money in place of that money, the obligation is treated as if expressed in the new money at the rate of conversion the issuing country establishes for the payment of like obligations denominated in the former money.¹³¹ Since the official ECU falls within the definition of foreign money under the Act, all obligations expressed in the official ECU will be treated as if expressed in the euro at the 1:1 rate established under EC law for the payment of such private ECU obligations.

3. General UCC Definition of Money and the Legal Status of the ECU under New York Law

The revised definition of money in the UCC, which expressly broadens the definition of money to include monetary units of account established by intergovernmental organizations, has not been adopted in eight states.¹³² Significantly, the amended definition has not been adopted in New York State, which is the jurisdiction whose laws govern the great majority of private ECU obligations governed by the laws of U.S. jurisdictions. In order to establish whether the official ECU is a lawful currency under New York law it is therefore useful to consider the general UCC definition of money that has been adopted by New York State: money is a medium of exchange authorized or adopted by a foreign government as a part of its currency.¹³³ As discussed previously, this definition rejects the narrow view that money is limited to legal tender.¹³⁴ The test adopted is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government.¹³⁵

It can be argued that the official ECU of the EC falls within the general definition of money that has been adopted by New York State. The official ECU is a medium of exchange insofar as it is used as a means of settlement between the EMI, the national central banks of the EU member states and certain other non-EU central banks and international monetary institutions.¹³⁶ The issuance of the official ECU by the EMI (and previously the EMCF) has been authorized by the governments of the EU member states, pursuant to the terms of the Maastricht Treaty and as part of the operation of the European Monetary System.¹³⁷ The fact that ECUs circulate with official recognition between the central banks of

¹³⁰UNIF. FOREIGN-MONEY CLAIMS ACT § 1(7), cmt. 7 (1989); *see also* Fairfax Leary, Jr. and Howard T. Rosen, *The Uniform Foreign Money Claims Act*, 12 U. PA. J. INT’L BUS. L. 51, 63 (1991).

¹³¹UNIF. FOREIGN-MONEY CLAIMS ACT §12(a) (1989), discussed *supra* pp. 85-86.

¹³²**Kansas:** KAN. STAT. ANN. § 84-1-201(24) (1996); **Kentucky:** KY. REV. STAT. ANN. § 355-1-201(24) (Michie 1996); **Massachusetts:** MASS. ANN. LAWS ch. 106, § 1-201(24) (Law Co-op. 1984); **New York:** N.Y. U.C.C. § 1-201(24) (McKinney 1993); **Rhode Island:** R.I. GEN. LAWS § 6A-1-201(24) (1992); **South Carolina:** S.C. CODE ANN. § 57A-1-201(24) (Law Co-op. 1977); **Tennessee:** TENN. CODE ANN. § 47-1-201(24) (1996); **Wisconsin:** WIS. STAT. ANN. § 401.201(24) (West 1995). The revised definition has not been adopted in the U.S. territories of Guam and the Virgin Islands. **Guam:** 13 GUAM CODE ANN. § 1201(24) (1996); **Virgin Islands:** V.I. CODE ANN. tit. 11A, § 81-201(24) (1995).

¹³³N.Y. U.C.C. § 1-201(24) (McKinney 1993 & Supp. 1997), discussed *supra* pp. 81-85.

¹³⁴*See* U.C.C. § 1-201(24), off. cmt. 24, 1 U.L.A. 72 (1989), discussed *supra* pp. 90-91.

¹³⁵*See id.*

¹³⁶*See supra* pp. 148-50.

¹³⁷*See id.*

EMS countries has led some commentators to conclude that the official ECU has the characteristics of a genuine currency.¹³⁸ This view also appears to have been echoed by the European Commission, which has noted that “[t]he monetary nature of the ECU is thus based on the EMS.”¹³⁹

As against that, however, the official ECU plays an extremely limited role as a currency. ECUs can only be held by EU central banks and certain other monetary authorities.¹⁴⁰ The fact that the official ECU is issued against dollar and gold reserves means that its creation is contingent on factors that are outside the control of the EU member states (i.e., the direction of the U.S. dollar and the price of gold).¹⁴¹ In addition, the issuer has a very limited access to the reserves against which the ECU is created.¹⁴² Some commentators have argued that although the official ECU has the legal characteristics of a currency, it should still be considered as a developing or quasi-currency in view of the restrictions on its uses and its limited circle of users.¹⁴³

Notwithstanding these limitations on the use of the official ECU, a case can still be made that the official ECU falls within the definition of money under the New York Uniform Commercial Code. The fact that the official ECU is only used as a medium of exchange between central banks and that its uses are limited need not necessarily deprive it of its monetary status because the New York UCC only requires that the medium be authorized by a foreign government as *a part* of its currency.¹⁴⁴ It is not essential that the medium be the sole currency of a country but rather that it be a partial currency. The limitations on the uses of the official ECU do not detract from its primary function as a medium of exchange between monetary institutions that has been authorized by the governments of EU member states. In addition, the fact that the official ECU is not a legal tender for the payment of all debts is irrelevant in view of the UCC’s rejection of the narrow concept of money as legal tender.¹⁴⁵

New York courts would also be impressed by the fact that the International Monetary Fund (IMF) has implicitly accepted for many years that the ECU is a foreign currency. Beginning in 1984 the IMF began to exclude gold and dollar deposits of central banks held with the European Monetary Cooperation Fund from countries’ assets for the purpose of making the calculations necessary to determine the apportionment of Special Drawing Rights (SDRs), instead including the ECUs created by these deposits in countries’ foreign exchange reserves, thereby implying that the ECU is considered a currency by the IMF.¹⁴⁶

In conclusion, the argument can be made that the official ECU falls within the definition of money under New York law and that the 1:1 replacement of references to the official ECU by references to the euro will be recognized in accordance with the relevant provisions of EC law. As against that, however, it may still be argued that, in view of its limited uses, the official ECU should not be regarded as money within the meaning of the New York UCC. The fact that the New York State Legislature has not amended the UCC to expressly include monetary units of account such as the ECU and the SDR within the definition of money might be advanced as evidence that the official ECU falls outside the ambit of the New York UCC definition. If the official ECU is not classified as legal money within the meaning of the New York UCC, obligations denominated in ECU must be regarded as pure creatures of contract. To the extent that the private ECU is a creation of contract law, it is necessary to consider the legal status of private ECU obligations governed by New York law in accordance with New York law as the governing

¹³⁸See Conway, *supra* note 36, at 276; Mehnert, *supra* note 22, at 375.

¹³⁹Removing the Legal Obstacles to the Use of the ECU, *supra* note 42, at 4.

¹⁴⁰See *id.*

¹⁴¹See *supra* pp. 148-50.

¹⁴²See *id.*

¹⁴³See Louis & de Lhoneux, *supra* note 29, at 336.

¹⁴⁴N.Y. U.C.C. § 1-201(24) (McKinney 1993) (emphasis added).

¹⁴⁵See *supra* pp. 90-91.

¹⁴⁶See Mehnert, *supra* note 22, at 407 (citing 37 International Financial Statistics 7 (1984)).

law of the contract rather than EC law as the law of the currency. Under New York law legislation has recently been enacted that provides for the continuity of ECU contracts after EMU in a manner that is substantially identical to the EU Council regulations on the introduction of the euro. The content of the New York legislation will be considered below.¹⁴⁷

4. Development of the ECU as a Contingent Currency After Maastricht

A credible argument can also be made that the ECU underwent a radical transformation at the time the Maastricht Treaty came into operation. According to this argument, ECU obligations created after the Maastricht Treaty came into force were transformed into partial monetary obligations insofar as such obligations might mature after the ECU becomes a currency in its own right. The ECU became, in a sense, a contingent currency whose monetary status was dependent upon the occurrence of EMU. Thus, if EMU takes place obligations denominated in ECU will be transformed from being pure creations of contract law into obligations denominated in a currency that will be issued under the authority of the European Central Bank.

This interpretation of ECU obligations created after Maastricht as constituting contingent monetary obligations finds a certain degree of support in the wording of the UCC definition of money. Official Comment 24 to the UCC definition of money states that the test adopted by this definition is that of sanction of government, *whether by authorization before issue or adoption afterward*.¹⁴⁸ This comment by the Code drafters implies that a medium of exchange which is not sanctioned by a government at the time of its issue can be adopted as money by that government subsequently. Thus, the Code drafters envisaged that in the ever-changing world of finance, media of exchange can emerge which become increasingly acceptable in the financial markets, eventually leading to their official recognition as currency by governmental authorities. A plausible argument can be made that this encapsulates the essence of the transformation of the ECU into a currency in its own right, beginning with its progressive development as a basket currency and culminating in the single currency. If this argument is accepted, private ECUs created after Maastricht, while possibly contractual in nature at the time of their creation, would be treated as having a monetary aspect insofar as they are capable of being transformed into obligations denominated in a legal currency backed by a central bank.

Appealing though this argument might be, it is difficult to predict with any certainty how much credence it might be given by the legal community. In the absence of any certainty, it would be prudent to assume for the purpose of argument that all ECU obligations governed by New York law, whether created before or after the coming into operation of the Maastricht Treaty, are pure creations of market convention whose legal content must be interpreted solely in accordance with New York law as the governing law of the contract. This line of reasoning refers us to the provisions of recent legislation enacted by the New York State Legislature for a determination of the legal status of ECU obligations governed by New York law.¹⁴⁹

5. Development of the Private ECU as a Quasi-Currency

In addition, it might also be argued that the private ECU, based on its progressive development as a quasi-currency, has become a medium of exchange authorized by the member states of the European Union in accordance with the UCC definition of money. Some commentators have suggested that because the private ECU is in practice used as a currency by the financial markets there must be a reasonable possibility that the private ECU can be treated as a legal currency.¹⁵⁰ The private ECU market has developed to such an extent that banks operating in the interbank market can borrow, lend, buy and sell ECUs just as they do with any currency.¹⁵¹ The widespread acceptance by the financial markets of

¹⁴⁷See *infra* pp. 169-75.

¹⁴⁸U.C.C. § 1-201(24), off. cmt. 24, 1 U.L.A. 72 (1989) (emphasis added).

¹⁴⁹See *infra* pp. 169-75.

¹⁵⁰See Brown, *supra* note 48, at 208; BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 167, 169.

¹⁵¹See BROWN & SHEA, CLIFFORD CHANCE, *supra* note 51, in ECU, *supra* note 5, at 167, 170; see also *supra* pp. 149-50.

the “open basket” definition of the private ECU has facilitated the development of a sophisticated private ECU clearing system that does not permit ECU settlement through the component currencies.¹⁵² The private ECU displays the market characteristics of an independent currency with an exchange rate and interest rate that does not correlate to its theoretical rates based on the component currencies.¹⁵³ Most important of all, the fortunes of the private ECU in the marketplace have become inextricably linked to the process of European monetary integration.¹⁵⁴ Taking all of these factors into account, one might be tempted to argue that the private ECU has, based on market practice, already been transformed into a currency in its own right.

In support of this argument it might be pointed out that an American court recognized the regional taels issued through private financial institutions in China with the acquiescence of the Chinese government during the late 19th century as legal money.¹⁵⁵ It appears, however, that these taels circulated as the sole money of account in China at that time, which readily distinguishes them from the private ECU.¹⁵⁶

It is submitted that the better view is that until such time as the private ECU is issued by a sovereign power and enjoys the backing of a lender of last resort it cannot, of itself, be readily characterized as a legal currency.¹⁵⁷ While the private ECU has always been used as a medium of exchange in the financial markets, it lacks monetary status by virtue of the fact that no government has authorized or adopted the private ECU as a part of its currency. It is true that all member states have accorded the private ECU the legal status, either *de facto* or *de jure*, of a foreign currency.¹⁵⁸ However, the UCC definition of money requires that the medium be adopted or authorized by a foreign government as a part of *its* currency,¹⁵⁹ and to date no EU member state has adopted the private ECU as a part of its domestic currency. Thus, unlike the official ECU, there is no public issuer of the private ECU.¹⁶⁰ Although a sophisticated settlement system for the clearing of the private ECU has developed, there is no monetary authority that plays the role of a lender of last resort with respect to the private ECU market in the same way as a central bank in a domestic money market.¹⁶¹

It is also the case that EU sovereign and supranational issuers have in practice played an important role in providing liquidity to the private ECU market by issuing a significant share of the ECU bond market.¹⁶² Moreover, it might be argued, the supervisory role which the EMI has played with respect to the private ECU market since the coming into operation of the Maastricht Treaty establishes an implicit support by the EU member states for the private ECU market.¹⁶³ Thus, the EMI, as precursor to the European Central Bank, is charged under the Treaty with responsibility to oversee the role of the private ECU market, including the smooth functioning of the ECU clearing system.¹⁶⁴ However, it is submitted that these developments, while psychologically important to participants in the private ECU market, do not add any financial security to the use of the private ECU.¹⁶⁵ Private ECUs are created by private

¹⁵²See *supra* pp. 154-55.

¹⁵³See *supra* p. 155.

¹⁵⁴See *id.*

¹⁵⁵*Gordon v. Magone*, 40 F. 747, 748-50 (C.C.S.D.N.Y. 1889), discussed *supra* pp. 65-66.

¹⁵⁶*Gordon*, 40 F. at 750.

¹⁵⁷See *BROWN & SHEA, CLIFFORD CHANCE, supra* note 51, in *ECU, supra* note 5, at 170; *SUNT, supra* note 8, at 57.

¹⁵⁸See *supra* p. 156.

¹⁵⁹U.C.C. § 1-201(24), 1 U.L.A. 65 (1989) (emphasis added).

¹⁶⁰See *supra* p. 153.

¹⁶¹See *supra* pp. 154-55.

¹⁶²See *supra* p. 156.

¹⁶³See *supra* p. 156.

¹⁶⁴EC TREATY, art. 109f (2); *id.* Protocol (No 4) on the Statute of the European Monetary Institute, art. 4.1, discussed *supra* p. 156.

¹⁶⁵See *Mehnert, supra* note 22, at 392.

financial institutions against the initial deposit of component currencies, and the value of the private ECU must ultimately rest on its presumed convertibility into the component currencies.¹⁶⁶ At bottom, in the absence of an official issuer or lender of last resort the private ECU may be regarded as a creature of contract that derives its legal status from the terms of an agreement between contracting parties. Where such an agreement is governed by New York law, regard must be had to New York contract law as the governing law of the contract rather than EC law as the law of the currency in resolving the legal status of ECU obligations after EMU.

E. Act of State Doctrine and Private ECU Obligations

The 1:1 transformation of obligations denominated in ECU into obligations denominated in euro is an act of state, and under the act of state doctrine the provisions of the EU Council regulations relating to private ECU obligations are therefore applicable to all ECU obligations whose situs are located in EU member states.¹⁶⁷ To the extent that the act of state doctrine is rooted in federal law, it takes precedence over conflicting state law, including state legislation.¹⁶⁸ Thus, the applicable provisions of the EU Council regulations may be applicable to all ECU obligations that involve obligors based in EU member states and/or payments that are to be discharged within EU member states, regardless of whether such obligations are governed by the laws of U.S. jurisdictions.

F. New York General Obligations Law

1. New York General Obligations Law and ECU Obligations

In July 1997 the Governor of New York signed into law an amendment to the New York General Obligations Law enacted to ensure the continuity of contracts after EMU.¹⁶⁹ With respect to ECU obligations, the New York General Obligations Law provides that if a subject or medium of payment of a contract, security or instrument is the ECU, the euro will be a commercially reasonable substitute and substantial equivalent that may be either (i) used in determining the value of the ECU or (ii) tendered, in each case at the conversion rate specified in, and otherwise calculated in accordance with, the regulations adopted by the Council of the European Union.¹⁷⁰ The term “ECU” or “European Currency Unit” is defined to mean the currency basket that is from time to time used as the unit of account of the European Community as defined in European Council Regulation No. 3320/94.¹⁷¹ The New York General Obligations Law further provides with respect to ECU contracts that, when the euro first becomes the monetary unit of participating member states of the European Union, references to the ECU in a contract, security or instrument that also refers to the definition of the ECU as set forth above shall be replaced by references to the euro at a rate of one euro to one ECU.¹⁷² References to the “ECU” in a contract, security or instrument without such a definition of the ECU shall be presumed, unless either demonstrated or proved to the contrary by the intention of the parties, to be references to the currency basket that is from time to time used as the unit of account of the European Community.¹⁷³

The cumulative effect of these provisions is that in a contract governed by New York law the euro is treated as a commercially reasonable substitute and substantial equivalent for the ECU. The provisions of the New York General Obligations Law ensure the continuity of ECU contracts in a manner that is substantially identical with the EU Council regulation on certain provisions relating to the introduction of

¹⁶⁶See *supra* p. 153.

¹⁶⁷See *supra* pp. 74-78.

¹⁶⁸See *supra* p. 76.

¹⁶⁹S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604).

¹⁷⁰*Id.* § 5-1602(1)(B).

¹⁷¹*Id.* § 5-1601(3).

¹⁷²*Id.* § 5-1601(3).

¹⁷³*Id.*

the euro.¹⁷⁴ Thus, the ECU is defined in accordance with its official definition as laid down in European Council Regulation No. 3320/94. As with the EU Council regulation,¹⁷⁵ all ECU obligations defined by reference to the official ECU shall be automatically converted into euro obligations at the 1:1 conversion rate. Again, consistent with the EU Council regulation,¹⁷⁶ ECU obligations that do not contain a definition of ECU shall be presumed to refer to the official ECU, in which case such ECU obligations shall become euro obligations at the 1:1 rate. This presumption may be rebutted by evidence of a contrary intention by the parties.

2. ECU Obligations Not Defined by Reference to the Official ECU

Although the vast majority of ECU obligations governed by New York law are derived from contracts that define the ECU by reference to the official ECU, there may be some ECU obligations that are derived from contracts which do not define the ECU. In such circumstances the parties might disagree as to what is meant by the term “ECU” after the introduction of the single currency. One party might rely on the presumption under the New York General Obligations Law that the ECU refers to the official ECU, references to which must be replaced by references to the euro on a 1:1 basis. The other party might argue that the ECU simply refers to the basket of currencies underlying the ECU at the time the contract matures, in which case the obligation may have to be discharged in a recomposed ECU basket after EMU (i.e., a basket comprising the euro and those currencies reflected in the basket that do not participate in EMU). This raises the question of the extent to which the presumption under the New York General Obligations Law that the ECU refers to the official ECU may be rebutted by evidence of a contrary intention by the parties to a particular ECU contract.

The ultimate goal in contract interpretation is the realization and effectuation of the parties’ intent.¹⁷⁷ The intention of the parties is found through an objective consideration of the language used (i.e., what a reasonable person in the position of the parties would have thought was meant), even though this may not accord with the subjective intention of the parties.¹⁷⁸ As a general matter, a sensible meaning of words should be sought by courts in the interpretation of contracts under New York law, giving effect to the spirit and purpose of the agreement.¹⁷⁹ When the language used is susceptible of more than one interpretation, the courts will look to the surrounding circumstances existing when the contract was entered into, the situation of the parties and the subject matter of the instrument.¹⁸⁰ Thus the parties to a contract on a subject matter concerning which known usages or customs prevail are deemed to have incorporated such usages by implication into their agreement, if nothing is said to the contrary.¹⁸¹ Where contracts are negotiated by counsel for sophisticated commercial parties, courts will interpret ambiguous language to realize the reasonable expectations of the ordinary businessperson.¹⁸²

¹⁷⁴See *supra* pp. 159-60.

¹⁷⁵Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 2(1), 1997 O.J. (L 162/1), discussed *supra* pp. 159-60.

¹⁷⁶*Id.* art. 2(1).

¹⁷⁷See *Frye v. Brown*, 592 N.Y.S.2d 527, 529 (N.Y. App. Div. 1993) (citations omitted); see also *Empire Properties Corp. v. Mfrs. Trust Co.*, 43 N.E.2d 25, 28 (N.Y. 1942) (citations omitted); 22 N.Y. JUR. 2D, *Contracts* § 224 (1996).

¹⁷⁸See *Cutter v. Peterson*, 611 N.Y.S.2d 368, 369 (N.Y. App. Div. 1994) (citations omitted); *Peripheral Equip., Inc. v. Farrington Mfg., Co.*, 285 N.Y.S.2d 99, 101 (N.Y. App. Div. 1967) (citations omitted); *City of New York v. Pullman Inc.*, 477 F. Supp. 438, 442 (S.D.N.Y. 1979) (citations omitted); 22 N.Y. JUR. 2D, *Contracts* § 226 (1996).

