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Economic and Monetary Union in Europe: Legal Implications of the Arrival of the Single Currency

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Werner Van Lembergen and Margaret G. Wachenfeld

Abstract

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ECONOMIC AND MONETARY UNION IN EUROPE: LEGAL IMPLICATIONS OF THE ARRIVAL OF THE SINGLE CURRENCY

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INTRODUCTION

On January 1, 1999, Economic and Monetary Union ("EMU") will be achieved among eleven Member States of the European Union (or "EU"). On that day, Europe's single currency, the "euro,"[1] will be introduced. Three years later, after a transitional period designed to permit Europe, and the rest of the world, to accommodate the use of a single currency, the euro will be the sole legal tender in the Member States that participate in EMU. The move to a single currency is a remarkable achievement. It is the result of a series of efforts to coordinate the Member States' economic policies and to pool monetary sovereignty at the European level.[2]

Following the suggestions made in a 1989 report of a special

1. According to the Commission of the European Communities ("Commission"), the name euro "is inspired by the Greek epsilon pointing back to the cradle of European civilization and the first letter of Europe, crossed by two parallel lines to indicate the stability of the Euro." Commission of the European Communities, COM (97) 75 Final (1997).

2. For a discussion of the history of Economic and Monetary Union ("EMU"), see Claude Gnos, *La transition vers l'union économique et monétaire: Les vertus négligées*, 360

committee chaired by then President Jacques Delors of the Commission of the European Communities ("Commission"),[3] the European Council[4] decided in June 1989 to introduce EMU in three stages.[5] Stage I of EMU began on July 1, 1990 with the removal of all restrictions on the movement of capital between Member States.[6] For the realization of Stages II and III, the Treaty establishing the European Community[7] ("EC Treaty") had to be revised to establish the required institutional structure. It is the amendments to the EC Treaty introduced by the Maastricht Treaty[8] that laid the groundwork for the most important stages—Stages II and III—with the move to a single monetary policy and single currency.[9] As of January 1, 1994, the start of Stage II, Member States undertook to reduce excessive govern-

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REVUE DU MARCHÉ COMMUN ET DE L'UNION EUROPÉENE 621-26 (July-Aug. 1992); *EMU: An Awfully Big Adventure*, ECONOMIST, Apr. 11, 1998, at 3-4.

3. The European Council decided at its meeting of June 1988 to set up a special committee charged with studying and proposing concrete stages leading to EMU. *See* Hanover European Council, Conclusions of the Presidency, 21 E.C. BULL., no. 6, at 165-66 (1988). The report of the Delors Committee has been published in Eur. doc. 1550/1551 of Apr. 20, 1989. The idea of an economic and monetary union substantially predates the 1988 meeting. It is a long-held ambition of European political leaders. *See EMU: An Awfully Big Adventure*, *supra* note 2, at 3.

4. The "European Council" is a political organ composed of the Heads of State or Goverment of the European Union ("EU") Member States, plus a member, usually the President, of the Commission. The European Council is to be distinguished from the "Council of Ministers," which is the highest decision-making body within the European Union and which is, as a general rule for economic and finance affairs, composed of the economic affairs and finance ministers of the Member States or their staff ("ECOFIN").

5. Madrid European Council, Conclusions of the Presidency, 22 E.C. BULL., no. 6, at 11 (1989).

6. *See* Council Directive No. 88/361, O.J. L 178/5 (1988) (discussing implementation of Article 67 of Treaty Establishing the European Community ("EC Treaty")). All remaining restrictions on the cross-border flow of capital needed to be eliminated by January 1, 1990, with temporary exceptions for Spain, Portugal, and Greece.

7. Treaty establishing the European Community, Feb. 7, 1992, O.J. C 224/1 (1992), [1992] 1 C.M.L.R. 573 [hereinafter EC Treaty], *incorporating changes made by* Treaty on European Union, Feb. 7, 1992, O.J. C 224/1 (1992), [1992] 1 C.M.L.R. 719, 31 I.L.M. 247 [hereinafter TEU]. The Treaty on European Union ("TEU" or "Maastricht Treaty") amended the Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter EEC Treaty], *as amended by* Single European Act, O.J. L 169/1 (1987), [1987] 2 C.M.L.R. 741 [hereinafter SEA], *in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES (EC Off'l Pub. Off. 1987).

8. Treaty on European Union, Feb. 7, 1992, O.J. C 224/1 (1992), [1992] 1 C.M.L.R. 719, 31 I.L.M. 247 (amending EEC Treaty, *supra* note 7).

9. *See* EC Treaty, *supra* note 7, arts. 102a-109m, O.J. C 224/1, at 33-43 (1992), [1992] 1 C.M.L.R. at 636-55.

ment deficits under close review at the European level.[10] Further, Member States established the European Monetary Institute ("EMI"), the forerunner of the current European Central Bank ("ECB"). As of January 1, 1999, Stage III of EMU will commence with the irrevocable locking of the exchange rates of the currencies of the eleven participating Member States that have met certain convergence requirements laid out in the Maastricht Treaty and have elected to participate in EMU (the "Participating Member States") and with the conduct of the single monetary policy under the responsibility of the ECB.[11]

During a three-year transitional period beginning at the start of Stage III, the euro will exist only in paperless form, pending the production of euro banknotes and coins and their release by January 1, 2002. From the start of Stage III, the Participating Member States' currencies will cease to be independent currencies but will remain legal tender. The currencies will become denominations of the euro, and the conversion rate of each participating national currency will be irrevocably fixed to the euro. At the end of the three-year transitional period, the introduction of the euro will be completed by physical replacement of all participating national currency notes and coins by euro notes and coins. At that time, the participating national currencies will cease to be legal tender.

Financial markets and their participants are preparing the necessary systemic changes to permit a large part of public and private bonds, securities, derivatives, and other financial instruments to be issued, traded, and settled in a euro-denominated form from the start of Stage III. Although the retail sector will be compelled by consumer demand to list simultaneously prices in euros and national currencies during the transitional period, it is expected that large-scale use of the euro at the retail level will commence only by the end of the transitional period. How quickly the business sector will switch over to the new currency depends on the size and nature of the business; for multinational companies, the change is a welcome relief from dealing in

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10. *See id.* art. 109e(4), O.J. C 224/1, at 40 (1992), [1992] 1 C.M.L.R. at 648; *id.*, Protocol on the excessive deficit procedure, O.J. C 224/1, at 120-21 (1992), [1992] 1 C.M.L.R. at 769-70.

11. The European Central Bank ("ECB") was established on June 1, 1998. *See infra* notes 31 and 32.

multiple currencies and will be implemented as quickly as possible.

There is currently no Stage IV of EMU under serious discussion, but a logical further step for Member States would entail a move towards a single economic policy, including, among others, a move towards more harmonized fiscal and social policies. Given the controversy surrounding the move to a single monetary policy and single currency, the long and painful discussions about apparent loss of sovereignty for Member States, and the sheer magnitude of the task of initially replacing eleven currencies by a single currency, serious discussions concerning a formal post-Stage III scenario are not expected in the near future. At the end of the day, however, EMU is essentially a political process, involving an increased pooling of sovereignty by Member States, initially at the monetary level, but undoubtedly, with spillovers at the fiscal, financial, and other socio-economic levels.[12]

Part I of this Article presents an overview of EMU, addressing first the Member States that will participate in EMU from the outset and how they were chosen, as well as the new institutions that will guide and support EMU. This Article will then focus on the EU regulations that provide the legal framework for EMU, analyzing issues in the regulations of particular legal interest. This structural discussion will also describe what Participating Members States must achieve to ensure that EMU stays on track and how EU institutions will supervise their performance. Part I closes with a brief look at the international role of the euro. After discussing the structure of EMU, this Article will focus in Part II on what EMU will mean for companies operating in the brave new world of the "euro zone" and, in particular, on the legal issues raised by the introduction of the euro. This Article will look at the implications for the public obligations of companies, and, in particular, concerns about the continuity of contracts denominated in European Currency Unit ("ECU") or in one of the national currencies that will be replaced by the euro. It will then look at how the financial markets—debt, equity, and derivatives—are expected to change and what the change implies for companies seeking to raise financing in these markets. This Arti-

12. C.A.E. Goodhart, *The Transition to EMU*, *in* EUROPEAN ECONOMIC AND MONETARY UNION: THE INSTITUTIONAL FRAMEWORK 3-21 (Mads Andenas et al. eds., 1997).

cle will finally and briefly look at the new systems to be put in place under EMU to facilitate the increased flow of expected transactions.

I. *AN OVERVIEW OF ECONOMIC AND MONETARY UNION*

A. *Inside EMU and Inside the European Union*

1. Participating in EMU—Meeting the Convergence Criteria

The convergence criteria that successful EMU candidates must meet are set out in Article 109j of the EC Treaty.[13] These criteria represent the indispensable economic conditions for creating a strong and stable single currency, which, it is hoped, will be at least as strong as the strongest participating national currency. The convergence criteria are: (i) a high degree of price stability, as reflected in the rate of inflation, (ii) sustainability of the government financial position as reflected in a government budgetary position without excessive deficits, (iii) sustainable exchange rate stability in the European Monetary System (or "EMS") for at least two years prior to participation, and (iv) durable convergence as reflected in long-term European interest rate levels.[14] The specific requirements implementing the excessive deficit convergence criteria are further elaborated in Article 104c of the EC Treaty: prospective candidates must maintain a

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13. EC Treaty, *supra* note 7, art. 109j, O.J. C 224/1, at 42 (1992), [1992] 1 C.M.L.R. at 651-53. To avoid confusion, this Article will refer to the original numbering of the articles of the EC Treaty and the Maastricht Treaty, and not the new numbering resulting from the codification of the texts of the EC Treaty and the Treaty of Amsterdam. Treaty of Amsterdam amending the Treaty on European Union, the Treaties establishing the European Communities and certain related acts, Oct. 2, 1997, O.J. C 340/1 (1997) (not yet ratified) [hereinafter Treaty of Amsterdam]; Consolidated version of the Treaty on European Union, O.J. C 340/2 (1997), 37 I.L.M. 56 (not yet ratified), *incorporating changes made by* Treaty of Amsterdam, *supra*; Consolidated version of the Treaty establishing the European Community, O.J. C 340/3 (1997), 37 I.L.M. 79 (not yet ratified), *incorporating changes made by* Treaty of Amsterdam, *supra*. By virtue of the Treaty of Amsterdam, articles of the TEU and the EC Treaty will be renumbered in the Consolidated version of the Treaty on European Union and the Consolidated version of the Treaty establishing the European Community, respectively. Treaty of Amsterdam, *supra*, art. 12, O.J. C 340/1, at 78-79 (1997).

14. *See* EC Treaty, *supra* note 7, Protocol on the convergence criteria referred to in Article 109j of the Treaty establishing the European Community, O.J. C 224/1, at 121 (1992), [1992] 1 C.M.L.R. at 770-71; *see also* Commission of the European Communities, *The Euro: Explanatory Notes*, EURO PAPERS, No. 17, Feb. 1998 (visited Nov. 3, 1998) <http://www.europa.eu.int/euro/html> (on file with the *Fordham International Law Journal*) (offering more detailed explanation of statistical data used in assessing Member State's compliance with convergence criteria).

ratio of planned or actual government deficit to gross domestic product of three percent and a ratio of public debt to gross domestic product that does not exceed sixty percent.[15] An additional selection requirement set forth in Articles 107 and 108 of the EC Treaty is the independence of a Participating Member State's national central bank.[16]

Over the weekend of May 1, 1998, the Council of Ministers, in its exceptional composition of the Heads of State and Government,[17] decided which Member States met the convergence criteria.[18] Their decision was preceded by a series of decisions and analyses required by the terms of the Maastricht Treaty.[19] The Commission and the EMI first prepared convergence reports analyzing each Member State's level of preparation. The reports were then presented, together with a Commission recommendation, to the economic affairs and finance ministers of the Member States ("ECOFIN"), which in turn, after consulting the European Parliament, submitted a recommendation to the Council of Ministers.

As a result, of the fifteen Member States of the European Union, EMU will proceed at the start of Stage III with eleven Member States.[20] Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and

15. The Maastricht Treaty provided a considerable margin of discretion in determining whether an EU Member State met the convergence thresholds. *See* EC Treaty, *supra* note 7, Protocol on the excessive deficit procedure, O.J. C 224/1, at 120-21 (1992), [1992] 1 C.M.L.R. at 769-70.

16. *Id.* arts. 107-08, O.J. C 224/1, at 37 (1992), [1992] 1 C.M.L.R. at 642-43. It is noteworthy that despite its decision not to participate, Sweden was the only Member State not to have met this condition.

17. The Council of Ministers' composition of the Heads of State and Government was an exception to the general rule that the Council of Ministers is normally composed of ministers of the Member States. *See supra* note 4.

18. Council Decision No. 98/317 in accordance with Article 109j(4) of the Treaty, O.J. L 139/30 (1998) [hereinafter Council Decision No. 98/317]. For interesting comments on the political decision-making process employed during the May weekend, see Editorial Comments, *The Birth of the Euro*, 35 COMMON MKT. L. REV. 585, 585-94 (1998).

19. EC Treaty, *supra* note 7, art. 109j, O.J.C 224/1, at 142 (1992), [1992] 1 C.M.L.R. at 651-53.

20. There is already a long-standing "monetary union" between Belgium and Luxembourg. The so-called Belgian-Luxembourg Economic Union ("BLEU") was established by the Belgium-Luxembourg Treaty on Economic Union, as amended in 1963, at which time the Luxembourg franc was tied to the Belgian franc at a 1:1 rate. Belgium-Luxembourg Treaty on Economic Union, Feb. 12, 1921, 547 U.N.T.S. 141. Belgian banknotes and coins are legal tender in Luxembourg, whereas Luxembourg banknotes and coins are not legal tender in Belgium but can be exchanged without costs. The

Spain were judged to have met the necessary conditions for adopting the single currency. Greece and Sweden[21] did not meet all the relevant Maastricht Treaty criteria and thus will not participate until they have met all the conditions.[22] The United Kingdom has decided to exercise its "opt-out" of Stage III,[23] and Denmark will not exercise its formal "opt-in" to EMU granted under the Maastricht Treaty.[24] Article 109j(4) of the EC Treaty includes a legal undertaking among the Member States to proceed with Stage III, and this undertaking exists even if not all, or even a majority, of Member States are ready to join. As recently as one year before the May 1998 Summit, there were serious concerns about whether EMU would go forward at all, and it was assumed at that time that if it went ahead on schedule, Stage III would start with a smaller group of Member States. A year of

external value to all other currencies is identical and exchange rate policy in relation to currencies of third countries is adopted by mutual agreement.

21. Contrary to the United Kingdom and Denmark, Sweden does not have a formal opt-out from possible participation in Stage III in the Maastricht Treaty. Sweden was therefore not excluded from the examination, despite Sweden's political decision not to participate. Sweden was found not to meet the requirements concerning the independence of its central bank. One can only speculate what diplomatic solutions would have been found if an unwilling Sweden had met all the selection criteria and thus would have been under a Treaty obligation to participate in Stage III.

22. Council Decision No. 98/317, O.J. C 139/30 (1998). Even if it had qualified, Sweden had already chosen not to participate in EMU, even though it did not have a formal opt-out.

23. *See* EC Treaty, *supra* note 7, Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, O.J. C 224/1, at 123-25 (1992), [1992] 1 C.M.L.R. at 773-75; Ian Harden, *The Maastricht Treaty and Economic and Monetary Union and the UK opt-out Protocol*, 23 TILBURG FOREIGN L. REV. 105 (1993). According to the Economist, there is a tacit political understanding that the United Kingdom will join by January 1, 2001. *EMU: An Awfully Big Adventure, supra* note 2, at 3-4.

24. *See* EC Treaty, *supra* note 7, Protocol on certain provisions relating to Denmark, O.J. C 224/1, at 125 (1992), [1992] 1 C.M.L.R. at 775. At the December 1992 Edinburgh Summit, the European Council made special arrangements for Denmark, including the agreement that Denmark would not participate in the final stage of EMU, thus paving the way for the second Maastricht referendum in Denmark on the ratification of the Maastricht Treaty. *See* Council Notice, O.J. C 348/1(1992) [hereinafter Denmark and the TEU]; AGENCE EUROPE, no. 5878, Dec. 13, 1992, at 13; *see also* D.M. CURTIN & R.H. VAN OOIK, DE BIJZONDERE POSITIE VAN DENEMARKEN IN DE EUROPESE UNIE 675 *et seq* (S.E.W., 1993). The expectation is that a decision by the United Kingdom to join would pull in Sweden and Denmark as well. *See EMU: An Awfully Big Adventure, supra* note 2, at 8-9; J.P. Morgan, *Look for Britain to Join EMU in 2002*, 10 EUROWATCH, No. 14, at 1; *Practical Issues Arising from the Introduction of the Euro*, No. 7, BANK OF ENGLAND, at 89-93 (Mar. 12, 1998) <http://www.bankofengland.co.uk/euroiss7.htm> (on file with the *Fordham International Law Journal*) [hereinafter *Practical Issues Arising from the Introduction of the Euro*, No. 7].

serious budget cutting, improved economic performance, and the sheer force of will of the current European leaders produced a remarkable outcome that gives far greater credence to the concept of a single currency for Europe than a currency with a limited number of Participating Member States ever could.[25]

2. Supporting EMU—the Institutional Structure

EMU will function based on a single monetary policy directed by the decision-making bodies of the ECB, which was established on June 1, 1998.[26] The ECB and Member States' independent national central banks will together comprise the European System of Central Banks ("ESCB").[27] The primary objective of EMU monetary policy will be to maintain price stability, i.e., non-inflationary growth.[28] The yardstick for price stability is the average rate of inflation of the three Member States whose inflation rates are the lowest, and the permitted deviation is 1.5 percent per annum.[29] Price stability is an objective to be pursued by all the Participating Member States.[30] The special importance of this goal is evident from the independent role assigned to the ECB and the national central banks.[31] To counterbalance the lack of political accountability of the ECB, the Participating Member States have formed an informal political "Euro-Eleven Group" to discuss streamlining national budgetary policies, exchange rate policies, etc.[32]

25. For a graphic depiction of the state of Europe's preparations for EMU as late as October 1997, see the cover of THE ECONOMIST from October 11-17, 1997.

26. With the establishment of the ECB on June 1, 1998, the European Monetary Institute ("EMI") completed its tasks and is currently in the process of being liquidated. *See European Central Bank Will Be Established on 1 June, Now That Appointments of President and Executive Board are Final*, AGENCE EUROPE, No. 7729, May 27, 1998, at 6; EC Treaty, *supra* note 7, art. 106(3), O.J. C 224/1, at 37 (1992), [1992] 1 C.M.L.R. at 642.

27. EC Treaty, *supra* note 7, Protocol on the Statute of the European System of Central Banks and of the European Central Bank, O.J. C 224/1, at 104-15 (1992), [1992] 1 C.M.L.R. at 741-60 [hereinafter ECB Statute]; *id.*, Protocol on the Statute of the European Monetary Institute, O.J. C 224/1, at 115-20 (1992), [1992] 1 C.M.L.R. at 760-69.

28. *Id.* art. 105(1), O.J. C 224/1, at 36 (1992), [1992] 1 C.M.L.R. at 641; *id.*, ECB Statute, *supra* note 26, art. 2, O.J. C 224/1, at 105 (1992), [1992] 1 C.M.L.R. at 741.

