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Self-Regulation in Global Electronic Markets through Reinvigorated Trade Usages

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I. ABSTRACT

In a global electronic market the role of trade usages must be reinvigorated to better suit the needs of market participants. Contrary to the approach to trade usages often adopted by courts and scholars, usages should not be seen as merely a device to interpret disputed terms in a contract. Rather, they should be viewed as a legal foundation for existing and new trade practices and, therefore, as a source of authority for and legal obligation arising from such practices. In sum, they should be regarded as a means by which participants in global electronic markets can engage in self-regula-
The world's largest financial market, the global currency bazaar, is an outstanding case study of the need to reinvigorate trade usages in a cross-border, high-technology market. In brokered foreign currency transactions, a practice called "switches" lacks a legal foundation. In a switch, one bank attempts to rescind a foreign exchange contract because the counterparty to that contract is an undesirable credit risk exposure. The bank further attempts to conclude a new contract with a different counterparty on the same terms and conditions as the first contract. By switching counterparties, the bank seeks to expunge the undesirable credit risk, and preserve the benefits of the initial contract.

However, whether a switch is legally permissible, and whether it effectively rescinds one contract and creates another, is uncertain. By reinvigorating the concept of a trade usage and recognizing a switch as a reinvigorated usage, a legal foundation for it would exist. Banks trading foreign exchange would then be able to regulate their credit risk exposures by switching counterparties. Indeed, to address concerns of government regulators, it is proposed that banks further refine this practice by developing a five-minute right of rescission usage.

For three reasons, self-regulation through reinvigorated trade usages is needed. First, it has several advantages. It will reduce uncertainty, protect expectations, provide flexibility, and promote efficiency. Second, alternative legal foundations—namely, rule-based regulation through contract rules on assignment and adequate assurances of performance—may exacerbate uncertainties and not represent a Pareto improvement. Third, the process of domestic and international contract law reform cannot anticipate and meet the needs of banks in the global currency bazaar regarding credit risk. This process is reactive and cumbersome.

Business usage may . . . provide a way of doing business without the aid of law (though not in violation of it). The means of bringing it within the legal regime should be available. The modern state has more and more tried to provide its subjects with a comprehensive, just and coercive regime for the settlement of man-to-man controversies.¹

To the extent that a commercial code must acknowledge and

¹. STATE OF NEW YORK, LAW REVISION COMMISSION, STUDY OF THE UNIFORM COMMERCIAL CODE — PROBLEMS OF CODIFICATION OF COMMERCIAL LAW 48 (1955).
accommodate a distinct mercantile community, the UCC has failed. 2

II. RETHINKING THE ROLE OF TRADE USAGES

A. Argument

In order to meet the needs of participants in global electronic markets, the concept of a usage of trade should be reinvigorated. 3 No longer should a usage be regarded as a mere interpretive device trotted out by a court to resolve a dispute about a contractual term. It should be seen as a legal foundation for a practice engaged in by market participants. As such, it should confer legitimacy and authority on that practice, and be a source of obligation for the participants. In short, trade usages should be seen as a means of self-regulation.

In this reinvigorated role, a trade usage can reduce uncertainty, protect expectations, provide flexibility, and foster efficiency. Alternatives to reinvigorated usages do not offer these advantages. First, express statutory rules of contract fail to address adequately the pressing needs of participants in global electronic markets. In that sense, Chen's above-quoted conclusion is correct. Application of statutory rules may generate uncertainty and not yield potential Pareto improvements. 4 Second, the process of reforming contract law is too cumbersome and reactive to anticipate and meet the participants' needs. 5 Changes wrought may help in the long run but cannot possi-


3. Usages of trade are governed by section 1-205 of the Uniform Commercial Code (U.C.C.). Unless otherwise noted, all references herein to provisions of the U.C.C. are to the official 1990 version published by the American Law Institute and National Conference of Commissioners on Uniform State Laws.

The term "electronic" as used herein includes telephonic communication links, electronic messaging systems, and computer-to-computer interfaces.

4. See infra note 185 and accompanying text.

bly meet their needs in the short-term.

The global currency bazaar—the market for trading foreign exchange—is an outstanding case study of a global electronic market in which to explore the need to reinvigorate trade usages. In this bazaar, banks must manage carefully credit risk and Herstatt risk. The extent and magnitude of these risks are difficult to ascertain when foreign exchange contracts are arranged through a broker acting as an agent for the partially disclosed bank principals. In cer-

6. The term “currency” as used herein includes exchanges of credits to bank account balances denominated in a particular foreign currency.

7. Credit risk is the risk of nonpayment by the counterparty. CHARLES J. WOELFEL, ENCYCLOPEDIA OF BANKING AND FINANCE 270-71 (10th ed. 1994) (The counterparty is the other or opposite party in a transaction.). In the context of a foreign exchange transaction, credit risk is the risk that one bank will not receive payment of a foreign currency owed by its counterparty.

“Herstatt risk” is a species of credit risk and refers to the possibility that one party delivers foreign currency to its counterparty pursuant to its payment obligation but does not receive delivery of the currency owed by the counterparty. The nondelivery occurs because the counterparty fails, or is closed by regulatory authorities, before it has the opportunity to satisfy its payment obligation, and because the counterparty is located in a different time zone from the first party.

The term “Herstatt risk” arises from the famous 1974 case in which a German bank (Bankhaus I.D. Herstatt K.G.a.A.) that had entered into foreign exchange contracts was closed by German bank regulators. See Delbrueck & Co. v. Manufacturers Hanover Trust Company, 609 F.2d 1047, 1049-51 (1979). In the case, Herstatt had received settlement of foreign currency to which it was entitled under the contracts, but was closed by the authorities before it could fulfill its settlement obligations to its counterparty (Delbrueck & Company). “Herstatt risk” arises whenever the settlement of the two portions or “legs” of a spot foreign exchange transaction do not occur simultaneously. The settlements never occur simultaneously when the parties to the transaction are located in different time zones.