¹⁷⁹See *Heller v. Pope*, 164 N.E. 881, 882 (N.Y. 1928) (quoting *William C. Atwater & Co. v. Panama R. Co.*, 159 N.E. 418, 419 (N.Y. 1927)); 22 N.Y. JUR. 2D, *Contracts* § 213 (1996).

¹⁸⁰See *Fleischman v. Furgueson*, 119 N.E. 400, 401 (N.Y. 1918) (citation omitted); *Germaine v. Safeguard Ins. Co.*, 181 N.Y.S.2d 315, 316 (N.Y. App. Div. 1958); *Thorp v. Pittsburgh Bicentennial Assoc.*, 199 N.Y.S.2d 53, 57 (N.Y. Sup. Ct. 1960); 22 N.Y. JUR. 2D, *Contracts* § 223 (1996).

¹⁸¹See *Edelman v. Becker*, 599 N.Y.S.2d 578, 579 (N.Y. App. Div. 1993); *Kasen v. Morrell*, 175 N.Y.S.2d 315, 317 (N.Y. App. Div. 1958); *Hollywood Plays v. Columbia Pictures Corp.*, 77 N.Y.S.2d 568, 576 (N.Y. Sup. Ct. 1947) (citation omitted), *aff'd* 83 N.Y.S.2d 302 (N.Y. App. Div. 1948), *rev'd on other grounds* 85 N.E.2d 865 (N.Y. 1949); *Christiania Gen. Ins. Corp. of New York v. Great Am. Ins. Co.*, 979 F.2d 268, 274 (2d Cir. 1992) (citation omitted).

¹⁸²See *Bank of New York v. Amoco Oil Co.*, 35 F.3d 643, 662 (2d Cir. 1994) (citations omitted).

The argument that the term “ECU”, as used in a particular contract, refers to the basket of currencies underlying the ECU, as opposed to the official ECU as changed from time to time, might be best advanced by arguing that the basic purpose underlying the contract was to limit the exposure to exchange rate risks by investing in a basket of currencies whose cumulative exchange rate fluctuations are less violent than the fluctuations of a single currency. Indeed, the use of the private ECU as a convenient hedge against currency fluctuations is an oft-cited advantage of the basket.¹⁸³

While it is undoubtedly true that the exchange rate hedge has historically been an important factor making the private ECU an attractive investment asset, this will not suffice to establish that the parties to a particular ECU contract intended to freeze their rights and obligations by reference to the composition of the ECU basket at the time they entered into the contract. The primary explanation behind the growth of the private ECU market has been the general acceptance by financial markets of the “open basket” definition of the private ECU, which allows the definition of the private ECU to change in line with changes to the composition of the official ECU.¹⁸⁴ Thus, the continuity of ECU contracts was not challenged in the aftermath of prior revisions to the ECU basket. This was the case notwithstanding the fact that the composition of the ECU changed quite significantly following the inclusion of the Spanish peseta in the ECU in 1989. Although the external value (i.e., U.S. dollar equivalent value) of the ECU remained unchanged following each revision, the subsequent direction of the ECU’s exchange rate against the dollar has clearly been affected by the inclusion of new currencies in the basket.¹⁸⁵ The 1:1 continuity of ECU obligations was assured following previous revisions to the composition of the ECU because the use of the “open basket” definition is so widespread that it is implicitly understood in all ECU contracts that the “open basket” formula applies.¹⁸⁶

The “open basket” formula implies that the private ECU always follows alterations to the official ECU. It is submitted that such alterations include not only changes in the composition of the official ECU but also changes in the nature of the official ECU such as its transformation into a currency in its own right. This argument is particularly compelling with respect to ECU obligations created after the Maastricht Treaty came into force. It is a reasonable interpretation of post-Maastricht ECU obligations that the “open basket” definition of the ECU implies that all references to ECU in private contracts shall be replaced by references to euro at the rate of one ECU for one euro. As was the case with prior revisions to the composition of the ECU, the transformation of the ECU into a currency in its own right shall not of itself modify the external value of the new currency (i.e., the exchange rate between the ECU basket and the U.S. dollar immediately prior to EMU will be identical to the exchange rate between the euro and the dollar immediately after EMU).¹⁸⁷

The most sensible interpretation of the term ECU in a private contract is that it refers to the official ECU of the EC. This interpretation gives effect to what a reasonable person would have thought was meant by the term “ECU”, even though it may not necessarily reflect the subjective beliefs of all contracting parties. This interpretation is consistent with the circumstances surrounding the private ECU market, including the customary usage of the “open basket” formula and the development of the private ECU as a basket currency separate and apart from the basket’s component currencies. In this regard, some commentators have explicitly rejected the notion that the exchange rate hedge explains the popularity of the private ECU, pointing to the close link between the direction of the private ECU’s market value and the overall process of European monetary integration.¹⁸⁸ It has also been suggested that the argument that the open basket formula implicitly applies in all private ECU contracts will hold greater

¹⁸³See Conway, *supra* note 36, at 276; Louis & de Lhoneux, *supra* note 29, at 338, 344; Mehnert, *supra* note 22, at 393; Shulman, *supra* note 24, at 403; Works, *supra* note 36, at 503-04.

¹⁸⁴See *supra* pp. 153-54.

¹⁸⁵See *supra* pp. 147-48, 155.

¹⁸⁶See SUNT, *supra* note 8, at 48-49.

¹⁸⁷See *supra* pp. 147-48, 157-58.

¹⁸⁸See GROS, *supra* note 8, in ECU, *supra* note 5, at 13, 21-22; STEINHERR & PEREE, EUROPEAN INVESTMENT BANK, *supra* note 75, in ECU, *supra* note 5, at 111; see also *supra* p. 155.

sway in the wholesale financial and interbank markets as opposed to the retail markets.¹⁸⁹ Most, if not all ECU contracts governed by New York law involve sophisticated corporate and financial participants in the wholesale markets who can be reasonably expected to have understood the implications of the “open basket” formula.

In conclusion, the widespread acceptance of the “open basket” definition of the private ECU will make it difficult to rebut the presumption under the New York General Obligations Law that the term “ECU” as used in private contracts refers to the official ECU of the EC references to which should be replaced by references to euro on a 1:1 basis. This presumption will be particularly compelling where the contract was entered into after Maastricht and the parties are sophisticated financial or corporate institutions. It will, however, always be open to the parties to adduce clear evidence of a contrary intention. Such is the prevalence of the “open basket” definition of the ECU that, even in the absence of legislation in New York, obligations denominated in ECU would, under normal principles of contract interpretation, be interpreted as referring to the official ECU of the European Community. As a matter of contract interpretation, obligations denominated in the official ECU would therefore be construed sensibly so as to follow the 1:1 replacement of references to the official ECU by references to the euro.

3. Continuity of ECU Contracts

Mirroring the language of the EU Council regulation on the introduction of the euro,¹⁹⁰ the New York General Obligations Law provides that the introduction of the euro shall not have the effect of discharging or excusing performance under any contract, security or instrument, or give a party the right to unilaterally alter or terminate any contract, security or instrument.¹⁹¹ This provision ensures the continuity of ECU contracts after EMU by preventing parties from invoking doctrines such as frustration or impossibility at common law or commercial impracticability under the UCC as a means of terminating or otherwise discharging ECU obligations based on EMU.

It is submitted that the provisions of the New York General Obligations Law ensuring the continuity of ECU contracts after EMU are largely declaratory of existing law and do not alter pre-existing contractual rights. This is because parties could not have successfully invoked the doctrines of commercial impracticability, frustration or impossibility in the absence of the New York legislation. In order to avail of the UCC doctrine of commercial impracticability or the common law doctrines of frustration or impossibility to terminate or otherwise discharge contractual obligations denominated in ECU it is necessary to show that the event rendering performance impracticable or otherwise frustrating the contract was unforeseeable.¹⁹² In the case of the replacement of references to the ECU by references to the euro, it would therefore be necessary to show that the transformation of the ECU into a currency in its own right was unforeseeable. The development of the ECU as a currency in its own right first became a real possibility before the Maastricht Treaty was even drafted when in 1990, following an intense and highly publicized political debate, the European Council rejected a dual currency proposal and decided that the ECU would be the single currency of the European Community.¹⁹³ It is clear that market expectations, both within and outside the European Community, regarding the role of the ECU in the process of European monetary integration played an important role in the development of the private ECU market at that early stage.¹⁹⁴ This was followed by the signing of the Maastricht Treaty in early 1992, which specifically provided that the ECU would become a currency in its own right.¹⁹⁵ Market

¹⁸⁹See SUNT, *supra* note 8, at 49.

¹⁹⁰Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 3, 1997 O.J. (L 162/1), discussed *supra* pp. 24-25.

¹⁹¹S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604).

¹⁹²See *supra* pp. 105-07, 116-17, 119-20.

¹⁹³See *supra* pp. 156-57.

¹⁹⁴See *id.*

¹⁹⁵See *supra* pp. 157-58.

expectations regarding the role of the ECU in the development of the single currency have continued to play an important role in the evolution of private ECU exchange and interest rates.¹⁹⁶

The implications of the Maastricht Treaty for the private ECU market have been repeatedly spelt out by the European Community since the Treaty went into force, and this has resulted in the EU Council regulation providing for the 1:1 replacement of references to the ECU by references to the euro (unless the contracting parties intended otherwise).¹⁹⁷ These clear signals from the European Community have prompted a flurry of activity in the financial markets over the past number of years, and market operators have decided to update their ECU documentation to expressly take account of EMU.¹⁹⁸ The long-standing foreseeability of the transformation of the ECU into a currency in its own right would preclude the invocation of contractual doctrines such as commercial impracticability, frustration or impossibility in order to terminate or otherwise discharge ECU obligations governed by New York law in the aftermath of EMU.

The U.K. Financial Law Panel has, however, expressed a contrary viewpoint. The Panel has suggested that the euro may be much stronger than the ECU because the euro will be the currency of those member states with the strongest economies while the ECU basket includes certain currencies that may not satisfy the Maastricht Treaty's economic convergence criteria.¹⁹⁹ The Panel argues that obligors under contracts involving ECU-denominated obligations which were incurred before the details (or even the possibility) of EMU became clear would be unhappy to discover that their obligations had in practice been increased by the introduction of the euro.²⁰⁰ In the aftermath of EMU, parties to such ECU contracts might be inclined to argue that performance has been frustrated. Such an argument would point to the change in the nature of the ECU from a basket currency to a currency in its own right together with a possible appreciation in the value of the euro compared to the ECU on the international currency markets after January 1, 1999.

IPMA has strongly criticized the position adopted by the Financial Law Panel, arguing that the Panel may not have given sufficient weight to the expectations of the market because investors in ECU obligations expect such obligations to be transformed into euro obligations on a one-for-one basis.²⁰¹ It is submitted that the view expressed by IPMA on this point is more consistent with the weight of evidence establishing the long-standing foreseeability of the 1:1 replacement of references to of the ECU basket by references to the euro.

4. Floating Rate Obligations

Another issue that might arise under New York law is whether the possible disappearance of ECU price sources might frustrate or render commercially impracticable the performance of ECU interest rate obligations, particularly interest rate swaps.²⁰² This issue is specifically addressed by the New York General Obligations Law which provides that calculating or determining the subject or medium of payment of a contract, security or instrument with reference to an interest rate or other basis that has been substituted or replaced due to the introduction of the euro and that is a commercially reasonable substitute and substantial equivalent shall not have the effect of discharging or excusing performance under any contract, security or instrument, or give a party the right to unilaterally alter or terminate any contract, security or instrument.²⁰³ This provision ensures that the replacement of a euro rate source for an ECU

¹⁹⁶See *supra* p. 155.

¹⁹⁷See *supra* pp. 158-60.

¹⁹⁸See *supra* pp. 160-61.

¹⁹⁹FINANCIAL LAW PANEL, *supra* note 121, at 2-5, 11-12; FINANCIAL LAW PANEL, *supra* note 122, at 4-6.

²⁰⁰FINANCIAL LAW PANEL, *supra* note 121, at 5; see also DAVID CURRIE, THE PROS AND CONS OF EMU 71-72 (1997).

²⁰¹INTERNATIONAL PRIMARY MARKET ASSOCIATION, IPMA PRELIMINARY REPLY TO FINANCIAL LAW PANEL'S PAPER ON "THE NEED FOR THE ECU" (Dec.1995).

²⁰²See *supra* pp. 121-28.

²⁰³S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604, § 5-1602(2)).

rate source will not threaten the continuity of floating rate ECU obligations. In this respect, the New York General Obligations Law confirms the general continuity principle under the EU Council regulation.²⁰⁴

G. Illinois Euro Conversion Act

In July 1997 the Governor of Illinois signed into law the Illinois Euro Conversion Act which provides for the continuity of ECU obligations in a manner that is substantially identical to the EU Council regulation on certain provisions relating to the introduction of the euro and the New York General Obligations Law.²⁰⁵ One interesting drafting distinction between the Illinois Euro Conversion Act and the New York General Obligations Law is that under the Illinois Euro Conversion Act a reference to “ECU” in a contract, security or instrument *without defining* “ECU” shall carry the presumption, rebuttable by a showing of the contrary intention of the parties, that it is a reference to the official ECU,²⁰⁶ whereas under the New York legislation this presumption applies to all ECU obligations not defined by reference to the official ECU.²⁰⁷ Thus, under the Illinois Euro Conversion Act, an ECU obligation which does contain a definition of the ECU, but where that definition does not refer to the official ECU, would not benefit from the presumption under the Illinois legislation. In view of the fact that most if not all contractual definitions of the ECU refer to the official ECU,²⁰⁸ it may be the case that this drafting distinction between the New York legislation and the Illinois Euro Conversion Act has no practical importance. The New York legislation is more consistent with the approach taken by the EU Council regulation on this particular point.²⁰⁹

Another interesting point to note is the distinction between the definition of the ECU used in the Illinois Euro Conversion Act and the definitions used in other provisions of Illinois law. While the ECU is defined in the Euro Conversion Act as the currency basket that is from time to time used as the unit of account of the European Community,²¹⁰ the ECU is expressly included within the definition of money under the UCC and the Uniform Foreign-Money Claims Act adopted under Illinois law. Under the Illinois UCC money is defined to include a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations, which of course includes the ECU.²¹¹ Under the Uniform Foreign-Money Claims Act, money is defined to include a store of value authorized or adopted by inter-governmental agreement, which is also intended to cover the ECU.²¹² While these provisions explicitly acknowledge the monetary nature of the official ECU, the Illinois Euro Conversion Act does not appear to take a position on this point. The recognition of the monetary nature of the official ECU helps to buttress the 1:1 replacement of references to the ECU by references to the euro.

It is also worth recalling that under the Illinois Uniform Foreign-Money Claims Act it is provided that all obligations expressed in the official ECU must be treated as if expressed in the euro at the 1:1 replacement rate established under EC law.²¹³ The Illinois Euro Conversion Act supplements this

²⁰⁴See *supra* pp. 24-25, 124-25.

²⁰⁵Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), §§ 5, 10(b), 25.

²⁰⁶Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 25.

²⁰⁷S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604), § 5-1601(3).

²⁰⁸See *infra* pp. 177-81.

²⁰⁹Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 2(1), 1997 O.J. (L 162/1).

²¹⁰Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 5.

²¹¹ILL. ANN. STAT. ch. 810, para. 5/1-201(24) (West 1993), discussed *supra* pp. 162-63.

²¹²*Id.* para. 5/12-631(7), discussed *supra* pp. 163-64.

²¹³*Id.* para. 5/12-642(a), discussed *supra* pp. 163-64.

provision by explicitly applying the presumption that all ECU obligations that do not contain a definition of the ECU refer to the official ECU.²¹⁴

H. ECU Contract Clauses

The terms and conditions of most private ECU obligations governed by New York law ensure the 1:1 replacement of references to the ECU by references to the euro. This is because most private ECU obligations are specifically defined by reference to the official ECU.²¹⁵ Under New York law, either the monetary status of the official ECU will be recognized, in which case the 1:1 replacement will be acknowledged in accordance with the applicable provisions of EC law, or alternatively a contractual reference to the official ECU will be construed as requiring the 1:1 replacement in accordance with the applicable provisions of the New York General Obligations Law.

Often the definition of the ECU used in private contracts explicitly refers to the transformation of the official ECU into a currency in its own right. On the other hand, some uncertainty has been expressed regarding the interpretation of older private ECU contracts that defined the ECU as the ECU used in the European Monetary System.²¹⁶ This study will now consider the import of relevant contractual definitions.

1. ECU Used in the European Monetary System

Prior to the joint statement by IPMA and ISDA recommending the adoption of a revised definition of the private ECU,²¹⁷ all ECU swaps governed by the ISDA standard form documentation contained a provision defining the ECU as “a currency, one unit of which is equal in value to the European Currency Unit that is used in the European Monetary System.”²¹⁸ In addition to including this definition of the ECU, many ECU bonds also contained provisions calling for repayment in U.S. dollars or a component currency of the ECU if the ECU ceases to be used in the European Monetary System.²¹⁹

The European Commission’s 1994 analysis of the ECU bond market criticized this provision as endangering the continuity of contracts if EMS rules were deeply revised after the start of a partial monetary union (i.e., a monetary union enjoying the participation of some but not all EU member states).²²⁰ The issuance of ECUs against dollar and gold reserves will cease upon the introduction of the euro. The European Council resolution establishing the framework for a new exchange-rate mechanism (ERM II) that will replace the existing European Monetary System demonstrates that the euro will play a much more significant role in ERM II than the ECU does in the existing ERM.²²¹ Some of the features of ERM II bear a close resemblance to the existing ERM (e.g., a 15% standard fluctuation band with the possibility of narrower bands, compulsory intervention at the margins of the bands together with the possibility of coordinated intramarginal intervention, and the availability of a very short-term financing

²¹⁴Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 25.

²¹⁵See INTERNATIONAL PRIMARY MARKET ASSOCIATION, *supra* note 201.

²¹⁶See *infra* pp. 177-79.

²¹⁷See *supra* pp. 160-61, *infra* pp. 179-80.

²¹⁸See INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., 1991 ISDA DEFINITIONS, § 1.5(g) (1991); INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., 1992 ISDA FX AND CURRENCY OPTION DEFINITIONS § 3.2(h) (1992).

²¹⁹See EUROPEAN COMMISSION (DGII), *supra* note 111.

²²⁰*Id.*

²²¹Resolution of the European Council on the establishment of an exchange-rate mechanism in the third stage of economic and monetary union, June 16, 1997, discussed *supra* pp. 25-26.

facility to support the bands).²²² However, the fluctuation bands which the central banks are required to defend will be constructed around the euro in ERM II, whereas in the existing ERM the bands are based on bilateral exchange rates rather than the ECU.²²³ While the ECU is used in the current EMS for the purpose of indicating divergence by EMS currencies from their central rates against the ECU, the divergence indicator does not require EMS central banks to intervene in support of the ECU central rates.²²⁴ The very particular role played by the ECU in the EMS raises the question of whether the ECU used in the EMS would be interpreted by the courts to refer to the single currency after EMU.

It is submitted that ECU obligations defined by reference to the ECU used in the European Monetary System will be interpreted as referring to the euro after EMU.

- First, the ECU that is used in the EMS is the official ECU, and under the New York General Obligations Law obligations denominated in the official ECU will automatically become obligations denominated in euro at the 1:1 replacement rate.²²⁵ In addition, the official ECU issued by the European Monetary Institute and used as a means of settlement between EMS central banks may be regarded as a legal currency under New York law, in which case the 1:1 replacement of contractual references to the ECU by references to euro will be enforced in accordance with the applicable provisions of EC law.²²⁶
- Second, the former ISDA provision describing the ECU as “a currency” implies that the definition of the private ECU in ISDA swap contracts should always follow the law of the currency (i.e., European Community law) under which the official ECU is issued, thereby ensuring the 1:1 transformation of private ECU obligations into obligations in euro.
- Third, the definition of the ECU as the ECU used in the EMS is of the “open basket” variety.²²⁷ Even in the absence of the New York legislation courts may interpret this definition to cover not only changes in the composition of the ECU (i.e., changes in the weightings or currencies included in the basket) but also changes in the nature of the ECU (i.e., its transformation into a currency in its own right), particularly with respect to ECU obligations created after the Maastricht Treaty entered into force.²²⁸

Nonetheless, contract clauses defining the ECU by reference to the ECU used in the EMS have given rise to interpretive difficulties. The limited role of the ECU in the existing ERM compared to the role envisaged for the euro in the revised ERM II has caused some uncertainty regarding whether the ECU used in the EMS can be properly regarded as referring to the new single currency. Market leaders such as ISDA and IPMA have recommended the adoption of alternative contractual definitions of the ECU.²²⁹

2. ECU Used as the Unit of Account of the European Communities

In December 1995 IPMA and ISDA issued a joint recommendation proposing a legal definition of the private ECU that defines it to be “the same as the ECU that is from time to time used as the unit of account of the European Communities” and providing that “[c]hanges to the ECU may be made by the

²²²See *supra* pp. 25-26.