29. *Id.*, Protocol on the excessive deficit procedure, O.J. C 224/1, at 120-21 (1992), [1992] 1 C.M.L.R. at 769-70.

30. *Id.* art. 105(1), O.J. C 224/1, at 36 (1992), [1992] 1 C.M.L.R. at 641.

31. *Id.* arts. 107-08, O.J. C 224/1, at 37 (1992), [1992] 1 C.M.L.R. at 642-43.

32. "The Ministers of the States participating in the euro area may meet informally among themselves to discuss issues connected with their shared specific responsibilities

There are three decision-making bodies of the ECB. The Executive Board is comprised of the ECB President, the ECB Vice-President, and four ECB members.[33] This body is responsible for implementing the euro monetary policy and gives the necessary instructions to the national central banks to carry out operations necessary to support the single monetary policy.[34] It is the broader decision-making body, the Governing Council, that formulates the euro monetary policy.[35] The Governing Council is comprised of the Executive Board and the governors of the Participating Member States' central banks. The Governing Council operates on a one-person, one-vote basis, with decisions based on a simple majority, except for financial matters, where only the national central bank governors vote on a weighted basis, with decisions taken by a qualified majority. The national central banks of the non-participating Member States are not represented in the Governing Council, but are represented in the third decision-making body, the ECB General Council ("General Council").[36] The General Council[37] will take over the tasks of the EMI relating to the central banks of non-participating Member States, prepare the analysis of non-partici-

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for the single currency. The Commission and the European Central Bank—when appropriate, will be invited to take part in the meetings. Matters of common interest will be discussed by all Member States. Decisions will in all cases be taken by ECOFIN in accordance with the procedures laid down in the Treaty." Luxembourg European Council, Conclusions of the Presidency, Dec. 12-13, 1997, pt. 44, annex 1, pt. 6.

33. On May 3, 1998, the governments of the Participating Member States formally appointed the President, the Vice-President, and the four other members of the Executive Board. Council Recommendation of 3 May 1998 on the appointments of the President, the Vice-President and the other members of the Executive Board of the European Central Bank, O.J. L 139/36 (1998). Their appointment took effect on June 1 and marked the establishment of the ECB. This approach was based on Article 109a of the EC Treaty, in conjunction with Article 50 of the Protocol on the Statute of the European System of Central Banks and of the European Central Bank ("ECB Statute"). EC Treaty, *supra* note 7, art. 109a, O.J. C 224/1, at 38 (1992), [1992] 1 C.M.L.R. at 645; *id.*, ECB Statute, *supra* note 27, art. 50, O.J. C 224/1, at 114 (1992), [1992] 1 C.M.L.R. at 759.

34. EC Treaty, *supra* note 7, ECB Statute, *supra* note 26, art. 12.1, O.J. C 224/1, at 107 (1992), [1992] 1 C.M.L.R. at 745.

35. This policy shall include making decisions relating to intermediate monetary objectives, key interest rates, and the supply of reserves in the ESCB. *Id.*

36. The General Council is comprised of the President and Vice-President of the ECB and the Governors of all 15 EU national central banks. *Id.* art. 45.2, O.J. C 224/1, at 113 (1992), [1992] 1 C.M.L.R. at 757.

37. The General Council's responsibilities are listed in Article 47 of the ECB Statute. *Id.* art. 47, O.J. C 224/1, at 114 (1992), [1992] 1 C.M.L.R. at 757-58.

pating Member States' convergence as they move towards participating in EMU, and monitor the functioning of the successor of the European exchange rate mechanism with regard to exchange rate differences between the euro and the non-participating Member States' currencies, the so-called "ERM2."[38]

The primary monetary policy instrument will be open-market operations to direct short-term market interest rates. The ECB may also intervene by imposing capital reserve requirements on credit institutions.[39] On July 7, 1998, the ECB exercised this option by adopting a recommendation for a Council Regulation concerning the application of minimum reserves by the ECB.[40] Pursuant to the recommendation, the ECB will require all credit institutions in the euro zone to deposit a certain percentage—between 1.5 percent and 2.5 percent—of their deposits with their respective national central banks by January 1, 1999.[41]

The capital of the ECB is held by the Participating Member States' national banks.[42] The amount of capital owed by the national banks to the ECB and the amount of seigniorage income of the ESCB will allocate to each national bank is calculated in proportion to the individual country's demographic and economic weight.[43] The Participating Member States' official reserves in non-EU currencies and gold[44] will be pooled at the level of the ESCB, initially up to a level of approximately forty billion euros, with the possibility for the ECB to call in additional

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38. Council Resolution of 16 June 1997, O.J. C 236/5, at 5-6 (1997) (concerning establishment of exchange-rate mechanism in third stage of EMI); *see also* Jan Meyers & Damien Levie, *The Introduction of the Euro: Overview of the Legal Framework and Selected Legal Issues*, 4 COLUM. J. EUR. L. 321, 333 (1998).

39. *See The Single Monetary Policy in Stage Three: General Documentation on ESCB Monetary Policy Instruments and Procedures*, EUR. MONETARY INST. 48 (Sept. 1997).

40. Recommendation of the European Central Bank for a Council Regulation concerning the minimum reserves by the European Central Bank, O.J. C 246/6 (1998).

41. *Id.* The Governing Council of the ECB will decide by November 1998 at the latest on the technical details of the system of compulsory reserves. These rules must be adopted by the ECOFIN Council in the form of a Council regulation and by a qualified majority of the votes. EC Treaty, *supra* note 7, ECB Statute, *supra* note 27, art. 19, O.J. C 224/1, at 108 (1992), [1992] 1 C.M.L.R. at 748.

42. EC Treaty, *supra* note 7, ECB Statute, *supra* note 27, art. 28, O.J. C 224/1, at 110 (1992), [1992] 1 C.M.L.R. at 750-51.

43. *Id.* art. 29, O.J. C 224/1, at 110 (1992), [1992] 1 C.M.L.R. at 751.

44. These official reserves in non-EU currencies are gold constituting 10-15 percent of the total reserves. *See* Kenneth Gooding, *Gold Trade Hopeful on ECB Reserves*, FIN. TIMES, June 11, 1998, at 38 (quoting Mr. Wim Duisenberg, President of ECB).

reserves.[45]

The ECB is empowered by the Maastricht Treaty to make regulations, to take decisions, to make recommendations, and to deliver opinions in certain fields.[46] An ECB regulation will be analogous to a regulation adopted on the basis of the usual law-making rules within the European Union, in that it will be binding in its entirety and directly applicable,[47] although only in Participating Member States. Similarly, ECB decisions will be binding on those persons in Participating Member States to whom they are addressed. The ECB will be entitled to impose fines or periodic penalty payments on natural and legal persons for failure to comply with obligations under its regulations and decisions in the various competence of the ECB. The ECB may impose a maximum fine of euro 500,000 and a maximum periodic penalty payment of euro 500,000 and a maximum periodic penalty payment of euro 100,000 per day of infringement for a maximum period of six months.[48] Only the ECB can authorize the issue of euro banknotes and coins.[49]

As for the exchange rates between the euro and non-EU currencies, the Council of Ministers[50] will be responsible for determining the "general orientations" for the external monetary policy vis-à-vis non-EU currencies such as the U.S. dollar or the

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45. EC Treaty, *supra* note 7, ECB Statute, *supra* note 27, art. 30, O.J. C 224/1, at 110 (1992), [1992] 1 C.M.L.R. at 751-52.

46. *Id.* art. 34, O.J. C 224/1, at 111-12 (1992), [1992] 1 C.M.L.R. at 753-54; *see* Council Decision on the consultation of the European Central Bank by national authorities regarding draft legislative provisions, O.J. L 189/42 (1998).

47. Pursuant to Article 189, paragraph 2 of the EC Treaty, a regulation is directly applicable in each EU Member State, which means that the EU Member States in principle may not adopt measures applying the regulation that modify its scope or add provisions to it unless this has been provided for in the regulation itself. *See* Firma Max Neumann v. Hauptzollamt Hof/Saale, Case 17/67, [1967] E.C.R. 441. The system established by a regulation "must therefore be applied with the same binding force in all the Member States within the context of the Community legal system which they have set up and which, by virtue of the Treaty, has been integrated into their legal systems." *Id.* at 453. Regulations are also considered to have "direct effect" and are, as such, capable of creating individual rights that may be relied upon before the national courts of EU Member States.

48. Recommendation of the European Central Bank for a council regulation concerning the powers of the European Central Bank to impose sanctions, O.J. C 246/9 (1998).

49. EC Treaty, *supra* note 7, art. 106, O.J. C 224/1, at 37 (1992), [1992] 1 C.M.L.R. at 642.

50. The Council of Ministers is most often composed of the national Member State ministers of economic affairs and finance, the so-called ECOFIN Council.

Japanese yen, and the ECB will "ordinarily" be in charge of exchange rate policy with the ESCB implementing foreign exchange market interventions. The EU Finance Ministers will become involved only if there are overriding political reasons or during a political crisis.

Finally, a number of EU Member States have monetary and exchange rate arrangements with third countries, sovereign entities, or territories. The specific features of each arrangement will determine whether it needs to be adapted in light of the introduction of the euro. The EC Treaty specifically addresses some of the arrangements: Declaration No. 6 of the EC Treaty deals with the continuation of the arrangements with Monaco, San Marino, and the Vatican City,[51] and Protocol No. 13 deals with the continuation of the arrangement on the Comptoirs Francais du Pacific francs.[52] For the remaining arrangements, each arrangement must be assessed individually to determine whether Article 109 of the EC Treaty will apply.[53] There is a consensus that Article 109 will apply to arrangements that involve the euro, i.e., national currencies of Member States participating in the euro zone, and that are binding for all the parties. The applicability of Article 109 will be assessed, according to the Commission, on the basis of an arrangement's potential implications for the monetary and exchange rate policy of the euro zone.[54]

The Transeuropean Automated Real-time Gross Settlement Express Transfer (the "TARGET") system will be the ECB's own payment system for processing large value payments.[55] Cross-

51. *Id.*, Declaration on monetary relations with the Republic of San Marino, the Vatican City and the Principality of Monaco, [1992] 1 C.M.L.R. at 783, 31 I.L.M. at 365. Pursuant to Treaty of July 17, 1918 between France and Monaco the French franc was adopted by Monaco as its sole currency. This monetary accord must be distinguished from full monetary union.

52. *Id.*, Protocol on France, O.J. C 224/1, at 126 (1992), [1992] 1 C.M.L.R. at 775. This is the currency used in French Polynesia.

53. Article 109 of the EC Treaty states that the Council of Ministers may "conclude formal agreements on an exchange rate system for the ECU [euro] in relation to non-Community currencies" or decide on "agreements concerning monetary or foreign-exchange regime matters . . . with one or more states or international organizations." *Id.* art. 109, O.J. C 224/1, at 37-38 (1992), [1992] 1 C.M.L.R. at 643-44. These areas will become EU competence as of January 1, 1999.

54. EURO PAPERS, No. 17, *supra* note 14, at 100.

55. *See* COMMISSION OF THE EUROPEAN COMMUNITIES, REPORT IN PROGRESS TOWARDS CONVERGENCE AND RECOMMENDATIONS WITH A VIEW TO THE TRANSITION TO THE THIRD

border payments within Europe have, until now, been effectuated primarily by using an independent correspondent bank or a bank's own local branch or subsidiary to access the appropriate foreign national payment system depending on the currency of the payment. The TARGET system will interlink the real-time gross settlement ("RTGS") systems now being established at the national level.[56] The TARGET system's use will be compulsory for all payments directly related to the implementation of the single monetary policy.

The main competitors to the RTGS routes are likely to be the main net end-of-day systems, notably the current German system for German marks ("EAF2"), which will become a euro system, and the Euro Banking Association ("EBA") system, which will provide a netting and clearing route alternative for private parties for both domestic and cross-border operations. Neither system is designed for high volume transactions with either the general public or small enterprises. Considering that it will not be cost-effective to operate a dual system for this later group, it is expected that these payment systems will be kept in national currency until the final changeover to the euro.

3. Defining EMU—the Legal Framework

Because the objective of EMU is to introduce a single currency, the legal framework for the euro sets forth the foundation for the move toward EMU. The legal framework is set out in Title VI of the EC Treaty[57] and two EU implementing regulations—Council Regulation No. 1103/97 on Certain Provisions Relating to the Introduction of the Euro[58] ("Regulation 1103/97") and Council Regulation No. 974/98 on the Introduction of the Euro ("Regulation 974/98").[59] The first regulation is directly applicable as law in all EU Member States ensuring simul-

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STAGE OF ECONOMIC AND MONETARY UNION 201 (Mar. 1998); *Practical Issues Arising from the Introduction of the Euro*, No. 8, BANK OF ENGLAND at 17-20 (June 11, 1998) <http://bankofengland.co.uk/euroiss8.htm> (on file with the *Fordham International Law Journal*) [hereinafter *Practical Issues Arising from the Introduction of the Euro*, No. 8].

56. *See* EMI, MINIMUM COMMON PERFORMANCE FEATURES OF RTGS SYSTEMS (1997).

57. EC Treaty, *supra* note 7, tit. VI, O.J. C 224/1, at 33-43 (1992), [1992] 1 C.M.L.R. at 636-55 (setting forth tit. VI, Economic and Monetary Policy, with economic policy provisions, arts. 102a-104c, monetary policy provisions, arts. 105-109, institutional provisions, arts. 109a-109d, and transitional provisions, arts. 109e-109m.

58. Council Regulation No. 1103/97, O.J. L 162/1 (1997).

59. Council Regulation No. 974/98, O.J. L 139/1 (1998).

taneous and uniform application of the issues covered throughout the European Union. The second regulation is applicable only in the Participating Member States. Besides the Treaty provisions discussed above and the core secondary legislation discussed below, there is a further package of legislation to prepare for the more technical aspects of the introduction of the single currency, which will be discussed in other sections of this Article.[60] Further European and national legislation is being adopted concerning the activities of the ECB and the actual introduction of the euro. The discussion under sub-sections one and two below summarizes the main provisions of the two core regulations.

An issue of particular legal concern with the move toward the new currency is the continuity of existing legal instruments after the introduction of the euro. Two fundamental questions arise. First, will the monetary change in itself affect the monetary continuity of existing legal instruments denominated in national currencies of Participating Member States or in ECU? Second, will the monetary change in any way affect the contractual continuity, or, in other words, the termination or change of certain contractual provisions, such as interest rates, or even contracts in their totality? While the monetary continuity of legal instruments governed by Member State laws is, as a general matter, confirmed by EU law,[61] the continuity of legal instruments governed by non-Member State law is less clear. This later continuity will depend upon the non-Member State's recognition of the euro as the legitimate replacement currency of a Member State's currency.[62] Monetary continuity of ECU-denominated in-

60. This package includes: Council Regulation No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, O.J. L 209/1 (1997); Council Regulation No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, O.J. L 209/6 (1997); Council Resolution of 16 June 1997 concerning Establishment of an Exchange-Rate Mechanism in the Third Stage of Economic and Monetary Union, O.J. C 236/5 (1997); Council Regulation No. 3603/93 on the prohibition of direct financing of the public sector referred to in articles 104 and 104b(1) of the EC Treaty, O.J. L 332/1 (1993); Council Regulation No. 3604/93 on the prohibition of privileged access referred to in article 104a of the EC Treaty, O.J. L 332/4 (1993); and Council Regulation No. 3605/93 on the application of the protocol on the excessive deficit procedure, O.J. L 332/7 (1993).

61. Council Regulation No. 1103/97, *supra* note 58, O.J. L 162/1 (1997).

62. *See* Part I, Section III, Subsection A.

struments also raises interesting legal issues.[63] The question whether contracting parties can rely on the continuity of contracts denominated in national currencies of Participating Member States or ECU—irrespective of whether these contracts are governed by Member State's law or a third country's law—will be of direct relevance to a large number of companies.[64]

a. Regulation 1103/97 on Certain Provisions Relating to the Introduction of the Euro

Regulation 1103/97 came into force on June 20, 1997 and applies to all EU Member States, whether or not they participate in EMU.[65] The principle objectives of Regulation 1103/97 are to provide legal certainty that contracts will remain unaffected by the introduction of the euro, to affirm the rights and obligations deriving from contracts denominated in ECU or the currency of a Participating Member State, and to facilitate technical preparations for the changeover to the euro, particularly regarding the rules for conversion and rounding.

i. Replacement of the ECU

The euro will replace the ECU at a rate of 1:1.[66] References to the ECU in a contract will, by the presumption created in Regulation 1103/97, be considered as references to the euro unless the parties specifically indicate otherwise.[67] For example, with some of the older private ECU-denominated financial or other

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63. *See* Part I, Section I, Subsection C, Subsubsection 3.

64. *See* Part II, Section III, Subsection A.

65. The legal basis for Council Regulation No. 1103/97 is Article 235 of the EC Treaty, which reads: "If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures." EC Treaty, *supra* note 7, art. 235, O.J. C 224/1, at 78 (1992), [1992] 1 C.M.L.R. at 716.

66. Council Regulation No. 1103/97, *supra* note 58, art. 2(1), O.J. L 162/1, at 2 (1997).

67. The European Currency Unit ("ECU") as used in Council Regulation No. 1103/97 is the ECU referred to in Article 109g of the EC Treaty and as defined in Council Regulation No. 3320/94 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. *See* EC Treaty, *supra* note 7, art. 109g, O.J. C 224/1, at 41 (1992), [1992] 1 C.M.L.R. at 650; Council Regulation No. 3320/94, O.J. L 350/27 (1994). Article 2(2) of Council Regulation No. 1103/97 repeals Council Regulation No. 3320/94. Council Regulation No. 1103/97, *supra* note 58, art. 2(2), O.J. L 162/1, at 2 (1997).

contracts where parties agreed to their own, different basket of currencies, the automatic conversion of 1:1 would not apply.[68]

ii. Continuity of Contracts

The introduction of the euro will not have the effect of altering a contract, or discharging or excusing performance, or giving any party the right to alter or to terminate a legal instrument unilaterally, subject to express agreement to the contrary between the parties.[69] "Legal instruments" are defined very broadly as legislative and statutory provisions, acts of administration, judicial decisions, contracts, unilateral legal acts, payment instruments other than banknotes and coins, and other instruments with legal effect.[70]

iii. Conversion Rates

The conversion rates for expressing one euro in terms of each national currency shall be expressed in six significant figures, i.e., £.765435 or DM1.92003.[71] Conversion rates cannot be rounded or truncated and inverse rates—expressing one national currency unit in terms of euro units—cannot be used.[72] When converting from a national currency to the euro, the national amount is to be divided by the relevant conversion rate rather than multiplied by its reciprocal—the latter method would increase inaccuracies for larger sums.[73] A conversion between two national currencies must, as a rule, be made through a two-step procedure, the so-called "triangulation" method that uses an algorithm,[74] into and from the euro. First, monetary

68. For an analysis of the application of the monetary continuity principle, see *infra* Part II, Section C.

69. Council Regulation No. 1103/97 refers to the "introduction" of the euro, not just the substitution of the euro for national currency units, thereby including the replacement of the ECU and any other direct effects of the introduction of the euro within the scope of the continuity principle. Council Regulation No. 1103/97, *supra* note 58, art. 3, O.J. L 162/1, at 2 (1997). For a discussion on monetary continuity between ECU and euro, see *infra* Part I, Section A, Subsection 3(c).

