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I. Introduction of the Euro into the European Union

In many ways, 1998 can be described as a year of positive surprises in the move toward the third stage of European Economic and Monetary Union (EMU), which commenced on January 1, 1999. The year began with uncertainty over which nations would qualify for participation in the first wave of entrants, and at what exchange rate, and with concern over whether all necessary work would be completed in time to introduce the euro on January 1. In the end, the countries that most people believed would qualify did indeed qualify. The bilateral rate settings between the currencies of these countries survived volatility in the foreign exchange markets remarkably unscathed, and the euro was launched with few operational problems. Work on the legal aspects of introducing the new currency played a large role in these successes. This article will examine some of the more important EMU-related legal developments of 1998 and will look at the first month of the new currency's existence.

Probably the most important legislative development of 1998 was the adoption of the second major EMU regulation by the Council of the European Union, EC No. 974/98 of 3 May 1998 or article 1091(4) regulation.[1] Unlike the previous EMU regulation,[2] EC No. 1103/97 or the article 235 regulation, which has the force of law in all fifteen states of the European Union, the article 1091(4) regulation is law only in the eleven participating states.[3] The other European Community states, however, should recognize its provisions under general principles of international law, as should other countries in the world.

The article 1091(4) regulation accomplished several key objectives in establishing the legal framework for the euro. Articles 2, 3, and 4 address the fundamental matters of installing the new currency, in that they provide that the euro shall be the currency of each participating state, that the euro shall be substituted for each of those currencies at the respective, irrevocably fixed conversion rates, and that the euro will be the unit of account of the European Central

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1. Often referred to as the article 1091(4) regulation, after the provision in the Maastricht Treaty authorized it. Council Regulation 974/98, 1998 O.J. (L 139) 1 [hereinafter Article 1091(4) regulation].
2. Council Regulation 1103/97, 1997 O.J. (L 162) l.
3. *See* Article 1091(4) regulation art. 1.

Bank and each central bank of the participating states.[4] Because euro bills and coins will not be introduced until 2002 (in no small part due to the extraordinary amounts of each that have to be printed and minted—there are an estimated 12 billion bills and 75 billion coins in circulation in the euro-zone—and the logistical demands of their distribution), the national currency units of the participating states will continue to exist until then. This period between January 1999 and January 2002 is called the transition period. Articles 5 through 9 of the regulation address certain legal issues that are posed by the co-existence of the euro and the national currency units during that time.[5] These provisions definitively establish the euro as the sole currency of each participating state, with the national currency unit being merely a denomination of (i.e., another way to express) the euro.[6] The relationship can be analogized to that between the U.S. dollar and $5 or $10 bills.

Article 8 of the article 109l(4) regulation contains two other critical provisions. The first is set forth in article 8(3) and is often referred to as the "no compulsion/no prohibition" principle.[7] In essence, when a payment originally denominated in a euro-zone currency is to be made by credit to a bank account in the euro-zone, then notwithstanding the original denomination of the payment, the debtor may pay in euro.[8] The amount will appear in that account in the denomination chosen by the creditor, with conversion to be made, at no charge, at the fixed irrevocable conversion rate between that national currency unit and the euro announced on December 31, 1998.[9] Thus, the parties are neither compelled to use the euro nor prohibited from doing so.

The other critical provision of article 8 follows in paragraph (4), which gives member states, and by extension private issuers, the power to change the denomination of their outstanding debt obligations to euro.[10] The decision that all new public sector debt issued after January 1, 1999, by euro-zone countries must be denominated in euro raised concerns that having old debt denominated in the national currency units would hamper the overall liquidity of a country's obligations and confuse investors. Article 8(4) remedies these concerns, and as they are not limited to public sector debt, article 8(4) also gives private issuers the right to redenominate their debt if the government of the participating state in whose currency unit the debt originally was denominated also has done so, provided that the underlying debt contract does not expressly exclude redenomination.[11] Since January 1, 1999, all the participating states have redenominated their debt into euro, and many private issuers are considering doing likewise. Most debt agreements accommodate this change, and in fact throughout 1997 and 1998 there were numerous issuances in the European markets of "tributary" bonds which were designed expressly to be converted into euro once the third stage of EMU began.

The remainder of the article 109l(4) regulation addresses issues relating to bills and coins and to the final conversion of references in legal instruments to national currency units to euro which will occur at the end of the transition period on January 1, 2002. With this regulation now in place, the legal framework for the euro at the European Community level is complete, to be filled in at the participating state level by additional legislation as necessary.

4. *See id.* arts. 2-4.
5. *See id.* arts. 5-9.
6. *See id.*
7. *See id.* art. 8(3).
8. *See id.*
9. *See id.*
10. *See id.* art. 8(4).
11. *See id.*

On the legislative front in the United States, Michigan and Pennsylvania passed EMU-related legislation during 1998, joining New York, Illinois, and California. The legislation, which is substantially similar in each state, codifies the positions that the euro is an acceptable substitute for each participating country's currency and that its introduction will not have the effect of altering or discharging any contract unless the contract explicitly so provides. Many legal scholars believed that the introduction of the euro would not interfere with continuity of contracts, even in the absence of legislation, on the basis of the legal principle that a country may choose its own money *(lex monetae)*. Among the analyses that have concluded so is a comprehensive survey[12] by Niall Lenihan, a lawyer with the European Central Bank, entitled "The Legal Implications of European Monetary Union under U.S. and New York Law," which examined *lex monetae* as well as other legal theories and relevant case law. Nonetheless, the legislation clarifies any residual uncertainty regarding the continuity of contracts governed by the laws of those states and as such is a useful addition to the framework supporting the euro.