²²³See *supra* p. 26.

²²⁴See *supra* pp. 150-51.

²²⁵See *supra* pp. 169-70.

²²⁶See *supra* pp. 148-50, 164-66.

²²⁷See SUNT, *supra* note 8, at 108.

²²⁸See *supra* pp. 171-73.

²²⁹See *supra* pp. 160-61, *infra* pp. 179-81.

European Communities, in which event the ECU will change accordingly.”²³⁰ Many ECU bonds also provide for discharge in U.S. dollars or a component currency of the ECU if the ECU ceases to be used as the unit of account of the European Communities.²³¹ This definition of the ECU refers to the official ECU of the EC, and therefore requires the 1:1 replacement of references to ECU by references to euro in accordance with the provisions of EC law and the New York General Obligations Law. This definition expressly contemplates all manner of changes to the ECU by the European Community, including its transformation into a currency in its own right.

Prior to the passage of the EU Council regulation on certain provisions relating to the introduction of the euro it had been suggested by the Financial Law Panel in London that if the ECU is abolished at the start of EMU, it will not then be used as the unit of account of the European Communities.²³² However, under the Maastricht Treaty the ECU will not be abolished but rather will become a currency in its own right.²³³ The preamble to the Council regulation specifically states that as from January 1, 1999 the euro will be the unit of account of the institutions of the European Communities.²³⁴ Given that the euro will be used as the unit of account of the European Community, this definition of the ECU should ensure the 1:1 replacement of references to ECU by references to euro. This legal interpretation of the unit of account formula has been supported by both IPMA and the European Commission.²³⁵ Moreover, contractual clauses that contemplate general unspecified changes to the ECU may cover all possible modifications to the ECU, including its transformation into a currency in its own right.²³⁶

Following the re-affirmation of the 1:1 replacement rate at the European Council summit meeting in December 1995, IPMA and ISDA recommended the adoption of language which dispelled any residual doubt regarding this issue by specifically providing that “[f]rom the start of the third stage of European monetary union all payments [payable in ECU] will be payable in euro at the rate then established in accordance with the Treaty.”²³⁷

3. ECU Used as the Currency of the European Union

Many ECU bond issues contain clauses providing for the satisfaction of ECU obligations in U.S. dollars or a component currency of the ECU in “the event that the ECU is neither used as the unit of account of the European Communities nor as the currency of the European Union.”²³⁸ The Financial Law Panel has suggested that the second limb of this test calling for payment in U.S. dollars if the ECU is no longer used as the currency of the European Union would be triggered in the event of a partial monetary union because in such circumstances the single currency would merely be the currency of those member states participating in EMU rather than the currency of the entire European Union.²³⁹

This argument overlooks the pivotal role that EMU is designed to play in the process of European political and economic integration. The preamble to the Maastricht Treaty clearly regards the establishment of an economic and monetary union as part of “the process of creating an ever closer union

²³⁰INTERNATIONAL PRIMARY MARKET ASSOCIATION AND INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *supra* note 115.

²³¹See EUROPEAN COMMISSION (DGII), *supra* note 113.

²³²FINANCIAL LAW PANEL, *supra* note 122, at 4.

²³³EC TREATY, art. 109I(4).

²³⁴Resolution of the European Council of 7 July 1997 on the legal framework for the introduction of the euro, Annex Draft Council Regulation on the introduction of the euro, 1997 O.J. (C 236/7), preamble(9).

²³⁵INTERNATIONAL PRIMARY MARKET ASSOCIATION, *supra* note 200; European Commission (DGII), *supra* note 111.

²³⁶See PROCTOR & THIEFFRY, NORTON ROSE, *supra* note 123, at 10; European Commission (DGII), *supra* note 111.

²³⁷INTERNATIONAL PRIMARY MARKET ASSOCIATION AND INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., *supra* notes 117 and 118.

²³⁸EUROPEAN COMMISSION (DGII), *supra* note 111.

²³⁹FINANCIAL LAW PANEL, *supra* note 122, at 4.

among the peoples of Europe.”²⁴⁰ The Treaty contemplates that the non-participation of certain member states in EMU should be transitional and that such member states should be admitted to the euro area as soon as they satisfy the necessary conditions for the adoption of the single currency.²⁴¹ To this end the Maastricht Treaty provides for the establishment of a General Council of the European Central Bank as a third decision-making body of the ECB through which the interests of non-participating member states will be represented.²⁴² The inclusion of non-participating member states in one of the European Central Bank’s decision-making bodies clearly demonstrates that the euro will be the currency of the European Union even though certain EU member states may not initially adopt the single currency. This interpretation of the euro as the currency of the European Union in the event of a partial monetary union is supported by the European Commission.²⁴³

Nonetheless, a number of U.S. issuers have adopted language that seeks to avoid all possible doubt on this point by expressly providing that payments on ECU bonds will be made in the single currency where the single currency is used as the currency of some or all of the member states of the European Union.²⁴⁴

4. Bonds Denominated in Euro

Beginning in 1997 a number of international issuers have issued bonds denominated in euro which provide for the performance of the bonds prior to the introduction of the euro in ECU at the rate of one ECU for one euro.²⁴⁵ These bonds will thus be treated in the same manner as bonds denominated in ECU that are required to be discharged in euro at the 1:1 rate. The first such bond denominated in euro and governed by New York law was issued in June 1997.²⁴⁶

5. ISDA EMU Continuity Clause

ISDA has adopted an EMU continuity clause that ensures the continuity of all obligations denominated in the official ECU in a manner that is consistent with the EU Council regulation by also providing that the substitution of the new single or unified European currency (whether known as the euro or otherwise) for the ECU as the unit of account of the European Community will not affect the continuity of ISDA contracts.²⁴⁷ The ISDA EMU continuity provision also provides that the disappearance or replacement of a relevant rate option or other price source for the ECU, or the failure of the agreed sponsor (or a successor sponsor) to publish or display a relevant rate, index, price, page or screen, will not have the effect of altering any term of, or discharging or excusing performance under an agreement or transaction documented under an ISDA master agreement.²⁴⁸

²⁴⁰TREATY ON EUROPEAN UNION, Feb. 7, 1992, preamble, 31 I.L.M. 247 (1992).

²⁴¹See *supra* pp. 26-27.

²⁴²EC TREATY, art. 109l(3); *id.* Protocol (No 3) on the Statute of the European system of central banks and of the European Central Bank, arts. 45-47.

²⁴³European Commission (DGII), *supra* note 111; see also INTERNATIONAL PRIMARY MARKET ASSOCIATION, *supra* note 201.

²⁴⁴ DONALDSON, LUFKIN & JENRETTE, INC., MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Feb. 9, 1996) (on file with Securities and Exchange Commission); GENERAL SIGNAL CORPORATION, MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Apr. 30, 1996) (on file with Securities and Exchange Commission); MORGAN STANLEY GROUP INC., GLOBAL MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (May 2, 1996) (on file with Securities and Exchange Commission), GLOBAL MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (Feb. 21, 1997) (on file with Securities and Exchange Commission); AMERICAN INTERNATIONAL GROUP, INC., MEDIUM-TERM NOTES PROSPECTUS SUPPLEMENT (June 11, 1996) (on file with Securities and Exchange Commission); PRUDENTIAL FUNDING CORPORATION, EURO MEDIUM TERM NOTE PROGRAMME OFFERING CIRCULAR (May 29, 1996) (on file with Luxembourg Stock Exchange).

²⁴⁵See BANK OF ENGLAND, 4 PRACTICAL ISSUES ARISING FROM THE INTRODUCTION OF THE EURO 53 (Apr. 1997).

²⁴⁶GENERAL ELECTRIC CAPITAL CORPORATION, EURO BONDS DUE 2002 PRICING SUPPLEMENT (June 3, 1997) (on file with Luxembourg Stock Exchange).

²⁴⁷*Id.*

²⁴⁸INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC., EMU CONTINUITY PROVISION (July 1997).

I. Summary

The official ECU is expressly recognized as a legal currency under the laws of 43 U.S. jurisdictions, and references to the official ECU in obligations that are governed by the laws of these jurisdictions will therefore be replaced by references to the euro at the 1:1 rate established under EC law.²⁴⁹ While the official ECU is not explicitly recognized as a legal currency under New York law, the argument can be made that the official ECU falls within the general legal definition of money under New York law, in which case references to the ECU in obligations governed by New York law will be similarly replaced by references to the euro at the 1:1 rate applicable under EC law.²⁵⁰ In addition, a credible argument may also be made that ECU obligations underwent a radical transformation after the Maastricht Treaty came into force insofar as ECU obligations created after Maastricht constitute contingent monetary obligations that will become obligations denominated in euro after EMU.²⁵¹

As against that, it is not certain that the official ECU would be recognized as a legal currency under New York law because of its limited uses as a reserve asset.²⁵² Also, it is unclear to what extent the argument that the ECU underwent a radical alteration after the Maastricht Treaty entered into force would be accepted under New York law.²⁵³ In addition, the development of the private ECU as a quasi-currency based on its widespread usage in the financial markets does not of itself support the argument that the private ECU may be properly regarded as legal money.²⁵⁴ In the absence of legal certainty regarding the monetary status of private ECU obligations governed by New York law, it is necessary to determine the legal status of such ECU obligations in accordance with New York law as the governing law of the contract rather than EC law as the law of the currency.²⁵⁵ This requires the legal status of private ECU obligations to be determined under the provisions of recent legislation enacted by the New York State Legislature.²⁵⁶

Under the act of state doctrine, the replacement of references to the ECU by references to the euro in accordance with the EU Council regulations may be regarded as an act of state applicable to all ECU obligations governed by the laws of U.S. jurisdictions where those obligations have their situs in an EU jurisdiction (i.e., where the obligor is based in an EU member state and/or payments are to be made in an EU member state).²⁵⁷

Under the recently enacted provisions of the New York General Obligations Law the euro is treated in contracts as a commercially reasonable substitute and substantial equivalent for the ECU, and (consistent with the EU Council regulations) references to the official ECU in contracts shall be replaced by references to the euro at the rate of one euro to one ECU.²⁵⁸ References to the ECU in contracts not defined by reference to the official ECU shall (consistent with the EU Council regulations) be presumed to be references to the official ECU, unless demonstrated to the contrary by the intention of the parties.²⁵⁹ In view of the widespread usage of the “open basket” definition of the ECU, it will be difficult to rebut this presumption under the New York General Obligations Law that the term “ECU” refers to the official

²⁴⁹See *supra* pp. 162-64.

²⁵⁰See *supra* pp. 164-66.

²⁵¹See *supra* pp. 166-67.

²⁵²See *supra* pp. 164-66.

²⁵³See *supra* pp. 166-67.

²⁵⁴See *supra* pp. 167-69.

²⁵⁵See *supra* pp. 167, 169.

²⁵⁶See *supra* pp. 169-75.

²⁵⁷See *supra* p. 169.

²⁵⁸See *supra* pp. 169-70.

²⁵⁹See *supra* pp. 170-71.

ECU of the European Community.²⁶⁰ The New York General Obligations Law (again consistent with the EU Council regulations) ensures the continuity of all ECU contracts, including floating rate ECU obligations, thereby preventing parties from raising the doctrines of commercial impracticability, impossibility or frustration as a means of terminating or otherwise discharging ECU obligations after EMU.²⁶¹ The long-standing foreseeability of the transformation of the ECU basket into a currency in its own right (even before the signing of the Maastricht Treaty) would, in any case, have precluded the invocation of such contractual doctrines.²⁶²

Finally, the terms and conditions of most private ECU obligations are specifically defined by reference to the official ECU and will therefore ensure the 1:1 replacement of all references to ECU by references to euro.²⁶³

²⁶⁰*See supra* pp. 171-73.

²⁶¹*See supra* pp. 173-75.

²⁶²*See id.*

²⁶³*See supra* pp. 177-81.

VIII. U.S. INTERNATIONAL TREATIES

Under the U.S. Constitution "all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land, and the Judges in every state shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."¹ The power to make treaties is vested in the President, to be exercised by and with the consent of a two thirds vote of the U.S. Senate.² Treaties so signed and ratified prevail over state law and are binding on all American courts. There are various bilateral and multilateral treaties which have been ratified by the United States that are relevant to the legal implications of EMU under U.S. law.

A. Bilateral Treaties of Friendship

The United States has entered into bilateral treaties providing for friendly, reciprocal commercial relations with a majority of the EU member states. Since the Second World War the United States has entered into such friendship treaties with nine EU member states — Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg and the Netherlands.³ It does not appear that the U.S. has entered into any modern bilateral friendship treaties with the remaining six EU member states (Austria, Finland, Portugal, Spain, Sweden and the United Kingdom) that contain provisions relevant to EMU.

The nine relevant treaties contain provisions that will help to support the continuity of contractual obligations after EMU in accordance with the EU Council regulations.

- Under eight of the relevant treaties (with the exception of the U.S.-Italy Treaty) it is provided in similar terms that neither High Contracting Party shall take unreasonable or discriminatory measures that would impair the [legally acquired] rights and/or interests within its territories of nationals and companies of the other Party in the enterprises which they have established or in their capital.⁴ This provision could be interpreted as prohibiting the United States from taking any measures that would impair the contractual rights of EU nationals that are parties to contracts denominated in EU currencies by not recognizing the conversion of the EU currencies participating in EMU into euro pursuant to the applicable provisions of the EU Council regulations. This argument might be particularly forceful with respect to financial institutions and companies located in the EU that are participants in the international financial markets, who could be discriminated against if the continuity of their obligations were to be enforced in accordance with the laws of EU jurisdictions but were not to be recognized under U.S. law.

¹U.S. CONST. art. VI, cl. 2.

²U.S. CONST. art. II, § 2, cl. 2.

³**Belgium:** Treaty of Friendship, Establishment and Navigation between the United States of America and the Kingdom of Belgium, Feb. 21, 1961, U.S.-Bel., 14 U.S.T. 1284 [hereinafter U.S.-Belgium Friendship Treaty]; **Denmark:** Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of Denmark, Oct. 1, 1951, U.S.-Den., 12 U.S.T. 908 [hereinafter U.S.-Denmark Friendship Treaty]; **France:** Convention of Establishment between the United States of America and France, Nov. 25, 1959, U.S.-Fr., 11 U.S.T. 2398 [hereinafter U.S.-France Establishment Treaty]; **Germany:** Treaty of Friendship, Commerce and Navigation between the United States of America and the Federal Republic of Germany, Oct. 29, 1954, U.S.-Ger., 7 U.S.T. 1839 [hereinafter U.S.-Germany Friendship Treaty]; **Greece:** Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of Greece, Aug. 3, 1951, U.S.-Gre., 5 U.S.T. 1829 [hereinafter U.S.-Greece Friendship Treaty]; **Ireland:** Treaty of Friendship, Commerce and Navigation between the United States of America and Ireland, Jan. 21, 1950, U.S.-Ire., 1 U.S.T. 785 [hereinafter U.S.-Ireland Friendship Treaty]; **Italy:** Treaty of Friendship, Commerce and Navigation between the United States of America and the Italian Republic, Feb. 2, 1948, U.S.-It., 63 Stat. 2255 [hereinafter U.S.-Italy Friendship Treaty]; **Luxembourg:** Treaty of Friendship, Establishment and Navigation between the United States of America and the Grand Duchy of Luxembourg, Feb. 23, 1962, U.S.-Lux., 14 U.S.T. 251 [hereinafter U.S.-Luxembourg Friendship Treaty]; **Netherlands:** Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of the Netherlands, Mar. 27, 1956, U.S.-Neth., 8 U.S.T. 2043 [hereinafter U.S.-Netherlands Friendship Treaty].

⁴U.S.-Belgium Friendship Treaty, *supra* note 3, art. 4(2); U.S.-Denmark Friendship Treaty, *supra* note 3, art. VI(4); U.S.-France Establishment Treaty, *supra* note 3, art. IV(1) ("The lawfully acquired rights and interests of nationals and companies of either High Contracting Party shall not be subjected to impairment, within the territories of the other High Contracting Party, by any measure of a discriminatory character"); U.S.-Germany Friendship Treaty, *supra* note 3, art. V(3); U.S.-Greece Friendship Treaty, *supra* note 3, art. VIII; U.S.-Ireland Friendship Treaty, *supra* note 3, art. V; U.S.-Luxembourg Friendship Treaty, *supra* note 3, art. IV(2); U.S.-Netherlands Friendship Treaty, *supra* note 3, art. VI(3).

- Under seven of the treaties (with the exception of the U.S.-Ireland and U.S.-Italy Treaties) it is provided in similar terms that neither High Contracting Party shall impose exchange restrictions except in general to protect the level of its monetary reserves.⁵ Significantly, all seven treaties define the term “exchange restrictions” broadly to include all restrictions, regulations or other requirements imposed by either High Contracting Party which burden or interfere with payments, remittances or transfers of funds or of financial instruments between the territories of the two Parties.⁶ Any action by the United States that would interfere with the European Union's preparations for a smooth transition to EMU (including the development of euro payment systems) could contravene the United States' bilateral treaty obligation to refrain from the imposition of restrictions which would burden or interfere with payments and funds transfers between the U.S. and the relevant EU countries (including France, Germany and the three Benelux countries). In particular, the United States may not impose restrictions or requirements that burden or interfere with the making of credit transfer payments from the United States to the relevant EU member states that are made in the euro unit or the applicable national currency units during the transitional period in accordance with the “no compulsion, no prohibition” principle enshrined in the EU Council regulation on the introduction of the euro.⁷
- Finally, two treaties (the U.S.-Ireland and the U.S.-Italy Treaties) provide in similar terms that any control imposed by either High Contracting Party over financial transactions (defined to include all international payments and transfers of funds effected through the medium of currencies, securities, bank deposits, dealings in foreign exchange or other financial arrangements) shall be so administered as not to influence disadvantageously the competitive position of the commerce or investment of capital of the other Party in comparison with the commerce or the investment of capital of any third country.⁸ This provision applies to all forms of control of financial transactions.⁹ Here again any action by the United States that disrupts the smooth transition to EMU contemplated by the development of euro payment systems in replacement for national currency payment systems could be inconsistent with these treaty obligations.

B. Bretton Woods Agreement

1. Exchange Contracts

The transition to a single European currency does not currently contemplate the introduction of any exchange control regulations. Nonetheless, in view of the relatively unprecedented nature of the monetary reform involved in the changeover to the single currency, restrictions on the free exchange of money were contemplated in the earlier stages of the preparations for EMU. Thus, the initial drafts of the

⁵U.S.-Belgium Friendship Treaty, *supra* note 3, art. 10(2); U.S.-Denmark Friendship Treaty, *supra* note 3, art. XII(2); U.S.-France Establishment Treaty, *supra* note 3, art. X(2); U.S.-Germany Friendship Treaty, *supra* note 3, art. XII(3) (“Neither Party may, with respect to the other Party, in any manner impose exchange restrictions which are unnecessarily detrimental to or arbitrarily discriminate against the claims, investments, transportation, trade or other interests of nationals and companies of such other Party or their competitive position.”); U.S.-Greece Friendship Treaty, *supra* note 3, art. XV(2); U.S.-Luxembourg Friendship Treaty, *supra* note 3, art. XI(2); U.S.-Netherlands Friendship Treaty, *supra* note 3, art. XII(2). Under six of these treaties (with the exception of the U.S.-Germany Friendship Treaty) it is provided in similar terms that this provision does not alter the obligations of the parties to the International Monetary Fund.

⁶U.S.-Belgium Friendship Treaty, *supra* note 3, art. 10(5); U.S.-Denmark Friendship Treaty, *supra* note 3, art. XII(5); U.S.-France Establishment Treaty, *supra* note 3, art. X(5); U.S.-Germany Friendship Treaty, *supra* note 3, art. XII(5) (“The term ‘exchange restrictions’ ... includes all restrictions, regulations, ... and other requirements imposed by either Party, which burden or interfere with the assumption of undertakings for, or the making of, payments, remittances, or transfers of money and financial instruments”); U.S.-Greece Friendship Treaty, *supra* note 3, art. XV(5); U.S.-Luxembourg Friendship Treaty, *supra* note 3, art. XI(5); U.S.-Netherlands Friendship Treaty, *supra* note 3, art. XII(5).