70. Council Regulation No. 1103/97, *supra* note 58, art. 1, O.J. L 162/1, at 1 (1997). For an analysis of the application of the continuity-of-contract principle, see Part I, Section C.

71. Council Regulation No. 1103/97, *supra* note 58, art. 4(1), O.J. L 162/1, at 3 (1997).

72. *Id.* art. 4(2), O.J. L 162/1, at 3 (1997).

73. *Id.* art. 4(3), O.J. L 162/1, at 3 (1997).

74. For several numerical examples of the application of the "triangulation"

amounts to be converted from one national currency unit into another shall be converted into a monetary amount expressed in the euro unit. This amount may be rounded to not less than three decimals and then converted into the other national currency unit. No official bilateral rates between the national currency units will be announced. They can be used, however, provided that they produce the same results as the algorithm. Practically, this result is almost impossible to achieve.[75] Finally, conversions between third country currencies and national currency units will have to be carried out by means of the conversion rate between the national currency unit and the euro unit, as explained above, and the exchange rate between the euro unit and the third currency.[76] For example, to convert from U.S. dollars (or "USD") into Belgian francs ("BEF"), the USD amount is first converted into a euro amount by application of the USD/EUR exchange rate. The intermediate euro amount is then converted into a BEF amount using the BEF/EUR conversion rate.

iv. Rounding

Monetary amounts converted into euro should be rounded up or down to the nearest cent. Monetary amounts converted into the national currency units should be rounded up or down to the nearest sub-unit, if available, or the nearest unit. If the conversion gives a result that is exactly half-way, the sum should be rounded up. This rounding obligation applies when a monetary amount after conversion into euro is to be "paid or accounted for."[77] The term "accounted for" is used in its legal sense. One example is where two parties arrange for netting by bringing into an account several items for settlement.[78] This rounding calculation is necessary to establish precisely how

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method, see *Practical Issues Arising from the Introduction of the Euro,* No. 8, *supra* note 55, at 101-107.

75. Commission of the European Communities, *Update on the Practical Aspects of the Introduction of the Euro,* EURO PAPERS, No. 21, Feb. 1998, at 10 (visited Oct. 1, 1998) <http://www.europa.eu.int/euro/html> (on file with the *Fordham International Law Journal*).

76. Council Regulation No. 1103/97, *supra* note 58, art. 4(1), O.J. L 162/1, at 3 (1997).

77. *Id.* art. 5, O.J. L 162/1, at 3 (1997).

78. For further details on the rounding of currency amounts, see Commission of the European Communities, *The Introduction of the Euro and the Rounding of Currency Amounts,* EURO PAPERS, No. 22, Mar. 1998; *see also* EURO PAPERS, No. 21, *supra* note 75.

much is to be paid in order to discharge a debt after conversion. Double conversions, i.e., conversion into the euro unit and at a later stage of the payment process, back into the national currency unit or vice versa, may result in a difference between the initial and the final amount, which should, except for the conversions, be exactly the same.[79] In the case of rounding inaccuracies, the debtor must make sure that his creditor received the amount that was agreed upon.[80] It is only if and when the creditor does not have an account denominated in the unit in which his claim is denominated that he has to accept any discrepancy caused by the necessary rounding effectuated by his own bank.[81] The example of the USD/BEF conversion above is, however, not subject to rounding because the intermediate euro amount resulting from this operation is not "to be paid or accounted for."

b. Regulation 974/98 on the Introduction of the Euro

Regulation 974/98 executes Article 109l(4) of the EC Treaty[82] and was adopted in conjunction with the selection of the Participating Member States. Regulation 974/98 applies only to Participating Member States and comes into effect on January 1, 1999 at the start of Stage III. It sets out the provisions of monetary law that will govern the transition to the euro during a period of not greater than three and one half years—i.e., three years transition plus a maximum of six months of simultaneous use of euro notes and coins and national currency notes and coins—starting on January 1, 1999. The purpose of Regula-

79. The Commission has urged the Member States to consider adopting legislation that defines by law under what circumstances a debt is discharged where conversions and reconversions, e.g., from Dutch guilders to euro and back into Dutch guilders, results in a situation where the initial and reconverted amounts differ. EURO PAPERS, No. 21, *supra* note 75, at 10.

80. Council Regulation No. 974/98, *supra* note 59, art. 8(3), O.J. L 139/1, at 4 (1998).

81. Council Regulation No. 1103/97, *supra* note 58, art. 5, O.J. L 162/1, at 3 (1997).

82. Article 109l(4) of the EC Treaty reads: "At the starting date of the third stage, the Council shall . . . adopt the conversion rates at which their currencies shall be irrevocably fixed and at which irrevocably fixed rate the ECU [euro] shall be substituted for these currencies, and the ECU [euro] will become a currency in its own right. This measure shall by itself not modify the external value of the ECU [euro]. The Council shall, acting according to the same procedure, also take the other measures necessary for the rapid introduction of the ECU [euro] as the single currency of those Member States." EC Treaty, *supra* note 7, art. 109l(4), O.J. C 224/1, at 43 (1992), [1992] 1 C.M.L.R. at 655.

tion 974/98 is to provide companies and the public with increased certainty regarding the time-frame for the completion of the changeover, to set out the scope of the use of the euro during the transitional period in its own denomination and in the form of national currency units, and to provide for the exchange of national notes and coins at the end of the changeover process for bank notes and coins denominated in euro.

i. Euro

The euro will be the currency of the Participating Member States, the ECB, and the central banks of the Participating Member States beginning January 1, 1999. It will be divided into 100 cents.[83]

ii. Conversion Rates

The euro will be substituted for the national currencies of the Participating Member States at the irrevocable conversion rates to be adopted on the first day of Stage III, January 1, 1999.[84] With a view to guiding markets in the run-up to Stage III, the ECOFIN fixed a method for determining the conversion rate on May 3, 1998: the exchange-rate mechanism ("ERM") bilateral central rates of the national currencies calculated as of May 3, 1998 will be used to determine the irrevocable conversion rates between the euro and the national currency units and among national conversion units on January 1, 1999.[85] The central banks of Participating Member States will ensure through market techniques that on December 31, 1998, the market exchange rates between each pair of "in" currencies are equal to the ERM bilateral central rates of May 3, 1998. This procedure ensures that the adoption of the conversion rates will not modify the external value of the ECU, which will be replaced on a 1:1 basis by the euro, as is required under the Treaty.[86] It is, how-

83. Council Regulation No. 974/98, *supra* note 59, art. 1, O.J. L 139/1, at 3 (1998).

84. *Id.* arts. 3-4, O.J. L 139/1, at 3 (1998). It should noted as well that pursuant to Article 4(3), "inverse" conversion rates will not be allowed; therefore, in order to convert the euro into a national currency, the euro amount must be multiplied by the conversion rate.

85. Joint Communiqué of 3 May 1998 by the Ministers and Central Bank Governors of the Member States Adopting the Euro as their Single Currency, the Commission and the European Monetary Institute concerning the determination of the irrevocable conversion rates for the euro, O.J. C 160/1 (1998).

86. *Id.*

ever, impossible to announce before the end of 1998 the irrevocable conversion rates between each participating currency and the euro because the ECU is a currency basket that includes the pound sterling, Danish krone, and Greek drachma, none of which will participate in the single currency on January 1, 1999. To calculate the irrevocable conversion rates on December 31, 1998, a procedure similar to the standard concentration procedure for calculating daily official ECU rates will be used. This daily ECU procedure involves three steps: (i) each EU national central bank must determine the exchange rate of its currency against the U.S. dollar; (ii) the Commission calculates the exchange rates that the official ECU obtains in the USD/ECU exchange rate—expressed as ECU1:$x—by adding the U.S. dollar equivalents of national currency amounts that compose the ECU; and (iii) the official ECU exchange rates against the EU currencies are calculated, rounded to the sixth significant digit, by multiplying USD/ECU exchange rate by their respective U.S. dollar exchange rates.[87] Exactly the same calculation method will be used in determining the irrevocable conversion rates against the euro for the Participating Member State currencies on December 31, 1998. As for the first step, however, the bilateral rates between the euro zone participating currencies obtained by crossing the respective U.S. dollar rates will be equal to the pre-announced ERM bilateral central rates, up to the sixth significant digit.[88]

iii. Transitional Provisions

The following provisions apply during the transitional period between January 1, 1999 and December 31, 2001:

(a) National Currency Units

The euro will be divided into national currency units according to the irrevocably fixed conversion rates.[89] National currencies will continue to exist during the transition period not as currencies on their own but as subunits of the euro, to be called national currency units. This means that during the transitional

87. *Practical Issues Arising from the Introduction of the Euro*, No. 7, *supra* note 24, at 26-51.

88. For an illustration of the calculation method, see *Practical Issues Arising from the Introduction of the Euro*, No. 8, *supra* note 55, at 26.

89. Council Regulation No. 974/98, *supra* note 59, art. 6, O.J. L 139/1, at 3 (1998).

period the euro will exist in several denominations—the euro unit itself, and its subunit, the "cent," and national currency units, as non-decimal subdivisions of the euro. Thus, the euro units and national currency units will become expressions of the same currency, although their function and the possibility of using the different units may differ, as laid out in the provisions of Regulation 974/98, national provisions, or in the terms of a contract. Except as provided in Regulation 974/98, the monetary law of the Participating Member States shall continue to apply.[90] Thus, for example, national provisions on payments by legal tender will continue to apply throughout the transitional period.[91] Reference to a national currency unit in a legal instrument will be valid as if it referred to the euro in accordance with the conversion rates and will not affect its validity or alter the denomination.[92]

(b) Payments

Payments will be made in accordance with the applicable contract or other underlying legal instrument. Therefore, contracts stipulating the use of a national currency payment will be paid in the national currency unit, and contracts stipulating the use of euro will be paid in euro, unless the parties agreed otherwise.[93]

(c) Cashless Payments

As an exception to the payment principle noted above, amounts denominated in the euro unit or the national currency unit of a Participating Member State and payable within that Member State by crediting an account of the creditor, can be paid in either the euro unit or the national currency unit.[94] The

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90. *Id.*

91. *See* Commission of the European Communities, *The Legal Framework for the Use of the Euro: Questions and Answers on the Euro Regulations*, EURO PAPERS, No. 10, Dec. 1997.

92. Council Regulation No. 974/98, *supra* note 59, arts. 6(2), 7, O.J. L 139/1, at 3 (1998).

93. *Id.* art. 8(1), O.J. L 139/1, at 4 (1998).

94. *Id.* art. 8(3), O.J. L 139/1, at 4 (1998). Although checks are in principle covered by Article 8(3), Article 8(3) does not confer a unilateral right on a debtor to settle a debt expressed in the national currency through payment with a check denominated in the euro, or vice versa. As for the relationship between the person who has received a check and his bank, the second sentence of Article 8(3) is relevant: if a person ac-

bank of the creditor is *de lege* obliged to convert the sum, if necessary, to the denomination of the account at the irrevocably fixed conversion rates.[95] At the same time, the receiving bank does not need to seek the authorization of the account holder to make that conversion. This measure aims to ensure that the euro can and will be used during the transitional period when parties might not be inclined to start using the new currency, thereby counteracting the consequences of a poor market reception of the euro. If parties continue to use only national currencies during the transitional period, this might weaken the euro, leading the financial markets to attribute different values to the euro and its national currency components, notwithstanding their full legal equivalence.

The provisions on payments by crediting an account also apply to those cross-border payments that are denominated in the euro unit or the national currency unit of the creditor's account, provided that in the latter case the creditor's account is denominated in the national currency unit of the Member State where the account is located. The debtor, creditor, and account need not all be in the same Member State.[96] For example, in the case of a contract stipulating a payment to be made in German marks to an account in Germany denominated in German marks, the debtor may pay either in German marks or the euro unit independent of where his account is located. On the contrary, a payment of a German mark amount to a German mark account in France is not covered by this provision.[97] The idea

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cepts a check written in euro although his account is denominated in a national currency, the crediting of his account will trigger the obligation on the bank to convert the proceeds of the euro-denominated check into the national currency unit of his account. With regard to checks written without a denomination, deliberately or not, banks are entitled to do whatever is appropriate, including returning the check. As for credit card payments, the currency unit in which the transactions will be processed depends on the agreement between the shopkeeper/creditor and his bank or credit card company. *See* EURO PAPERS, No. 10, *supra* note 91, at 7-9.

95. Council Regulation No. 974/98, *supra* note 59, art. 8(3), O.J. L 139/1, at 4 (1998). This obligation is not explicitly addressed to banks, including national central banks; however, they will in practice be concerned almost exclusively.

96. *Id.* recital 13, O.J. L 139/1, at 2 (1998).

97. A French bank would therefore be obliged to make the necessary conversions between the French franc and the euro but not between the German mark and the euro. For this situation, the bank would either convert under a general mandate or hold the amount in the original currency unit in a sub-account pending instructions of the client, which is in line with the current banking practice. *See* EURO PAPERS, No. 10, *supra* note 91, at 4-5.

behind this restriction is that the receiving bank should only be obliged to make the necessary conversions between the euro unit and the national currency unit of the Member State where the bank is located. Payments into and within non-EU countries, or non-Participating Member States, are not covered by Regulation 974/98. Such payments, however, will be covered as soon as the payment arrives at an account located in a Participating Member State, provided that the payment is denominated in the euro unit or the national currency unit of the Member State where the creditor's account is located. For example, a contract stipulating that a payment be made in BEF to an account located in Belgium would be covered, even if the debtor is located in Tokyo and initiates the payment from his New York account in euro. The application of this provision depends only on the location of the crediting of the account; it is independent of the nationality or location of the creditor or debtor and the contractual law underlying the payment.[98]

(d) Bonds

Participating Member States can take measures to redenominate into euro, outstanding government debt denominated in their national currency. If a Member State chooses to do so, private issuers may redenominate in euro debt in the national currency unit issued by the general government, bonds, other forms of securitized debt negotiable in the capital markets, and money market instruments issued by other debtors, unless expressly excluded by the contract terms.[99]

(e) Organized Markets

Participating Member States can take measures to permit, but not to compel, markets—for securities, money market instruments, financial futures interests rates, options, etc.—and the regular exchange and clearing and payment settlement systems to change their operations to the euro during the transitional period.[100] This provision represents another exception to

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98. *Id.* at 5.

99. Council Regulation No. 974/98, *supra* note 59, art. 8(4), O.J. L 139/1, at 4 (1998); *see infra* Part II, Section D.

100. *Id.* art. 8(4)(b), O.J. L 139/1, at 4 (1998); *see infra* Part II, Section E.

the no compulsion/no prohibition rule in Article 8(1) discussed below.

(f) Netting and Set-Off

If netting[101] and set-off transactions are permitted under Participating Member State law, they can be continued irrespective of whether the obligation is denominated in a participating national currency unit or the euro. The necessary conversions between the national currencies and the euro to complete netting and set-off will be made at the irrevocably-fixed conversion rates.

(g) No Compulsion/No Prohibition

Acts to be performed under legal instruments stipulating the use of, or denominated in, a national currency shall be performed in the national currency unit and similarly, contracts stipulating the use of, or denominated in, euro shall be performed in euro.[102] This means that in performing acts under legal instruments, parties will use the unit upon which they previously agreed. Parties cannot be compelled to use the euro during the transitional period, with the exceptions noted above; as a corollary, because the euro will be a currency of the Participating Member States, parties cannot be prohibited from using the euro. This rule is the "no compulsion/no prohibition" rule.[103] Parties are free to use whichever unit they choose in contractual relations. Article 8(2) gives private parties the option to restrict or to eliminate the "no compulsion" principle. National legisla-

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101. Netting refers to converting into one net claim or one net obligation a series of claims and obligations resulting from payment orders sent over a period of time, which a settlement system either sends or receives.

102. Council Regulation No. 974/98, *supra* note 59, art. 8(1), O.J. L 139/1, at 4 (1998). Acts "in the sense of Article 8(1) comprise not only everything which produces a legal effect, but all kinds of acts which have to be performed under any legal instrument: offers, payments, invoices, requests for payments and other notifications which are made under contractual relationships . . . . The term . . . also includes all kinds of acts which are governed by statutory obligations, including for example, the submission of tax declarations, the publication of accounts or the registration of legal instruments." EURO PAPERS, No. 10, *supra* note 91, at 13-14. This rule means that if a contract is set up in French francs, all statements of accounts, invoices, etc. will have to be made in French francs unless the parties agree otherwise.

103. Council Regulation No. 974/98, *supra* note 59, art. 8(1), O.J. L 139/1, at 4 (1998).

tion cannot interfere with the parties' contractual freedom.[104] Even where a Member State provides in national legislation that certain types of contracts be made in the national currency unit, i.e., for consumer protection concerns, parties have the possibility by virtue of Article 8(2) to deviate from these national provisions. Member States, however, could still require during the transitional period that acts linked to certain contracts governed by statutory obligations are carried out in the national currency unit. One example would be the registration of certain contracts, i.e., in land registers, in the national currency.[105]

(h) Legal Tender

Bank notes and coins denominated in the national currency unit will retain their status as legal tender during the transitional period,[106] and possibly up to six months beyond.[107] Given that euro notes and coins will not become available until the end of the transitional period, all cash payments will have to be made in national currency units during the transitional period.

iv. From January 1, 2002

(a) Euro

Euro notes and coins will be put into circulation and the euro will become the sole legal tender. The first series of euro coins will include eight denominations in the range from one cent to two euros.[108] National currency notes and coins may circulate for an additional period of up to six months, until June 30, 2002 at the latest, depending on each Member State's decision[109] and will retain their status as legal tender during that pe-

104. *Id.* art. 8(2), O.J. L 139/1, at 4 (1998).

105. EURO PAPERS, No. 10, *supra* note 91, at 13. This possibility is because national laws are "legal instruments" and registration in the land registry are "acts to be performed" under the legal instrument that stipulated the use of the national currency within the meaning of Article 8(1) of Regulation 974/98.

106. Council Regulation No. 974/98, *supra* note 59, art. 9, O.J. L 139/1, at 4 (1998).

107. *Id.* art. 15(1), O.J. L 139/1, at 5 (1998).

108. *See* Council Regulation No. 975/98, O.J. L 139/6 (1998) (concerning denominations and technical specifications of euro coins intended for circulation).

109. Council Regulation No. 974/98, *supra* note 59, art. 15(2), O.J. L 139/1, at 5 (1998). For example, France is considering shortening the transition period to 10 weeks. *France Plans Cut in Time Alloted for Euro Change*, WALL ST. J., July 3, 1998, at 14. It is widely expected that most Participating Member States will have a period of dual circulation that is substantially shorter than six months.

riod. Thereafter, national currency notes and coins may still be exchanged for euro but not used.