Another positive surprise in 1998 was the continuation of the almost unprecedented degree of cooperation between private sector companies, trade associations, settlement systems exchanges, and governmental entities in laying the groundwork for the euro. This cooperation occurred both in the operational arena, where institutions collaborated to assure smooth operation of support systems through the euro conversion, but also in the legal arena. Under the auspices of the International Swaps and Derivatives Association, Inc. (ISDA), a trade association, many financial institutions participated in an effort to find a solution to the vexing problem of how to accommodate EMU and its resulting changes within existing legal agreements without inundating each other, and the markets, with amendment requests. The result, called the ISDA EMU Protocol, was a standard set of terms addressing five aspects of financial derivatives contracts that are affected by EMU: continuity of contracts; replacement of price sources (e.g., local interest rates such as the Paris interbank offered rate for French franc borrowings that might have been the basis for an interest rate swap but that are superseded by the introduction of the euro); definition of business days; clarification of payment netting; and adjustment of bond options (to take into account the possible redenomination of the underlying bonds).[13]

As envisioned by the protocol, an institution could agree, or, in the language of the protocol, adhere, to any one or more of these terms by submitting an adherence letter to ISDA. ISDA would then post that adherence letter on its internet site, www.isda.org, and under the terms of the protocol, that letter would constitute a bilateral offer to each other institution to amend the relevant provisions of their master agreement accordingly. That offer could be accepted, in whole or in part, by each other institution through its own adherence letter. If two parties' adherence letters match on a particular set of terms, their master agreement is deemed amended to that extent.

ISDA launched the EMU Protocol on May 1, 1998, and designated September 30 as the last date by which institutions could adhere. The protocol was open both to ISDA member institutions and to non-members. In the end, over 1,100 institutions adhered to the protocol, with the vast majority agreeing to all terms. ISDA estimated that over 600,000 master agreements were amended through this process. The efficiency of the process and the use of the internet to accomplish the amendment has led to the protocol being hailed as the legal deal of the year

12. European Commission, Economic Paper Number 126 (1998).
13. *See* International Swaps & Derivatives Association, *EMU Protocol* (visited Mar. 17, 1999) <http://www.isda.org/fprot95.pdf>.

by one commentator[14] and as a model for how future amendments or even master agreements should be structured. The Financial Markets Lawyers' Group and the British Bankers' Association (BBA) picked up on the protocol and published a similar document to amend foreign exchange master agreements, an effort that also was quite successful.

On a transactional level, a key development during 1998 was the introduction of Euribor, the pan-euro zone interest rate for the euro that has replaced most of the participating countries' interest rates, such as the previously mentioned Paris rate. Euribor is calculated based on the rates quoted by fifty-seven banks in the euro-zone for borrowing in euro. It quickly has achieved pre-eminence as the floating rate source for the euro in exchange-traded financial instruments and over-the-counter financial derivatives contracts. Another interbank euro interest rate, Euro Libor, which is published by the British Bankers' Association based on rates quoted by sixteen banks in the London market, was initially expected to attract users based on the quality of the quoting banks and the tradition behind Libor rates. Almost universal acceptance of Euribor within the euro-zone, however, has upset those expectations. As a result, it is foreseeable that multicurrency loan agreements in the United States increasingly will refer to Euribor as the benchmark floating rate for euro borrowings.

As may be obvious from the fact that euro bills and coins do not exist yet, at this point the euro is a currency of the financial markets. That is not to say, however, that it has had a negligible impact. One half of all the international bonds issued in January 1999 were denominated in euro. By comparison, the percentage of international bonds denominated in the participating countries' currencies collectively never exceeded thirty-five percent. EMU also already has had a significant impact on the structure of the financial services industry in the euro-zone, playing a large role in the rationale behind the Banco Santander-Banco Central Hispano merger in Spain and Société Générale's proposed takeover of Paribas in France. With the euro moving quickly toward reserve currency status, it is apparent that the financial markets have not had any problem accepting the new currency.

For the last few years, the imminent introduction of the euro posed several unique legal issues. The year 1998 marked the culmination of efforts to address those issues. Although it certainly is too soon to tell about the overall success of EMU, it is not too soon to describe the underlying legal work as such.

II. The Russian Financial Crisis

In August 1998, the Russian government responded to its country's deepening currency crisis by issuing a moratorium on payment of foreign debt and calling for a restructuring of Russian sovereign debt obligations which, de facto, resulted in a default on $40 billion of domestic bonds. The Russian government and Central Bank of Russia (CBR) issued a joint press release on August 17, 1998,[15] that announced the debt moratorium which suspended payments for 90 days, from August 17 to November 14, 1998, in foreign currency by Russian legal entities to foreign creditors involving certain transactions. On September 9, 1998, the CBR published Directive No. 344-u "On Suspension of Payments from Residents to Non-Residents under the Forward Currency Contracts."[16] This directive formalized the joint press

14. Christopher Stoakes, *Internet Reconciles 100 Lawyers*, EUROMONEY, Jan. 1999, at 21.

15. *Government & Central Bank Declare Exchange Rate Policy*, ITAR-TASS News Agency, Aug. 17, 1998, *available in* LEXIS NEWS Library, NON-US File [hereinafter *Exchange Rate Policy*].

16. CENTRAL BANK OF RUSSIA, ON SUSPENSION OF PAYMENTS FROM RESIDENTS TO NON-RESIDENTS UNDER THE FORWARD CURRENCY CONTRACTS (Sept. 9, 1998).

release issued the prior month which did not define the term foreign currency contract but was interpreted to include transactions involving the transfer of foreign currency with a settlement date of three days or more from trade date.

