

INTRODUCTION OF THE EURO BILL

The introduction of the Euro will take place on 1 January 1999. Given the prevalence of the European currencies, it will affect a large number of contracts worldwide including Hong Kong. In response to a proposal by the banking industry, the Government has decided to introduce specific legislation in relation to the introduction of the Euro which is similar to that in New York and the European Union. The primary objective of the new legislation is to provide certainty to the continuity of legal obligations in Hong Kong upon the introduction of the Euro. The proposed legislation should be of benefits to all contracted parties and it is fully supported by the financial sector in Hong Kong.

The introduction of the Euro

The Euro will come into being on 1 January 1999. On that date, the conversion rates between the Euro and the national currencies of the eleven participating countries¹ in the European Monetary Union (EMU) will be irrevocably fixed and the Euro will replace the existing national currencies of the participating countries although the physical currency will not be put into circulation until 2002.

Although the impact of the changeover to the Euro on authorized institutions in Hong Kong will be less than for banks in Europe, this is by no means insignificant given the number and size of operation of foreign banks in Hong Kong (which ranks only after New York and London). Generally speaking, an institution which currently provides any products or services involving any participating national currency or the ECU will be affected by the introduction of the Euro. These would include a wide range of banking services like foreign exchange trading, treasury products, trade financing, other loans and advances, deposit taking, payment and remittance services and custodian service (e.g. keeping custody of bonds denominated in the existing national currencies). Apart from ensuring that their existing systems will have the operational capability to accommodate the use of both the Euro and the existing national currencies during the transitional period, institutions will also need to examine the legal implications arising from the introduction of the Euro.

Legal implications

There are already European Council Regulations which confirm that the Euro will replace the existing national currencies of the participating member states from 1 January 1999 and which provide certainty for continuity of contracts denominated in the ECU and the existing national currencies in European Union (EU) countries. Article 3 of Council Regulation No.1103/97 provides for the continuity of contracts in the following terms:

“The introduction of the Euro shall not have the effect of altering any term of a legal instrument or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate a legal instrument. This provision is subject to anything which parties may have agreed.”

It is worth noting that a key objective of this Regulation is to allay the concerns about legal uncertainty while respecting the parties' freedom of contract.

In relation to the ECU, Article 2 of Council Regulation No.1103/97 provides that as from 1 January 1999:

“Every reference in a legal instrument to the ECU as referred to in Article 109 g of the

¹ These countries are France, Germany, Italy, Spain, Belgium, the Netherlands, Luxembourg, Portugal, Austria, Finland and Ireland.

Treaty and as defined in Council Regulation (EC) No. 3320/94, is replaced by a reference to the Euro at a rate of one Euro to one ECU. References in a legal instrument to the ECU without such a definition shall be presumed, such presumption being rebuttable taking into account the intentions of the parties, to be references to the ECU as defined in Council Regulation (EC) No. 3320/94.”

Thus, where any contractual obligation refers to the ECU, as officially defined, then that reference will be replaced by a reference to the Euro at the conversion rate of 1:1. If the contract is silent as to the definition of ECU, it will be presumed to be a reference to the official definition and the ECU obligation will become a Euro obligation also at the conversion rate of 1:1 unless the parties concerned can prove that they had intended to refer to the ECU as it existed at a particular time.

The need for legislation

The EC Regulations take direct effect as part of the law of all Member States of the EU, including those which will not adopt the single currency on 1 January 1999 such as the UK. However the situation outside the EU is less clear as these Regulations cannot, on their own, resolve continuity issue for contracts governed by the laws of third countries.