(b) References to National Currency

Once the transitional period ends, any references to national currency units in legal instruments will automatically be read as references to euros, according to the respective conversion rates, without the need to physically re-write the legal instruments. Regulation 974/98, on December 31, 2001, will have the effect of automatically and theoretically redenominating all existing legal instruments expressed in national currency units into euro.

c. Monetary Continuity in the EU System—From the European Currency Unit to a Single Currency

A legal distinction is traditionally drawn between the "official" ECU and the "private" ECU. The "official" ECU, a basket currency composed of specified quantities of the EU national currency units,[110] serves as a means of settlement between monetary authorities in the European Monetary System, as a transaction unit in the EMS credit and intervention mechanism, and as unit of accounting used by the EU institutions.[111] The composition of official ECU also has a theoretical value vis-à-vis the national currencies, which is determined each business day at 2:30 PM by the European Commission on the basis of the bilateral exchange rates among the national currencies concerned. The composition of the ECU basket, and thus the definition of the official ECU, was modified at the occasion of the introduction of

110. *See* Council Regulation No. 3320/94, O.J. L 350/27 (1994) (concerning consolidation of existing community legislation on definition of ECU following entry into force of TEU). The ECU is made up of: 30.6242 German marks + 0.08784 pounds sterling + 1.332 French francs + 151.8 Italian lira + 0.2198 Dutch guilders + 3.301 Belgian francs + 0.130 Luxembourg francs + 0.1976 Danish krone + 0.008552 Irish pounds + 1.440 Greek drachmas + 6.885 Spanish pesetas + 1.393 Portuguese escudos. *Id.* art. 1, O.J. L 350/27, at 27-28 (1994). As the ECU basket composition was definitively fixed on November 1, 1993, the national currencies of Austria, Sweden, and Finland, which joined the EU on January 1, 1995, were left out.

111. *See* C. SUNT, LEGAL ASPECTS OF THE ECU 48 (1989); Jacques Steenbergen, *L'ECU: Aspects Juridiques De L'Utilisation De L'Unité Monétaire Européene*, REVUE INTERNATIONALE DE DROIT ECONOMIQUE 181 (1987); G. SCHRANS & H. VAN HOUTTE, INTERNATIONAL HANDELS—EN FINANCIEEL RECHT 248 (1991).

new EU Member States prior to November 1, 1993[112] when the definition was irrevocably fixed. This modification explains the absence of the currencies of Austria, Sweden, and Finland in the ECU as these countries joined the European Union only in 1995.[113]

The ECU is also used as a payment unit in private transactions among commercial parties. Because the ECU is not full-fledged legal tender but at most a currency index, payment in ECU will release the debtor from his debt only if and when the creditor accepts the payment. In other words, the use of the "private" ECU is a matter of contractual autonomy of the parties involved and its underlying value will depend on the definition to which the parties agree.[114] This statement must, however, be viewed in light of the fact that many mostly-European jurisdictions have recognized the ECU as a foreign currency similar to other foreign currencies.[115] In practice, private parties almost always link their "private" ECU definition to the "official" ECU for purposes of avoiding confusion and enhancing legal certainty.[116] In fact, Article 2 of Regulation 1103/97 now confirms that references to the ECU without a proper definition are pre-

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112. Greece joined the European Union in 1984 and Spain and Portugal joined in 1989.

113. EC Treaty, *supra* note 7, art. 109g, O.J. C 224/1, at 41 (1992), [1992] 1 C.M.L.R. at 650.

114. *See* SCHRANS & VAN HOUTTE, *supra* note 111, at 597; MEYERS & LEVIE, *supra* note 38, at 342; Thierry Vissol, *De L'ECU L'ECU, Quelques Commentaires à Propos du Traité de Maastricht,* REVUE DU MARCHE COMMON ET DE L'UNION EUROPEENNE 280-372 (1992).

115. Schrans and Van Houtte indicate that in France, the United Kingdom, the Netherlands, Sweden, Switzerland, the United States, and Japan, local companies are entitled to run an accounting system in ECU. SCHRANS & VAN HOUTTE, *supra* note 111, at 641.

116. The International Primary Markets Association ("IPMA") and the International Securities Dealers Association ("ISDA") have developed standard language for ECU-issued documentation and derivatives contracts. The definition of the ECU in the 1991 ISDA definitions is a standard definition and does not produce a closed basket ECU, which would negate the application of Article 2 of Council Regulation No. 1103/97. Regulation 1103/97, *supra* note 58, art. 2, O.J. L 162/1, at 2 (1997). Since December 1996, most issuers and derivatives dealers have used the definition of the ECU jointly recommended by the IPMA and ISDA, which contemplates the conversion of the ECU into the euro. *See* ISMA AND IPMA, JOINT STATEMENT ON THE LEGAL DEFINITION OF THE ECU (Sept. 6, 1995) (stating that "ECU, as referred to in Article 109g of the Treaty establishing the European Communities, as amended by the Treaty on European Union (the "Treaty") and as defined in Council Regulation (EC) No. 3320/94 that is from time to time used as the unit of account of the European Communities. Changes to the ECU may be made by the European Communities, in which event the ECU will change accordingly.").

sumed to be defined as an ECU in accordance with Regulation 3320/94, but this presumption is rebuttable by evidence of a contrary intention by the parties.[117]

The ECU can therefore rightfully be considered to have several, although not all, functions of proper legal tender: a single definition, the status of foreign currency in many countries, and a limited "official" function within the EMS.[118] The ECU is, however, not issued in the form of notes or coins,[119] and there is no ECU central bank that plays the role of emission bank and lender of last resort.[120]

Article 2 of Regulation 1103/97 provides that as of January 1, 1999, all references in legal instruments to the ECU—as referred to in Article 109g of the EC Treaty and defined in Regulation 3320/94—will be replaced by references to the euro, on a 1:1 basis.[121] As mentioned above, all references to the ECU without the official definition are presumed to carry the definition as in Regulation 3320/94. From a legal point of view, monetary continuity is upheld in that the current basket ECU and the future single currency, euro, are one and the same currency.[122] The transition from ECU to euro should be considered to be the final change in the definition of the ECU. This conversion occurs directly by virtue of primary law.[123] No secondary legislation is required to achieve this effect.[124] Therefore, except if a

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117. This practice confirms the view taken before by the ECU Banking Association in *Legal Aspects of the Transition to the Single Currency*, 7 De Pecunia, No. 2, Oct. 1995, at 10-17; JOINT STATEMENT ON THE LEGAL DEFINITION OF THE ECU, *supra* note 116.

118. *See* J.V. LOUIS, L'AVÈNEMENT DE LA MONNAIE UNIQUE, C.J. 39-42 (1996); Opinion on Removing the Legal Obstacles to the Use of the ECU, O.J. L 133/36 (1994).

119. Notwithstanding, the "ECU" coins issued in Belgium and Ireland are collectors' items.

120. *See* Peter Rooryck, *Juridische Aspecten van de Invoering van de EURO*, 3 TIJDSCHRIFT VOOR RECHTSPERSOON EN VENNOOTSCHAP 117, 122 (1997).

121. At the European Council in Madrid, from December 15-16, 1995, the decision was taken that the name of the single currency will be the "euro" rather than the "ECU" referred to in the EC Treaty, as of the start of EMU. *See* Madrid European Council, Conclusions of the Presidency, E.U. BULL., no 12, at 9 (1995).

122. *See, e.g.*, 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* (Dec. 1995).

123. *See* EC Treaty, *supra* note 7, art. 109g, O.J. C 224/1, at 41 (1992), [1992] 1 C.M.L.R. at 650.

124. This argument is challenged by D.R.R. Dunnett, who wrote: "[The ECU] remains a unit of account, and not a currency. It cannot be transformed into a currency any more than any unit of account may be converted into the thing it measures . . . . The automatic conversion does not address the case where the parties have not defined

legal instrument explicitly indicated that the ECU is defined in another way than by reference to the official ECU, all references in legal instruments to the ECU will be automatically replaced by references to the single currency. In this respect, it is a generally accepted principle of international financial law that money, or "legal tender," and it is only the law of the country that issues a specific currency that determines what is legal tender and how, in the case of currency alteration, sums expressed in the former currency are to be converted into the new currency—*lex monetae*.[125] Thus, obligations denominated in any currency unit are to be redeemed in that currency, whatever the real value of the currency. In other words, whether the currency is the national currency of the contracting parties or is a foreign currency, the obligation is defined in nominal, not in real terms. This principle has been endorsed in the monetary laws of many countries, including all the Member States. Pursuant to the *lex monetae* rule,[126] this monetary continuity and automatic transition also apply to legal instruments that are not governed by the law of a Participating Member State and will be respected by the courts outside the euro zone.

It cannot be excluded, however, that a national court will not consider the ECU as a currency but merely as a unit of account of the European Communities, thereby disregarding the ECU's additional functions which, even if not strictly defined as a currency function, qualify the ECU as a *de facto* currency. Under this line of reasoning, the ECU and the euro are conceptually different and the ECU would not "become" the euro. If the ECU is "abolished" and "replaced" by the euro, rather than "becoming" the euro, the alternative-currency mechanism may be triggered in many market documents.[127] Accordingly, the

the ECU that they have used." D.R.R. Dunnett, *Transition to Stage III: Impact on the Financial Markets*, in EUROPEAN ECONOMIC AND MONETARY UNION: THE INSTITUTIONAL FRAMEWORK, *supra* note 12, at 59. The author disregards the gradual change in definition and characteristics of the ECU.

125. For a description of the so-called "nominalistic" and *lex monetae* principles, see F.A. MANN, THE LEGAL ASPECT OF MONEY 272 (5th ed. 1992); ARTHUR NUSSBAUM, MONEY IN THE LAW: NATIONAL AND INTERNATIONAL 353-59 (1950); Part I, Section C, subsection 1.

126. MANN, *supra* note 125, at 465.

127. One of the counter-arguments will be that the European institutions seem to have confirmed the nominal continuity of all money obligations expressed in ECU on May 12, 1995. Explanatory note concerning new clauses in the prospectuses of loans and bonds of the European Communities, O.J. C 130/5 (1995).

cautious conclusion to be drawn is that parties may want to issue or to modify documentation to provide specifically that the introduction of the euro will not have the effect of abolishing the euro and that ECU debt will be repaid after 1999 on the basis of one euro for each ECU.[128]

Despite the legal parity of the ECU and the euro affected by Regulation 1103/97, because the ECU is composed of certain weaker currencies that will not initially be converted into euros, the euro will be a stronger currency than the ECU. Consequently, the interest rate of the basket-ECU will be higher than the euro interest rate.

4. Maintaining EMU—the Stability and Growth Pact

A central objective of EMU is to create a zone of long-term macroeconomic stability within Europe. Therefore, now that the Participating Member States have qualified for EMU, they must continue on their path of economic moderation or EMU will eventually be torn apart by economic disparities. Discipline will be enforced, in part, by the application of the "no bail out" rule—the European Union will not be liable for any financial obligations of the Participating Member States.[129] In addition, to ensure that Participating Member States pursue consistent economic policies and maintain the budget discipline that was required to join EMU, Member States have agreed to abide by the Stability and Growth Pact. The much-touted Stability and Growth Pact is a package of one political resolution[130] and two regulations.[131]

The first regulation, Regulation 1466/97,[132] reinforces the elements of the surveillance of Member State budgetary posi-

128. The European Investment Bank has adopted this approach in its issue documentation. *See* European Investment Bank, The Strategic Framework for the Bank, O.J. C 269/5, at 9 (1998).

129. EC Treaty, *supra* note 7, art. 104b, O.J. C 224/1, at 34-35 (1992), [1992] 1 C.M.L.R. at 638.

130. Resolution of the European Council on the Stability and Growth Pact of 17 June 1997, O.J. C 236/1 (1997).

131. The Stability and Growth Pact was supplemented and the respective commitments enhanced by a declaration of the Council of Ministers on May 1, 1998 (the "Waigel Declaration"). Declaration by ECOFIN and the Ministers Meeting in that Council, O.J. L 139/28 (1998).

132. Council Regulation No. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positons and the surveillance and coordination of economic policies, O.J. C 209/1 (1997). This regulation entered into force on July 1, 1998.

tions by the Council of Ministers and the surveillance and coordination of economic policies contained in Article 103 of the EC Treaty. Regulation 1466/97 sets out rules governing the content, submission, examination, and monitoring of medium-term budgetary programs of Participating Member States, referred to as "stability programs," and non-participating Member States, referred to as "convergence programs." These programs will be made public. The key objective of the programs will be achieving the medium-term objective of a budgetary position close to balance or in surplus. The objective of Regulation 1466/97, like the other components of the Stability and Growth Pact, is to provide an early warning of excessive deficits that may upset the goal of achieving continued price stability.

The second regulation, Regulation 1467/97,[133] concerns speeding up and clarifying the excessive deficit procedure set out in Article 104c of the EC Treaty for the purpose of deterring excessive general government deficits. If excessive deficits occur, Regulation 1467/97 lays out a framework for ensuring prompt correction. The Commission is charged with reviewing the economic position of Member States and reporting to the Council of Ministers if an excessive deficit exists. The Council of Ministers, in turn, is empowered to make recommendations to the Member State on steps to correct the problem, together with deadlines for carrying out the recommendations. If the Member State does not take satisfactory action, then the Council of Ministers can impose monetary sanctions on the Member State, graded according to the Member State's gross domestic product. Regulation 1467/97 permits a certain flexibility in applying sanctions to take account of exceptional circumstances that have a major impact on the financial position of the general government.

Whether the sanction procedure of Regulation 1467/97 will ever be used is doubtful; the Stability and Growth Pact is considered an efficient means of applying political pressure on less-disciplined Participating Member States. Political pressure has served as an effective tool in the past to keep the European Union on course towards an ever closer union and will serve an

133. Council Regulation No. 1467/97 of 7 July 1997 on speeding up and clarifying the implementaition of the excessive deficit procedure, O.J. L 209/6 (1997). The regulation will enter into force on January 1, 1999.

even more important role under EMU. Aside from the specific sanctioning provisions of Regulation 1467/97, the European Union has little choice other than persuasion. Neither the Maastricht Treaty nor any current EU legislation provides for the possibility of altering the initial conversion rates between the euro and the national currencies, allowing or obliging a Participating Member State to leave EMU to terminate EMU as a whole. It is clear from the absence of such provisions that the European leaders were not willing to open the door to the unraveling of EMU.

Although the title given to the move towards a single currency implies that both economic and monetary policies will be unified from the start of Stage III, that is not the case. Member States agreed to a single monetary policy; a single economic policy covering issues such as a unified fiscal and labor market policy is beyond the terms of the current economic and monetary union.[134] Each Member State will continue to set its own economic policy. Member States' economic policies must, however, comply with the Stability and Growth Pact described above,[135] must be coordinated with, but not determined by, ECOFIN,[136] and should be consistent with the single monetary policy of the ECB and the broader economic objectives of the European Union.[137]

Member States have shown a recent willingness to discuss closer harmonization on several economic fronts, including taxes and employment policies. For example, in the tax area, the Commission's Action Plan for the Single Market gives priority to measures to reduce tax competition, to eliminate distortions on the taxation of capital income, and to eliminate withholding tax on interest payments between companies.[138] Euro-

134. As the Member of the Commission with responsibility for EMU stated, "[the Maastricht] Treaty rules out any idea of merging national budgets into a sort of 'super federal budget.'" Yves-Thibault de Silguy, Member of the Commission of the European Communites, "Economic-Policy Coordination in the Euro Area," speech to Foundation "Notre Europe" (Brussels, Belgium, May 29, 1997) <http://europa.eu.int/euro> (on file with the *Fordham International Law Journal*).

135. *See* Part I, Section A, Subsection 4.

136. EC Treaty, *supra* note 7, art. 103, O.J. C 224/1, at 33-34 (1992), [1992] 1 C.M.L.R. at 636-37.

137. *Id.* art. 102a, O.J. C 224/1, at 33 (1992), [1992] 1 C.M.L.R. at 636.

138. Proposal for a Council Directive to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community, O.J. C 212/1, at 13 (1998); Action plan for the single market, CSE (97) 1 of June 4, 1997; *see* Commis-

pean leaders have come to recognize that the absence of sufficient flexibility in the European labor markets could have severe consequences for the sustainability of EMU.[139]

B. *Outside EMU but Inside the European Union—the "Pre-Ins"*

1. Moving Towards EMU—Non-Participating Member States' Responsibilities

Membership in EMU is open to non-Participating Member States, or "pre-ins," if and when they qualify for membership in accordance with the convergence criteria applied to the original participants.[140] In the meantime, non-Participating Member States will retain their national currencies and continue to determine their national monetary policy independently, although all Member States, including pre-ins, must treat their exchange rate policies as a matter of common interest.[141] Pre-ins remain subject to the Stage II requirement to avoid "excessive government deficits,"[142] although pre-ins will not be subject to the penalty provisions of the Stability and Growth Pact in the event of persistent excessive budget deficits.[143] On becoming a member of the euro zone, the same provisions of the EC Treaty that apply to the first-wave countries on January 1, 1999 will become applicable to the Member State concerned.[144] In addition, second-wave coun-

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sion of the European Communities, Communication from the Commission to the Council and the European Parliament: A Package to Tackle Harmful Tax Competition in the European Union, COM (97) 564 Final (May 1997).

139. As the Commission pointed out, "It is generally accepted . . . that the absence of greater flexibility in the euro-area markets—and particularly in labour markets—could jeopardize the principle of monetary leadership with severe consequences for the sustainability of EMU. Accordingly, supply-side reform has risen to the top of the economic policy agenda in most Member States in an effort to secure high rates of sustainable growth and employment creation in the medium term." *See* EURO PAPERS, No. 17, at 35.

140. Pursuant to Article 109k(2) of the EC Treaty, the heads of state or government of the Member States will have to reassess at the latest every two years, or earlier upon request of a particular Member State, whether the eligibility requirements are met. EC Treaty, *supra* note 7, art. 109k(2), O.J. C 224/1, at 43 (1992), [1992] 1 C.M.L.R. at 653.

141. *Id.* art. 109m, O.J. C 224/1, at 43 (1992), [1992] 1 C.M.L.R. at 655.

142. *Id.* art. 109e(4), O.J. C 224/1, at 40 (1992), [1992] 1 C.M.L.R. at 648.

143. Council Regulation No. 1467/97, *supra* note 133, art. 1, O.J. L 209/1, at 6 (1997).

144. *See* EC Treaty, *supra* note 7, art. 104c(9), (11), O.J. C 224/1, at 35-36 (1992), [1992] 1 C.M.L.R. at 639-40 (sanctions with respect to excessive deficit procedure, including sanctions resulting from Stability and Growth Pact); *id.* art. 105(1), (2), (3),

tries[145] will be expected to adopt the *acquis communautaire* of the euro zone, in other words, all decisions already taken by the first-wave countries with respect to EMU.

As for the Central and Eastern European countries that are currently negotiating their membership applications with the European Union,[146] they are not expected to join EMU immediately upon joining the European Union. It is likely that the new Member States will enter the European Union with a derogation from EMU.[147]

2. The Exchange Rate Mechanism After the Introduction of the Euro

Another side-effect of the division between the eleven Participating Member States and the four non-Participating Member States is the need to introduce a "second-generation" European exchange-rate mechanism, as a successor to the current European Monetary System.[148] For Member States outside the euro zone, the Council of Ministers adopted a new exchange-rate mechanism to link these currencies to euro at the start of Stage III. Participation in the new mechanism will be voluntary. The mechanism will establish central rates bilaterally linking non-euro currencies with the euro and allowing relatively wide standard fluctuation bands of fifteen percent between the non-euro currencies and the euro. The fluctuation bands may be narrowed as a pre-in Member State comes gradually closer to the

(5), O.J. C 224/1, at 36 (1992), [1992] 1 C.M.L.R. at 641 (monetary policy); *id.* art. 105a, O.J. C 224/1, at 36-37 (1992), [1992] 1 C.M.L.R. at 642 (issuing notes and coins); *id.* art. 108a, O.J. C 224/1, at 37 (1992), [1992] 1 C.M.L.R. at 643 (instruments for conduct of monetary policy); *id.* art. 109, O.J. C 224/1, at 37-38 (1992), [1992] 1 C.M.L.R. at 643-44 (exchange rate agreements with non-EU countries); *id.* art. 109a(2)(b), O.J. C 224/1, at 38 (1992), [1992] 1 C.M.L.R. at 645 (nomination of Executive Board of ECB).