The August 17, 1998, joint press release also announced a restructuring of federal debt which President Yeltsin formalized in Decree No. 988[17] on August 25, 1998. This decree authorized the Russian government to develop an unspecified restructuring program for existing debt obligations and a procedure for issuing new debt obligations. The Russian government issued Decree No. 1007[18] on that same day. The decree called for the premature redemption of any GKOs (short-term couponless treasury notes) and OFZs (Federal coupon bonds) which went into circulation prior to August 17, 1998 and that had a term expiring by December 31, 1999. The initial GKO/OFZ Restructuring Program sought to redeem those bonds by September 25, 1998, and, in turn, issue new government securities which would have a much longer term and much lower yield than the redeemed GKOs and OFZs bonds.

At the end of September 1998, the foreign holders of the affected Russian debt scrambled to renegotiate a better deal with the Russian government whose GKO/OFZ redemption offer would give creditors approximately ten percent of the value of the redeemed bonds. Lehman Brothers, the U.S. investment bank, won a United Kingdom court order granting an injunction against two Russian banks resulting in a freeze of $113 million held by Inkimbank and Oneximbank. Lehman claimed to have acted on behalf of clients whose forward foreign exchange contracts were in doubt because of Russian counterparties' unwillingness or inability to fulfill their contractual obligations.

Foreign investors also threatened to declare a default on Russia's other outstanding debt instruments, Eurobonds, and MinFin bonds, in order to force a general renegotiation of the terms of the GKO/OFZ Restructuring Program. In particular, foreign creditors looked at cross default clauses in their documentation in order to provoke a general default. As the 90-day moratorium on commercial debt repayments expired on November 14, 1998, groups of foreign banks held negotiations with the Russian Government to restructure the Russian debt to be redeemed.

In the end of December, Russia defaulted in part on $30 billion Soviet-era debt owed to the London Club of commercial bank creditors. The cash payment due on the principal loans (PRINs) was not made although the cash payment due on the interest arrears notes (IANs) was paid. At the beginning of 1999, negotiations were ongoing between Vneshekonombank, the foreign trade bank for the former Soviet Union responsible for the debt, and Bank of America, the Restructuring agent for the London Club. In addition, Bank of America informed Vneshekonombank that the London Club creditors were reserving their rights under the loan agreements rather than exercising them pending further negotiations.

III. Canadian Banking Law Reform

During 1998 the first official report was published describing an approach to regulation of Canada's financial services sector in the next millenium. 1998 was also the year in which

17. *See Exchange Rate Policy*, *supra* note 15; *see also* Decree of the President of the Russian Federation No. 988 of Aug. 25, 1998 on Some Measures to Stabilize the Financial System of the Russian Federation, *available in* LEXIS, INTLAW Library, RFLAW File.

18. *See* Decision of the Government of the Russian Federation No. 1007 of Aug. 25, 1998, on Redeeming State Short-Term Non-Coupon Bonds & Federal Borrowing Bonds with Constant & Variable Coupon Yield Maturing Before Dec. 31, 1999, & Issued Before Aug. 17, 1998, *available in* LEXIS, INTLAW Library, RFLAW File.

proposals for two mergers were tabled, involving four of the country's five largest banks. The merger proposals came at a time when the government's schedule for dealing with financial services policy was at an early stage. In interrupting that schedule, they reminded the government of the changes which had already occurred and were continuing in financial services, in terms of both international developments and rapid technological change. Even though the mergers were not allowed to proceed, they stimulated extensive discussion of the issues involved, and in so doing highlighted the necessary policy choices.

In the previous decade there had been very considerable change (including consolidation) in the financial services industry generally, and the Canadian Federal Government had struggled to keep up. At first there was a willingness to recognize the new realities: the 1992 legislative revisions to the Bank Act (and other statutes governing federally regulated financial institutions)[19] allowed cross ownership among the "four pillars" and broadened business powers across the financial services sector. The marketplace used these authorities aggressively, and the shape of the sector changed significantly by 1997, when the legislation again came up for review.[20] However, this hopeful beginning was not followed through—in the 1997 revisions a number of significant regulatory changes were postponed, in the expectation that broader study, and a vision, of the evolution of the financial sector should guide further important regulatory developments. In the meantime the technological revolution in financial services delivery systems continued. And there was increasing competition in banking from both domestic and foreign non-banks. Foreign banks, on the other hand, remained unable to operate directly in the domestic market,[21] even while their consolidation, especially in the United States, continued. In this environment the pressures on Canadian financial services policy continued to grow, both domestically and internationally.

As part of its efforts to establish a broader context for policy, the government established a task force in December 1996,[22] which in turn set a deadline of September 1998 for delivering a report which was to be the foundation for the government's promised "comprehensive review of the appropriate framework for the financial sector in the 21st century." More specifically,

19. *See* Bank Act, R.S.C., Ch. B-1 (1985) (Can.); Trust Companies Act, R.S.C., ch. T-20 (1985) (Can.); Canadian and British Insurance Companies Act, R.S.C., ch. I-12 (1985) (Can.); Cooperative Credit Associations Act, R.S.C., ch. C-41 (1985) (Can.). Beginning with the 1992 regulatory revisions, an attempt was made to coordinate review and revision of these statutes with bank powers under the Bank Act, so that all institutions would to the extent possible be on a "level playing field." Legislation and regulations in respect of federal financial institutions are available at the website of the Office of the Superintendent of Financial Institutions (OSFI) (visited Mar. 18, 1999) <http://www.osfi-bsif.gc.ca/AndreE/Legisla.htm>.