⁷See Document from the European Council Dublin Presidency, The Legal Framework for the use of the euro. ann. II, Draft Council Regulation on the introduction of the euro, art. 8(3) (Dec. 1996), discussed *supra* pp. 18-20.

⁸U.S.-Ireland Friendship Treaty, *supra* note 3, arts. XVII(1), XVII(4); U.S.-Italy Friendship Treaty, *supra* note 3, arts. XVII(1), XVII(4).

⁹U.S.-Ireland Friendship Treaty, *supra* note 3, art. XVII(1); U.S.-Italy Friendship Treaty, *supra* note 3, art. XVII(1).

EU Council regulation on the introduction of the euro contained provisions rendering exchange contracts between EU national currencies or between the euro and the national currencies or between the euro and the ECU at rates other than the irrevocably fixed conversion rates unenforceable unless such rates were agreed before the adoption of the irrevocably fixed conversion rates.¹⁰ This section will briefly consider the legal status of any potential exchange contracts that might be introduced in the course of the changeover to the single currency, however remote the possibility that such controls might be introduced.

Under Article VIII, Section 2(b) of the Bretton Woods Agreement “[e]xchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member.”¹¹

Article VIII, Section 2(b) has been enacted into law in the United States.¹² In 1949 the Board of Directors of the IMF issued an interpretation of this provision, stating that “the obligations of such contracts will not be implemented by the judicial or administrative authorities of member countries, for example, by decreeing performance of the contracts or by awarding damages for their nonperformance.”¹³ The Board further stated that “such contracts will be treated as unenforceable notwithstanding that under the private international law of the forum, the law under which the foreign exchange control regulations are maintained or imposed is not the law which governs the exchange contract or its performance.”¹⁴ The Board interpretation has been fully accepted by American courts,¹⁵ and it is beyond question that the courts will decline to enforce exchange contracts that involve the currency of any IMF member and are contrary to that member’s exchange control regulations.¹⁶

The Bretton Woods Agreement does not define the term “exchange contracts” and the IMF’s Board interpretation offers no guidance on the matter. Broad and narrow interpretations of the term have been advanced by courts and commentators alike, and one U.S. court has described the conflicting views as follows: “[t]he narrow view of “exchange contracts” in Article VIII, Section 2(b) is that they are contracts for the exchange of one currency against another or one means of payment against another. The broad view is that they are contracts involving monetary elements.”¹⁷

On the whole U.S. courts have tended to define the term more narrowly than broadly. Thus the New York courts “are inclined to view an interpretation of subdivision (b) of Section 2 that sweeps in all contracts affecting any members’ exchange resources as doing considerable violence to the text of the section. It says ‘involve the currency’ of the country whose exchange controls are violated; not ‘involve the exchange resources.’”¹⁸ The narrow interpretation of “exchange contracts” has confined the term to

¹⁰European Commission (DG II), Legal Framework for the Use of the Euro, Working Document of the Commission Services, II/354/96-EN, art. 11 (on file with author); European Commission (DG II), Legal Framework for the Use of the Euro, Working Document of the Commission Services, II/401/96-EN (June 1996), art. 12 (on file with author); European Commission (DG II), Legal Framework for the Use of the Euro, Working Document of the Commission Services (Draft), II/401/96-EN-Rev. 1 (July 1996), art. 11 (on file with author).

¹¹ Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, art. VIII, § 2(b), 60 Stat. 1401, 2 U.N.T.S. 39, as amended Apr. 30, 1976, 29 U.S.T. 2203, T.I.A.S. 8937.

¹²Bretton Woods Agreement Act, 22 U.S.C. § 286h (1976) (“the first sentence of Article VIII, Section 2(b) . . . shall have full force and effect in the United States . . .”).

¹³INTERNATIONAL MONETARY FUND, INTERNATIONAL MONETARY FUND ANNUAL REPORT 82-83 (1949), 14 Fed. Reg. 5208, 5209 [1949].

¹⁴*Id.*

¹⁵*See* Banco do Brasil, S.A. v. A.C. Israel Commodity Co., 190 N.E.2d 235, 236-37 (N.Y. 1963); Southwestern Shipping Corp. v. Nat’l City Bank of New York, 173 N.Y.S.2d 509, 522-23 (N.Y. Sup. Ct. 1958), *aff’d* 178 N.Y.S.2d 1019 (N.Y. App. Div. 1958), *rev’d on other grounds* 160 N.E.2d 839 (N.Y. 1959).

¹⁶*Id.*; *see also* Braka v. Bancomer, S.A., 589 F. Supp. 1465, 1473 (S.D.N.Y. 1984), *aff’d* 762 F.2d 222 (2d Cir. 1985); Libra Bank Ltd. v. Banco Nacional de Costa Rica, 570 F. Supp. 870, 897-900 (S.D.N.Y. 1983); Weston Banking Corp. v. Turkiye Garanti Bankasi, 442 N.E.2d 1195, 1200 (N.Y. 1982); J. Zeevi and Sons, Ltd. v. Grindlays Bank (Uganda) Ltd., 333 N.E.2d 168, 174 (N.Y. 1975); Confederation Life Association v. Ugalde, 164 So.2d 1, 2 (Fla. 1964); Brill v. Chase Manhattan Bank, 220 N.Y.S.2d 903, 904 (N.Y. App. Div. 1961).

¹⁷Libra, 570 F. Supp. at 897 (citing JOSEPH GOLD, II THE FUND AGREEMENT IN THE COURTS 425 (1982)).

¹⁸Banco do Brasil, 190 N.E.2d at 236 (rejecting the views expressed by F.A. Mann, *The Private International Law of Exchange Control Under the International Monetary Fund Agreement*, 2 INT’L & COMP. L.Q. 97, 102 (1953), and by Gold and Lachman, *The Articles*

contracts involving the exchange of currency, with courts emphasizing the word “exchange” as being synonymous with the concept of barter, swap and foreign exchange.¹⁹ Thus, the term has been interpreted to apply to a contract to exchange lire for dollars while Italy maintained exchange control regulations,²⁰ but has been held not to apply to a contract of sale involving a foreign currency payment obligation,²¹ a U.S. dollar letter of credit established by a foreign bank in favor of a foreign partnership,²² a U.S. dollar loan agreement calling for repayment in U.S. dollars and designating New York as the situs of repayment,²³ and insurance policies payable in U.S. dollars to foreign nationals or residents in the United States.²⁴

Notwithstanding this impressive array of authorities, some U.S. courts have advanced a broader view of “exchange contracts”, especially with respect to contracts involving foreign currency obligations.²⁵ One court endorsing a narrower view of “exchange contracts” preferred a definition of the term that covers all foreign currency transactions, and not just foreign exchange contracts: “transactions which have as their immediate object exchange, that is, international media of payment . . . , or a contract where the consideration is payable in the currency of the country whose exchange controls are violated.”²⁶ The notion that all foreign currency transactions are governed by Article VIII, Section 2(b) of the Bretton Woods Agreement has been supported in other cases. Thus it has been held that a triable issue existed as to whether a check payable in Cuban pesos contravened Cuban exchange regulations and was therefore in violation of the Bretton Woods Agreement.²⁷ If the transaction did not involve an exchange contract within the meaning of the Bretton Woods Agreement there would have been no triable issue for the lower court to resolve.

In one New York case involving a promissory note governed by New York law calling for payment in New York by one foreign bank to another foreign bank in Swiss francs, it was stated that Article VIII, Section 2(b) of Bretton Woods “renders unenforceable any agreement involving the currency of a member state which is contrary to *that member’s* currency control regulations.”²⁸ While the court did not find it necessary to resolve the question of the applicability of the Bretton Woods Agreement, the court “recognize[d] the validity of the Bretton Woods Agreement and its potential controlling effect over international currency transactions,” notwithstanding the fact that the case concerned a foreign currency debt rather than a foreign exchange contract.²⁹ A dissenting opinion in the same case went further still and explicitly rejected the narrow interpretation of Article VIII, Section 2(b) of Bretton Woods. Citing the conclusions reached by courts in other countries which are members of the IMF and the views of leading commentators, it was stated that “[a]lthough there are contrary views, the majority view reads “exchange contracts” as used in the agreement, in light of the legislative history of the provision, broadly

of Agreement of the International Monetary Fund and the Exchange Control Regulations of Member States, JOURNAL DU DROIT INTERNATIONAL (July-Sept. 1962)). The above quotation from Banco do Brasil has been cited with approval in *Libra*, 570 F. Supp. at 897-98 and *Zeevi*, 333 N.E.2d at 174.

¹⁹See *Libra*, 550 F. Supp. at 899-900.

²⁰*Southwestern Shipping*, 173 N.Y.S.2d at 522-25.

²¹*John Sanderson & Co. (Wool) Pty. Ltd. v. Ludlow Jute Co., Ltd.*, 569 F.2d 696, 699 (1st Cir. 1978).

²²*Zeevi*, 333 N.E.2d at 174.

²³*Libra*, 570 F. Supp. at 900.

²⁴*Pan-Am Life Ins. Co. v. Blanco*, 362 F.2d 167, 170-71 (5th Cir. 1966) (citing *Theye Y Ajuria v. Pan Am. Life Ins. Co.*, 161 So.2d 70, 73-74 (La. 1964)); *Pan Am. Life Ins. Co. v. Rajj*, 156 So.2d 785, 786 (Fla. Dist. Ct. App. 1963).

²⁵See *Braka*, 589 F. Supp. at 1473 (citing *Weston Banking*, 442 N.E.2d at 1200; *Ugalde*, 164 So.2d at 2); *Brill*, 220 N.Y.S.2d at 904; cf. *Banco do Brasil*, 190 N.E.2d at 236.

²⁶*Banco do Brasil*, 190 N.E.2d at 236 (quoting Arthur Nussbaum, *Exchange Control and the International Monetary Fund*, 59 YALE L.J. 421, 426 (1949)).

²⁷*Brill*, 220 N.Y.S.2d at 904.

²⁸*Weston Banking*, 442 N.E.2d at 1200.

²⁹*Id.*

enough to encompass a transaction based in contract which involves exchange or affects the balance of payments or exchange resources of a member nation.”³⁰

The broad view of Article VIII, Section 2(b) has found support in other cases. In one Floridian case it was held that the courts of Florida were obliged by the Bretton Woods Agreement to apply Cuban currency control laws to a U.S. dollar denominated insurance policy issued by a Canadian company to a Cuban resident and governed by Cuban law.³¹ In another U.S. federal case the court showed a willingness to hold that a U.S. dollar denominated certificate of deposit payable in Mexico could fall within the scope of Article VIII, Section 2(b).³²

In summary, U.S. courts are divided regarding the scope and coverage of the Bretton Woods Agreement with respect to the enforceability of exchange contracts that are inconsistent with exchange control regulations imposed by IMF members. The majority of courts have adopted a narrow view of the Bretton Woods provision, appearing to confine its application to foreign exchange contracts, but a minority of courts have taken a more expansive position and held that it may also apply to other foreign currency transactions and possibly even certain U.S. dollar transactions that are inconsistent with the exchange control regulations of foreign countries. Should the EU Council introduce exchange controls in the course of the transition to EMU the extent of the coverage of Article VIII, Section 2(b) could become very important for EU currency transactions involving U.S. elements.

2. Institutional Reform of the IMF after EMU

The creation of a single European currency and concomitant establishment of a European Central Bank raise broad institutional questions with respect to the future roles of the institutions of the European Community and the individual EU member states in the International Monetary Fund and under the Bretton Woods Agreement generally.³³ Because of the transfer under the Maastricht Treaty of the monetary sovereignty of the individual EU member states to the European Union and the attendant responsibilities that will be acquired by the European Central Bank, the EU will become increasingly relevant for the achievement of the purposes and operation of the International Monetary Fund after EMU.³⁴ It has been suggested that consideration be given to an amendment of the Bretton Woods Agreement in order to admit the European Union to membership of the IMF.³⁵ Also, the composition of the SDR, whose value is currently calculated on the basis of the relative weights assigned to the U.S. dollar, the Deutsche mark, the French franc, the Japanese yen and Pound sterling, will need to include the euro.³⁶ In accordance with the State theory of money, references in international treaties to the currencies of participating EU member states will be automatically replaced by references to the euro at the irrevocably fixed conversion rates, and any renegotiation of international agreements for the sole purpose of modifying the monetary unit is therefore unnecessary.³⁷ These are issues which the U.S. Treasury and Federal Reserve are monitoring.

³⁰*Id.* at 1203-04 (Meyer J, dissent.) (citations omitted).

³¹Ugalde, 164 So.2d at 2.

³²Braka, 589 F. Supp. at 1473 (citations omitted).

³³*See generally* European Commission (DGII), External Aspects of Economic and Monetary Union, 1 Euro Papers SEC(97) 803 15-16 (July 1997).

³⁴*See* Rutsel Silvestre J. Martha, *The Fund Agreement and the Surrender of Monetary Sovereignty to the European Community*, 30 COMMON MKT. L.REV. 749 (1993); European Commission, *supra* note 33, at 16..

³⁵Martha, *supra* note 34, at 779-82.

³⁶*Id.* at 761.

³⁷*See* European Commission (DG II), The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations 12 (Nov. 1997).

IX. NEW YORK AND ILLINOIS STATE LEGISLATION

With the establishment of the Wall Street Committee on the transition to EMU in late 1995, followed by the establishment of an ISDA New York EMU working group in mid-1996, representatives of Wall Street financial institutions, law firms and trade associations began to consider whether the continuity of contracts governed by New York law might be best protected after EMU by the enactment of legislation by the New York State Legislature in Albany.¹ In February 1997, the New York EMU working group (which includes ISDA, the Financial Markets Lawyers Group, the Public Securities Association and the Securities Industry Association) forwarded a draft legislative proposal to the New York State Legislature in Albany that seeks to confirm the continuity of contracts affected by EMU.² In July 1997 the legislative proposal drafted by the New York EMU working group was passed by both Houses of the New York State Legislature and was signed into law by the Governor of New York as an amendment to the New York General Obligations Law.³

Similar legislative proposals have been forwarded to the Illinois and California State Legislatures, and in July 1997 the legislative proposal drafted by the New York EMU working group was enacted in Illinois as the Illinois Euro Conversion Act.⁴

A. State Legislation and the Monetary Sovereignty of the European Union

The New York General Obligations Law and the Illinois Euro Conversion Act confirm the continuity of contracts denominated in EU national currencies and the ECU basket in a manner that is broadly consistent with the EU Council regulations on the introduction of the euro. This is consistent with the fact that, as discussed below, the enactment of any legislation by an American state that fails to fully recognize the monetary sovereignty of the European Union over the currencies of EU member states would represent an unconstitutional infringement on the Federal Government's undisputed authority over international monetary relations.⁵ The New York and Illinois legislation must therefore be interpreted in a manner that is fully consistent with the EU Council regulations on the introduction of the euro. This approach accords with the well-established principle that state statutes will, whenever possible, be interpreted so as to avoid constitutional difficulties.⁶ In addition, in the case of any conflict between the state legislation and the EU Council regulations, the applicable provisions of the EU Council regulations shall prevail insofar as the State theory of money forms part of federal common law.⁷

The New York EMU legislation amending the New York General Obligations Law implicitly recognizes that the State theory of money is applicable to all contractual obligations governed by New York law that are affected by foreign currency alterations. Thus, the General Obligations Law provides that in circumstances of currency alteration, other than the introduction of the euro, the relevant provisions of the General Obligations Law shall not be interpreted as creating any negative inference or negative presumption regarding the validity or enforceability of contracts, securities or instruments denominated in whole or in part in a currency affected by such alteration⁸ This is because it is the law of

¹See Niall Lenihan, *Wall Street Committee on the Transition to European Monetary Union*, EMU, the Continuity of Contracts and New York Law (Mar. 29, 1996) (unpublished manuscript, on file with author); Memorandum from Daniel P. Cunningham and R. Brent Jones, *Cravath, Swaine & Moore*, to Financial Markets Lawyers Group, International Swaps and Derivatives Association and Securities Industry Association, Economic and Monetary Union and Continuity of Contract Under New York Law 32-34 (Feb. 24, 1997) (on file with author).

²New York EMU Working Group, An Act to amend the general obligations law and the uniform commercial code in relation to the continuity of contracts and the single currency of the European Union (Feb. 25, 1997) (on file with author).

³S.B. 5049, 220th Leg. 1 1997-98 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604).

⁴Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30).

⁵See *infra* pp. 215-21.

⁶See, e.g., *Frisby v. Schultz*, 487 U.S. 474, 483 (1988); *Graham v. Richardson*, 403 U.S. 365, 382-83 (1971); *Alabama State Fed'n of Labor v. McAdory*, 325 U.S. 450, 470 (1945); 16 AM. JUR. 2D, *Constitutional Law* §§219, 221 (1979 & Supp. 1997) (and the cases cited therein).

⁷See *supra* pp. 33-35.

⁸S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW § 5-1601-1604), § 5-1604(2).

the currency that determines what things pass as legal currency and how, in case of a currency alteration, sums expressed in the former currency are to be converted into the existing one.⁹

B. Retroactive Application of New York and Illinois State Legislation

It has been suggested that it is doubtful that the New York and Illinois EMU legislation will have any retroactive effect with respect to contracts entered into prior to the enactment of the legislation in mid-1997.¹⁰ It is submitted that whether the New York and Illinois legislation applies retroactively is of little legal significance in view of the application of the State theory of money under U.S. federal law. Thus, in accordance with the State theory of money, all relevant contractual obligations created before the passage of the New York and Illinois legislation must be discharged in accordance with the EU Council regulations on the introduction of the euro, regardless of whether the New York and Illinois legislation has any retroactive effect.¹¹

For the sake of completeness we will now consider whether the legislation, and particularly the New York legislation, may be considered to have retroactive application.

1. Language of Legislation

Generally, legislation may only apply prospectively, unless there is a clear indication that a contrary interpretation is to be applied.¹² The question whether a given statute is prospective or retroactive is a question of statutory interpretation to be determined by ascertaining the legislative intent.¹³ The surest guide in determining the legislative intent is the language of the statute itself.¹⁴ Thus, it is well settled that a statute will not be given a retroactive construction unless its language, either expressly or by necessary implication, requires that it be so construed.¹⁵

Neither the New York EMU legislation amending the New York General Obligations Law nor the Illinois Euro Conversion Act expressly provide that the legislation applies retroactively to contracts entered into before the passage of the legislation. The New York legislation provides that “[t]his Act shall take effect immediately.”¹⁶ The Illinois Euro Conversion Act provides in similar terms that “[t]his Act takes effect upon becoming law.”¹⁷ There is extensive authority holding that where a statute by its terms directs that it is to take effect immediately, it does not have any retroactive operation and effect.¹⁸

⁹See *supra* pp. 35-36.

¹⁰Alan H. Kaufman (Jones, Day, Reavis & Pogue), Overview: the U.S. and European Legal Context of the Euro Currency 3 (Oct. 23, 1997) (unpublished manuscript, on file with author).

¹¹See *supra*, pp. 35-100.

¹²See, e.g., *Deutsch v. Catherwood*, 294 N.E.2d 193, 194 (N.Y. 1973); *Mulligan v. Murphy*, 199 N.E.2d 496, 498 (N.Y. 1964); *Ayman v. Teachers' Retirement Bd. of City of N.Y.*, 172 N.E.2d 571, 573 (N.Y. 1961); *Morales v. Gross*, 657 N.Y.S.2d 711, 712 (N.Y. App. Div. 1997); see also *Quincy Trading Post, Inc. v. Dep't of Revenue*, 298 N.E.2d 789, 795 (Ill. App. Ct. 1973); N.Y. STATUTES § 51(c) (McKinney 1971); 97 N.Y. JUR., *Statutes* § 234 (1992); 73 AM. JUR. 2d, *Statutes* §§ 350-351 (1974 & Supp. 1997) (and the cases cited therein).

¹³See *Longines-Wittnauer Watch Co. v. Barnes & Reinecke, Inc.*, 209 N.E.2d 68, 73 (N.Y. 1965); N.Y. STATUTES § 51(d) (McKinney 1971); 73 AM. JUR. 2d, *Statutes* § 350 (1974 & Supp. 1997) (and the cases cited therein).

¹⁴See N.Y. STATUTES § 51(d) (McKinney 1971).