145. The Central and Eastern European countries that become EU Member States may join the euro zone if and when they meet the convergence criteria. *See Poles Take Pragmatic Line on Euro*, EUROPEAN DIALOGUE, July-Aug. 1998, at 12.

146. These Central and Eastern European countries include the Czech Republic, Estonia, Hungary, Poland, Slovenia, and Cyprus.

147. EURO PAPERS, No. 17, *supra* note 14, at 101.

148. For the principal rules of the "second-generation" European exchange-rate mechanism ("ERM2"), see Council Resolution of 16 June 1997 concerning establishment of an exchange-rate mechanism in the third stage of economic and monetary union, O.J. C 236/03, at 5 (1997)). The operating procedures are set forth in the agreements between the European System of Central Banks ("ESCB") and the central banks of the respective Member States.

EC Treaty's convergence criteria. At the other extreme, if an exchange rate reaches the margin of the standard fluctuation band, intervention in principle will be automatic and unlimited, with very short-term financing available. The ECB and the other central banks, however, would suspend their intervention if this conflicted with their primary objective of achieving price stability.[149] The flexible use of interest rates will be an important feature of the mechanism.

C. *Outside EMU and Outside the European Union*

1. International Recognition of the Euro

EU Council Regulation 1103/97 pertaining to the recognition of the single currency and the continuity of contracts is binding only on EU Member States.[150] Contracts creating financial obligations denominated in the existing national currency of an EU Member State or enforced outside the European Union, regardless of the choice of law in the contract, but governed by the law of a non-EU Member State, may therefore be the subject of concern. Approximately one half of the derivative 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 portion of swap contracts in other financial centers, i.e., Frankfurt, Paris, Tokyo, Singapore, and Hong Kong. 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. There are also many long-term loan agreements and cross-border commercial transactions governed by the law of U.S. jurisdictions that also involve obligations denominated in EU currencies. In these cases, it is necessary to establish whether the law of the non-EU country will recognize the euro as the currency replacing the existing national currency of the relevant Member State.

As discussed above with regard to the transition from the ECU to the euro,[151] it is a widely accepted principle of private international law that a debt denominated in the currency of any

149. *See* EURO PAPERS, No. 17, *supra* note 14, at 15; Meyers & Levie, *supra* note 38, at 334.

150. *See* Part I, Section A, Subsection 3(a).

151. *See* Part I, Section A, Subsection 3(c).

country involves an obligation to pay the nominal, and not the real, amount of the debt in whatever is legal tender at the time of payment according to the law of the currency—*lex monetae.*[152] The courts most often also recognize that it is for the law of the state issuing the currency to decide what is legal tender for the purpose of validly discharging a debt expressed in the currency governed by that law. According to the *lex monetae* principle, it will also be the law of the state issuing the currency that will determine how sums expressed in the former currency are to be converted to the existing one in case of a currency alteration. This principle is analogous to the Act of State doctrine in international law, as endorsed by law in many national jurisdictions, which holds that national courts will not examine the validity of the acts of a foreign government done within its own territory.[153] As a result, it is the law of the currency that determines what is money and what nominal value is attributed to it.

Contrary to what is officially proclaimed by the Commission,[154] there are valid concerns that the concept of *lex monetae* does not appear to be applied by all jurisdictions and, therefore, that claims questioning the continuity of contracts governed by foreign law that contain references to the ECU or Member State currencies may be upheld in the relevant foreign jurisdictions. To address this problem, several U.S. jurisdictions are in the process of adopting, or have already adopted, legislation confirming the continuity of contracts. New York State adopted General Obligations Law 5049-A on April 16, 1997 amending the New York law to provide for the continuity of contracts that refer to currency units replaced by the euro.[155] Section 5-1603, Effect of

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152. For a description of the so-called "nominalist" and *lex monetae* principles, see MANN, *supra* note 125, at 272.

153. IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 494-95 (4th ed. 1990).

154. *See* Commission of the European Communities, *The Legal Implications of the European Monetary Union Under U.S. and New York Law*, EURO PAPERS, No. 15, Jan. 1998. The Commission pointed out that as a result of its contacts with third country governments and market participants, the principle of *lex monetae*, or the "state theory of money," is followed in the main financial centers of the world. The Commission takes it for granted that in any event, "for competitive reasons, these jurisdictions have themselves an interest in recognizing the euro and the continuity of contracts and will take any steps, if necessary, to further increase legal certainty." EURO PAPERS, No. 10, *supra* note 91, at 9.

155. Section 5-1602 now reads:

(a) If a subject or medium of payment of a contract, security or instrument is a currency

Agreement, provides that "[t]he Provisions of this Title shall not alter or impair and shall be subject to any agreements between parties with specific reference to or agreement regarding the introduction of the euro."[156] A New York court will, in all likelihood, interpret an agreement to make payment in an old currency of an EU Member State participating in Stage III as an agreement to make payment in the currency that constitutes legal tender at the time of performance. Illinois also enacted the Euro Conversion Act, effective July 30, 1997, which provides for similar continuity of contract language regarding the introduction of the euro.[157] California recently adopted a similar bill.[158] A creditor can minimize the existing uncertainties by presenting his or her claim for payment to a U.S. court as a suit

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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.

(b) 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.

(c) Performance of any of the obligations described in paragraph (a) and (b) of this subdivision may be made in the currency or currencies originally designated in such contract, security or instrument (so long as such currency or currencies remain legal tender) or in euro, but not in any other currency, whether or not such 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 or the euro. None of: (A) the introduction of the euro; (ii) the tendering of euros in connection with any obligation in compliance with paragraph (A) or (B) of subdivision one of this section; (C) the determining the value of any obligation in compliance with paragraphs (A) or (B) of subdivision one of this section; or (D) the calculating or determining of the subject or medium of payment of a contract, security or instrument with reference to interest rate or other basis has been substituted or replaced due to the introduction of the euro and has a commercially reasonable substitute and substantial equivalent, shall either 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.

N.Y. GEN. OBLIG. LAW, §§ 5-1601-1604 (Consol. 1998), S. 5049-A. For a comprehensive analysis of the enforceability of participating currency-denominated or ECU-denominated obligations before U.S. courts, see Michael Gruson, *The Introduction of the Euro and Its Implications for Obligations Denominated in Currencies Replaced by the Euro,* 21 FORDHAM INT'L L.J. 65, 65-107 (1997).

156. Gruson, *supra* note 155, at 105, n.189.

157. Euro Conversion Act, 1998 ILL. LAWS, PUBL. ACT 90-268 (1997).

158. CAL. CIV. CODE § 1663 (West 1998).

for payment in U.S. dollars or by suing the debtor before the courts of an EU Member State, provided that the chosen tribunal has the requisite jurisdiction to hear the creditor's claim.[159]

It must still be determined to what extent the same concerns may exist in other third country legislation,[160] such as the applicable rules in Asia's financial centers.[161] The Japanese Civil Code endorses the principle of nominalism—and thus contractual continuity—in the event of currency alteration.[162] Canadian legal practice is generally of the view that continuity legislation is not necessary in Canada because the doctrine of frustration will apply to recognize and to give effect to the introduction of the euro. Consequently, no continuity legislation is currently planned in Canada. To avoid such uncertainties, most issuers are including disclosure language about EMU in their prospectuses.[163]

It will also be necessary to establish in non-EU Member State jurisdictions whether there are any grounds for claiming that a financial obligation ought to be revalued or devalued to allow for any depreciation or appreciation of the money in which the debt was originally denominated. Contrary to *lex monetae*, it is the proper law of the contract, *lex contractus*, or the law of the obligation, *lex causae*, that normally determines whether a contract debt ought to be revalorized or devalorized.

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159. *See* Gruson, *supra* note 155 (analyzing, among others, THE THIRD RESTATEMENT OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES (1987)); *see* N.Y.U.C.C. Law on § 3-107; *see* Commission of the European Communities, N. Lenihan, *The Legal Implications of the European Monetary Union Under U.S. and New York Law*, EURO PAPERS, No. 18, May, 1998.

160. The London-based Financial Law Panel concluded in its recently-published report on continuity of contracts under Swiss law that EMU is unlikely to produce any substantial or unexpected difficulties. The only potential problem arises for ECU obligations because the ECU is a "basket" of currencies and not a currency in itself, and *lex monetae*, therefore, does not apply without dedicated legislation. This potential problem, however, is academic because Swiss market practice is for such transactions to be governed by the law of a jurisdiction outside Switzerland. FLP REPORT 122 (1998).

161. The question of continuity of contract is being addressed by the Hong Kong Monetary Authority. Although there are unlikely to be significant legal problems, whether or not legislation should be made available to provide absolute legal certainty is currently being addressed. Commission of the European Communities, *External Aspects of Economic and Monetary Union*, EURO PAPERS, No. 1, July, 1997, at 5.

162. Article 402 of the Japanese Civil Code states that if the designated currency loses its effect as legal tender, or *kyosei tsuyo-zyoku*, the debtor is obliged to make payments in another currency. MINPO, art. 402.

163. For an example of a disclosure language, see IPMA, EMU AND OUTSTANDING EUROBONDS—A GUIDE FOR ISSUERS, app. V, at 36 (Spring 1998).

Otherwise, the question of whether in the case of non-payment of a debt, damages may be claimed in respect of the depreciation because the date of maturity should be answered in accordance with the law governing the obligation.[164] This question may arise, for example, in the unlikely event that the euro is weaker than the German mark or the ECU, which it replaced and in which the relevant contract debt was originally denominated.[165]

To the extent that there is any doubt at the time of making a contract, it may be prudent for contracting parties to check the legal position in a relevant non-EU country or to select another governing law, i.e., of an appropriate Member State, to apply to their contract. Several associations in the financial sector such as the International Primary Market Association ("IPMA") and the International Securities Dealers Association ("ISDA") have produced a specimen continuity clause for inclusion in issue documentation and derivative contracts.

2. A Currency to Rival the U.S. Dollar?

The international economic implications of the euro are expected to reach far beyond the bounds of Europe. The euro is eventually expected to rival the U.S. dollar in terms of weight and importance in the international market.[166] The financial markets are anticipating a shift to euro-backed portfolios, thus presaging the increasing importance of European financial markets. Treasuries and other investors are expected to shift a percentage of their foreign reserve holdings into euro and out of U.S. dollars and yen.[167] The rise in the euro should also lead to greater symmetry in the international monetary system with the European Union playing an increasingly important role in international institutions responsible for the international monetary

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164. *See* MANN, *supra* note 125, at 280 (referring to RABEL, CONFLICT OF LAWS 34 (1950) (stating that "[t]he effects of a currency on the amount of the debt shall be subject to the law governing the debt.")).

165. The European institutions, however, seem to have confirmed the nominal continuity of all money obligations expressed in ECU on May 12, 1994. Explanatory note concerning new clauses in the prospectuses of loans and bonds of the European Communities, O.J. C 130/5, at 6 (1994).

166. Fred Bergsten, *The Dollar and the Euro*, 76 FOREIGN AFF., July/Aug. 1997; Philipp Hartmann, *The Future of the Euro as an International Currency: A Transactions Perspective*, *in* CENTRE FOR EUR. POL. STUD. RES. REP., NO. 20 (Dec. 1996).

167. EURO PAPERS, No. 17, *supra* note 14, at 89-90.

system.[168] On the commercial level, the euro is expected to play an increasingly important role as a trade invoicing currency.[169] European companies anticipate that overseas suppliers and customers that currently invoice in predominantly U.S. dollars or German marks will shift in part to euro, thus limiting or eliminating exchange-rate risks for European companies.

Although the current EMU legal framework is not designed to consider the risk of a partial or total failure of EMU, it is not unthinkable that the combination of unified national monetary and exchange rate policies, asymmetric economic developments in the euro zone, fierce competition between national fiscal regimes, and inflexible labor markets may lead to a reversal of the EMU process within the transitional period or a termination of EMU after January 1, 2002.[170] While these problems may, to a large extent, be relieved by intra-national fixed transfers, some have suggested that it would be highly desirable to have a federal "stabilization scheme" in the form of a strictly limited fiscal federalism to compensate those losing out because of EMU.[171] Although the risk of a political and macro-economic failure of EMU is very remote and its consequences for dealings between companies and financial institutions unpredictable, contracting parties may want to hedge their risks by explicitly qualifying an EMU failure as a *force majeure* event or a renegotiation event.

II. *SPECIFIC LEGAL CONCERNS FOR COMPANIES ARISING FROM THE INTRODUCTION OF THE EURO*

A. *Introduction*

EMU will become a new reality for companies doing business in Europe beginning January 1, 1999. Many companies,

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168. *See* Commission of the European Communities, *External Aspects of Economic and Monetary Union*, EURO PAPERS, No. 1, Apr. 1997, at § D (discussing implications for International Monetary Fund).

169. *See* Commission of the European Communities, *The Implications of the Introduction of the Euro for Non-EU Countries*, EURO PAPERS, No. 26, July 1998, at 2; Vicki Barnett, *Watch Out, Dollar*, FIN. TIMES, Apr. 23, 1998, at A11.

170. P. DE GRAUWE, THE ECONOMICS OF MONETARY INTEGRATION 69-84, 191-210 (3rd ed. 1997); *see also Euro May Crash Before 2004, Say Managers in Survey*, WALL ST. J., July 15, 1990, at 4.

171. A. Italianes & M. Vanheukelen, *Proposals for Community Stabilisation Mechanisms, Some Historical Applications*, *in* EUROPEAN ECONOMY, REPORTS AND STUDIES 5, 493 (1993).

particularly large multinationals, started planning several years ago for the introduction of the euro. Others are scrambling to catch up as the inevitability of the change becomes more apparent. Some companies will lose out in the changeover to EMU, but the overall assessment of the impact of EMU on the EU Single Market is positive. The introduction of the euro is expected to improve the effectiveness of the Single Market because a single unit of accounting will facilitate price comparisons by consumers and producers across borders, thus intensifying competition. Consumers will have a greater array of choices and producers will have greater incentives to concentrate their manufacturing facilities to achieve economies of scale. This chage, in turn, may result in a further wave of mergers and acquisitions as companies expand across borders. Both groups should benefit from the elimination of foreign-exchange transaction costs—approximately .3-.4 percent of EU gross domestic product, i.e., ECU20-25 billion, or US$22-27.5 billion, annually.[172] A single currency is also expected to promote growth and employment because it will be based on an economic framework in which public deficits are under control and price stability is secured. Public administrations in the Participating Member States will play a large role in ensuring the smooth introduction of the euro, not only by keeping public deficits under control, but also by ensuring that the public sector is ready to use the euro from the start of Stage III as the public sector represents approximately fifty percent of European gross domestic product throughout Europe.

The second half of this Article outlines changes companies will see in the marketplace, particularly the financial marketplace and issues that companies will need to consider as they change their operations to euros. It focuses in particular on what will happen during the transitional period and shortly thereafter. This section is written from the perspective of larger multinational companies that use the European financial markets. Small and medium-sized companies will need to consider many of the same issues and no doubt will have their own problems in adjusting to the change in currency given their limited scope of resources and available funds.

172. *Practical Issues Arising from the Introduction of the Euro*, No. 8, *supra* note 55, at 5-13.

B. *Public Obligations*

In the late 1980s and early 1990s as serious discussions about the possible structure of EMU began, European institutions had an extensive debate about whether the euro should be introduced over a period of time or all at once. The transitional proponents succeeded. Although the three-year transitional period permits businesses and consumers an opportunity to adjust to the new currency alongside their traditional currencies, it raises a series of questions, particularly with regard to public obligations such as the payment of taxes and pricing.

The Participating Member States' fiscal authorities, in particular, have had to resolve several important questions: (i) from which date fiscal declarations and payments can be made in the single currency; (ii) whether the introduction of the euro is a taxable event; (iii) the treatment of administrative errors and delays by companies in completing their fiscal documentation; (iv) arrangements for dealing with the changeover during a fiscal year; and (v) fiscal treatment of investment costs associated with the changeover to the single currency such as depreciation. All Participating Member States have presented their transition plans, including statements on accounting, reporting, and tax declarations in euro.[173] Each of these countries has paved the way for companies to choose the full "euro option," permitting companies to change over their accounting, reporting, tax declarations, and tax payments to euro from the calendar year 1999 onwards.[174] As a general rule, most of the national legislation provides that once a company opts to switch to the euro, it cannot switch back. As an application of the "no compulsion/no prohibition" rule, Participating Member States cannot oblige companies or individuals to report in euros during the transitional period if they choose not to report.[175]

173. Commission of the European Communities, EURO PAPERS, No. 21, *supra* note 75, at 1; Commission of the European Communities, *Fact Sheets on the Preparation of National Public Administrations to the Europe*, EURO PAPERS, No. 27, June 1998, at 3.

174. Even though the Participating Member States will permit private parties to report in euros during the transitional period, they will continue to use the national currency units internally with some adjustments as necessary for the issuance of new tradeable debt. Commission of the European Communities, *Practical Aspects of the Introduction of the Euro*, EURO PAPERS, No. 8, Nov. 1997, at 5.

175. See "no compulsion/no prohibition" principle under Part I, Section A, Subsection 3(b); *see also* EURO PAPERS, No. 17, *supra* note 14, at 20.

Such a uniform response from the Participating Member States, at least on the general principles of tax filings, was not a foregone conclusion. As noted above, the responsibility for fiscal policy under EMU remains with Member States. The fact that they have all chosen to permit business entities to move to financial declarations from the start of Stage III will not only promote the use of the euro, but also significantly facilitate tax management for multinationals with operations in several Participating Member States.

The principal tax issue concerning the introduction of the euro is the question of whether the mere conversion of existing national currency positions into euro positions is considered a taxable event.[176] It is currently unclear in various Participating Member State jurisdictions whether such a conversion is deemed a realization of a gain or loss in respect of financial assets. It seems unjustified that the "public" conversion to the euro in itself, i.e., without the involvement of private parties, would bring about adverse tax effects for private parties.

Other countries have also been forced to address the tax consequences of the conversion to the euro. The U.S. Internal Revenue Service ("IRS") recently issued final and temporary regulations relating to U.S. taxpayers operating, investing, or otherwise conducting business in the currencies of EU Member States that will participate in EMU and switch to the euro.[177] The new U.S. regulations seek to minimize the federal income tax consequences arising from the introduction of the euro. With certain exceptions, under the new temporary tax regulations, the conversion from national currencies to the euro will be a non-taxable event; conversion to the euro will not be a taxable exchange with respect to instruments and contracts denominated in a currency of a Participating Member State used prior to the substitution of the euro. In addition, qualified business units will not recognize a gain or loss upon converting their "functional currency," generally the local currency in which the qualified business unit keeps its books, to the euro. Qualified business units that use one of the Participating Member State currencies will be

176. For a broader discussion of the accounting issues associated with the introduction of the euro, see Commission of the European Communities, *Accounting for the Introduction of the Euro*, EURO PAPERS, No. 2, July 1997.