20. Only vestiges of the "four pillars"—banking, insurance, securities, and trusts—remained. The large banks in particular had acquired the largest Canadian securities dealers and [most] trust company assets and/or businesses, and had significant interests in the insurance industry. In addition to cross ownership, cooperation on operational matters (e.g. outsourcing) and networking among financial institutions were accepted, though regulated, facts of life. *See, e.g.*, Bank Act § 468 (cross ownership). OSFI, *Policy Statement #1997-02/Outsourcing of Business Functions by FRFI's* (visited Mar. 19, 1999) <http:www.osfi-bsif.gc.ca/outgoing/pdf/outsource/paf>; Securities Act, § 229 (networking by securities dealer registrants with other financial institutions).

21. Banking licenses are only given to subsidiary operations, under full supervision of OSFI. *See* Bank Act pt. XII.

22. The Task Force on the Future of the Canadian Financial Services Sector. The antecedent report on which the Task Force was based was the White Paper *1997 Review of Financial Sector Legislation: Proposals for Changes*, Ministry of Finance, Canada (June, 1996), which set out primary objectives for the 1997 round of legislative changes (strengthening consumer protection and easing the regulatory burden). The report and related material are available at the website of the Task Force. *See* <http://finservtaskforce.fin.gc.ca/index_e.htm>.

it was to provide the basis for the legislative changes to be enacted in the next review of federal financial services legislation (mandated to occur in 2002).[23]

In this context, 1998 opened with the announcement on January 23 by Royal Bank and Bank of Montreal of their intention to carry out a "merger of equals" as soon as regulatory approvals were obtained. And on April 17 the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank added a request for approval of a merger of their own. These announcements ran counter to the policy—which had not been specifically articulated in statute or regulation—that "big shall not buy big."[24]

As a legal matter, there were two primary regulatory processes involved in consideration of the mergers. First, it was necessary that the Competition Bureau review the merger proposals and determine if they were "likely to prevent or lessen competition substantially."[25] Secondly, it was necessary that the Minister of Finance give his approval.[26] In addition, the September report of the task force (now known as the MacKay Task Force) was identified by the minister as a key context for his decision.

Of these, the MacKay Task Force Report appeared first, on September 15, 1998.[27] It took no position directly on the merger proposals, but among its 124 recommendations[28] it advocated relaxing the informal policy that "big shall not buy big," in favor of a case-by-case review on the merits. On the other hand, the report also recommended an expanded process for considering large mergers, which would include a formal Public Interest Review Process, and mechanics for the making and enforcement of undertakings (including undertakings made during the process) by the proposed merger partners.[29]

23. *See* Bank Act § 21.

24. When the proposal by Royal Bank and Bank of Montreal was announced, the most recent pronouncement on the topic had been in July of 1997. At that point, in response to a question posed on an urgent basis by government, the task force (which had just published an outline of the issues it would address in its September 1998 report) advocated abandonment of the "big shall not buy big" principle as a general rule, with provisos, but specifically excluding from its consideration the Schedule 1 (widely owned) banks. Letter from Pierre Y. Ducros, Interim Chairman of the Task Force, to The Honourable James Peterson, Secretary of State for International Financial Institutions (July 11, 1997) <http://www.fin.gc.ca/newse97/data/97-058lete.html>. The provisos to removal of the "big shall not buy big" constraint were that actual approvals should be on a case-by-case basis, and in particular should be subject to satisfaction of all competitive concerns, and that proper attention should be given in each case to safety and soundness and the public interest (further identified as involving impacts on international competitiveness, customers, employment, and adoption of innovative technologies). *See id.*

25. *See* S. 92(1) of the *Competition Act* (Canada). Under normal procedures the bureau would discuss its findings with the proposed merger partners, to allow for problem areas to be dealt with by changes to the merger proposal. Under S. 92, the bureau has the power to seek an order from the Competition Tribunal blocking proposed mergers, or requiring divestiture in cases where the merger is already completed. The Minister of Finance is empowered to exempt a bank merger from the exercise of these powers (although in this case he had stated that he was unlikely to do so).

26. Sections 223-231 govern the arrangements under which mergers, known as "amalgamations," are effected. *See* Bank Act §§ 223-31. The act also provides for ministerial approval. *See id.* § 225.

27. *See Change, Challenge and Opportunity: Report of the Task Force on the Future of the Canadian Financial Services Sector* (visited Mar. 19, 1999) <http://finservtaskforce.fin.gc.ca/rpt/pdf/main_E.pdf>.

28. The 124 recommendations were grouped around four key themes: enhancing competition and competitiveness (including further powers for life insurance companies, establishment of a holding company structure, and sector-wide ownership rules retaining widely held Canadian ownership requirements for large institutions); empowering consumers (including further disclosure and privacy requirements, and expansion of tied selling prohibitions); Canadians' expectations and corporate conduct (including better access to financial services by consumers—but generally avoiding increased formal regulatory requirements or processes); and improving the regulatory framework (broadening the powers exercised by OSFI as the regulator of federal financial institutions). *See id.*

29. The recommendations on merger policy and process are numbered 45-52. *See id.* at 205-08.

Parliament also contributed to the process, in the form of reports on the MacKay Task Force by committees in the House of Commons and in the Senate.[30] Again, neither of the reports took any position directly on the merger proposals. While the Senate committee was generally supportive of the MacKay proposals, in relation to mergers its report[31] proposed limiting the "big shall not buy big" condition to acquisitions/mergers involving a large bank and a large life insurance company. It also discussed the process for merger approval—and stressed that the process must run on "a fairly tight timetable," and be predictable and objective.[32] The House report also generally concurred with the MacKay Report's recommendations.[33]