¹⁵See, e.g., *Dorfman v. Leidner*, 565 N.E.2d 472, 474 (N.Y. 1990); *Vaughn v. Manor Towers Owners Corp.*, 521 N.Y.S.2d 680, 682 (N.Y. App. Div. 1987); *Cady v. County of Broome*, 451 N.Y.S.2d 206, 207 (N.Y. App. Div. 1982); *Harradine v. Bd. of Supervisors of Orleans County*, 425 N.Y.S.2d 182, 185 (N.Y. App. Div. 1980); see also N.Y. STATUTES § 51(b) (McKinney 1971); 97 N.Y. JUR., *Statutes* § 228 (1992).

¹⁶S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. § 2 (N.Y. 1997)

¹⁷Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268, § 99.

¹⁸See, e.g., *Coane v. American Distilling Co.*, 81 N.E.2d 87, 89 (N.Y. 1948); *In re Miller*, 18 N.E. 139, 141 (N.Y. 1888); *Morales*, 657 N.Y.S.2d at 713; *Sloam v. Sloam*, 586 N.Y.S.2d 651, 653 (N.Y. App. Div. 1992); *Lusardi v. Lusardi*, 570 N.Y.S.2d 376, 377 (N.Y. App. Div. 1991); *County of Rensselaer v. City of Troy*, 501 N.Y.S.2d 534, 535 (N.Y. App. Div. 1986); *Murphy v. Bd. of Ed., N. Bellmore Union*, 480 N.Y.S.2d 138, 139 (N.Y. App. Div. 1984), *aff'd* 476 N.E.2d 651 (N.Y. 1985); *Moynihan v. N.Y. State Employees' Retirement Sys.*, 596 N.Y.S.2d 570, 571 (N.Y. App. Div. 1971); see also N.Y. STATUTES § 51(b) (McKinney 1971); 97 N.Y. JUR., *Statutes* § 230 (1992); 73 AM. JUR. 2d, *Statutes* § 352 (1974) (and the cases cited therein).

This factor does not, however, appear to be dispositive as remedial and other legislation made effective immediately has been held to have retroactive effect.¹⁹

In a section captioned “Application”, the New York EMU legislation provides that “[n]otwithstanding the Uniform Commercial Code or any other law of this State, this title *shall* apply to *all* contracts, securities and instruments, including contracts with respect to commercial transactions, and *shall not be deemed to be displaced by any other law of this State.*”²⁰ In a section captioned “Statutory Construction” the Illinois Euro Conversion Act provides in similar terms that “[t]his Act *shall* apply to *all* contracts, including commercial contracts governed by any other law of this State, and *shall not be deemed to be displaced by the provisions of any other law of this State.*”²¹

There is considerable authority holding that a statute framed in future words such as “shall” is construed as prospective only.²² This would indicate that the legislation is prospective.

The use of the word “all” implies that the legislature intended the statute to apply to *all* contracts affected by EMU, whether entered into before or after the passage of the legislation.²³ As against that it has been suggested that even where the words used in legislation are so general and broad as in their literal sense to comprehend existing cases, they must be construed as applicable only to such cases as may thereafter arise, unless the intention to embrace all is plainly and unequivocally expressed.²⁴ Thus, it might be argued that the legislation shall apply only to all those contracts entered into after the enactment of the legislation.

Another possible argument in favor of retroactivity is that the provision that the legislation shall not be deemed to be displaced by any other law of the state implies that the legislation may not be displaced by any other such law with respect to contracts entered into prior to the legislation’s enactment. As against that it might also be argued that this provision only requires that the legislation not be displaced by any other law with respect to contracts entered into since the passage of the legislation.

It is submitted that this provision does not, in and of itself, establish that the legislation is intended to operate retroactively. This provision was not inserted into the New York and Illinois legislation so as to ensure that the legislation applies retroactively. Rather the provision was drafted so as to avoid the need to amend the New York Uniform Commercial Code in addition to the New York General Obligations Law. Because some contracts affected by EMU, and particularly transactions involving the exchange of money, may be governed by the UCC, whereas other contracts involving debt and interest rate obligations are governed by the general principles of common law, the drafters of the legislation inserted this provision into the General Obligations Law in order to ensure that *all* contractual obligations governed by New York or Illinois law would be subject to the provisions of the legislation, regardless of whether such obligations are subject to the general principles of common law or the UCC.²⁵ In this

¹⁹See Cady, 451 N.Y.S.2d at 207; McGuirk v. City Sch. Dist. of N.Y., 501 N.Y.S.2d 477, 479 (N.Y. App. Div. 1986); In re Meegan, 478 N.Y.S.2d 150, 151 (N.Y. App. Div. 1984), *rev’d on other grounds* 475 N.E.2d 449 (N.Y. 1984); Majewski v. Broadalbin-Perth Cent. Sch. Dist., 653 N.Y.S.2d 822, 824-25 (N.Y. Sup. Ct. 1996); In re New York City Transit Authority, 538 N.Y.S.2d 161, 163-64 (N.Y. Sup. Ct. 1989); *see also* 97 N.Y. JUR., *Statutes* § 230 (1992).

²⁰S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW § 5-1601-1604), § 5-1604(1) (emphasis added).

²¹Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 30 (emphasis added).

²²*See, e.g.*, Dalziel v. Rosenfeld, 191 N.E. 841, 842 (N.Y. 1934); Weiler v. Dry Dock Sav. Inst., 17 N.Y.S.2d 192, 194 (N.Y. App. Div. 1940), *aff’d* 29 N.E.2d 938 (N.Y. 1940); Dillon v. Coughlan, 539 N.Y.S.2d 880, 885 (N.Y. Sup. Ct. 1989), *aff’d* 550 N.Y.S.2d 115 (N.Y. App. Div. 1989); Jespersen-Kay Modular Constr. Ltd. v. Clinton Ave. Paul Place Houses, Inc., 381 N.Y.S.2d 407, 412 (N.Y. Sup. Ct. 1976); In re Karnbach’s Estate, 144 N.Y.S.2d 872, 875 (N.Y. Surr. Ct. 1955); *see also* N.Y. STATUTES § 51(b) (McKinney 1971); 97 N.Y. JUR., *Statutes* § 229 (1992).

²³*See* City of New York v. Foster, 133 N.Y.S. 152, 155-56 (N.Y. App. Div. 1911); *cf.* Longines-Wittnauer, 209 N.E.2d at 73.

²⁴*See* N.Y. STATUTES § 51(b) (McKinney 1971) (cited in Abelson v. Abelson, 298 N.Y.S.2d 381, 388 (N.Y. Sup. Ct. 1969)).

²⁵*See* Memorandum from Daniel P. Cunningham, R. Brent Jones and Patricia L. Hogan, *Cravath Swaine & Moore*, for Financial Markets Lawyers Group, International Swaps and Derivatives Association, PSA The Bond Market Trade Association and Securities Industry Association, Continuity of Contract Statutory Language (Apr. 10, 1997) (on file with author).

regard, Section 1-103 of the UCC provides that the provisions of the UCC may be supplemented by general provisions of law and equity, but only if such general principles have not been “displaced by particular provisions of [the UCC].”²⁶ The effect of the New York and Illinois legislation is that no provision in the legislation will be deemed displaced by the provisions of the UCC, including the UCC provisions excusing performance if performance as agreed has been made impracticable by the occurrence of a contingency, the non-occurrence of which was a basic assumption on which the contract was made.²⁷ This provision does not, however, directly address the question of the legislation’s retroactive application.

Based solely on the wording of the New York and Illinois EMU legislation, it is not clearly established that the legislation is intended to apply retroactively.

2. Legislative History and Purpose of Legislation

Leaving aside the language of a particular statute, a legislative intent that a statute be applied retroactively may also be established by its legislative history,²⁸ as evidence by committee and legislative reports,²⁹ floor debates,³⁰ governors’ memoranda approving legislation³¹ and legislative recommendations made by non-legislative bodies that are relied upon by the legislature.³² The occasion of the enactment of a law may also be looked at to assist in determining its character as retroactive or prospective, and its purpose may be evidence that the legislature intended it to apply retrospectively.³³ However, an act will only be given retroactive application where the intent of the legislature to do so is clearly and unequivocally established.³⁴ Thus, it has been held that a statute should not be given retroactive effect when it is capable of any other construction.³⁵

The strongest arguments in favor of the retroactive application of the New York and Illinois EMU legislation lie not so much in the wording of the legislation as in the legislative history preceding its enactment. The sponsors of the New York legislation were prompted to propose legislation because of a specific concern that the introduction of the euro “will create uncertainty in relation to *existing* contracts” affected by EMU.³⁶ The sponsors stated that “[t]his bill clarifies that *such* contracts will still be fully enforceable, since ‘euros’ may be substituted, at the appropriate exchange rate, for the original currency referred to.”³⁶ This demonstrates a clear legislative intention that the New York legislation applies to both existing and future contracts affected by EMU.³⁷

²⁶U.C.C. §1-103, 1 U.L.A. 20 (1989).

²⁷U.C.C. §2-615, 1 U.L.A. 195 (1989), discussed *supra* pp. 101-15.

²⁸*See, e.g.*, *Beary v. City of Rye*, 377 N.E.2d 453, 457-58 (N.Y. 1978); *Gleason v. Gleason*, 256 N.E.2d 513, 516-18 (N.Y. 1970); *Shielcrawt v. Moffett*, 61 N.E.2d 435, 439-40 (N.Y. 1945); *Morales*, 657 N.Y.S.2d at 713-14; 465 Greenwich St., Etc. v. Schmidt, 455 N.Y.S.2d 83, 85 (N.Y. App. Div. 1982); *Parkchester Apts. Co. v. Lefkowitz*, 381 N.Y.S.2d 230, 233 (N.Y. App. Div. 1976), *aff’d* 363 N.E.2d 712 (N.Y. 1977); *Kaplan v. Kaplan*, 297 N.Y.S.2d 881, 884 (N.Y. App. Div. 1969); *see also* 97 N.Y. JUR., *Statutes* § 231 (1992).

²⁹*See, e.g.*, *Gleason*, 256 N.E.2d at 518; *Morales*, 657 N.Y.S.2d at 713-14; *Kaplan*, 297 N.Y.S.2d at 884.

³⁰*See, e.g.*, *Gleason*, 256 N.E.2d at 517 n.7; *Morales*, 657 N.Y.S.2d at 713; 465 Greenwich St., 455 N.Y.S.2d at 85.

³¹*See, e.g.*, *Shielcrawt*, 61 N.E.2d at 439-40; *Morales*, 657 N.Y.S.2d at 713.

³²*See* *Beary*, 377 N.E.2d at 457.

³³*See, e.g.*, *Beary*, 377 N.E.2d at 457-58; *Gleason*, 256 N.E.2d at 516-19; *Shielcrawt*, 61 N.E.2d at 439-40; *Morales*, 657 N.Y.S.2d at 714-15; *see also* N.Y. STATUTES § 51(d) (McKinney 1971); 97 N.Y. JUR., *Statutes* § 232 (1992).

³⁴*See, e.g.*, *Gleason*, 256 N.E.2d at 516-17; *Shielcrawt*, 61 N.E.2d at 439; *Kaplan*, 297 N.Y.S.2d at 883; *see also* N.Y. STATUTES § 51(b), (d) (McKinney 1971).

³⁵*See* *Waddey v. Waddey*, 49 N.E.2d 8, 9 (N.Y. 1943); *In re Balsam’s Trust*, 296 N.Y.S.2d 969, 981-82 (N.Y. Sup. Ct. 1968); *see also* N.Y. STATUTES § 51(b) (McKinney 1971).

³⁶NEW YORK STATE ASSEMBLY, MEMORANDUM IN SUPPORT OF LEGISLATION (Bill Number: Assembly 8047) (May 22, 1997) (on file with New York Legislative Service).

³⁷*See* Memorandum from Daniel P. Cunningham and Patricia L. Hogan, *Cravath, Swaine & Moore*, for International Swaps and Derivatives Association, Continuity of Contract Statutory Language 3 (Oct. 24, 1997) (on file with author).

It is also clear that the New York EMU working group that drafted the legislation intended the legislation to apply to existing as well as future transactions. In particular, the drafters recommended the introduction of legislation partly because of a concern that EMU only became a foreseeable event after the signing and entry into force of the Maastricht Treaty in 1992-93, and that there might therefore be legal uncertainty with respect to contractual obligations created prior to Maastricht.³⁸ This demonstrates that the drafters were motivated by a desire to address legal uncertainties associated with contracts entered into long before the possibility of legislation in New York and Illinois had even been conceived.

The basic purpose of the New York EMU legislation also supports the retroactive application of the legislation. The justification advanced for the introduction of the New York legislation by its sponsors was that “NY law is the governing law for many international contracts, so it is particularly important that NY law be clear on this issue.”³⁹ Thus, the need for legal certainty was driven by a desire to protect New York’s position as an international financial center.⁴⁰ Because of the enormous number of transactions affected by EMU that were entered into prior to the passage of the New York legislation in mid-1997, the legislation would not, *of itself*, accomplish its stated goal of providing legal certainty for the New York financial markets if its application is prospective only.

3. No Impairment of Contractual Rights

Another factor that should tip the balance in favor of the retroactive application of the legislation is that a statute not affecting a substantial right of a party ordinarily may be given retroactive effect, whereas a statute that impairs one’s substantial rights will generally not be applied retroactively.⁴¹ Indeed, it has been suggested that the general presumption against the retroactive application of statutes is designed only to prevent impairment of vested rights.⁴² Thus, it is less likely that legislation will be applied retroactively where the legislation imposes new conditions upon contracts already existing.⁴³

The New York and Illinois EMU legislation does not deprive contracting parties of pre-existing contractual rights. This is because, notwithstanding certain possible discrepancies, the legislation confirms the continuity of contracts in a manner that is broadly consistent with the EU Council regulations on the introduction of the euro, consistent with the State theory of money.⁴⁴ Thus, the New York and Illinois EMU legislation may be properly regarded as remedial legislation that only operates in furtherance of the confirmation of vested contractual rights, and as such does not come within the legal conception of a retrospective law or the general rule against the retrospective operation of statutes.⁴⁵

4. Conclusion

³⁸See Memorandum from Daniel P. Cunningham and R. Brent Jones, *Cravath Swaine & Moore*, for Financial Markets Lawyers Group, International Swaps and Derivatives Association, PSA The Bond Market Trade Association and Securities Industry Association, Economic and Monetary Union and Continuity of Contract Under New York Law 29-30, 32-33 (Feb. 24, 1997) (on file with author); see also Memorandum from Daniel P. Cunningham and Patricia L. Hogan, *Cravath, Swaine & Moore*, for International Swaps and Derivatives Association, Continuity of Contract Statutory Language 3-4 (Oct. 24, 1997) (on file with author).

³⁹NEW YORK STATE ASSEMBLY, MEMORANDUM IN SUPPORT OF LEGISLATION (Bill Number: Assembly 8047) (May 22, 1997) (on file with New York Legislative Service).

⁴⁰See also Memorandum from Daniel P. Cunningham and R. Brent Jones, *Cravath Swaine & Moore*, for Financial Markets Lawyers Group, International Swaps and Derivatives Association, PSA The Bond Market Trade Association and Securities Industry Association, Economic and Monetary Union and Continuity of Contract Under New York Law 32-34 (Feb. 24, 1997) (on file with author).

⁴¹See, e.g., *Longines-Wittnauer*, 209 N.E.2d at 73; *Shielcrawt*, 61 N.E.2d at 439; *Lusardi*, 570 N.Y.S.2d at 377; *Cady*, 451 N.Y.S.2d at 207; *Weiler*, 17 N.Y.S.2d at 194; *Phillips v. Agway, Inc.*, 389 N.Y.S.2d 977, 979 (N.Y. Sup. Ct. 1976); see also N.Y. STATUTES § 53 (McKinney 1971); 73 AM. JUR. 2d, *Statutes* §§ 349-350 (1974 & Supp. 1997) (and the cases cited therein).

⁴²See *Rooney v. City of Long Beach*, 345 N.Y.S.2d 66, 72 (N.Y. App. Div. 1973), app. dis. 307 N.E.2d 564 (N.Y. 1973).

⁴³See, e.g., *Lusardi*, 570 N.Y.S.2d at 377; *Weiler*, 17 N.Y.S.2d at 194; *Pioneer*, 471 N.Y.S.2d at 521; *Phillips*, 389 N.Y.S.2d at 979.

⁴⁴See *infra* pp. 197-205, 211-13.

⁴⁵See 73 AM. JUR. 2d, *Statutes* § 354 (1974 & Supp. 1997) (and the cases cited therein); see also N.Y. STATUTES § 54(a) (McKinney 1971) (and the cases cited therein).

In conclusion, while the wording of the EMU legislation enacted in New York and Illinois might suggest that it only applies prospectively to transactions entered into since the legislation's enactment, there is compelling evidence that the legislation was intended to apply both to existing contracts as well as future transactions. Regardless of whether the New York and Illinois legislation has retroactive effect, all contractual obligations entered into prior to the enactment of the New York and Illinois legislation must be discharged in conformity with the EU Council regulations on the introduction of the euro, consistent with the State theory of money. In view of the application of the State theory of money under U.S. law, the question whether the New York and Illinois legislation has retroactive application is of little legal significance.

C. Obligations Denominated in EU National Currencies

With respect to obligations denominated in EU national currencies, the New York General Obligations Law and the Illinois Euro Conversion Act each provide that if a subject or medium of payment of a contract, security or instrument is a currency that has been substituted or replaced by the euro, the euro will be a commercially reasonable substitute and substantial equivalent that may be either (i) used in determining the value of such currency or (ii) tendered, in each case at the conversion rate specified in, and otherwise calculated in accordance with, the regulations adopted by the Council of the European Union.⁴⁶ The "euro" is defined as the currency of participating member states of the European Union that adopt a single currency in accordance with the Treaty on European Union (i.e., the Maastricht Treaty).⁴⁷ Thus, the euro is treated in all contracts as a commercially reasonable substitute and substantial equivalent for the EU national currencies participating in EMU at the irrevocably fixed conversion rates established by the EU Council.

The treatment of the euro as a commercially reasonable substitute and substantial equivalent for the EU national currencies at the applicable conversion rates confirms the application of the recurrent link between the euro and the EU national currencies that will be established by the EU Council. An interesting point here is whether, in view of the widespread acceptance of the State theory of money under U.S. law, the euro is in fact the legal equivalent of EU national currencies in which contractual obligations are denominated, and not only a "commercially reasonable substitute" and "substantial equivalent" for those currencies. In this regard it is instructive to note that under the Uniform Foreign-Money Claims Act adopted in California and Illinois a new currency is explicitly treated in contracts as the legal equivalent of its predecessor currency in accordance with the recurrent link. Thus, it is provided under the Uniform Foreign Money Claims Act that if, after an obligation is expressed or a loss is incurred in a foreign money, the country issuing or adopting that money substitutes a new money in place of that money, the obligation or the loss is treated as if expressed or incurred in the new money at the rate of conversion the issuing country establishes for the payment of like obligations or losses denominated in the former money.⁴⁸

With respect to the definition of the euro as the currency adopted "in accordance with the Treaty on European Union," it is presumed that, in the absence of any guidance from an EU court considering the issue, an American court would not second-guess the decision of the EU Council as to which EU member states have fulfilled the necessary conditions for the adoption of the single currency. Such an inquiry by an American court would involve a highly sensitive analysis with important diplomatic repercussions that would intrude on the Federal Government's authority over foreign affairs, thereby endangering the constitutional validity of the legislation.⁴⁹

⁴⁶S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604), § 5-1602(1)(A); Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 10(a).

⁴⁷S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604), §§ 5-1601(1); Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 5.

⁴⁸CAL. CIV. PROC. ACT § 676.12(a) (West Supp. 1997); ILL. ANN. STAT. Ch. 735 para 5/12-642(a) (West 1992), discussed *supra* pp. 85-86.

⁴⁹See *infra* pp. 215-21.