In Hong Kong, as in other common law jurisdictions, the law of the currency or the *lex monetae* principle applies which means that the definition of a contractual obligation governed by Hong Kong law, expressed in a foreign currency, is determined by the law of the relevant foreign country. Applying this principle, performance of a contract governed by Hong Kong law which provides for payment in a currency replaced by the Euro should continue to be possible as payment must be made in the Euro at the conversion rate between the replaced currency and the Euro determined by the EC. However we believe that it would still be desirable to enact specific legislation to remove any concern that parties to contracts might be able to argue that the advent of the Euro is a fundamental change of circumstances bringing a given contract to an end. The EU has also seen fit to introduce legislation to deal with

this problem notwithstanding that the *lex monetae* principle is applied in a number of its jurisdictions. Given the status of Hong Kong as an international financial centre and a major foreign exchange trading centre in the world, it is desirable not to leave any doubt, even if we are reasonably confident that problems should not arise in respect of such contracts.

In addition, there will be uncertainty with respect to contracts providing for payment in the ECU. The ECU is not a currency as such. It is a basket of currencies comprising particular quantities of the individual currencies of the twelve Member States, originally designed as an official accounting unit for EU budgetary purposes which has subsequently also been adopted as a unit of account for private sector obligations. Within the EU, Article 2 of EC Regulation 1103/97 provides for a direct substitution of the ECU with the Euro at a 1:1 conversion rate. However, there is no equivalent legislation in Hong Kong and therefore such a substitution will not automatically take place as would be the case if the ECU were a currency.

The issue of continuity of contracts in relation to the Euro has also been of particular concern to other financial centres such as New York whose law is widely used as the governing law for cross-border agreements. To remove any uncertainty as to whether contracts containing obligations denominated in the ECU and the legacy currencies will be frustrated by the introduction of the Euro, the State of New York enacted legislation on 29 July 1997. The New York legislation contains provisions dealing with ECU/Euro conversion as well as continuity of contract in terms similar to those set out in the relevant EC Regulations.

The HKMA has consulted the banking industry on this issue in order to assess the need for introducing specific legislation. The banks that have been consulted are all concerned about the continuity issue, particularly in relation to the sizable amount of transactions in ECU deposits and lending (both customer and interbank) e.g. whether the borrower will use the frustration of contract as an excuse to refuse repayment. They support the introduction of specific legislation in Hong Kong to provide for the general continuity of contracts in relation to the introduction of the Euro. Apart

from saving much of their time and resources in seeking counterparties' consent to the amendments of contracts, this would provide them with certainty on continuity of contracts denominated in the ECU or other participating national currencies.

Like the legislation in the EU and New York, we propose that the new legislation in Hong Kong should not only deal with the ECU/Euro conversion but also remove any doubt about the general continuity of legal obligations arising from the introduction of the Euro. The new legislation should also respect the freedom of contracts to provide scope for contracting parties to review the underlying purpose of the legal obligation to see whether a direct substitution by the Euro is appropriate.

Accordingly the new legislation in Hong Kong proposes to achieve the following: -

- (i) provide for references in any legal obligation to the ECU (as officially defined in the relevant EC Regulation) to be replaced by references to the Euro at the rate of one Euro to one ECU. The official definition of the ECU should be presumed to apply unless it is otherwise expressly agreed or provided;
- (ii) provide for continuity of legal obligations while respecting the freedom of contract, i.e. subject to any agreement or provision to the contrary, the introduction of the Euro and the changes consequential upon its introduction should not discharge or excuse any performance under a legal obligation nor give the obligor or obligee to the obligation the right to unilaterally alter or terminate the obligation; and
- (iii) put it beyond doubt that the new legislation should not be taken to affect the operation of the law relating to the validity or enforceability of a legal obligation, e.g. the application of the *lex monetae* principle, in future cases of currency alteration.

The two banking industry Associations, the Hong Kong Capital Markets Association and the Law Society of Hong Kong have been consulted and all expressed support of the new legislation in

Hong Kong. The Bill was published in the Gazette on 9 October and introduced to the Legislative Council on 4 November this year. The new legislation is expected to be enacted before the introduction of the Euro on 1 January 1999. ☒

- Prepared by the Banking Development Division