While these commentaries were relatively objective and used a macro approach to financial services sector regulation, a reminder of the political context came from another review undertaken by the National Caucus Task Force.[34] The resulting report also looked at all aspects of financial services policy, and included a recommendation that the mergers not be approved.[35]

These reports set the stage for the first two weeks in December, during which the Office of the Superintendent of Financial Institutions (OSFI) as the banking regulator and the Competition Bureau delivered their comments and report, and in which the Minister of Finance announced his final decision. OSFI's letter of December 10[36] responded to the minister's request for any prudential reasons why the merger proposals should not be approved. OSFI was not able to identify any prudential issues which in its view precluded approval. However, OSFI did indicate that dealing with any financial difficulties arising in either merged entity could create additional problems, because restructuring these larger entities might either create competition concerns (in relation to any domestic buyer) or other ownership difficulties (if buyers had to be solicited from outside of Canada).

The Competition Bureau (which had in July published guidelines for assessing the mergers)[37] delivered its findings to the proposed merger partners and also to the Minister of Finance on

30. The House Standing Committee on Finance and the Senate Standing Committee on Banking, Trade and Commerce.

31. *See A Blueprint for Change: Response to the Report of the Task Force on the Future of the Canadian Financial Services Sector* (visited Mar. 19, 1999) <http://www.fin.gc.ca/bnks/bankse.html>.

32. *See id.*, §§ 338-40.

33. *See The Future Starts Now: A Study on the Financial Services Sector in Canada* 16-20 (visited Mar. 19, 1999) <http://www.parl.gc.ca/InFoComDoc/36/1/FINA/Studies/Reports/finarp/2-c.htm>.

34. This group of members of the Liberal Caucus (Members of the House of Commons belonging to the ruling Liberal Party) was formed shortly before announcement of the mergers, to look into financial services in Canada, largely from the public's (consumer) viewpoint. Many hearings were held across the country by what came to be known as the "Ianno Committee" (for Chairman Tony Ianno). After the mergers were announced, a main focus of the committee (as reflected in Chapter One of its report) was consideration of the mergers.

35. *See* National Liberal Caucus Task Force, *A Balance of Interest: Access and Fairness to Canadians in the 21st Century* (visited Mar. 19, 1999) <http://www.interlog.com/ianno/final_report_en.pdf>. Ultimately, this document was signed by over fifty members of parliament and senators.

36. *See* Office of The Superintendant of Financial Institutions Report to the Minister of Finance: *Proposed Mergers Between the Royal Bank of Canada and the Bank of Montreal, and the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank* (visited Mar. 19, 1999) <http://www.fin.gc.ca/OSFI/asfirpt_e.html>.

37. See Competition Bureau, Merger *Enforcement Guidelines as Applied to a Bank Merger*, (visited Mar. 19, 1999) [hereinafter The Guidelines] <http://strategis.ic.gc.ca/SSG/ct01280e.html>. The guidelines departed from regular merger review practice in that they did not envisage immediate discussion between the bureau and the merging parties regarding ways (normally asset sales and restructuring of the merger proposal) in which any the competitive concerns could be addressed. Rather, in light of the powers of the Minister of Finance, the findings would be transmitted with general indications of the types of remedies that had historically been utilized, which could then be discussed further if appropriate in the context of the terms of the decision of the Minister of Finance. The bureau's website also has other general information regarding the mergers. *See id.*

December 11.[38] The bureau found that each of the mergers was "likely to lead to a substantial lessening or prevention of competition that would cause higher prices and lower levels of service and choice for several key banking services in Canada."[39] The businesses identified where these effects arose were certain local markets[40] in each of the areas selected for further review: branch banking services to individuals and businesses, credit cards and securities.

As the final step, the Minister of Finance announced on December 14 that neither merger would be allowed to proceed.[41] The minister cited in particular an "unacceptable" concentration of power, a "significant reduction" in competition, and a reduction in "the government's policy flexibility to address potential future prudential concerns." It was a response that was certainly unwelcome to the four banks involved, and at the same time committed the government to implementing a new framework, identified by the minister as addressing a broad range of issues in relation to the financial services sector.[42] Specifically with regard to future merger proposals, he said that no merger among major banks would be considered until the new policy framework was in place—and, even then, that a positive response would depend on a showing that the concerns he had identified had been addressed.

IV. Enforcement of Claims Against Foreign Debtors

In *Elliot Associates L.P. v. Peru & Banco de la Nacion,* the United States District Court in the Southern District of New York dismissed the claim brought by Elliot[43] to recover monies due and owing on Peruvian debt it acquired by assignment in the secondary capital markets. Banco de la Nacion is the principal debtor and the Republic of Peru had provided a guarantee of payment of that debt. Although the Republic of Peru and Banco de la Nacion (the defendants)

38. Letters of December 11, 1998, from Konrad von Finckenstein (Director of Investigation and Research, the Competition Bureau) to Mr. Cleghorn (RBC) and Mr. Barrett (BMO) and to Mr. Flood (CIBC) and Mr. Baillie (TD), copied in each case to Mr. Martin (Minister of Finance). Available through the bureau's website. *See id.*

39. In relation to the merger analysis, as of December 31, 1997, in terms of value of Canadian assets, Royal Bank and Bank of Montreal were first and third (aggregating C$315 billion), and CIBC and TD were second and fifth (aggregating C$275 billion). While there were very significant variations in the markets which the two mergers were found to affect (and in general the RBC/BMO merger created more competitive issues), the differences were insufficiently substantial to have any impact on the government's response, which did not significantly differentiate between the two.