D. Principle of Continuity of Contracts

Tracking the language of the EU Council regulation on certain provisions relating to the introduction of the euro,⁵⁰ the New York General Obligations Law and the Illinois Euro Conversion Act both provide that the introduction of the euro (which is defined to include the implementation from time to time of EMU in member states of the European Union pursuant to the Maastricht Treaty) shall not have the effect of discharging or excusing performance under any contract, security or instrument, or give a party the right to unilaterally alter or terminate any contract, security or instrument.⁵¹ As with the EU Council regulation, this provision ensures the continuity of contracts after EMU by preventing parties from invoking doctrines such as frustration or impossibility at common law or commercial impracticability under the UCC as a means of terminating or otherwise discharging contractual obligations based on EMU. In particular, this provision ensures the continuity of fixed interest rate swaps together with cross-currency swaps and currency options involving two EU currencies participating in EMU.⁵²

With respect to floating rate obligations, the New York General Obligations Law and the Illinois Euro Conversion Act expressly provide that calculating or determining the subject or medium of payment of a contract, security or instrument with reference to an interest rate or other basis that has been substituted or replaced due to the introduction of the euro and that is a commercially reasonable substitute and substantial equivalent shall not have the effect of discharging or excusing performance under any contract, security or instrument, or give a party the right to unilaterally alter or terminate any contract, security or instrument.⁵³ This provision explicitly ensures the continuity of floating rate swaps denominated by reference to a floating rate price source linked to an existing EU national currency that may be replaced by a successor price for the euro. In this respect the legislation expressly confirms the continuity of floating rate obligations in accordance with the general principle of the continuity of contracts applicable under the EU Council regulation.⁵⁴

Finally, the New York General Obligations Law and the Illinois Euro Conversion Act also expressly provide that the tendering of euros in connection with, or the determining of the value of any obligation contained in a contract, security or instrument the subject or medium of payment of which is either a currency that has been substituted or replaced by the euro shall not have the effect of discharging or excusing performance under any contract, security or instrument, or give any party the right to unilaterally alter or terminate any contract, security or instrument.⁵⁵ This provision would appear to be a re-affirmation of the general continuity provision outlined above.

E. Freedom of Contract

The New York General Obligations Law embraces the principle of the freedom of contract, providing that the EMU legislation shall not alter or impair and shall be subject to any agreement between parties with specific reference to or agreement regarding the introduction of the euro.⁵⁶ The Illinois Euro

⁵⁰Council Regulation (EC) No 1103/97 of 17 June 1997 on certain provisions relating to the introduction of the euro, art. 3, 1997 O.J. (L 162/1), discussed *supra* pp. 24-25.

⁵¹S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604), §§ 5-1601(2), 5-1602(2); Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), §15(1).

⁵²*See supra* pp. 111-14, 127-28.

⁵³S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW § 5-1601-1604), § 5-1602(2); Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 15(4).

⁵⁴*See supra* pp. 124-25.

⁵⁵S.B.5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW §§ 5-1601-1604), § 5-1602(2); Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 10(2)-(3).

⁵⁶S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW § 5-1601-1604), § 5-1602(2).

Conversion Act provides in similar terms that the Act is subject to anything that the parties to a contract agree with specific reference to the introduction of the euro.⁵⁷ In this respect the New York and Illinois legislation is consistent with the applicable provisions of the EU Council regulation.⁵⁸ It should be noted that these provisions may have the effect of abrogating contract clauses that call for the payment of obligations in U.S. dollars where the currency of the contract is no longer used by the government of the country issuing such currency.⁵⁹ This is because such clauses were not drafted with specific reference to the introduction of the euro.

F. No Compulsion, No Prohibition

The New York General Obligations Law and the Illinois Euro Conversion Act also provide for the performance of obligations originally denominated in EU national currencies either in the relevant national currency unit or the euro unit during the 3-year transitional period prior to the withdrawal of national currency banknotes from circulation. In this regard, the legislation seeks to apply the “no compulsion, no prohibition” principle to obligations governed by the laws of New York and Illinois. In particular, it is provided that performance of any of the obligations contained in a contract, security or instrument the subject or medium of payment of which is either a currency that has been substituted or replaced by the euro or the ECU may be made in the currency or currencies originally designated in the contract, security or instrument (so long as that currency or those currencies remain legal tender), or in the euro, but not in any other currency, whether or not the other currency (i) has been substituted or replaced by the euro or (ii) is a currency that is considered a denomination of the euro and has a fixed conversion rate with respect to the euro.⁶⁰

It might be argued that the “no compulsion, no prohibition” provisions in the New York and Illinois legislation differ from the corresponding provisions in the EU Council regulation on the introduction of the euro. Under the EU Council regulation, the general rule is that subject to anything which parties may have agreed, acts to be performed under legal instruments stipulating the use of or denominated in a national currency unit shall be performed in that national currency unit, and acts to be performed under legal instruments stipulating the use of or denominated in the euro unit shall be performed in the euro unit.⁶¹ By way of exception to this general rule, the regulation provides that any amount denominated either in the euro unit or in the national currency unit of a given participating member state and payable within that member state by crediting an account of the creditor, can be paid by the debtor either in the euro unit or in that national currency unit, and the amount paid shall be credited to the account of the creditor in the denomination of his account, with any conversion being effected at the irrevocably fixed conversion rate.⁶²

The “no compulsion, no prohibition” principle included in the New York and Illinois legislation may be contrasted with the EU Council regulation in two respects.

1. EU National Currency Obligations

First, under the New York General Obligations Law and the Illinois Euro Conversion Act it would appear at first glance that *all* obligations originally denominated in EU national currencies may be

⁵⁷Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 20.

⁵⁸See *supra* p. 25.

⁵⁹See *supra* pp. 138-39.

⁶⁰S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW § 5-1601-1604), § 5-1602(1)(C); Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 10(c).

⁶¹Resolution of the European Council of 7 July 1997 on the legal framework for the introduction of the euro, Annex Draft Council Regulation on the introduction of the euro, art. 8(1)-(2) [hereinafter Draft Council Regulation on the introduction of the euro].

⁶²*Id.* art. 8(3), discussed *supra* pp. 18-20.

performed in the euro unit during the transitional period.⁶³ By contrast, under the EU Council regulation, not all obligations originally denominated in EU national currencies may be performed in the euro unit during the transitional period; rather the only obligations that may be performed in the euro unit are those which are payable to a creditor's account in the currency of the member state in which the account is located.⁶⁴ Thus, the New York and Illinois legislation appears to contemplate that a wider range of payments can be effected in the euro unit than is provided for under the EU Council regulation.

It may be that such a broad interpretation of the “no compulsion, no prohibition” principle would represent an infringement on the monetary sovereignty of the European Union.⁶⁵ For example, if under the New York and Illinois legislation obligations denominated in the Deutsche mark may, during the transitional period, be performed by a debtor in the euro unit by way of a credit transfer to a creditor's account located in any financial center outside Germany (*e.g.*, London, Paris, Brussels or Luxembourg), this would be inconsistent with the provisions of the EU regulation which contemplate that such credit transfer payments may only be made to accounts located in Germany. Insofar as the monetary sovereignty of the European Union forms part of federal common law, any conflicting provision of state law would be superseded by applicable provisions of EU legislation enacted pursuant to the monetary sovereignty of the European Union over the currencies of EU member states.⁶⁶

In addition, the “no compulsion, no prohibition” principle contained in the EU Council regulation is an act of state, and would therefore be directly applicable to all contractual obligations whose situs are located in EU member states by virtue of the act of state doctrine.⁶⁷ As a doctrine rooted in federal law, the act of state doctrine would also supersede conflicting provisions of state legislation.⁶⁸ Thus, the provisions of the EU Council regulation permitting obligations denominated in the national currency units to be performed in the euro unit during the transitional period would be applicable to obligations that involve obligors based in EU member states and/or payments that are to be discharged within EU member states, regardless of what law is stated to govern performance of the contract.

Another issue is whether a provision in the New York and Illinois legislation that permits *all* obligations denominated in the national currency units to be performed in the euro unit would impose requirements that burden or interfere with payments or transfers of funds, contrary to the terms of the United States' bilateral friendship treaties with several EU member states (including France, Germany and the three Benelux countries).⁶⁹ In this regard, it may be that financial institutions in the European Union would be unwilling to readily provide conversion facilities between any national currency unit and the euro unit other than the domestic national currency unit of the member state in which that financial institution is located. Thus, New York legislation permitting parties to perform an obligation originally denominated in a national currency unit in the euro unit could impose burdensome requirements with respect to cross-border payments and funds transfers in transactions the performance of which are governed by New York or Illinois law.

In view of the importance of the “no compulsion, no prohibition” principle to the legal framework for the changeover to the single currency, it may be necessary to attribute a narrower interpretation to the New York and Illinois legislation in order to avoid any possible intrusion on the monetary sovereignty of the European Union as expressed in the EU Council regulations on the introduction of the euro. A corollary of the doctrine that it is the duty of the courts, where possible, to construe a state statute so as to

⁶³S.B. 5049, 220th Leg., 1997-1998 Reg. Sess. (N.Y. 1997) (to be codified at N.Y. GEN. OBLIG. LAW § 5-1601-1604), § 5-1602(1)(C); Euro Conversion Act, Public Act No. 90-268, 1997 Ill. Adv. Legis. Serv. 268 (to be codified at 815 ILL. COMP. STAT. 617/1-30), § 10(c).

⁶⁴*See supra* pp. 18-19.

⁶⁵*See supra* pp. 58-60.

⁶⁶*See supra generally* pp. 33-35.

⁶⁷*See supra* pp. 74-78.

⁶⁸*See supra* p. 76.

⁶⁹*See supra* pp. 185-86.

avoid constitutional difficulties is that if a state statute is readily susceptible to a narrowing construction that would make it constitutional, the narrowing construction will be applied so as to uphold the legislation.⁷⁰ In applying this principle of statutory construction, the Supreme Court has stated that courts should not rewrite a state law to conform it to constitutional requirements.⁷¹

Based on the above principles, it is submitted that the “no compulsion, no prohibition” principle contained in the New York General Obligations Law and the Illinois Euro Conversion Act should be interpreted in a restrictive manner so as to be fully consistent with the EU Council regulation. This would accord with the presumed policy of the New York and Illinois State Legislatures to confirm the continuity of obligations in a manner that is consistent with the EU Council regulations. This common sense interpretation also ensures uniformity in the increasingly integrated international financial markets and avoids unnecessary confusion regarding the scope of payments that can be made in the euro unit in cross-border funds transfers during the 3-year transitional period. This narrowing interpretation ensures that the New York and Illinois legislation does not infringe the monetary sovereignty of the European Union. It also ensures that the legislation is interpreted consistently with the obligations of the United States under various bilateral friendship treaties.

To the extent that the New York or Illinois legislation is not readily susceptible to such a narrowing construction, the discrepancies between the state legislation and the EU Council regulations must be resolved by applying the relevant provisions of the EU Council regulations insofar as the monetary sovereignty of the European Union is recognized under federal law by virtue of the State theory of money.⁷²

2. Euro Obligations

The second distinction between the New York and Illinois legislation and the EU Council regulation with respect to the application of the “no compulsion, no prohibition” principle relates to obligations denominated in the euro unit. Under the EU Council regulation, an obligation denominated in the euro unit, which would include obligations originally denominated in ECU prior to EMU, may, where payable by credit transfer, be paid in the national currency unit of that member state in which the creditor’s account is located. By contrast, the New York and Illinois legislation does not appear to contemplate the performance in a national currency unit of an obligation denominated in the euro unit. Rather, the New York and Illinois legislation provides that obligations denominated in ECU may be performed either in the currency originally designated in the contract (so long as such currency remains legal tender) or in euro, but not in any other currency. Where the ECU is the currency originally designated in the contract, neither the ECU nor the euro unit that substitutes the ECU will be a legal tender during the transitional period. Thus, the New York and Illinois legislation only permits obligations denominated in ECU to be performed in the euro unit. In this respect, the scope of the “no compulsion, no prohibition” principle embraced by the New York and Illinois legislation is narrower than that included in the EU Council regulation.

The fact that the New York and Illinois legislation does not make provision for the performance in a national currency unit of obligations originally denominated in ECU does not mean that the corresponding provisions of the EU Council regulation are inapplicable to transactions governed by New York or Illinois law. If a transaction involves an obligation originally denominated in the official ECU, it is arguable that the relevant provisions of the EU Council regulation may be recognized under the State theory to the extent that the official ECU is classified as a legal currency.⁷³ If the transaction involves an obligation originally denominated in the euro unit after EMU, a stronger case can be made for the

⁷⁰See, e.g., *Virginia v. Am. Booksellers Association, Inc.*, 484 U.S. 383, 397 (1988); *Ernoznik v. City of Jacksonville*, 422 U.S. 205, 216 (1975); *Dombrowski v. Pfister*, 380 U.S. 479, 497 (1965); see also 16 AM. JUR. 2D, *Constitutional Law* §223 (1979 & Supp. 1997) (and the cases cited therein).

⁷¹See, e.g., *Virginia*, 484 U.S. at 397.

⁷²See *supra* pp. 33-35, 76.

⁷³See *supra* pp. 161-67.

application of the provisions of the EU Council regulation under the laws of U.S. jurisdictions on the ground that the provisions were adopted pursuant to the monetary sovereignty of the European Union.⁷⁴ Thus, the provisions of the EU Council regulation would be applicable, and the New York and Illinois legislation would have to be interpreted accordingly (i.e., as not implicitly preventing the performance of obligations originally denominated in the euro unit in the national currency unit of that member state in which a creditor's account is located).

In addition, under the act of state doctrine the provisions of the EU Council regulation relating to the performance in the national currency units of obligations originally denominated in ECU or the euro unit during the transitional period may be applicable to all such obligations whose situs is located in an EU member state.⁷⁵

Finally, it should be noted that any interpretation of the New York and Illinois legislation as preventing the performance of obligations originally denominated in the euro unit in a national currency unit might also be regarded as conflicting with the bilateral treaty obligation of the United States to refrain from imposing requirements that burden or interfere with payments or transfers of funds between the U.S. and several member states of the European Union (including France, Germany and the three Benelux countries).⁷⁶

G. Bond Redenomination and Netting

Matters not addressed by the New York General Obligations Law or the Illinois Euro Conversion Act but covered by the EU Council regulations include provisions permitting bond redenomination and a provision permitting the application of netting, set-off or techniques with similar effects to monetary obligations during the transitional period, irrespective of their currency denomination, if that denomination is in the euro unit or in a national currency unit with any conversion being effected at the conversion rates.⁷⁷ In accordance with the expansive interpretation of the State theory of money accepted under U.S. law, strong arguments can be made that the provisions of the EU Council regulation permitting the redenomination of bonds are applicable to bonds governed by the laws of U.S. jurisdictions.⁷⁸

The netting provision in the EU Council regulation cannot of itself be applied outside the EU member states that participate in EMU because, by its terms, the EU Council regulation only provides for the application of national legal provisions of *participating* EU member states which permit or impose netting, set-off or techniques with similar effects.⁷⁹ In the United States, the question of whether contractual provisions that permit or impose netting, set-off or techniques with similar effects will allow amounts denominated in one national currency unit to be netted against amounts denominated in another national currency unit raises a question of contract interpretation. In the absence of a specific contractual provision addressing this issue, a plausible argument can be advanced that contractual provisions permitting or imposing the netting of amounts in a particular currency against amounts in that same currency cover the netting of one euro national currency unit against another euro national currency unit because each such unit is a denomination or expression of the same currency.⁸⁰

⁷⁴See *supra* pp. 35-100.

⁷⁵See *supra* pp. 74-78.

⁷⁶See *supra* pp. 185-86.

⁷⁷Draft Council Regulation on the introduction of the euro, *supra* note 61, art. 8(4), (6).

⁷⁸See *supra* pp. 60-61.

⁷⁹Draft Council Regulation on the introduction of the euro, *supra* note 61, art. 8(6).

⁸⁰See *supra* p. 25.

X. CONSTITUTIONAL LIMITATIONS ON RETROACTIVE STATE LEGISLATION

The legislation passed by the New York and Illinois State Legislatures that confirms the continuity of contracts after EMU may apply retrospectively to all relevant contractual obligations created prior to the passage of the legislation. The Constitution of the United States contains several provisions limiting the ability of State Legislatures to enact retroactive legislation. In addition, the Constitution of the State of New York contains provisions limiting the ability of the New York State Legislature to enact retroactive legislation. The limitations in the U.S. Constitution applicable to State Legislatures are contained in two provisions:

- First, the Contract Clause provides that “No State shall . . . pass any . . . law impairing the Obligation of Contracts.”¹
- Second, the fourteenth amendment to the U.S. Constitution prohibits the States from depriving any person of life, liberty, or property, without due process of law.²

As discussed in more detail below, retroactive state legislation clearing the hurdle of the Contract Clause can be reasonably expected to survive a constitutional challenge under the less onerous requirements of the fourteenth amendment’s Due Process Clause. The Contract Clause and the fourteenth amendment by their terms only apply to state legislatures. In addition to the restrictions of the U.S. Constitution, retroactive legislation enacted by the New York State Legislature is also subject to the limitations contained in the Due Process Clause of the New York State Constitution which provides, in similar terms to the Due Process Clause of the U.S. Constitution, that “No person shall be deprived of life, liberty, or property without due process of law.”³

A. Contract Clause of the United States Constitution

While the Contract Clause was interpreted expansively by the Supreme Court during the nineteenth century to invalidate statutes that retrospectively impaired almost any contractual obligation,⁴ the Court has abandoned this position during this century and shown itself willing to tolerate retrospective limitations on contractual rights introduced to protect basic societal interests such as the “strong public interest” in preventing environmental harm,⁵ the “significant and legitimate State interest” in protecting consumers from the escalation of natural gas prices caused by deregulation,⁶ a state’s interest in preventing excessive litigation over uncertain land titles,⁷ and the economic interest of a state “to safeguard the vital interests of its people” during an economic emergency such as the Great Depression of the 1930s.⁸

Several principles can be gleaned from the case law as to whether legislation violates the Contract Clause. The threshold inquiry is whether the state law has in fact operated a substantial impairment of a contractual relationship.⁹ The severity of the impairment measures the height of the hurdle the state

¹U.S. CONST. art I, § 10, cl. 1.

²*Id.* amend. 14, § 1 (“...nor shall any State deprive any person of life, liberty or property, without due process of law....”).

³N.Y. CONST. art I, § 6.

⁴See JOHN E. NOWAK AND RONALD D. ROTUNDA, CONSTITUTIONAL LAW 394-400 (4th ed. 1991).

⁵*Keystone Bituminous Coal Ass’n v. DeBenedictis*, 480 U.S. 470, 502-05 (1987).

⁶*Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 416-17 (1983).

⁷*City of El Paso v. Simmons*, 379 U.S. 497, 509-17 (1965).

⁸*Compare Home Bldg. & Loan Association v. Blaisdell*, 290 U.S. 398, 434-35, 444 (1934) *with* *W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935) *and* *W.B. Worthen Co. v. Thomas*, 292 U.S. 426 (1934).

⁹See *General Motors Corp. v. Romein*, 503 U.S. 181, 186-87 (1992) (citing *Energy Reserves*, 459 U.S. at 411 (quoting *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978)); *Keystone*, 480 U.S. at 504; *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1, 17 (1977)).

legislation must clear,¹⁰ and a minimal alteration of contractual obligations may end the inquiry at its first stage.¹¹ Whether the nullification of contractual obligations imposes a completely unexpected liability is a factor that may be considered in this context,¹² and the Supreme Court has held that the foreseeability of legislation altering contractual rights is a basis for holding that a party's reasonable expectations have not been impaired and that there has therefore been no substantial impairment of contractual rights.¹³

Assuming that an impairment of contractual obligations has occurred the next step involves a consideration of whether that impairment is permitted under the Constitution.¹⁴ This involves a two-step inquiry. First, it must be examined whether the law was enacted to protect a significant and legitimate public purpose (e.g., whether the law was enacted to deal with a broad and general social or economic problem).¹⁵ Legislation enacted to protect a narrow class rather than a broad societal interest is less likely to survive constitutional attack.¹⁶ Second, assuming that the public welfare is at stake, consideration must then be given to whether the adjustment of contractual rights is appropriately tailored to the strong public interest that it was designed to meet.¹⁷ Unless the state is itself a contracting party, courts should properly defer to legislative judgment as to the necessity and reasonableness of a particular measure.¹⁸ States are therefore given a broad latitude to abrogate contractual rights in pursuit of a strong public interest.

B. Due Process Clause of the United States Constitution

As previously noted, retrospective state legislation also “must meet the test of due process” laid down in the fourteenth amendment: “a legitimate legislative purpose furthered by rational means.”¹⁹ The Supreme Court has laid down several principles regarding the constitutionality of retrospective federal²⁰ and state legislation under due process standards. The Court has stated that the strong deference accorded legislation in the field of national economic policy is no less applicable when that legislation is applied retroactively.²¹ Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative branch.²² Retroactive legislation does however have to meet a burden not faced by legislation that has only future effects.²³ That burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.²⁴

¹⁰See *Energy Reserves*, 459 U.S. at 411 (citing *Allied Structural*, 438 U.S. at 245).