177. 63 Fed. Reg. 40,366 (1998); *see* Sindhu Hirani, *Euro Conversion to Remain Tax-Neutral, Proposed, Final, Temporary Rules State*, 145 DAILY TAX REP., July 29, 1998, at 67-68.

deemed to have automatically changed their functional currency to the euro at the beginning of the year in which they change their books and records to the euro. The IRS regulations do not specifically address the deductibility of costs associated with the euro conversion. The IRS is seeking further comments from the public concerning other issues involving the conversion to the euro such as the effect of the conversion on the reporting of hedging transactions.

Public obligations with regard to the dual display of prices in euro and national currency units during the transitional period will not, after much debate, be governed by EU law. The Commission was considering whether the display of dual prices in euro and national currency units during the transitional period should be the subject of EU legislation that would be binding on all of the Participating Member States. Regulation 974/98 specifically mentions that further legislation may be necessary to deal with additional transitional issues. After consultation with a variety of businesses and consumer organizations, the Commission recommended that EU legislation need not be adopted to harmonize issues such as dual price displays and conversion fees, i.e., the cost for changing a denomination of a monetary amount from the national currency unit into the euro unit and vice versa, during the transitional period. As for dual price displays, the Commission concluded that voluntary codes of conduct could serve as a minimum basis for negotiations between businesses and consumers with the objective of agreeing on standards of transparency and providing information.[178] On the pricing issue, companies will also have to consider how to deal with prices that translate from national currency units into awkward euro values.

C. *Contractual Continuity Versus Freedom of Contract*

The continuity of contracts is one of the principle concerns in the changeover to the new currency. Without a legally binding statement that the introduction of EMU will not affect the continuity of contracts, there was widespread fear in the financial markets and the business community that the substitution *de jure* of national currencies by the single currency would provide

178. Commission Recommendation concerning dual display of prices and other monetary amounts, O.J. L 130/26 (1998).

a legal basis to terminate or to modify existing contracts and thus provoke a wave of litigation about contracts that were no longer as advantageous under the terms of EMU.[179] The Commission moved to deal with this issue early on, in the first euro regulation, with an admirably brief statement that provides for the continuity of contracts. Article 3 of Regulation 1103/97, which lays out the principle of continuity of contracts, attempts to override the doctrine of frustration in all its national permutations by stating that "subject to anything which the parties may have otherwise agreed, [t]he 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 such an instrument."[180]

By adopting an EU regulation that is binding on all Member States,[181] the Member States have addressed the legal uncertainty arising from the application of differing Member States laws on contracts concerning continuity.[182] Most of the EU national jurisdictions recognize the power to revise contracts on the basis of at least one of the following principles: (i) frustration of the parties' intent; (ii) destruction of the contract's basis; (iii) fundamental change of circumstances; (iv) circumstances where it would be bad faith to insist on continued performance; or (v) circumstances where it would be excessively onerous to perform the contract according to its terms.[183] In addition, *force*

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179. For example, such contracts might be mortgage loans at a fixed interest rate. *See* EUROPEAN MORTGAGE FEDERATION, MEMORANDUM OF THE EUROPEAN MORTGAGE FEDERATION ON THE COMMISSION'S GREEN PAPER ON THE PRACTICAL IMPLICATIONS OF THE SINGLE CURRENCY (Oct. 1995).

180. *See* Regulation 1103/97, *supra* note 58, art. 3, O.J. L 162/1, at 2 (1997).

181. As a result, any national measures, i.e., in the field of consumer protection, must be in line with the confirmed continuity-of-contract principle. In other words, measures conferring a unilateral right on one party to alter or to terminate an existing contract only because of the introduction of the euro will run counter to a Member State's obligation to respect the continuity principle adopted at the European level. EURO PAPERS, No. 10, *supra* note 91, at 12.

182. Differences in interpreting whether contracts will continue after the start of EMU may arise from differences in application of the conflict of law principle of the law of the contract, *lex contractus*, or the law of the obligation, *lex causae*.

183. Variants of the frustration of contract theory, based on the principle in Roman law of *rebus sic stantibus*, exist, *inter alia*, in the United Kingdom, Italy (*eccesiva onerosità*), Germany (*Wegfall der Geschäftsgrundlage*), the Netherlands (*imprevisieleer*), France (*théorie de l'imprévision*), Spain (*frustración del contracto*), Denmark (*bristede forudsaetninger*), and Greece. Other jurisdictions, such as Belgium, have a stricter interpreta-

majeure clauses in contracts generally excuse non-performance of a contract in circumstances beyond the control of the parties that prevent performance or that lead to a severe disruption of circumstances underlying the contract that could not be anticipated by the parties. It is very doubtful that EMU provides such *force majeure* conditions. Given almost a decade of preparatory work and extensive public knowledge surrounding the introduction of the euro, the event cannot be deemed to constitute an unforeseeable or disruptive change in economic conditions that would justify unilaterally canceling contracts made in a national currency of a Participating Member State or re-negotiating their terms.[184]

Clauses in contracts that expressly foresee the right of a party to change the terms of the contract or to terminate it will continue to apply. This continuance may open the door for possible arguments that specific contract language must be interpreted as partly or completely overriding the contract continuity principle of Regulation 1103/97. Contract language to the effect that such clauses are triggered, for example, in the event of the disuse of a national currency by the issuing country, could lead to the conclusion that the parties need to insert a specific contract continuity clause. On the other hand, while a broadly drafted *force majeure* clause or frustration of purpose clause may be considered "something on which the parties have agreed," and thus override the continuity principle, the wording of one of the prefatory recitals of Regulation 1103/97 buttresses the application of a broad-sweeping principle of continuity of contract and a limited exception based on an explicit intent to deviate as it states that "the principle of continuity should be compatible with anything to which parties might have agreed *with reference to*

tion of the conditions under which frustration can be invoked. *See* H. DE PAGE, TRAITÉ DE DROIT CIVIL, II, no. 577 (1970); C. Renard, *La théorie de l'imprévision dans les contrats*, REVUE DE DROIT INTERNATIONAL ET DE DROIT COMPARÉ, II, 17 (1950).

184. *See* Commission of the European Communities, One Currency for Europe: Green Paper on the Practical Arrangements for the Introduction of the Single Currency, COM (95) 333 Final (1995). Similar views have also been expressed by business associations and advisory brokers. *See Introduction of the Single Currency: The Views of the BFEU*, BANKING FEDERATION OF THE EUROPEAN UNION (Nov. 1995); *Supplemental Response to the Commission's Green Paper: The Need for Legislation to Ensure Continuity of Contracts*, CITY OF LONDON LAW SOC'Y (Jan. 1996); M. Wölker, *The Continuity of Contracts in the Transition to the Third Stage of Economic and Monetary Union*, 33 COMMON MKT. L. REV. 1117, 1117-32 (1996).

the introduction of the euro."[185] This clause implies that exceptions to the continuity principle must contain reasonably explicit references to the euro or EMU to fall within the opt-out of Article 3 of Regulation 1103/97. Companies will therefore want to weigh the option of using continuity clauses carefully, particularly where it has a series of contracts with the same party. Where a company chooses to insert specific continuity clauses, it should do so consistently for contracts of the same type and for contracts with the same parties. Otherwise, a company may find that far from clarifying its intention to ensure continuation of its contracts, it has cast the continuation of some of them in doubt. For instance, one of the parties may want to draw an *a contrario* conclusion that because the parties did not explicitly include the continuity clause in one of a series or similar contracts, it must be considered terminated.[186]

The doctrine of *force majeure* could be a concern where obligations under a contract are tied to a quoted rate, an index, or price sources that are bound to disappear after the start of EMU, leaving no basis or reasonable substitute for the original price source. The sponsors and publishers of quoted rates are well aware of the problem and are expected, if they have not done so already, to announce what rates they intend to publish after the introduction of the euro. For example, the EU Banking Federation has published Euro Inter-Bank Offered Rates[187]

185. Council Regulation No. 1103/97, *supra* note 58, recital 7, O.J. L 162/1, at 1 (1997) (emphasis added). The preamble of Regulation 1103/97 thus seems to contemplate that continuity would only be subject to challenge where the parties have agreed on a provision specifically dealing with the introduction of the euro, whereas the language in Article 3 of Regulation 1103/97 can extend to broadly-defined provisions. *Id.* art. 3, O.J. L 162/1, at 2 (1997). It remains to be seen to what extent EU national courts will take the interpretation set forth in the preamble into account when confronted with a specific clause.

186. *See* M. D'Assesse, *Que devient un swap en devises régi par la loi de l'Etat de New York?*, *in* L'ECHO DE LA BOURSE (July 17, 1996).

187. European Interbank Offered Rate ("EURIBOR") will be a measure of the average cost of funds over the whole euro zone based on a much larger panel of banks-initially 47 banks from "in" EU countries, four banks from "out" EU countries, and six large international banks from non-EU countries, including at least one from each Participating Member State. Domestic market participants in the euro zone may prefer to use EURIBOR, which will replace the existing national interbank rates, such as FIBOR, PIBOR, etc. For example, the French Futures and Options Exchange, MATIF, has announced that it will adopt EURIBOR, whereas Deutsche Termin Börse has announced that it will offer the market a choice, during the transition period, of EURIBOR and Euro LIBOR. *See* EURIBOR Press Release of July 13, 1998, No. 778.

("EURIBOR") and the International Swaps and Derivatives Association ("ISDA") has updated its contractual documentation for derivative products allowing parties to switch from national price sources to a euro rate or to deal with the disappearance of a national price source. The disappearance of reference rates is not a new phenomenon; it happened, for instance, in the course of the deregulation of EU capital markets.[188]

The introduction of the euro should not, in principle, affect interest rate payments, whether floating or fixed. None of the doctrines discussed above should prove useful to parties seeking to amend their interest payment obligations either on the theory that the essence of the contract has changed or that a reference rate used to determine the interest rate has disappeared. For floating rates, if a borrower has an obligation to pay in French francs at the Paris Interbank Offered Rate ("PIBOR") rate for French francs, the obligation will be converted to an obligation to pay interest in euro at the the EURIBOR rate, after the changeover to the euro. Likewise, an obligation to pay French francs at the London Interbank Offered Rate ("LIBOR") rate for French francs will be converted into an obligation to pay euro at the Euro LIBOR rate.[189] Although less evident, it is generally argued that longer-term contracts with fixed interest rate obligations entered into several years before the admission of the Participating Member State will continue as before the introduction of the euro, even where it will result in an obligation to pay a relatively high historic rate compared to what is expected to be a lower rate for the euro.[190] Interest rate changes are considered a well-known economic risk for any long-term contract and result from changes in macro-economic policies that individual contracting parties have never been able to control or to foresee

188. *See* Commission of the European Communities, *The Legal Framework for the Use of the Euro*, EURO PAPERS, No. 4, Sept. 1997, at 9.

189. Euro LIBOR will be the measure of the cost of Euro funds based on the offer rates quoted by 16 of the most active banks in the London market. Use of Euro LIBOR will benefit from familiarity and from the liquidity deriving from the existing weight of contracts based on the national currency LIBOR.

190. *But see* Dunnett, *supra* note 124, at 60-61. D.R.R. Dunnett states that "a long-term loan involving a commitment to pay a given fixed rate interest in, for example, Italian lira, is arguably a materially different obligation to that of paying the same rate of interest in euros after the lira has been converted into the euro. It may well depend on the circumstances of each contract to ascertain whether the parties foresaw an economic change as profound as EMU." *Id.*

entirely. In addition, given that interest rates in the group of Participating Member States have substantially converged, the advent of the euro will not produce a significant change in the interest rate level.

It is therefore highly unlikely that case law will develop confirming the application of *force majeure* or frustration doctrines to the introduction of the euro.[191] Parties may nonetheless want to clarify the implications of the introduction of the euro in their contracts by looking for substitute references for interest rates and price sources that will disappear.

D. *Implications for the Debt Market*

Large companies issuing debt in the euro zone can expect to find a much larger debt market, offering increased possibilities in terms of volume, instruments, and longer maturities.[192] Bond yields could be affected as currency risk is eliminated, shifting greater emphasis to other components of yield such as market liquidity, credit risk, and taxation differences. A bigger, more liquid market could lead to more efficient allocation of capital, making borrowing easier, in particular for companies. Sovereign borrowers will be limited in their borrowing by their obligation to maintain their economies in line with EMU targets.[193] As a result, the bond market will open up to further private participation, resulting in a bond market that is more evenly balanced between sovereign and private borrowers.

Greater corporate borrowing in a bigger market will also mean that well-known corporate names in one Member State market may cease to benefit from the same name recognition that they currently enjoy in the national markets. This situation may lead to an increase in the number of companies seeking credit ratings. On the other side of the coin, corporate credit ratings will no longer be potentially capped by the credit rating of the Member State in which they are located. As the European

191. *See* D. Livingston & B. Hutchings, *Legal Issues Arising from the Introduction of the Euro*, J.B.I.L. 63 (1997); Geoffrey Yeowart, *Legal Repercussions of a Single European Currency*, INT'L FIN. L. REV. 44, 44 (Dec. 1995).

192. *See* EURO PAPERS, No. 17, supra note 14, at 86-87.

193. The prevention of excessive public deficits is guaranteed in the long term by the Stability and Growth Pact.

Union will most likely receive a AAA credit rating,[194] this will have a beneficial effect for some larger corporations in financing new debt. In addition, EMU is expected to precipitate an increase in the securitization of corporate debt.

International bonds will be issued from the financial centers with the lowest transaction costs. The pace of consolidation will, to a certain extent, be determined by the manner in which the ESCB conducts its market operations. If the ESCB immediately moves to distributing open market transactions on the basis of the most competitive tenders, this will encourage consolidation on the most efficient markets.

There are a range of legal issues that companies must consider in their calculation of how and when to take advantage of the new opportunities in the euro zone debt markets. How quickly companies can issue new debt will depend on their own schedule and on the available market opportunities. How quickly they can move to redenominate their existing debt in a Participating Member State currency will depend on how quickly Member States move on the issue. Regulation 974/98 provides that each Participating Member State may redenominate[195] its outstanding debt in euro from the beginning of Stage III. The European Commission Giovannini Group Report on the effect of the euro on capital markets recommends that sovereign issuers redenominate their tradable debt at the start of Stage III, employing a "bottom-up" methodology with rounding to the nearest cent.[196] All Participating Member States have an-

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194. According to the credit rating houses Fitch IBCA, Moody's, and Standard and Poor's.

195. "Redenomination" means the change of the unit in which the outstanding amount is stated—in this case from national currency units to euro—without altering any other term of the debt. For example, if the conversion rate were to be 1 euro = DM 1.87848, a German mark bond with a face amount of DM1,000 would be converted into a euro-denominated bond of euro 532.35, i.e., DM1000/1.87848 = 532.345 euro, rounded to euro 532.35). Council Regulation No. 974/98, *supra* note 59, art. 1, O.J. L 139/1, at 6 (1998).

196. This method starts with each individual holding being converted into euro using the fixed conversion rates and rounded to two decimal places, i.e., to the nearest cent. The sum of all individual holdings is computed and matched against the total held at the central depository. Holdings at the central depositories remain unchanged and thus redenomination would not affect the total volume of securities issued. The cash flow from coupon payments and the maturity value of a bond would be virtually unchanged except for small—not more than one cent—potential rounding differences. All Participating Member States have indicated that they will adopt a bottom-up methodology. Commission of the European Communities, *The Impact of the Introduction of the*

nounced their intention to issue new debt in euro and to redenominate the majority of their outstanding debt in euro beginning January 1, 1999.[197] Once a Member State redenominates its outstanding debt, this opens the way for private issuers. Regulation 974/98 permits private issuers to redenominate bonds and other securitized debt negotiable in capital markets, and money market instruments if issued in the national currency of a Member State that has redenominated at least part of its outstanding debt issued by the general government.[198] This allowance means that the burden of promoting a euro debt market in existing debt at the start of Stage III rests at least initially and primarily on Participating Member States. Irrespective of whether a Participating Member State has redenominated existing debt, parties may agree privately to redenominate existing debt issued in a national currency unit pursuant to the principle of contractual freedom enshrined in Article 8(2) of Regulation 974/98.

Private issuers will want to consider carefully whether to pursue redenomination of their existing debt. However convenient it may be to have their debt in one currency, there appears to be more disadvantages than advantages in redenominating non-government debt securities unless the terms of a prospectus specifically provide for it. This situation is due to the cost of redenominating. A private issuer does not need the approval of bondholders for redenomination, which Regulation 975/98 defines narrowly as the change in the unit in which the debt is stated from a national currency unit to the euro unit.[199] Redenomination can be performed through a unilateral act pursuant to the provisions of Regulation 974/98.[200] Any further changes, however, to any terms of a bond, or renominalizing, to create more manageable currency amounts, remain subject to national law and, in most Participating Member States, entail calling bondholders meetings unless this requirement is otherwise dealt

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Euro on Capital Markets, EURO PAPERS, No. 3, July 1997, at 21-22. This report is not binding but is meant to provide guidance to the Commission.

197. EURO PAPERS, No. 17, *supra* note 14, at 83.

198. Council Regulation No. 974/98, *supra* note 59, art. 8(4), 98 O.J. L 139/1, at 3 (1998). This means, for example, that once the German government has redenominated at least part of the German government debt in euro, an Austrian issuer of a German mark debt under Luxembourg law can redenominate its debt.

199. *Id.* art. 1, O.J. L 139/1, at 2 (1998).

200. *Id.* art. 8(4), O.J. L 139/1, at 3 (1998).

with through national legislation.[201] Companies will want to consider the renominalization of bonds to the nearest euro cent to create round euro values because this would create a homogenous pool of euro securities, thus increasing market liquidity. Unless Member States adopt specific legislation concerning debt renominalization,[202] changing the terms of a bond would require the agreement of bondholders and would risk some form of compensatory payment that could have tax and reinvestment risk implications for investors. The issuer would have to absorb significant costs in addition to the logistical problems of managing the change.

The other method that could be used to avoid the problems of renominalization would be for issuers to make exchange offers swapping debt denominated in national currency units for debt denominated in round values. The advantages of an exchange offer would have to be weighed against the administrative costs of running an exchange and the need to offer a sufficiently attractive financial incentive to ensure investor response. Where appropriate, companies should be making provisions now in prospectuses for new issues that will be made or carry over into Stage III. Given the cost and administrative burden of redenomination, whether existing debt will be redenominated will depend in large part on the market's interest.

How debt will be redenominated or issued will depend on the markets as well—the European Union decided that it will not take legislative action to harmonize market conventions in the debt markets. This arena is being left to the markets to sort out. The move to harmonized market conventions will enhance transparency for investors and analysts in assessing euro assets against U.S. dollar and Japanese yen assets. The relevant trade associations issued a joint statement on harmonized market conventions for the euro in July 1997, recommending a series of harmonized conventions for the euro money markets, "actual/

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201. *Id.* recital 14, O.J. L 139, at 2 (1998).

202. *See Redenominating Shares Capital—Preparing for the Introduction of the Euro*, EUROPEAN COUNSEL 17-24 (June 1998) (discussing draft legislation that Participating Member States are introducing to accommodate introduction of euro and in context of article, redenomination of share capital). Legislation may also address redenomination of private debt. *See* EURO PAPERS, No. 21, *supra* note 75, at 5. It is not clear from Commission's summary, however, whether new legislation will cover just public debt redenomination or private redenomination as well.