40. The guidelines provided that the initial screening for possible competition issues would be done by using the forward sortation areas defined by the first three digits of the postal code. *See* The Guidelines, *supra* note 37. There are 1,500 such areas in Canada. Other material aspects of the reviews included: (a) assessment of the two mergers would be done on the basis of their aggregate effect on the market, rather than by analyzing the effects of the merger first proposed, and then proceeding to the second, as had previously been the case; (b) the possible impact of developing electronic distribution channels (and any other innovations) on competition was to be determined on the previously used two year time frame (and branch banking continued to be an important aspect of banking); and (c) any efficiency defenses in situations where a "strong likelihood of substantial prevention or lessening of competition" was found would have to be considered before the Competition Tribunal (i.e. the bureau would not agree with such a defense without a full hearing).

41. *See* News Release 98-124, *Statement by the Honorable Paul Martin, Minister of Finance on the Bank Merger Proposals* (visited Mar. 19, 1999) <http://www.fin.gc.ca/newse98/98-124e.html>. *See also* <http://www.fin.gc.ca/fin-eng.html> (containing other related items).

42. In committing the government to "move quickly," the minister identified six policy objectives: fostering jobs and economic growth; responding to the needs of consumers and small businesses; ensuring the sector continues to be financially sound and secure; promotion of competition by allowing new entrants, both in Canada and from abroad; enabling the sector to maintain leading edge technology; and allowing for strong Canadian institutions with a solid international presence. *See id.*

43. *See* Elliot Assoc. v. Peru, 12 F. Supp. 2d 328 (S.D.N.Y 1998).

did not contest the existence of the debt or the default on payment, the defendants successfully asserted a defense based on the common law principle of "champerty" that has been adopted in New York's Judiciary Law at section 489.[44] The court held that Elliott's assignment contracts violated section 489, could not be enforced, and dismissed Elliot's complaint with costs and disbursements to the defendants.

Section 489 makes unlawful the purchase of debt "with the intent and for the purpose of bringing an action or proceeding thereon."[45] The policy behind section 489 is to disallow litigation based on a right acquired solely to bring an action. The court construed section 489 to require the defendants to prove that there was no other purposes for the purchase of the debt except to bring an action. The court held that the defendants had presented clear and convincing evidence that Elliot had purchased the debt with the intent and sole purpose to sue to recover 100 percent of the value of the debt. The defendants' proof included: Elliot's investment strategy which focused on sovereign debt acquisition and filing lawsuits; the past business activities of individuals working on Elliot's Peruvian debt project which included similar sovereign debt acquisition and subsequent litigation; Elliot's delay in closing the Peruvian debt trades until after all litigation risks were clarified by the Second Circuit in the Pravin Banker matter, another Peruvian debt holder who did not participate in the Peruvian debt restructuring agreement; and Elliot's refusal to negotiate with the debtor after its purchases of the Peruvian debt. In addition, the court did not find persuasive any of Elliot's alternative reasons for why it acquired the Peruvian debt. Elliot has filed an appeal with United States Court of Appeals for the Second Circuit.

Both the Bond Market Association (BMA) and the Loan Syndication & Trading Association Inc. (LSTA) have filed *Amicus Curiae* briefs with the Second Circuit arguing against the district court's interpretation and application of section 489 in this case. Both the BMA and the LSTA argued that the court departed from legal precedent and misconstrued section 489 in finding that Elliot's intent and purpose in purchasing the Peruvian debt was solely to sue for full payment. In addition, the LSTA stressed that the court's decision could adversely impact the secondary loan market's ability to create liquidity that enables lenders to reduce the risk and allows banks and other lenders to extend credit. The BMA emphasized its purpose in submitting its brief was to preserve the principle of the enforceability of contracts legally entered into in the fixed income markets which includes the rule that contracts are freely assignable absent clear contractual language prohibiting assignment. The BMA urged the Second Circuit to consider whether it is appropriate to apply section 489 in the context of commercial transactions involving the fixed income markets. In particular, the BMA warned that section 489 could be used by debtors routinely or conveniently to challenge the enforcement of debts due and payable that were acquired in the secondary market.

In another case of interest to U.S. persons with claims against foreign debtors, the Supreme Court has granted certiorari in *Alliance Bond Fund, Inc. v. Grupo Mexicano de Desarrollo*, S.A., No. 98-231, to decide whether a district court may freeze assets in an action solely for monetary relief, where the assets are located abroad and are unrelated to the damages claims advanced in the lawsuit.[46]

Grupo Mexicano de Desarrollo, S.A. (GMD) participated in a Mexican government program that granted toll road concessions to companies that arranged private financing of intercity

44. N.Y. JUD. LAW § 489 (McKinney 1983) [hereinafter Section 489].
45. Section 489, *supra* note 44.
46. *See* Alliance Bond Fund, Inc. v. Grupo Mexicano de Desarrollo, 143 F.3d 688 (2nd Cir. 1998).

highway construction. In February 1994, GMD offered and sold $250 million of 8.25 percent notes due in 2001. Eleven investment funds in the United States (investors) purchased $75 million of the notes. In August 1997, GMD defaulted on the investors' notes. The Mexican government offered a bailout by promising GMD $309 million in government guaranteed Toll Road Notes in return for eventual government ownership of the toll roads. GMD planned to assign all but $5.5 million of the notes to creditors other than the investors.