¹¹See *Allied Structural*, 438 U.S. at 245.

¹²See *id.* at 247, 249.

¹³*Energy Reserves*, 459 U.S. at 415-16.

¹⁴See *Keystone*, 480 U.S. at 504; *United States Trust*, 431 U.S. at 21; *El Paso*, 379 U.S. at 506-07; *Blaisdell*, 290 U.S. at 428-29 (citation omitted).

¹⁵See *Keystone*, 480 U.S. at 503-05; *Energy Reserves*, 459 U.S. at 411-12 (citing *Allied Structural*, 438 U.S. at 247, 249-50); *El Paso*, 379 U.S. at 508 (citing *Blaisdell*, 290 U.S. at 428, 434-35, 437).

¹⁶See *Allied Structural*, 438 U.S. at 248-49.

¹⁷See *Keystone*, 480 U.S. at 505-06 (citing *Energy Reserves*, 459 U.S. at 412 (quoting *United States Trust*, 431 U.S. at 22)); *Blaisdell*, 290 U.S. at 445.

¹⁸See *Keystone*, 480 U.S. at 505 (citing *Energy Reserves*, 459 U.S. at 413 (quoting *United States Trust*, 431 U.S. at 23)).

¹⁹*General Motors*, 503 U.S. at 191 (citing *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 730 (1984)).

²⁰The constitutional validity of retroactive Federal legislation may be tested under the Due Process Clause of the fifth amendment which provides, in similar terms to the fourteenth amendment, that “No person shall...be deprived of life, liberty or property, without due process of law.” U.S. CONST. amend. 5.

²¹*Pension Benefit*, 467 U.S. at 729; see also *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976).

²²See *Pension Benefit*, 467 U.S. at 729. While this case concerned federal legislation, it has been cited with approval in a subsequent decision of the Court involving retroactive state legislation, *General Motors*, 503 U.S. at 191, and the Court's interpretation of the due process clause as it applies to retrospective federal legislation would appear to apply *mutatis mutandis* to the due process clause as it applies to retrospective state legislation.

²³See *Pension Benefit*, 467 U.S. at 730 (citing *Usery*, 428 U.S. at 16-17).

²⁴See *id.* at 730.

As is the case with the Contract Clause,²⁵ the starting point for an inquiry as to the constitutionality of legislation impairing private contractual rights under the Due Process Clause is whether the statute alters contractual rights or obligations.²⁶ If an impairment is found the reviewing court next determines whether the impairment is of constitutional dimension; if the alteration of contractual obligations is minimal, the inquiry may end at this stage.²⁷ However, when there is a substantial impairment of contractual obligations and the relevant legislation is reviewed under the Due Process Clause rather than the Contract Clause, the Supreme Court has stated that the Due Process Clause imposes “less searching standards” than “the limitations imposed on States by the Contract Clause.”²⁸ This next inquiry is especially limited, and the Court has held that the party asserting a due process violation “must overcome a presumption of constitutionality and ‘establish that the legislature has acted in an arbitrary and irrational way.’”²⁹

C. Due Process Clause of the New York State Constitution

As noted above, retroactive legislation enacted by the New York State Legislature must also meet the test of due process laid down in the New York State Constitution.³⁰ It was held in older cases that because the Due Process Clauses in both the United States and New York State Constitutions are formulated in the same words and are intended for the protection of the same fundamental rights “there is, logically, no room for distinction in definition of the scope of the two clauses”.³¹

More recently, however, it has been held that under New York State’s Due Process Clause the New York courts “may impose higher standards than those held to be necessary by the Supreme Court under the corresponding federal constitutional provision.”³² In the context of retrospective legislation affecting contractual obligations, it is doubtful that those standards will be higher than the standards imposed by the Contract Clause of the U.S. Constitution. The New York State courts have consistently held that in order to pass constitutional muster under the due process clauses of the New York State and United States Constitutions, the retroactive application of legislation must serve a compelling public interest and not be harsh, oppressive or unfair.³³

D. Constitutional Validity of Monetary Legislation Applying Retroactively to Contractual Obligations

The constitutional validity of federal legislation with retrospective application to private contracts that was enacted by Congress to effect a change in the monetary system was considered by the U.S. Supreme Court in the aftermath of the introduction of paper greenback dollars not backed by gold during the U.S. Civil War.

²⁵See *supra* p. 207.

²⁶See *National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 472 (1985) (citing *United States Trust*, 431 U.S. at 17-21).

²⁷See *National R.R. Passenger*, 470 U.S. at 472 (citing *Allied Structural*, 438 U.S. at 245).

²⁸*Pension Benefit*, 467 U.S. at 732-33; see also *National R.R. Passenger*, 470 U.S. at 472 n.25 (citing *Pension Benefit*).

²⁹*National R.R. Passenger*, 470 U.S. at 472 (quoting *Pension Benefit*, 467 U.S. at 729).

³⁰N.Y. CONST., art I, § 6; see *supra* p. 206.

³¹*Central Sav. Bank v. City of New York*, 19 N.E.2d 659, 659 (N.Y. 1939); see also *Metropolitan Life Ins. Co. v. New York State Labor Relations Bd.*, 20 N.E.2d 390, 395 (N.Y. 1939).

³²*People v. Isaacson*, 378 N.E.2d 78, 82 (N.Y. 1978) (citations omitted).

³³See, e.g., *Astoria Fed. Sav. & Loan Ass’n v. State of New York*, 644 N.Y.S.2d 926, 933-34 (N.Y. App. Div. 1996) (citations omitted); *Niagara Recycling, Inc. v. Town of Niagara*, 443 N.Y.S.2d 939, 946 (N.Y. App. Div. 1981) (citations omitted); *Valladares v. Valladares*, 438 N.Y.S.2d 810, 815 (N.Y. App. Div. 1981), *aff’d* 434 N.E.2d 1054 (N.Y. 1982).

In the *Legal Tender Cases*,³⁴ the Supreme Court rejected arguments that the legal tender legislation permitting debts originally denominated in gold dollars to be discharged in paper dollars was prohibited by the spirit of the Constitution because it indirectly impaired the obligation of pre-existing contracts and involved a taking of property without due process of law. First, the Court held that there was no impairment of the obligation of contracts because “the obligation of a contract to pay money is to pay that which the law shall recognize as money when the payment is to be made.”³⁵ This obligation was fully satisfied by the payment of legal tender notes in lieu of dollars backed by gold. Second, the Court stated that Congress is not prohibited from taking action that might indirectly have the effect of impairing the obligation of contracts as “contracts must be understood as made in reference to the possible exercise of the rightful authority of the government” — its constitutional and sovereign authority over its currency.³⁶ “[N]o obligation of a contract can extend to the defeat of legitimate government authority.”³⁷

This was reiterated by the Supreme Court in *Juilliard v. Greenman*,³⁸ where the Court held that when a particular power is vested in Congress under the Constitution — as is the power over the currency — “it is no constitutional objection . . . to its exercise that . . . the contracts of individuals may be incidentally affected.” Whether it is “wise and expedient” to issue paper currency “is a political question, to be determined by Congress when the question of exigency arises.”³⁹

The downfall of the Confederate dollar at the end of the American Civil War was followed by legislation in some states declaring all contracts the consideration of which was Confederate money to be null and void. In *Delmas v. Insurance Co.*,⁴⁰ the Supreme Court held that a provision in a State Constitution to this effect was an impairment of the obligation of contracts in violation of the U.S. Constitution.

As part of the economic reconstruction of the South following the American Civil War many of the former Confederate states enacted legislation revaluing Confederate dollar debts in U.S. dollars.⁴¹ The Supreme Court struck down as an unconstitutional impairment of the obligation of contracts state legislation requiring the value of the consideration furnished by a Confederate dollar creditor to a debtor to be taken into account in determining the extent of such revaluation.⁴² The Court held that a different value might be placed upon the contractual consideration than the price fixed by the parties in Confederate currency.⁴³

In the aftermath of the absorption of the island of Puerto Rico as a U.S. possession following the 1898 Spanish-American War Congress passed legislation fixing the exchange rate at which the U.S. dollar substituted the Puerto Rican peso and providing for the payment of debts denominated in the Puerto Rican peso at this fixed exchange. In *Succession of Serrales v. Esbri*,⁴⁴ the U.S. Supreme Court stated unequivocally that “[t]his [legislation] did not impair or change the obligation of any contract.”

The abolition of gold clauses in private contracts by Congress in 1933 clearly altered contractual rights and obligations by preventing parties from being paid an amount calculated by reference to the price of gold. In the *Gold Clause Cases* the Supreme Court held that there had been no taking of property

³⁴ 79 U.S. (12 Wall.) 457, 547-52 (1870), discussed *supra* pp. 37-39.

³⁵ *Legal Tender Cases*, 79 U.S. (12 Wall.) at 548.

³⁶ *Id.* at 549-51, esp. at 551.

³⁷ *Id.* at 551.

³⁸ 110 U.S. 421, 448 (1884) discussed *supra* p. 38.

³⁹ *Juilliard*, 110 U.S. at 450.

⁴⁰ 81 U.S. (14 Wall.) 661, 665-69 (1871).

⁴¹ See ARTHUR NUSSBAUM, MONEY IN THE LAW NATIONAL AND INTERNATIONAL 593-94 (1950).

⁴² *Wilmington and Weldon R.R. Co. v. King*, 91 U.S. (1 Otto) 3, 4-6 (1875).

⁴³ *Id.*

⁴⁴ 200 U.S. 103, 118 (1906), discussed *supra* pp. 42-43.

without due process of law, and reiterated that “contracts must be understood as having been made in reference to the possible exercise of the rightful authority of the Government” over the currency, and that “no obligation of a contract ‘can extend to the defeat’ of that authority.”⁴⁵ Significantly, the Supreme Court and the New York Court of Appeals signalled that this will hold true regardless of whether the contract is governed by the laws of the country whose currency is at issue and regardless of whether the contract is between nationals of the country issuing the currency.⁴⁶ The New York court approved the action of foreign courts in enforcing the Congressional prohibition on the use of gold clauses in U.S. dollar contracts, and by analogy could be reasonably expected to enforce the legislation of a foreign country affecting private contracts whenever such legislation would be enacted pursuant to that country’s sovereign power over its currency.⁴⁷ Overall, the position of the New York courts is that “[a] currency regulation which alters either the value or character of the money to be paid in satisfaction of contracts is not a ‘confiscation’ or ‘taking.’”⁴⁸

E. Constitutional Validity of Retroactive State Legislation regarding EMU

This study will now consider whether the retroactive application of the New York and Illinois legislation confirming the continuity of contracts after EMU would be compatible with the United States and/or New York State Constitutions. It is submitted that the retroactive application of the legislation would not violate the Contract Clause of the U.S. Constitution. The legislation does not impair pre-existing contractual obligations. This is because, notwithstanding certain possible discrepancies, the legislation ensures the continuity of contracts in a manner that is broadly consistent with the EU Council regulations on the introduction of the euro.⁴⁹

In accordance with the State theory of money, as articulated by U.S. and New York courts and codified by the Uniform Commercial Code and the Uniform Foreign-Money Claims Act, the obligation of a contract to pay foreign currency is to pay that which the law of the foreign country that issues such currency will recognize as its currency when the payment is to be made.⁵⁰ Thus, contractual obligations denominated in EU national currencies must be automatically converted into obligations denominated in the single currency at the irrevocably fixed conversion rates. Insofar as the New York and Illinois legislation confirms the application of the State theory of money to the introduction of the euro, thereby ensuring the continuity of contractual obligations in accordance with the applicable EU Council regulations, the legislation is purely declaratory of existing law, amounting to a detailed legislative codification of principles previously enunciated by American courts and already reflected in the Uniform Commercial Code.⁵¹ In this respect, the legislation is in the same genre as the EU Council regulations that specifically legislate for the continuity of contracts governed by the laws of EU jurisdictions, notwithstanding the universal acceptance of the State theory of money.

With respect to ECU obligations, the New York and Illinois legislation is drafted consistently with the EU Council regulations. Thus, obligations denominated in the official ECU will automatically become obligations denominated in euro at the rate of one euro to one ECU.⁵² This is consistent with a treatment of the official ECU as a legal currency under the laws of U.S. jurisdictions.⁵³ Even assuming

⁴⁵*Norman v. Baltimore & Ohio R.R. Co.*, 294 U.S. 240, 304-08, esp. at 305 (1935) (citing *Legal Tender Cases*); see also *Guaranty Trust Co. v. Henwood*, 307 U.S. 247, 258-59 (1939) (citing *Norman*); *Bethlehem Steel Co. v. Zurich Gen. Accident & Liab. Ins. Co.*, 307 U.S. 265, 267 (1939); *Compañía de Inversiones Internacionales v. Indus. Mortgage Bank of Finland*, 198 N.E. 617, 619-21 (N.Y.1935), discussed *supra* pp. 51-57.

⁴⁶*Bethlehem*, 307 U.S. at 267; *Compañía de Inversiones*, 198 N.E. at 621, discussed *supra* pp. 53-57.

⁴⁷*Compañía de Inversiones*, 198 N.E. at 621 (citations omitted).

⁴⁸*French v. Banco Nacional de Cuba*, 242 N.E.2d 704, 710 (N.Y. 1968) (citing *Gold Clause Cases*), discussed *supra* p. 69.

⁴⁹See *supra* pp. 197-205.

⁵⁰See *supra* pp. 35-100.

⁵¹*Id.*

⁵²See *supra* pp. 159-60, 169-70.

⁵³See *supra* pp. 161-67.

that the official ECU does not fall within the definition of money under New York law, obligations defined by reference to the official ECU should, under standard principles of contract interpretation, be understood as referring to the official ECU as it may change from time to time, including its transformation into a currency in its own right.⁵⁴ Moreover, the vast majority of private ECU obligations that are governed by New York and other U.S. laws contain definitions of the ECU that refer to the official ECU, and often explicitly to its transformation into a currency in its own right.⁵⁵ With respect to ECU obligations not expressly defined by reference to the official ECU, it will be presumed, absent a contrary intention, that a reference to the ECU refers to the official ECU and should therefore be replaced by a reference to the euro on a 1:1 basis.⁵⁶ This presumption is consistent with standard principles of contract interpretation under New York law.⁵⁷

In conclusion, the provisions in the state legislation with respect to ECU obligations do not alter or impair pre-existing contractual obligations but rather are declaratory of existing law.

It is arguable that the legislation enacted by the New York and Illinois State Legislatures does impair contractual obligations insofar as it abrogates contractual clauses calling for the discharge of obligations in U.S. dollars where the currency of the contract is no longer used by the government of the country issuing such currency.⁵⁸ Under the New York and Illinois legislation such clauses will not be triggered by EMU because they are general clauses that were not drafted with specific reference to the euro.⁵⁹ Insofar as this abrogation of contractual rights is consistent with the EU Council regulations, it may be that the relevant provisions of the New York and Illinois legislation are declaratory of existing law insofar as they give effect to the monetary sovereignty of the European Union over the currencies of EU member states.⁶⁰ Contracts for the payment of foreign money that are governed by New York law must be understood as having been made in reference to the rightful authority of foreign governments with respect to their monetary systems.⁶¹ State legislation confirming the continuity of contracts in accordance with the EU Council regulations ensure legal certainty for the financial markets by giving effect to the sovereign powers of the European Union over the currencies of EU member states. The Contract Clause of the U.S. Constitution may not be invoked to prevent the exercise of these legitimate powers.⁶²

Even if the New York and Illinois legislation does impair contractual rights, it is submitted that the legislation would still not violate the Contract Clause. In order to violate the Contract Clause, the legislation must operate a *substantial* impairment of a contractual relationship. Whether an impairment is substantial will turn on, among other things, the extent to which the legislation altering contractual rights was reasonably foreseeable. It is submitted that, in view of the long-standing foreseeability of EMU and the concomitant 1:1 replacement of contractual references to the ECU by references to the euro, it has been reasonably foreseeable for many years that obligations denominated in European national currencies and the ECU would be transformed into obligations denominated in the single currency.⁶³

In addition, an impairment of contractual obligations will be tolerated under the Contract Clause where it is designed to protect a broad societal interest implicating a generalized economic problem and is carefully tailored to protect that interest. State legislation ensuring the continuity of contracts after EMU

⁵⁴See *supra* pp. 171-73.

⁵⁵See *supra* pp. 177-81.

⁵⁶See *supra* pp. 170-73.

⁵⁷See *supra* pp. 171-73.

⁵⁸See *supra* pp. 138-39.

⁵⁹See *supra* p. 200.

⁶⁰See *infra* pp. 58-61.

⁶¹See *supra* pp. 35-100.

⁶²See *supra* pp. 206-11.

⁶³See *supra* pp. 8-11, 107-09, 156-61.

advances the important societal goal of preventing any unnecessary litigation that could disrupt a smooth transition to EMU in the increasingly integrated global financial markets. In this regard, the words of Chief Justice Chase in the *Legal Tender Cases* should be noted: “we assume as a fundamental proposition that it is the duty of every government to establish a standard of value. The necessity of such a standard is indeed universally acknowledged. Without it the transactions of society would become impossible.”⁶⁴ By analogy, transactions on the interdependent international financial markets could become impossibly burdensome if the continuity of contracts affected by EMU were not fully assured.

Moreover, the New York courts have repeatedly emphasized that New York has a strong policy interest in maintaining its status as an international financial and commercial center.⁶⁵ Thus, in *Weltover, Inc. v. Republic of Argentina*,⁶⁶ the U.S. Court of Appeals for the Second Circuit stated that “New York, as a preeminent commercial center, has an interest in protecting those who rely upon that reputation to do business, whether through the banking industry or otherwise.” The avoidance of litigation in the aftermath of EMU is an important societal goal in terms of promoting certainty and predictability in the financial markets and thereby protecting New York’s strong reputation as an international financial center.

Finally, the deference which the courts accord to the Legislature’s judgment as to the necessity and reasonableness of a particular measure also supports the constitutional validity of any legislation in this area. In this regard it should be recalled that in the *Gold Clause Cases* the Supreme Court went so far as to uphold the constitutional validity of a legislative abrogation of contractual clauses (i.e., gold clauses) enacted pursuant to the monetary sovereignty of the United States over its currency.⁶⁷ In these circumstances it is inconceivable that the constitutional validity of state legislation confirming the continuity of EU national currency contracts after EMU could be successfully challenged on the ground of its retroactive application.

State legislation having a retrospective effect on contractual obligations must also meet the test of due process. For the same reasons as under the Contract Clause, it is unlikely that legislation confirming the continuity of contracts after EMU will be regarded as altering contractual rights or obligations. Moreover, the courts will, in view of the importance of clarifying the legal status of contracts affected by EMU, defer to the Legislature’s judgment as to whether an impairment of contractual rights serves a legitimate legislative purpose and is further by rational means.

⁶⁴*Legal Tender Cases*, 79 U.S. (12 Wall.) 457, 583 (1870) (Chase, C.J., dissenting).

⁶⁵*See, e.g.*, *Matter of Allstate Ins. Co. (Stolarz)*, 613 N.E.2d 936, 939 (N.Y. 1993) (citing *J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda) Ltd.*, 333 N.E.2d 168, 172 (N.Y. 1975)); *Ehrlich-Bober & Co. v. Univ. of Houston*, 404 N.E.2d 726, 730-31 (N.Y. 1980) (citing *Intercontinental Planning, Ltd. v. Daystrom, Inc.*, 248 N.E.2d 576, 582-83 (N.Y. 1969)); *Pallavicini v. Int’l Tel. & Tel. Corp.*, 341 N.Y.S.2d 281, 283 (N.Y. App. Div. 1973) (citing *Daystrom*), *aff’d* 316 N.E.2d 722 (N.Y. 1974); *Wells Fargo Asia Ltd. v. Citibank, N.A.*, 936 F.2d 723, 726 (2d Cir. 1991), (citing *Zeevi*); *Fort Howard Paper Co. v. William D. Witter, Inc.*, 787 F.2d 784, 790-91 (2d Cir. 1986) (citing *Daystrom*; *Hutner v. Greene*, 734 F.2d 896, 899 (2d Cir. 1984)).

⁶⁶941 F.2d 145, 153 (2d Cir. 1991) (citation omitted).

⁶⁷*See supra* pp. 51-57.