360," the euro bond markets, "actual/actual," and the euro foreign exchange markets for financial instruments issued after Stage III and for financial instruments issued beforehand that are designated to be redenominated into euro.[203] Other recommended standards are the TARGET operating days as the definition of business days, the two-day rate fixing convention for derivatives contracts, the spot/two-day standard for settlement in money markets, and the continued application of the T+3 cycle as the standard settlement date for cross-border transactions in the bond market. The associations recommended that the existing conventions be retained for pre-1999 instruments.[204] The Commission's Giovannini Group made the same recommendation on the basis that it is in line with the principle of contract continuity.

E. *Implications for the Equity Markets*

The introduction of EMU is expected to change the nature of the debt market in Europe. It is also expected to have dramatic effects on the structure of the stock markets. Companies intending to list on the European exchanges will find new and more harmonized services available. Euro zone equity markets are expected to move towards the depth and diversity of choice that currently exists in the United States, including high-quality corporate bonds and junk bonds, asset-backed securities created from pools of financial assets such as bank loans and credit-card receivables, and collateralized mortgage securities. EMU is expected to prompt the present European stock exchanges to increase their co-operation in the fields of cross access to quotations, harmonized negotiation systems, identical settlement procedures, standardized software and working stations, and a family of joint indexes representing a pan-European equity market.[205] These developments could signal the beginning of a far

203. The relevant trade associations include: Association of Corporate Treasurers ("ACI"), Cedel Bank ("CEDEL"), European Federation of Financial Analyst Societies ("EFFAS"), International Primary Markets Association ("IPMA"), International Securities Market Association ("ISMA"), European Banking Federation ("EBF"), International Paying Agents Association ("IPAA"), and International Swaps and Derivatives Association ("ISDA").

204. IPMA, EMU AND OUTSTANDING EUROBONDS—A GUIDE FOR ISSUERS 23 (Spring 1998).

205. *See The Far-Reaching Strategic Alliance Between the London and Frankfurt Stock Exchanges*, FIN. TIMES, July 8, 1998, at 1; *see also Battle of the Bourses*, FIN. TIMES, May 14,

reaching process that could help reduce fragmentation in the European stock market.[206] Only exchanges able to offer the latest technology at the best prices and with the largest platform are expected to win from this consolidation process. The need for markets in each country will no longer be justified.

Although the competition among stock exchanges is heating up to keep pace with the dramatic changes wrought by the introduction of a single currency, the regulators are not keeping pace. It is expected that consolidation of products in the equity markets will change more slowly than in the bond market due to the considerable differences in legal systems, accounting, auditing procedures, and tax and stock market regulations in the European Union.

A combination of the introduction of the euro and the effect of the EU Investment Services Directive[207] is expected to affect profoundly the structure of the equities markets in Europe by increasing cross-border activity in equities throughout the euro zone.[208] As a result of the liberalization of investment services, once established in one of the Member States, or the "home country," an investment firm is in principle free either to open up a subsidiary or a branch or to offer its investment services in another Member State without the approval of the authorities in such other Member States, the "host country,"[209] subject to the right of the host country to impose certain restrictions in the "general good."[210] In this respect, further thinking is needed as to how and by whom European stock markets should be regu-

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1998, at 29 (discussing Euro NM and cooperation between French, German, and Swiss derivative exchanges).

206. *See A Survey of Financial Centers: Capital of Capitals*, ECONOMIST, May 9, 1998, at 20; *London Meets Its Match—Europe's Two Biggest Exchanges Plan to Create a Single Market for European Share Trading, That Will Not Be Easy*, ECONOMIST, July 11, 1998, at 70-71; *Euro Options: Diversity Born of Unity*, INT'L HERALD TRIB., July 11, 1998, at 19.

207. Council Directive No. 93/22, O.J. L. 141/27 (1993) (Directive on Investment Services in the Securities Field).

208. For an analysis, see LONDON STOCK EXCHANGE, ECONOMIC AND MONETARY UNION: PROPOSALS FOR THE EQUITY MARKETS (1998) [hereinafter EMU: PROPOSALS FOR THE EQUITY MARKETS].

209. Mutual recognition of investment firms is made possible as a result of a minimal harmonization on the EU level of the different rules of the EU Members States. Council Directive No. 93/22, *supra* note 207, recitals & art. 14, O.J. 141/27, at 37 (1993).

210. Host-country supervisors still make too much use of local business conduct rules based on this "general good" principle, thus impeding the liberalization of investment services.

lated. The legal method of mutual recognition, based on minimal harmonization, was well-tailored for trade between national Member State markets. In a truly European market the patchwork of national regulations may be preserved, while further harmonizing their rules, but the trouble is that the quality of regulation depends not so much on formal rules as on familiarity with markets that only the proximity of market practitioners can bring.[211] An alternative may therefore be to create a single pan-European regulator, in line with the U.S. approach, i.e., with the Securities and Exchange Commission.

The introduction of the euro will further increase foreign access to domestic markets, thus increasing liquidity on domestic markets. Large-cap European companies already sell over fifty percent of their new issues across national borders, but most of the stock comes back to the original country and secondary market trading is predominantly local. After the euro is introduced and shares are redenominated, companies are expected to list their shares on several stock exchanges of other Member States in the euro zone, as the removal of exchange risks will significantly enhance the size and liquidity of European capital markets and as competition drives the listing cost down.[212] Investors will increasingly classify equities in the euro zone by pan-European industry sector rather than by country.[213]

Subject to certain legislative reforms, institutional investors such as pension funds that are currently forbidden to hold certain securities in foreign currencies on the grounds of currency mismatch will be able to invest in any euro-denominated instruments regardless of national origin. The Commission is urging Member States to remove the quantitative restrictions on the investment of pension and life insurance assets outside domestic markets. In the euro zone, regulatory requirements forcing institutional investors such as insurance companies and pension funds to hold specific government and domestic currency assets

211. *Europe's Exchange and Mart*, ECONOMIST, July 11, 1998, at 14.

212. Note, however, that a company's tax residence will remain a key influence on its share price, and some incentives will remain for investors to purchase domestic equities.

213. European benchmarks, such as FTSE Eurotop 100 and 300, are being established to facilitate pan-European analysis of performance and pan-European derivatives trading.

will no longer be justifiable on the grounds that cross-border investment involves unacceptable currency risk.

EMU is also expected to boost the creation of a substantial pan-European venture capital market, similar to the United States' markets, where European entrepreneurs have timely access to considerable financing, and risk capital investors are offered a stream of good investment opportunities in Europe.[214] EASDAQ, the pan-European second-tier venture capital market, is becoming the NASDAQ-equivalent trading platform for European-wide listings of mid-cap, high-tech companies.[215] Another positive trend is the growing cooperation between some existing markets, such as Euro N.M. of the Amsterdam, Brussels, Paris, and Frankfurt national venture capital exchanges.[216] According to the European Commission, the main shortcomings in the regulatory framework to creating a pan-European risk capital market are as follows: (i) the absence of EU legislation on venture capital funds—Member States make too liberal use of the "general good" of due diligence principles; (ii) undue restrictions on institutional investors, such as Undertakings for Collective Investment in Transferable Securities ("UCITS"),[217] insurance companies, and pension funds, for investing in risk capital—for example, restrictions as regards the placement of funds by category of asset; (iii) the substantial margin of discretion for host-country supervisors under the EU Investment Services Directive to limit the activities of investment firms registered in another EU Member State; (iv) the lack of a single set of accounting rules in Europe taking into account international standards; and

214. Commission Communication, Risk Capital: A Key to Job Creation in the European Union, April 1998, in preparation of an Action Plan to be agreed by the Council and the European Parliament, COM (98) 122 (Apr. 1998) [hereinafter Risk Capital: A Key to Job Creation].

215. Werner Van Lembergen, *Easdaq—Pan-European Stock Market for High-Growth Companies*, BUTTERWORTHS J. OF INT'L BANKING AND FIN. L. 520, 520-524 (Dec. 1996).

216. N.M. stands for "new market" in each of the languages of the countries participating in the exchange.

217. Undertakings for Collective Investment in Transferable Securities, O.J. L 375/3 (1985). The Commission has recently taken action to improve equivalent market access and operating conditions for companies that manage collective investment undertakings ("management companies"); *see* Commission Proposal for a European Parliament and Council Directive Amending Directive No. 856/611/EEC on Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities ("UCITS") with View to Regulating Management Companies and Simplified Prospectuses, O.J. C 272/07 (1998).

(v) certain fiscal barriers, i.e., marginal tax rates applied to debt interest income appear to be significantly lower than those charged on equity income including stock dividends and retained earnings.[218]

The European stock exchanges, through the Federation of European Stock Exchanges, announced that they intend to pursue a Big Bang approach on the introduction of the euro. Beginning on January 4, the first trading day following the conversion weekend, the exchanges will trade and quote in euros.[219] This decision is based on several considerations. A common changeover date for all organized markets—money markets, bond markets, equity, derivatives, regulated, or over-the-counter—will enable market participants to plan their own changeover and systems based on the knowledge that all securities will be dealt with in euro from a certain date. As many of the exchanges cannot handle multi-currency trading, an immediate move to euro will avoid the problem of developing multi-currency trading systems for only an interim period. Finally, in the absence of any significant link between share nominal value and the price at which a share is traded, there is no strong argument in support of dual listing in both euro and the national currency unit.

Exchanges in Switzerland and Sweden have announced their intention to trade their most liquid securities in euros starting January 4, even though their governments are not joining EMU. The Swiss Exchange intends to trade in Swiss francs, but will have a currency conversion facility built into its system so that the equivalent euro price will be displayed alongside.[220]

In considering how to approach the stock markets, companies will have similar legal concerns as they had in reissuing debt or issuing new debt. Companies will want to consider how their share values will convert into euros and how the resulting values will affect their tradability and marketability.[221] Regulation 974/

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218. Risk Capital: A Key to Job Creation, *supra* note 214, COM (98) 122; EMU: PROPOSALS FOR THE EQUITY MARKETS, *supra* note 208.

219. EURO PAPERS, No. 3, *supra* note 196, at 30.

220. DOCUMENT OF SWISS PERMANENT REPRESENTATION TO THE EUROPEAN UNION, PREPARATIONS FOR EMU 3 (Feb. 1998).

221. Council Regulation No. 974/98, *supra* note 59, art. 14, O.J. L 139/1, at 5 (1998); *see* EURO PAPERS, No. 10, *supra* note 91, at 13. During the transition period, as long as the required percentage of shareholders agree to the change in capital, a company can require the minority shareholders to accept the redenominated shares in euro

98 specifically states that there is no need to alter physically legal instruments that refer to national currency units—automatic conversion will occur by operation of EU law at the end of the transition period to convert all amounts expressed in national currency units into euro without the need for any action on the companies' part.[222] The rounding rules of Regulation 1103/97 will apply to the converted share values to produce share values to the nearest cent.[223] Even though the European Commission has stated that the automatic conversion of share values at the end of the transition period by operation of EU law should not require the approval of shareholders or public authorities,[224] many Participating Member States have introduced or are introducing legislation designed to allow companies to convert their shares into euros not only at the end of the transitional period, but also during the transitional period by introducing fast-track company law procedures.[225] Member States are free to adopt legislation to facilitate the redenomination of share capital into euro, provided that they respect the bounds of Regulation 974/98. For example, as a result of the draft bill introduced in the Belgian House of Representatives on June 2, 1998, the existing procedure under the company Act for redenomination of share capital will be simplified. Redenomination will no longer require a special quorum and majority of shareholders, but will only require approval by an ordinary majority of shareholders present at the general meeting. This freedom means that while national measures that change the majorities necessary at shareholders meetings to decide on redenomination are compatible with EU law, measures that profoundly change the decision-making procedure by, for example, transferring the decision on redenomination from the shareholders meeting to the executive

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despite the "no compulsion/no prohibition" rule of Article 8(1) of Regulation 974/98 as a consequence of the exception in Article 8(2) that permits private parties to deviate from the general rule of Article 8(1). Council Regulation No. 974/98, *supra* note 59, art. 8, O.J. L 139/1, at 3 (1998).

222. *Id.* art. 14, O.J. L 139/1, at 5 (1998).

223. *Id.*

224. *See* EURO PAPERS, No. 10, *supra* note 91, at 19.

225. Germany and Ireland have dealt with this problem by adopting legislation providing that a "simple" conversion and rounding does not amount to an alteration of share capital. *See Rednominating Share Capital—Preparing for the Introduction of the Euro*, *supra* note 202, at 17-22.

board, would not be acceptable.[226]

The redenomination of shares will, however, often result in shares with an awkward value in euro that the simple rounding rules of Regulation 1103/97 will not fix. If so, companies may decide to adjust, or to renominalize the par value of the shares up or down to provide for more convenient values in euros. Doing so will result in a capital increase or decrease that will in turn require amendments to the company's articles of incorporation or association, which usually must be adopted by a supermajority vote at a shareholders' meeting.[227] Companies based in non-participating Member States will have the same considerations and may have several reasons to redenominate their share capital into euros voluntarily, one reason being to raise equity finance in the euro zone and to match its capital base against euro earnings.

An alternative to renominalizing shares to achieve round par values after conversion to the euro is to convert to shares of no par value, subject to shareholder approval. If a company converted its share capital wholly into shares of no par value, then the number of shares in issue would remain equal. There would be no par value to redenominate and no resulting decimal figures to round or to renominalize. Several Member States such as France, Germany, and Austria are introducing this option into their new legislation.[228] Companies should keep their eye on corporate law legislative developments at the Participating Member State level to determine if other Participating Member States will follow suit, thus simplifying the need to adopt different solutions for different Member States.

The only versions of no par shares explicitly provided for by the EU Second Company Law Directive (the "Directive") for public companies are the so-called "accountable par" value

226. *See* EURO PAPERS No. 10, *supra* note 91, at 19.

227. See, for example, the German "Act Regarding the Introduction of the Euro", Euro-Einführungsgesetz, BGB 1: I, 124, 2, adopted on April 1, 1998, as well as Austrian and Irish draft national legislation that is expected to be adopted in the course of the summer of 1998. For a discussion, see *Redenominating Share Capital—Preparing for the Introduction of the Euro*, *supra* note 202.

228. *Redenominating Share Capital—Preparing for the Introduction of the Euro*, *supra* note 202, at 20-21. The Commission has urged Member States to adopt legislation to provide for no par value shares because this would considerably facilitate the changeover. *See* EURO PAPERS, No. 10, *supra* note 91, at 19; G. Yeowart, *Eurowatch*, European Counsel, July-Aug. 1998, at 12.

shares.[229] This concept is not defined in the Directive and is therefore left to the company laws of the EU Member States. Belgium[230] and Luxembourg are the only jurisdictions that have currently implemented the accountable par value concept into their national laws. For accounting purposes, the "accounting par value" indicates what proportion of the company's capital is represented by each share. The problem with the "accountable par" concept is that it creates an artificial floor for new share issues because shares may not be issued at a price lower than the book value of a share. Another variant of par value shares that is frequently used in the United States and Canada, but unknown in the European Union is the "true" no par value share that represents a fraction of the company's equity. Use of this type of share avoids the complication that can result from giving a share a fixed nominal share value that is not connected with its true market value. For example, a share with a par value of DM100 might appear to be a good buy at a price of DM50, but its intrinsic value may be worth much less. Another advantage is the absence of the largely artificial distinction between the par value and the issue price of a share and between "nominal share capital" and "share premium."

The Giovannini Group Report suggests that the redenomination of shares need not happen at the beginning of Stage III because the redenomination of share capital will not affect the shares' economic value or an investor's ability to trade the shares.[231] Redenomination is more appropriately carried out at the time a company changes its accounting unit to the euro. While annual accounts cannot be prepared in euros for financial years ending before January 1, 1999, annual accounts must be prepared in euros for financial years ending after December 31, 2001. In order to avoid extra costs, companies should consider

229. Second Council Directive No. 77/91 on coordination of safeguards which, for the protection of the interest of members and others, are required by member states of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, O.J. L 26/1 (1991).

230. *See* Belgian Company Code, arts. 41, 52 bis, § 1 (as amended). M. Wyckaert, KAPITAL IN N.V. EN B.V.B.A., *Vermogens—en Kapitaalvorming door Inbreng—Rechten en Plichten van Vennoten*, Leuven (1995). In practice, most Belgian corporations are incorporated with no par value shares.

231. EURO PAPERS, No. 3, *supra* note 196, at 32.

presenting the decision to redenominate at a regularly-scheduled annual general meeting of shareholders because redenomination will require shareholders' approval. In redenominating shares, the Giovannini Group recommended following several basic principles: voting rights should not be adversely affected, shareholders should not be obliged to sell any of their holdings, and the number of shares issued should remain unchanged in order to avoid changes in relative share prices. Unlike in the bond area where the Giovannini Group provided a specific suggestion for the redenomination method to be used, it did not state a clear preference for share redenomination methods, although the group seems to lean towards the use of no par value shares.[232]

The harmonization of market rules and conventions appears to be less important for the equities markets than for other markets. The European stock exchanges prefer to avoid any changes in market conventions that are not strictly necessary for the changeover. Given that general rule, some areas such as tick sizes and settlement periods, would benefit from harmonization.

F. *Implications for the Derivatives Market*

The changeover to the euro is expected to cause most problems in the derivatives market because the changeover to a single currency may eliminate the financial rationale for a large number of European instruments, thus reducing the range of available products. EMU will eliminate the currency risk for both equities and fixed income products where the currencies involved are two Participating Member State currencies. The introduction of the euro will have an immediate impact on interest rate contracts, which constitute a large share of futures exchanges' volume.[233] To compensate for the loss of these products, the London International Financial Futures Exchange ("LIFFE") and Europe's other derivative exchanges will offer trading facilities for futures and options based on underlying

232. A number of options are available: (i) move to no par value shares; (ii) convert capital to euros rounded to the nearest cent; (iii) convert par value to euros rounded to the nearest cent; or (iv) convert capital to an unrounded euro amount.

233. *The Big Squeeze—Monetary Union, If It Happens Will Make Most of Europe's Derivatives Exchanges Redundant*, ECONOMIST, Sept. 7, 1996, at 69.

euro government bonds or interest rates.[234]

For a company that currently holds derivative products, the overriding concern that it faces is the continuity of its derivative contracts. The rule of continuity of contracts in Regulation 1103/97 will apply to derivatives because it is a general rule that applies to all types of contracts. Whereas the general rule of Regulation 1103/97 will be sufficient to overcome a claim of frustration concerning an ordinary contract, a frustration claim might have a greater chance in succeeding with regard to a derivatives contract concerning exchange and/or interest rate risks involving two currencies replaced by the euro. The classic example is a derivatives contract, such as cross-currency fixed interest rate swaps, entered into for hedging against or speculating on exchange rate changes or related interest variability in two currencies and whose delivery date falls after the start of Stage III. Some parties may argue that once the exchange rates between the national currencies and the euro are irrevocably locked, volatility between these currencies will be removed from this date onward. Such a derivative contract will be in one party's favor and in the other party's disfavor for the remainder of the contract, thus eliminating the balancing of risks and the commercial rationale of the contract. Parties agreeing to cover exchange-rate risks for European currencies took a foreseeable risk that the exchange rates concerned would become permanently fixed.[235] The performance of the parties' contractual obligations would still be possible and the continuity of contracts will apply for such contracts. As long as the national currencies exist, the contract will require both parties to deliver the initially agreed amounts of currencies. For example, a cross currency interest rate swap that refers to two participating national currencies will merely be transformed into an obligation of one party to make a series of net payments to its counterpart.[236] The last word in this discussion will be for the judges who are confronted with claims of frustration.