The investors filed suit in the Southern District of New York seeking monetary damages for breach of contract and a preliminary injunction restraining GMD from assigning or otherwise transferring the Toll Road Notes. A federal district court may issue a preliminary injunction freezing assets when the assets are the subject matter of a pending equitable action.[47]

The district court preliminarly enjoined GMD from transferring the Notes, and the Second Circuit affirmed. The court of appeals observed that the Investors' right to recover a monetary judgment would be defeated if GMD were able to transfer its Toll Road Notes assets to other creditors. The Second Circuit also was "impressed by England's successful twenty-year history of issuing 'Mareva injunctions' under circumstances substantially similar to those present on appeal."[48] Accordingly, the court held that a preliminary injunction was authorized under a district court's "general equitable power to ensure the preservation of an adequate remedy."[49]

The Second Circuit expressly noted a circuit split on this issue. The First, Third, Fourth, Sixth, Seventh, Eighth, and Ninth Circuits have all held that a district court can enjoin a defendant's assets in an action for monetary relief. The Fifth, Tenth, and Eleventh Circuits have reached a contrary condusion. The Second Circuit's decision arguably is in tension with *De Beers Consolidated Mines, Ltd. v. United States*,[50] which rejected the proposition that "[e]very suitor who resorts to chancery for any sort of relief by injunction may, on a mere statement of belief that the defendant can easily make away with or transport his money or goods, impose an injunction on him, indefinite in duration, disabling him to use so much of his funds or property as the court deems necessary for security or compliance with its possible decree."[51]

This case is of importance to institutional investors and other potential creditors of international and domestic firms. Under the minority view, financially troubled corporations can easily evade claims for monetary relief by transferring all assets prior to final judgment. Institutional investors and other businesses that deal with financially vulnerable foreign and domestic companies will want to stay informed about this case.

V. Extraterritorial Impact of U.S. Bankruptcy Laws

In a highly significant case under the U.S. bankruptcy laws, *Hong Kong & Shanghai Banking Corp. v. Simon*, the U.S. Court of Appeals for the Ninth Circuit has ruled that a foreign creditor may not bring a foreign collection proceeding against a debtor that has obtained a discharge under the bankruptcy law.[52] In so doing, the Ninth Circuit has affirmed the extraterritorial effect of the U.S. Bankruptcy Code.

Hong Kong and Shanghai Bank (HSB) had extended a U.S. $24 million loan to Odyssey International Holdings, Ltd., an international company incorporated in the British Virgin Islands.

47. *See* Fed. R. Civ. P. 65.
48. *Alliance Bond Fund*, 143 F.3d at 696.
49. *Id.* at 694.
50. De Beers Consol. Mines, Ltd. v. United States, 325 U.S. 212 (1945).
51. *Id.* at 222.
52. *See* Hong Kong & Shanghai Banking Corp. v. Simon, 153 F.3d 991 (9th Cir. 1998).

William Neil Simon, Odyssey's principal shareholder, personally guaranteed the loan. The guarantee provided for enforcement under the laws of Hong Kong in the courts of Hong Kong.

When the loan went into default, HSB called upon Simon to pay under his personal guarantee. At the time, Simon had personal debts of over U.S. $200 million, so he travelled to the United States and filed a personal bankruptcy petition under Chapter 7 of the U.S. Bankruptcy Code.

HSB filed a proof of claim in the bankruptcy proceeding with respect to a separate $37 million loan to Simon. It did not, however, file a proof of claim with respect to Simon's personal guarantee.

The U.S. bankruptcy court entered an order granting Simon a discharge of all his debts. The order contained an injunction against all creditors instituting any action to collect the debts of Simon. Shortly thereafter, HSB sought a declaratory judgment from the bankruptcy court to the effect that the discharge and injunction were not effective outside the United States. Evidently, the bank intended to file suit against Simon in the courts of Hong Kong. The bankruptcy court dismissed HSB's complaint for a declaratory judgment and the U.S. district court affirmed the bankruptcy court.

The Ninth Circuit has now affirmed both lower courts. The appellate court noted that the Bankruptcy Code confers jurisdiction over the debtor's property "wherever located and by whomever held."[53] Thus, the bankruptcy court has jurisdiction in rem over all the property in the debtor's estate. This includes property outside the territorial jurisdiction of the United States. Accordingly, a U.S. bankruptcy court has the power to enjoin a creditor from proceeding against the debtor's property before and after discharge of the debtor. The creditor's remedy is to file a proof of claim in the bankruptcy court.

The Ninth Circuit also noted that the discharge and injunction did not apply to the courts of Hong Kong. Rather, it applies to the foreign creditor, in this case HSB, which is subject to the jurisdiction of the U.S. bankruptcy court. If HSB were to ignore the injunction (by bringing suit in the Hong Kong courts), it would be subject to the imposition of sanctions by the U.S. court.

HSB had argued that principles of international comity dictate that the discharge and injunction should not apply to foreign proceedings. However, the Ninth Circuit found that considerations of international comity only apply where there is a conflict of jurisdictions. Here, an insolvency proceeding had not been initiated against Simon in Hong Kong or anywhere else. The U.S. bankruptcy proceeding was the only one in effect. Thus, the court held that international comity did not prevent the bankruptcy court from entering its injunction.

As a consequence of the Ninth Circuit's decision in *Simon*, if a foreign creditor is doing business in the United States and its debtor files for bankruptcy in the United States, it must look to the U.S. Bankruptcy Code for its remedies.