XI. CONSTITUTIONAL LIMITATIONS ON STATE LEGISLATION AFFECTING INTERNATIONAL MONETARY AFFAIRS

A. Federal Government's Authority Over International Monetary Affairs

It is uncontroverted that the Federal Government is entrusted with full and exclusive authority over the conduct of foreign affairs under the U.S. Constitution.¹ The power to make treaties is vested in the President, to be exercised by and with the consent of a two thirds vote of the U.S. Senate.² The "Power . . . to regulate Commerce with Foreign Nations" is vested in Congress.³ More broadly, the executive power of the United States is vested in the President.⁴

The conduct of foreign affairs clearly includes the regulation of monetary relations with foreign governments. The U.S. Constitution implicitly recognizes that the establishment of a new currency by a foreign country falls within the exclusive sovereignty of such country's government.⁵ Moreover, in accordance with the State theory of money, the monetary sovereignty of a foreign country with respect to its currency is recognized as extending to the use of that currency in transactions governed by the laws of American jurisdictions.⁶ Any action by an American state legislature that impinges on the monetary sovereignty of a foreign government therefore implicates the authority of the Federal Government over international monetary affairs.

B. Constitutional Restrictions on State Legislation Affecting Foreign Affairs

The foreign affairs powers conferred upon the Federal Government are to the exclusion of the state governments: "No State shall, without the consent of Congress, . . . enter into any Agreement . . . with a foreign power."⁷ Thus the Supreme Court has repeatedly held that the Federal Government must be free to exercise its powers in the field of foreign relations free from interference by the states.⁸ Consequently any state law that involves a state in the actual conduct of foreign affairs is unconstitutional.⁹

Notwithstanding these proscriptions on the exercise of state power over international affairs, U.S. state governments have played an increasingly robust role in foreign affairs in recent years. There is an extensive legal literature considering the constitutional validity of state and local legislation covering such diverse matters as measures to combat apartheid in the former South Africa and job discrimination in Northern Ireland, restrict the procurement of foreign goods in alleged contravention of free trade arrangements with foreign trading partners, admit refugees from Central America, resolve cross-border environmental problems with neighboring Canadian provinces, and so on.¹⁰

¹See, e.g., *Zschernig v. Miller*, 389 U.S. 429, 432 (1968) (citing *Hines v. Davidowitz*, 312 U.S. 52, 63 (1941)); *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 425, 427 n.25 (1964); *United States v. Pink*, 315 U.S. 203, 222-23 (1942) (citing *United States v. Belmont*, 301 U.S. 324, 328 (1937)); *Fong Yue Ting v. United States*, 149 U.S. 698, 711-13 (1893).

²U.S. CONST. art. II, § 2, cl. 2.

³*Id.* art. I, § 8, cl. 3.

⁴*Id.* art. II, § 1, cl. 1. For other provisions concerning foreign affairs powers upon the President, see *id.* art. II, § 2, cls. 1, 2.

⁵See *supra* pp. 80-81.

⁶See *supra* pp. 35-100.

⁷U.S. CONST. art. I, § 10, cl. 3.

⁸See *Zschernig*, 389 U.S. at 432; *Pink*, 315 U.S. at 223 (quoting *Belmont*, 301 U.S. at 331); *Hines*, 312 U.S. at 63; see also *Texas Indus., Inc v. Radcliff Materials, Inc.*, 451 U.S. 630, 641 (1981); *The Chinese Exclusion Case*, 130 U.S. 581, 606 (1889).

⁹See *Zschernig*, 389 U.S. at 440-41; *Trojan Technologies, Inc. v. Commonwealth of Pennsylvania*, 916 F.2d 903, 913 (3d Cir. 1990) (citing *Pink*, 315 U.S. at 223).

¹⁰See, e.g., Greg N. Anderson, *Achieving United States - Canadian Reciprocity in Sub-national Government Procurement: Federalism and the Canada-United States Free Trade Agreement.*, 4 IND. INT'L & COMP. L. REV. 131 (1993); Richard B. Bilder, *The Role of States and Cities in Foreign Relations*, 83 AM. J. INT'L L. 821 (1989); Howard N. Fenton, *The Fallacy of Federalism in Foreign Affairs: State and Local Foreign Policy Trade Restrictions*, 13 N.W. J. INT'L L. & BUS. 563 (1993); Peter R. Jennetten, *State Environmental Agreements with Foreign Powers: The Compact Clause and the Foreign Affairs Power of the States*, 8 GEO. INT'L ENVTL. L. REV. 141 (1995); Kevin P. Lewis, *Dealing with South Africa: The Constitutionality of State and Local Divestment Legislation*, 61 TUL. L. REV. 469

More relevant in the context of EMU has been the decision by the New York State Legislature and the 20 jurisdictions that have adopted the Uniform Foreign-Money Claims Act to pass legislation ensuring that courts may award damages in foreign currencies in respect of actions involving foreign currency obligations.¹¹ In particular, the Uniform Foreign-Money Claims Act provides that if, after an obligation is expressed in a foreign money, the country issuing or adopting such money substitutes a new money in place of that money, the obligation is treated as if expressed in the new money at the conversion rate established by the issuing country for the payment of like obligations denominated in the former money.¹²

It has been suggested by some commentators that legislation regarding foreign currency matters affects international relations and thus falls within the province of the Federal Government.¹³ This raises the question of whether legislation enacted by the New York State Legislature to ensure the continuity of contractual obligations in the aftermath of EMU would withstand constitutional challenge as an impermissible intrusion on the Federal Government's authority over foreign affairs.

The Supreme Court has held that legislation pertaining to a matter that has been traditionally regulated by the states must give way if it impairs the effective exercise of the Federal Government's foreign policy.¹⁴ Thus the Court struck down as an impermissible intrusion into the field of foreign affairs an Oregon inheritance statute that restricted the ability of aliens to inherit property under a will unless reciprocal inheritance rights were extended to U.S. citizens.¹⁵ It appears, however, that such legislation will only be declared unconstitutional where it is applied in such a manner as to intrude on the Federal Government's authority over international affairs.¹⁶ Thus the Oregon statute had a direct impact on foreign relations because the Oregon courts routinely launched inquiries into the type of government that obtained in the inheritor's country, inquiries that often radiated Cold War attitudes regarding Communist régimes, thereby holding great potential for embarrassment in U.S. relations with East Bloc countries.¹⁷ Courts have consistently upheld state legislation in areas normally falling within a state's competence where the legislation is uniform and is not applied selectively according to the foreign policy attitudes of the courts.¹⁸

The Supreme Court has also upheld the validity of state legislation which will only have some incidental or indirect effect in foreign countries provided it does not directly impact on foreign relations.¹⁹

(1987); Karl Manheim, *State Immigration Laws and Federal Supremacy*, 22 HASTINGS CONST. L.Q. 939 (1995); Peter J. Spiro, *State and Local Anti-South Africa Action as an Intrusion upon the Federal Power in Foreign Affairs*, 72 VA. L. REV. 813 (1986); Cheryl Tate, *The Constitutionality of State Attempts to Regulate Foreign Investment*, 99 YALE L. J. 2023 (1990).

¹¹See *supra* p. 131.

¹²UNIF. FOREIGN-MONEY CLAIMS ACT §12(a) (1989), discussed *supra* pp. 85-86.

¹³See Suzanne R. Westerheim, *The Uniform Foreign-Money Claims Act: No Solution to an Old Problem*, 69 TEX. L. REV. 1203, 1218-19 (1991); Ronald A. Brand, *Restructuring the U.S. Approach to Judgments on Foreign Currency Liabilities: Building on the English Experience*, 11 YALE J. INT'L L. 139, 174 (1985).

¹⁴Zschernig, 389 U.S. at 440.

¹⁵*Id.* at 440-41.

¹⁶See *id.* at 433-35, 440; Trojan, 916 F.2d at 913 (citing Zschernig).

¹⁷*Id.*; see also *Hoylake Invs. Ltd. v. Washburn*, 723 F. Supp. 42, 49 (N.D. Ill. 1989); *Re Alien Children Educ. Litig.*, 501 F. Supp. 544, 594 (S.D. Tex. 1980), *aff'd* 628 F.2d 448 (5th Cir. 1980), *aff'd* 457 U.S. 202 (1982); *Shames v. State of Nebraska*, 323 F. Supp. 1321, 1326-32 (D. Neb. 1971), *aff'd* 408 U.S. 901 (1972); *Bjarsch v. DiFalco*, 314 F. Supp. 127, 133 (S.D.N.Y. 1970); *Goldstein v. Cox*, 299 F. Supp. 1389, 1392-94 (S.D.N.Y. 1968), *app. dis.* 396 U.S. 471 (1970).

¹⁸See Trojan, 916 F.2d at 913-14 (upholding Pennsylvania statute requiring state agencies to use steel produced in the United States in public construction projects); *Hoylake*, 723 F. Supp. at 49 (upholding Illinois insurance statute requiring regulatory approval for a change of control of domestic insurance companies); *Alien Children*, 501 F. Supp. at 590-95 (while striking down Texas statute restricting access to a state educational fund to U.S. citizens on other grounds, held that statute did not impermissibly interfere with foreign policy); *Shames*, 323 F. Supp. at 1326-32 (upholding Nebraska statute prohibiting non-U.S. citizens from inheriting land close to cities and towns); *Bjarsch*, 314 F. Supp. at 133 (upholding New York statute restricting rights of alien beneficiaries to receive inheritances); *Goldstein*, 299 F. Supp. at 1392-94 (same).

¹⁹*Clarke v. Allen*, 331 U.S. 503, 516-17 (1947) (upholding Californian inheritance statute requiring non-resident aliens to prove existence of reciprocal inheritance rights for U.S. citizens before taking by succession); see also Trojan, 916 F.2d at 913; Pan Am. Health

The Court has pointed out that many state laws have incidental or indirect effects in foreign countries which nobody would claim cross the forbidden line.²⁰ In trying to decide where to draw the line it has been suggested that the mere possibility that the legislation might become the subject of international negotiations cannot of itself justify invalidation of a statute.²¹

The courts will not be bound by evidence that the State Department does not regard the relevant state statute as unduly interfering with the conduct of U.S. foreign relations.²² Nonetheless, courts have been influenced by the attitude of Congress and the Executive towards such state or local legislation. Thus, state legislation allegedly intruding upon the Federal Government's foreign affairs powers has been upheld where there was evidence that Congress had directed its attention to the matter implicated by the state statute and had taken no steps to preempt state legislation through the enactment of federal legislation.²³ Again, local laws have been upheld where the legislative history for related Congressional legislation evidenced a Congressional expectation that the matter at hand would be resolved by local law.²⁴ Factors that have been taken into consideration in upholding such local laws include the fact that Congress is free to remedy the situation by legislation and the existence of evidence that the State Department does not regard the legislation as intruding impermissibly into the conduct of foreign relations.²⁵

The cases regarding state legislation in the field of international trade relations also shed light on the limits of state power in the international arena. It is incontrovertible that international commerce, like foreign affairs generally, is pre-eminently a matter of federal concern.²⁶ Thus, a state's power in the context of foreign commerce is constrained because of the special need for federal uniformity.²⁷ The Supreme Court has held that if a state regulation prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments it is unconstitutional.²⁸ Thus, the Supreme Court has struck down novel state taxes that might lead to retaliation from foreign nations disadvantaged by the taxes.²⁹ More recently the Supreme Court appears to have eased its approach, upholding a controversial Californian method of computing taxes for multinational companies notwithstanding the fact that the governments of many of the United States' trading partners expressed strong disapproval of California's method of taxation.³⁰

The Supreme Court has also recognized that certain state regulations will not infringe the federal power to regulate international commerce where they merely have "foreign resonances".³¹ The fact that Congress has failed to preempt the state legislatures by affirmative regulation does not of itself mean that a state is free to legislate in that area because the Supreme Court, and not a state legislature, is the final arbiter of the competing demands of state and national interests.³² The Court has stated that the need for

Org. v. Montgomery County, 889 F. Supp. 234, 240-41 (D. Md.1994) (upholding a local zoning restriction applicable to a public international organization); Alien Children, 501 F. Supp. at 594; Shames, 323 F. Supp. at 1332 (citing Zschernig and Clarke).

²⁰Clarke, 331 U.S. at 517; *see also* Zschernig, 389 U.S. at 461-62 (Harlan J. dissenting).

²¹*See* Trojan, 916 F. 2d at 913-14.

²²*See* Zschernig, 389 U.S. at 434-35; *id.* at 443 (Harlan J. concurring).

²³*See* Trojan, 916 F. 2d at 913-14.

²⁴*See* Pan Am., 889 F. Supp. at 241.

²⁵*See id.* at 240-41.

²⁶*See* Barclays Bank Plc. v. Franchise Tax Bd. of California, 512 U.S. 298, 311 (1994) (citing Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434, 448 (1979) (quotation omitted)).

²⁷*See* Barclays, 512 U.S. at 311 (quoting Wardair Canada Inc. v. Florida Dept. of Revenue, 477 U.S. 1, 8 (1986)).

²⁸Japan Line, 441 U.S. at 450-51.

²⁹*Id.* at 451-54.

³⁰Barclays, 512 U.S. at 324 n.22.

³¹Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 194-97 (1983) (citations omitted) (upholding a Californian tax imposed on domestic corporations that included foreign subsidiaries in the calculation of income).

³²*See* Japan Line, 441 U.S. at 454 (citation omitted).

a consistent and coherent foreign policy, which is the exclusive responsibility of the Federal Government, enhances the necessity that Congressional authorization not be lightly implied.³³ Where the facts establish that the Federal Government affirmatively decides to permit the states to act, the state action will not be viewed by the Court as preventing the Federal Government from speaking with one voice in the regulation of international commercial relations.³⁴ In its most recent pronouncement on this subject, the Supreme Court stated that the Federal Congress need not convey its intent with unmistakable clarity but may more passively indicate that certain state practices do not impair federal uniformity in an area where federal uniformity is essential.³⁵ Thus the Supreme Court held that Congress had implicitly permitted the states to legislate based on evidence of Congress' failure to enact numerous bills introduced in Congress and based on the Senate's failure to ratify certain provisions in tax treaties that would have preempted the states.³⁶

C. Compatibility of State Legislation regarding EMU with Federal Government's Foreign Affairs Powers

The introduction of the single European currency clearly implicates the authority of the Federal Government over foreign affairs. In articulating the official position of the United States with respect to EMU, the Federal Government has stated that "America's relationship with Europe has long been the cornerstone of our economic and foreign policy" and that "[t]he United States has long supported the broad objectives of European integration."³⁷ In that vein, the Federal Government regards EMU as "the latest step in the process of European integration" and the official position of the United States is that EMU "is a European matter, for Europeans to decide."³⁸ Thus, "[t]he [U.S.] administration has never thought it fitting to enter the debate over whether economic and monetary union is right for Europe, nor *over the details of how it should be structured.*"³⁹ The questions "whether there will be or should be an EMU" and, significantly, how "should EMU be structured" are "questions ... for Europeans to answer for themselves."⁴⁰

In accordance with the State theory of money, the establishment of a new foreign currency is a matter that lies exclusively within the sovereign powers of the foreign government that issues such money, and this sovereignty extends to the regulation of monetary obligations contained in private contracts.⁴¹ The issue which arises here is the extent to which state legislatures may exercise the dormant powers of the Federal Government over the conduct of international monetary affairs so as to legislate for the continuity of contracts after EMU.

The regulation of private contract law is an area that has traditionally fallen within the competence of the states rather than the federal authorities. Moreover, New York, as a preeminent center of international financial activity, has a strong policy interest in ensuring that its laws are applied in such a manner as to protect its reputation in the financial community.⁴² The introduction of the single European currency has sparked a highly publicized debate in the international financial media regarding the status of financial contracts denominated in EU currencies and governed by New York law.⁴³ Because of the

³³South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 92 n.7 (1984).

³⁴See Wardair, 477 U.S. at 9; Container Corp., 463 U.S. at 196-97.

³⁵Barclays, 512 U.S. at 323.

³⁶*Id.* at 323-28.

³⁷Remarks by Deputy Treasury Secretary Lawrence H. Summers, EMU: An American View of Europe 1 (Apr. 30, 1997) (on file with U.S. Dep't of the Treasury, Office of Public Affairs, Index #1660).

³⁸*Id.*

³⁹Larry Summers, *American Eyes on EMU*, FINANCIAL TIMES, Oct. 22, 1997, at 14 (emphasis added).

⁴⁰Remarks by Deputy Treasury Secretary Lawrence H. Summers, *supra* note 37, at 1.

⁴¹See *supra* pp. 35-100.

⁴²See *supra* pp. 213-14.

⁴³See *supra* pp. 6-7.

significant amounts of foreign currency obligations in swap, derivative and bond contracts that are affected by this issue,⁴⁴ New York State has a legitimate interest in ensuring that there is no legal uncertainty in the financial markets after EMU.

In resolving the competing demands of state and national interests the federal courts will be persuaded by the fact that the state legislation confirms the continuity of contracts affected by EMU in a manner that is broadly consistent with the EU Council regulations on the introduction of the euro. Because the state legislation is broadly compatible with the exercise of the monetary sovereignty of the European Union over the currencies of EU member states there is little danger that the legislation will be applied in such a manner as to intrude on the Federal Government's authority over international affairs.

Any state legislation that fails to recognize the continuity of contracts in full conformity with the State theory of money would of course intrude on the Federal Government's foreign affairs powers. Such legislation would disrupt a smooth transition to EMU and could provoke an unfavorable reaction in the European Union. Thus the states' powers are carefully circumscribed so that any legislation enacted by the states in this area may only give full effect to the monetary sovereignty of the European Union by confirming the continuity of contracts in accordance with the EU Council regulations. It should be noted that this particular goal has already been explicitly accomplished in those jurisdictions, such as California and Illinois, that have adopted the Uniform Foreign-Money Claims Act.⁴⁵

It is true that legislation enacted by the New York State Legislature clarifying the legal implications of EMU would have a direct effect in member states of the European Union insofar as many EU nationals are parties to contracts governed by New York law.⁴⁶ Thus, it cannot be said that such legislation would only have "foreign resonances". Nonetheless, the effect of such legislation is incidental insofar as it implements the monetary sovereignty of the European Union in accordance with the State theory of money, and does not therefore alter the substance of relevant contractual obligations.

In view of the important implications of EMU for the international monetary system it might be prudent for American state legislatures to pay deference to the Federal Government's authority over foreign relations by informing Congress of any decision to pass legislation addressing the implications of EMU. This would ensure that the Federal Government would not be prevented from speaking with one voice on behalf of the United States with respect to EMU. This would also afford an opportunity for the Federal Government to indicate to the state authorities that it does not object to legislative initiatives by the states in this area. Evidence of the Executive's position, perhaps in the form of a letter from the Treasury Secretary, would also help to fully insulate state legislation from any possible constitutional challenge. Nonetheless, it is highly unlikely that the failure to consult the Federal Government would of itself prejudice the constitutional validity of any relevant state legislation.

In conclusion, it is submitted that state legislation, insofar as it seeks to confirm the continuity of private contracts after EMU in a manner that is broadly consistent with the applicable provisions of the EU Council regulations, does not intrude on the constitutional authority of the Federal Government to conduct international monetary affairs.

⁴⁴See *supra* pp. 3-5.

⁴⁵See *supra* pp. 85-86.

⁴⁶See *supra* pp. 3-4.

CONCLUSION

This study concludes that the introduction of the single European currency presents few uncertainties for the continuity of contracts governed by New York law and the laws of other U.S. jurisdictions. In accordance with the State theory of money, all contractual obligations denominated in EU national currencies and governed by the laws of U.S. jurisdictions must be discharged in accordance with the applicable provisions of the EU Council regulations on the introduction of the euro after EMU. The legislation enacted in New York and Illinois confirming the continuity of contracts after EMU is broadly consistent with the EU Council regulations. Possible discrepancies between the state legislation and the EU Council regulations can be overcome by interpreting the state legislation so as to harmonize it with the EU Council regulations. In any case, in the event of a conflict between the EU Council regulations and the New York or Illinois legislation, the provisions of the EU Council regulations shall prevail by virtue of the State theory of money.

Contractual obligations denominated in the official ECU and governed by the laws of most U.S. jurisdictions shall be discharged in accordance with the provisions of the EU Council regulations. ECU obligations governed by New York law shall be discharged either pursuant to the EU Council regulations or in accordance with the substantially identical provisions of the New York legislation confirming the continuity of contracts after EMU.

Because the state legislation confirms the continuity of contracts in a manner that is broadly consistent with the applicable EU legislation, it will not retroactively impair the obligation of contracts contrary to the provisions of the United States Constitution. Nor will the state legislation infringe the U.S. Federal Government's authority over international monetary relations. This is because the state legislation generally defers to the monetary sovereignty of the European Union over the currencies of EU member states.

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