The Giovannini Group Report highlights several important

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234. The London International Financial Futures Exchange ("LIFFE") already offers the Euromark future, which is the biggest interest rate futures product in Europe.

235. EURO PAPERS, No. 3, *supra* note 196, at 11; *see* Myers & Levie, *supra* note 38, at 342.

236. In such event, the contract continues but the parties may agree to close it out with a single net payment because the economic object or effect has changed.

points when considering the effects of the euro on the derivatives market. First, the markets should take care to ensure the legal continuity of both the underlying contract and the hedging contract. It will be important to achieve transparency and clarity in relation to the conventions used to calculate payment amounts and to determine payment days. Finally, any changes made to the underlying contract such as by conversion, redenomination, or the adoption of new price sources must be accurately paralleled in any related derivatives transaction.

It is likely that companies using derivatives contracts will want to address these issues in advance, in the contract if possible, or by *ad hoc* agreement afterwards or in keeping with whatever market practice develops. Certain trade associations have produced standard continuity clauses for this purpose. For example, the ISDA has developed a specimen continuity clause for possible inclusion in the ISDA's standard swap contract.

In addition, companies may want to be aware of splits in liquidity either to take advantage of the splits or to avoid the complications resulting from any splits. Liquidity in the national currency markets may differ from liquidity in the euro market during the transitional period. This difference in liquidity could mean that there are two different interest rates for what is technically the same currency. This variation could in turn pose a problem for contracts that must be settled in the lawful currency of the country because it would mean that there are two lawful currencies with two interest rates. LIFFE[237] foresaw this problem and changed its short-term interest rate ("STIR") contracts, bond contracts,[238] equity contracts, and commodity contracts so that they will settle against the euro and not national currencies.[239] Other exchanges may follow suit if they have not done so

237. LIFFE is Europe's largest derivatives exchange and the second largest in the world after the Chicago Board of Trade. About 210 million contracts were traded on LIFFE in 1997. For a description, see D. KYNASTON, LIFFE—A MARKET AND ITS MAKERS 385 (1997).

238. LIFFE lists three bond contracts—Bund, Bobl, and BTP—that will be affected by the EMU; the first 1999 bond futures contracts were listed in June 1998 and the first 1999 bond options contract in August 1998. LIFFE expects that the market will continue to require futures contracts linked to the bonds of individual government issuers at least for the foreseeable future. LIFFE will launch a futures contract in the fourth quarter of 1998 to service the specific needs of the German mark/euro interest rate swap contract, which will be called the LIFFE Libor-Financed Bond Contract. *See Practical Issue Arising from the Introduction of the Euro*, No. 7, *supra* note 24, at 56-58.

239. *Id.*

already. Companies will want to review their contracts for such potential problems.

G. *Corporate Borrowing*

The launch of the euro, in combination with the new EU financial services rules on the freedom of cross-border banking services[240] and the recently-adopted rules on cross-border collateral,[241] will have a wide impact on all financial institutions and foremost on commercial banks.[242]

In light of an almost fully-achieved single market for financial services, EMU will serve as a catalyst for increased opportunities and challenges for credit institutions and other undertakings providing financial services. The EU-integrated market for financial services is based on the principle of a minimal EU harmonization of Member States' banking rules, "mutual recognition" among Member States of each others' banking and financial institutions, and so-called "home country" control.[243] Pursuant to the Second Banking Co-ordination Directive, a single banking license granted in the home country authorizes a credit institution to engage in universal banking activities[244] throughout the European Union either by establishing branches or by the provisions of cross-border services without the need of further local authorizations, provided, at least, that such a credit

240. The Second Banking Coordination Directive 89/646 and the Freedom of Capital Movements Directive 88/361 are the foundations for the single market in financial services. Council Directive No. 89/646, O.J. L 386/1 (1989); Council Directive No. 88/361, O.J. L 178/5 (1988). The framework laid down for the banking sector has been replicated in the field of securities and insurance. As for securities, similar harmonization has been achieved by means of the EC Council Directive on Investment Services in the Securities Field. *See* Council Directive No. 93/22, *supra* note 207, O.J. L 141/27 (1993); *see also* Commission Interpretative Communication on the Freedom to Provide Services, Council Regulation No. 1467/97, O.J. L 128 (1997).

241. Council Directive No. 98/26 on settlement finality in payment and securities settlement systems, O.J. L 166/1 (1988).

242. J. Davidson, et al., *Wholesale Banking: The Ugly Implications of EMU, in* EUROPEAN ECONOMIC AND MONETARY UNION: THE INSTITUTIONAL FRAMEWORK, *supra* note 12; C. Holmsen et al., *Retail Banking: Managing Competition among Your Own Channels*, 1 MCKINSEY Q. (1998).

243. As explained under Part II, Section E.

244. As listed in Second Banking Coordination Directive No. 89/646, *supra* note 240, such universal banking activities include the acceptance of deposits and other repayable funds from the public, lending, factoring, financial leasing, money transmission services, issuing, and administering means of payment, i.e., credit cards, participation in securities issues, etc.

institution remains subject to prudential supervision in its "home" Member State. This license is mutually recognized by other Community banking supervisors[245] and is therefore called the "European Passport."

As an exemption to the mutual recognition rule, host Member States remain entitled to take "appropriate" measures to prevent or to punish irregularities within their territories that are contrary to the legal rules that they have adopted in the "general good."[246] At a procedural level, the host state's competent authority will, "if necessary," notify the credit institution wishing to open a branch in the host Member State of the conditions under which "in the interest of the general good" those activities must be carried on in the host Member State. As a limitation on the right of establishment and for the provision of services, the notion of the "general good" has been traditionally narrowly construed in the European Court of Justice's case law. Certain national measures have, however, been held justifiable, including consumer protection[247] and the preservation of the "good reputation of the national financial sector."[248] In order to be justifiable, the measure must also be non-discriminatory, objectively necessary, and proportionate to the objective pursued.[249] Finally, the national measure may not relate to a field that has been subject to minimal EC harmonization, such as own fund requirements, deposit guarantees, solvency ratios, etc. In order to contain the all-too-discretionary way in which Member State authorities have occasionally interpreted the "general good" exception, the Commission adopted an Interpretative Communication in 1997.[250] In the present context, the euro may be a cata-

245. *See* D. ISAACS, ET AL., EC BANKING LAW 228-92 (2d ed. 1994) (providing more detailed overview of EC banking law).

246. Council Directive No. 89/646, *supra* note 240, art. 21(5), O.J. L 386/1 (1989) (second banking coordination directive).

247. Commission v. Germany, Case 205/84, [1986] E.C.R. 3755, 3803-04, 3807, ¶¶ 30, 33, 41, [1987] 2 C.M.L.R. 69, 102, 105.

248. Alpine Investments BV v. Minister van Financien, Case C-384-93, [1995] E.C.R. I-1141, I-1149, ¶ 44, [1995] 2 C.M.L.R. 209, 222 (Dutch rules on cold-calling).

249. *See* Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, Case C-55/94, [1995] E.C.R. I-4165, I-4197-98, ¶ 37, [1996] 1 C.M.L.R. 603, 628.

250. *See* Commission Interpretative Communication, Freedom to Provide Services and the Interest of the General Good in the Second Banking Directive, SEC (97) 1193 Final (June 20, 1997). For an analysis, see E. Ducoulombier, et al., *La Communication Interprétative de la Commission Européenne Relative à la Deuxième Directive Bancaire*, *in* REVUE DE LA BANQUE/BANK-EN FINANCIEWEZEN 147, 162-73 (3d ed. 1998).

lyst to creating a level playing field in which national authorities are less inclined to take recourse against discriminatory behavior disguised as measures in the general good. Whether a new borderline will be drawn between the "ins" and "pre-ins," where financial institutions from "pre-ins" experience more disguised discriminatory measures from national authorities of "ins,"[251] remains to be seen.

The present organization of supervisory responsibilities at the national level will probably no longer be suited to a monetary union context. The further development of an internal banking market will be harmed by leaving banking supervision at the national level. Hence, banking policy and, in particular, prudential supervision, may need to be moved, at least in part, to the EC level.[252] Regulatory and supervisory powers in the field of banking could be allocated to the ESCB or to a specially constituted agency.[253] It could also be argued that the ESCB or the ECB needs a direct supervisory role, considering that banking policy in the monetary union should be not only centralized, but also combined with the monetary policy function.[254] The persuasive arguments for the allocation of responsibilities to the ECB or the ESCB relate to the need to control credit exposures that it or they might undertake as a lender of last resort or through its or their involvement in the operation of European payment systems.

EMU is expected to enhance the international consolidation tendencies in the European banking sector.[255] In asset

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251. C.S. Kerse, *Ins and Outs of EMU! No Grounds for Discrimination*, *in* EUROPEAN ECONOMIC AND MONETARY UNION: THE INSTITUTIONAL FRAMEWORK, *supra* note 12, at 37-44.

252. P.B. KERREN, ECONOMIC AND MONETARY UNION IN EUROPE: MOVING BEYOND MAASTRICHT 32 (1995).

253. On the creation of Community agencies with separate legal personality, see Koen Lenaerts, *Regulating the Regulatory Process: "Delegation of Powers" in the European Community*, 18 EUR. L. REV. 23, 40-49 (1995).

254. MADS ANDENAS & C. HADJIEMMANUIL, BANKING SUPERVISION: THE INTERNAL MARKET AND EUROPEAN MONETARY UNION 387-90; *see* R.M. LASTRA, CENTRAL BANKING AND BANKING REGULATION 61-62 (1996).

255. The past months have seen a spate of bank mergers in Europe, including the takeover by the Dutch banking group of ING of Belgium's Banque Bruxelles Lambert, a Bavarian marriage of Bayerische Vereinsbank with Bayerische Hypo-Bank, and outside the euro zone, the merger of Swiss Bank Corporation with Union Bank of Switzerland and the Fortis group acquiring Belgium's General Bank/Générale de Banque. *EMU: An Awfully Big Adventure*, *supra* note 2, at 9.

management, for example, German institutions have been buying London-based institutions and are building continental networks. The winners of this process are likely to be a small group of pan-European wholesale banks, offering the full range of capital markets and derivative products as well as a small number of specific products and services. Size will become an even more important advantage because the required investment in systems and communication technology is extremely large.[256] In the retail sector, the major change for banks will be the opportunity to use their home base for funding loans granted by branches in other EMU countries; they no longer need to rely on the expensive interbank market. The competitive advantage currently enjoyed by local banks having a large local deposit base for lending in their respective national currencies will be reduced significantly when these banks have to operate in a single currency environment. Investment banks should benefit from EMU because, in particular, cross-border corporate mergers will be encouraged and governments will continue to privatize.

For large companies, the expected consolidation in the banking center will result in a wider range of products, more sophisticated services, and a greater choice of lead banks beyond the company's national borders to meet their financing needs, but at the expense of a wider choice of banks in general. With regard to existing loans that spill over into the transitional period, companies must consider whether the introduction of the euro will trigger "increased cost" clauses in any loan documentation. Increased cost clauses typically allow a lender to pass on increased costs associated with the loan. The analysis depends on the specific wording and circumstances of the loan documentation, but it is unlikely that increased cost clauses that refer to changes in liquidity, reserve, or similar legal requirements will be triggered by the introduction of the euro and the implied change of the legal framework. If, however, Participating Member States introduce regulatory changes after the introduction of the euro that have an impact on lenders' costs, the increased refinancing costs thereby implied could, depending on the contract terms, be transferred to the borrower.[257]

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256. *See* T. de Claux, Europe and the Single Currency 23 (1997).

257. Euro Papers, No. 10, *supra* note 91, at 11.

H. *Establishing a Structure to Facilitate Euro Transactions*

In order to facilitate further the cross-border trading that is expected to augment after the introduction of the euro, the Council of Ministers and European Parliament adopted on May 19, 1998, Directive 98/26 on Settlement Finality in Payment and Securities Settlement Systems ("Settlement Finality Directive"),[258] which aims at reducing so-called "systemic" risks, i.e., the risk that the bankruptcy or failure of one participant, such as a bank, will have "knock-on" effects leading to the bankruptcy of other participants, ultimately leading to a widespread crisis of the financial system. The Settlement Finality Directive stipulates rules both as regards the finality and irrevocability in payment systems and securities settlement systems and coordinates rules concerning the perfection of collateral security. Although the Settlement Finality Directive is due to be implemented by the Member States by December 11, 1999, most of the Participating Member States will accelerate this timetable so that the new rules are in place by January 1, 1999.

The Settlement Finality Directive will eliminate the zero-hour rule that some Member States[259] use to annul payments made starting from midnight the day a company goes bankrupt. The Settlement Finality Directive requires that all Member States, including the non-participating Member States, must ensure that the legal concept of "netting" is legally enforceable and binding on third parties, even in the event of insolvency proceedings. Netting means that claims and obligations between participants in payment and security settlement systems are set off against each participant as a net credit or a net debit position only, which reduces the size of credit and liquidity exposures and hence the cost of these systems.[260]

In order to avoid or to reduce conflict-of-law problems, and thus legal uncertainty, in a cross-border situation in which a defaulting party is established in a country other than the Member State of the system, as chosen by the participants, the Settlement Finality Directive provides that the insolvency law applicable to

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258. Council Directive No. 98/26 on settlement finality in payment and securities settlement systems, O.J. L 166/45 (1998).

259. These rules are still in operation in Austria, Greece, Italy, and the Netherlands.

260. *See* Marc Vereecken, *Reducing Systemic Risk in Payment and Securities Settlement Systems*, 6 J. OF FIN. REG. & COMPLIANCE, No. 2, 107-34 (1998).

the obligations in connection with the system will be the law chosen by the parties to govern their system agreement—*lex contractus*.[261] All other rights and obligations of the failed participant, however, will be governed by the insolvency law indicated by the rules of private international law that provide the choice between the principle of universality[262] and the principle of territoriality.[263]

There is no question that cross-border payments will increase under EMU. The Settlement Finality Directive goes a long way towards settling some of the outstanding legal complications. It is now up to the markets to implement the structural changes necessary not only to ensure that the payment systems described above[264] will function properly, but also to develop further payment systems that can accommodate high volume transactions.

CONCLUSION

One year shy of the new millenium, eleven Member States of the European Union will move to a single currency—a unique achievement in the twentieth-century international monetary history. It results from a firm determination among European political leaders to pool monetary policy, exchange rate policy, and currency law—*lex monetae*—in an ongoing process of European integration. The idea of monetary union in Europe is not a new one, but since the adoption of the Stage II and Stage III provisions in the Maastricht Treaty in 1992, the process of constructing the framework for EMU has gathered steam at a rapid pace. The European Union has adopted binding legislation, non-binding pronouncements, reports, recommendations for codes of conduct, and a wide range of documentation after consultation with a broad range of professional organizations, consumer groups, governmental officials, and just about any other

261. It should be noted that EC legislation takes precedence over the Convention on the Law Applicable to Contractual Obligations (the "Rome" Convention), O.J. C 282/10 (1980).

262. Also known as the principle of "single entity," this principle implies that the winding-up of an insolvent entity is conducted, globally, covering all assets and branches, pursuant to the law of the country of incorporation of the entity.

263. Also known as the principle of "plurality," this principle implies that separate proceedings take place in each of the locations where the entity has assets of branches.

264. Part I, Section A, Subsection 2.

organization interested in discussing EMU. The adoption of legislation and other guidance documents has been accomplished by a massive publicity campaign targeted at all levels of society to increase awareness of the impending introduction of the euro.

The three-year transitional period, deemed necessary to permit the public, the financial markets, and businesses to accommodate the new currency, has created an inevitable set of unique issues. Use of the euro will be optional during the transitional period as a consequence of the no compulsion/no prohibition rule of Regulation 1103/97, with certain important exceptions. Participating Member States' currencies will remain legal tender for the transitional period, but only as denominations of the euro. For the public, the transitional period presents the perplexing issue of accommodating and using a currency that they will not yet have in their pockets until 2002. For the financial sector, the cashless payment exception to the no prohibition/no compulsion rule, the redenomination of government, and subsequently private, debt into euros, the immediate switch over of the stock exchanges to euro, all presage a tremendous change in the financial markets already from the start of the transitional period. These changes in the financial market will create new opportunities for businesses to raise financing and exploit new financial products.

For businesses, the transitional period requires a series of decisions about when and how to switch to the euro. Companies will need to address a wide range of issues, including the continuity of its contracts affected by the changeover to the euro. The changeover does not, as a general matter, entitle parties to terminate unilaterally or to modify existing contracts; EMU does not constitute an unforeseen event with an adverse effect on the performance of existing contracts such as frustration event in common law or *force majeure* in civil law. This issue is particularly relevant for contracts whose existence extends beyond December 31, 2001. Straightforward commercial contracts are unlikely to be jeopardized by the advent of the euro. For financial documents whose underlying object disappears as a result of the euro, such as certain derivative contracts, and contract clauses that qualify or prevail over continuity, such contracts require more careful consideration even before January 1, 1999. If a more than negligible risk is identified, the ideal situation would be a contractual amendment for the avoidance of legal uncer-

tainty confirming continuity after the start of the EMU and, if necessary, modifying the applicable choice of law if the current choice presents continuity risks.

On the longer-term, the introduction of the euro will have profound effects on the EU Single Market that businesses must consider. The most immediate and obvious effect is the elimination of exchange rate risks among the currencies participating in the EMU and all its attendant consequences. A single currency will permit price comparisons across borders, thus pushing companies to achieve economies of scale on the European level. This ability, in turn, presages a wave of mergers and consolidations that has in fact already begun.

On the international scale, while EMU implies a monetary and economic policy change primarily for the Participating Member States, it will also have important external implications. The euro zone is expected to have an economical potential comparable to that of the United States. Given the stability-oriented policy of the ECB, the euro may play an important role in financial portfolios worldwide and as a major reserve currency. The development of the euro into a major international currency will be gradual, but particularly important in countries with close financial and economic links with Participating Member States.

EMU TIMETABLE

Stage I:

July 1, 1990 – December 31, 1993

- Removal of restrictions on cross-border capital movements.

Stage II:

January 1, 1994 – December 31, 1998

- Member States entered into a best-efforts duty to avoid "excessive government deficits," meaning that public deficits should not exceed three percent of GDP and that public debts should not exceed sixty percent of GDP or should come close to this level at a satisfactory pace.
- Establishment of the European Monetary Institute, forerunner of the European Central Bank, whose task is to cooperate with the national central banks and to prepare

Stage III:

As of May 3, 1998

- Designation of EU Member States participating in EMU and announcement of the bilateral exchange rates between participating currencies, but not the conversion rates to the euro.
- Establishment of the European Central Bank.

Stage III:

As of January 1, 1999

- Conversion rates between national currencies and euro are irrevocably fixed.
- Introduction of the euro as the currency of the Participating Member States, although euro coins and notes will not be in circulation until 2002.
- National notes and coins continue in circulation, but will be treated as denominations of the euro.
- Cashless payments can be made in euro.
- ECU converted to euro at a conversion rate of 1:1.
- Monetary and exchange rate policy determined in euro by the European Central Bank.
- New issues of public debt made in euro and existing issues of public debt available for redenomination into euro.

As of January 1, 2002

- Euro notes and coins replace national currency notes and coins.

No later than July 1, 2002

- Withdrawal of national currencies. This time period may be shortened by each Member State at its discretion.
- Euro becomes sole legal tender.