VI. Rights Of Holders of American Depository Receipts

May the holder of American Depository Receipts (ADRs) reflecting ownership of shares in a Japanese corporation bring a shareholder derivative action on behalf of that corporation? Both U.S. and Japanese law provide for shareholder derivative actions. However, the U.S. Court of Appeals for the Ninth Circuit has held in ***Batchelder v. Kawamoto*** that under Japanese

53. *Id.* at 996.

law, which applied to the ADRs in question, the holder of the ADRs did not have standing to bring the derivative action.[54]

The plaintiff, Harry Batchelder, owned 1,246 ADRs each of which represented ten shares of stock in Honda Motor Company, Ltd., the Japanese automobile company. The ADRs were issued by Morgan Guaranty Trust Company of New York acting as depository. By purchasing the ADRs, Batchelder was able to invest in the Japanese company.

Batchelder brought the present action alleging that the directors of Honda Japan breached their fiduciary duties by failing to protect the company from bribery and kickback schemes perpetrated by certain employees of Honda's American subsidiary. The directors of Honda's American subsidiary were also named in the suit in what is known as a "double derivative" action, i.e., an action brought by a shareholder of a parent company, on behalf of that corporation, to enforce a cause of action in favor of the subsidiary company.

Honda maintained that Batchelder did not have standing to bring either derivative action because under Japanese law only shareholders, not holders of ADRs, may bring derivative actions. Batchelder purchased his ADRs under a deposit agreement with Morgan Guaranty and Honda Japan. The deposit agreement contained a choice of law clause which read as follows:

> This Deposit Agreement and the [American Depository] Receipts and all rights hereunder and thereunder and provisions hereof and thereof shall be governed by and construed in accordance with the laws of the State of New York, United States of America. It is understood that notwithstanding any present or future provision of the laws of the State of New York, the rights of holders of Stock and other Deposited Securities, and the duties and obligations of the Company in respect of such holders, as such, shall be governed by the laws of Japan.[55]

The Ninth Circuit held that under the second sentence of this choice of law clause, Japanese law governs the rights of holders of ADRs in Honda Japan. While Article 267 of the Japanese Commercial Code allows for a derivative action in the name of a Japanese company, the Ninth Circuit found, on the basis of expert testimony, that only shareholders have rights under Article 267 and dismissed the case.

Batchelder argued that he was never given a copy of and never consented to the deposit agreement. In response, the Ninth Circuit quoted a number of SEC releases to the effect that: [T]he deposit agreement constitutes the contract between the issuer of the deposited securities, the depository and the holders of ADRs. "ADR holders are deemed to have agreed to all terms in the deposit agreement by their acceptance and holding of ADRs."[56]

The holding in *Batchelder* may seem to be inequitable in that the plaintiff did not have his day in court. However, the case is significant in that it upholds the validity of choice of law clauses in financial contracts.

VII. Sales of Securities in the United States

In a world of global finance and capital flows, the extraterritorial reach of national securities laws needs to be clearly defined. In America, this is not the case. The absence of legislative guidelines has spawned considerable litigation.

54. *See* Batchelder v. Kawamoto, 147 F.3d 915 (9th Cir. 1998).
55. *Id.* at 918.
56. *Id.* at 919.

The latest case, *Europe & Overseas Commodity Traders, S.A. v. Banque Paribas London*, involved the sale of shares in a Luxembourg bond futures fund by the London office of Paribas.[57] Shares in the fund were sold by Paribas mostly outside the United States. However, Europe and Overseas Commodity Traders, S.A. (EOC), a Panamanian investment company, purchased its shares in the fund on the basis of telephone calls and other communications to its principal, Alan Carr, a Canadian citizen, while Carr was visiting Florida.

When its investment in the fund lost money, EOC sued Paribas in federal court in New York alleging violation of U.S. securities laws because the shares in the fund had never been registered with the SEC and Carr had been misled by Paribas officials. On June 4, 1998, the United States Court of Appeals for the Second Circuit dismissed EOC's suit, holding that phone calls and facsimiles to a person temporarily on U.S. soil are not sufficient to provide a basis for jurisdiction under the U.S. securities laws. In so doing, the Second Circuit narrowed somewhat the scope of U.S. securities laws over international transactions.

EOC had two claims: the first was that Paribas had sold it unregistered securities in violation of the Securities Act of 1933. The SEC has issued Regulation S in order to define the circumstances under which trans-national securities offerings need to be registered with the SEC. Regulation S provides that a sale of securities "outside the United States" is exempt from the registration requirement.[58] In determining when a sale occurs outside the United States, the court held that the "conduct" and "effects" tests should be applied.[59] These tests have been used by courts in suits under the anti-fraud provisions of the securities laws. Applying these tests to the registration requirement, the court found that there was insufficient conduct in the United States to invoke the jurisdiction of the 1933 Act. Paribas did not intend to create a market in the United States for the fund's shares. The sale to Carr was an isolated transaction. Thus, there was no significant effect in the United States either.

These tests were also relevant to EOC's claim against Paribas under the anti-fraud provisions of the Securities Exchange Act of 1934. As stated by the Second Circuit: "the surrounding circumstances show that no relevant interest of the United States was implicated. In other words, a series of calls to a transient foreign national in the United States is not enough to establish jurisdiction under the conduct test without some additional factor tipping the scales in favor of our jurisdiction."[60]

In effect, the court is saying that Paribas' solicitation of Carr while he was in his vacation home in Florida was de minimis. There was no pattern of solicitation of U.S. residents and no harm was done to U.S. securities markets. But this outcome leaves open the question how much solicitation is enough to justify jurisdiction in the United States.

57. *See* Europe & Overseas Commodity Traders v. Banque Paribas London, 147 F.3d 118 (2nd Cir. 1998)
58. *Id.* at 124.
59. *Id.* at 125.
60. *Id.* at 129.