Hereinafter, unless distinguished expressly, “credit risk” is meant to encapsulate “Herstatt risk.”

8. Foreign exchange brokers play a vital role in linking banks that want to buy or sell foreign currencies. In nine countries — Australia, Belgium, Canada, Denmark, Hong Kong, Portugal, Spain, the United Kingdom, United States — about one-third of all foreign exchange transactions are arranged through brokers. In France, the Netherlands, and Ireland, the proportion is 44-47 percent. In Japan, 25 percent of transactions are arranged by brokers. BANK FOR INTERNATIONAL SETTLEMENTS (BASLE, SWITZERLAND), CENTRAL BANK SURVEY OF FOREIGN EXCHANGE MARKET ACTIVITY IN APRIL 1992 Table VI at 21, 23-24 (1993) [hereinafter, 1992 BIS SURVEY]. In all such transactions, the brokers act as agents for partially disclosed principals. See RESTATEMENT (SECOND) OF AGENCY § 4(2) (1958) [hereinafter, RESTATEMENT OF AGENCY] (stating that “[i]f the other party has notice that the agent is or may be acting for a principal but has no notice of the principal’s identity, the principal for whom the agent is acting is a partially disclosed principal.”). Questions of agency law do not affect the analysis herein. See id. at § 26-27, 50-51.

Transactions not arranged through brokers are accomplished by banks deal-
tain transactions, a bank needs to avoid unwanted and possibly imprudent risks by rescinding a foreign exchange contract with one party and forming a new contract, on the same terms and conditions as the rescinded contract, with a different party.

Rules on assignment and adequate assurances of future performance do not satisfy this need. Nor can the bank wait for assistance from those responsible for reforming contract law rules. Instead, resolving uncertainties about credit risk can be addressed through a market practice called “switches” whereby one party is substituted for another in a foreign exchange contract. This practice illustrates (1) why the concept of a trade usage should be reinvigorated and (2) how a reinvigorated usage functions as a self-regulatory device. Further, to address concerns of government regulators, it is proposed that banks trading foreign exchange adapt this practice by developing a five-minute right of rescission usage. This refinement would give a bank five minutes from the time it learned the identity of its counterparty to assess the credit risk associated with the proposed counterparty, rescind a contract if the risk is unacceptable, demand that its broker obtain a new counterparty, and switch the new for the unacceptable counterparty.

B. Why the Global Currency Bazaar?

The size of the global currency bazaar is one reason why this market is an outstanding case study of the regulation of uncertainty through reinvigorated trade usages. It is the world’s largest financial market. Every day, an average of one trillion dollars worth of foreign currencies are traded in this bazaar. The bazaar is rapidly

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10. See GRABBE, supra note 9, at 65.

11. 1992 BIS SURVEY, supra note 8, at 5-7. The exact figure is $1.354 trillion in total reported gross turnover. After eliminating double-counting and gaps in reporting, “net net” global turnover is an average of $880 billion per day. The turnover statistics are for spot, forward, and derivative foreign exchange contracts. For a discussion of the differences among these types of contracts, see Raj Bhala, Risk Trade-offs in the Foreign Exchange Spot, Forward and Derivative Markets, 1 THE FINANCIER 34 (1994); B. Albert, A Foreign Exchange Primer for Commercial
getting bigger: average daily turnover increased 35 percent between April 1989 and April 1992.\textsuperscript{12}

The strong U.S. public interest in the bazaar is a second justification for using this case study to argue for a stronger legal effect for trade usages. U.S. commercial and investment banks are active traders in the bazaar, U.S. brokerage companies regularly arrange deals among traders, and the Federal Reserve frequently intervenes in the bazaar to affect the exchange rate of the U.S. dollar relative to other currencies. Notwithstanding the prominence of American institutions, the U.S. is ineluctably involved in the bazaar because of the prominence of its currency therein. Foreign exchange trading entails an exchange of currencies between two parties, and the U.S. dollar is by far the most widely traded currency in the bazaar. In 82 percent of all trades, the U.S. dollar is bought or sold against another foreign currency.\textsuperscript{13}

The characteristics of the foreign exchange market are a third reason why the global currency bazaar is an outstanding case study of trade usages and electronic commerce. \textit{It is a highly liquid, twenty-four hour, global, high-technology bazaar}.\textsuperscript{14} Indeed, the enormous and growing trading volumes should not be surprising because the bazaar never closes.\textsuperscript{15} The players are thousands of commercial and investment banks from around the world. While London, New York, and Tokyo are the most important trading centers,\textsuperscript{16} there is no cen-

\textsuperscript{12} Lending Officers, 2 COMM. LENDING REV. 40 (1987).
\textsuperscript{13} 1992 BIS SURVEY, supra note 8, Table I at 6. With respect to the "net-net" global turnover, the increase during the same period was 42 percent. 1992 BIS SURVEY, supra note 8, Table I at 6.
\textsuperscript{14} 1992 BIS SURVEY, supra note 8, at 8, Table IIa at 9. The most significant other currencies are German deutsche marks (which figure on one side of 40 percent of all transactions), Japanese yen (which figure on one side of 23 percent of all transactions), and English pounds (which figure on one side of 14 percent of all transactions). 1992 BIS SURVEY, supra note 8, at 8, Table IIa at 9.
\textsuperscript{15} In general, liquidity refers to the amount of time required to turn an asset into cash — the shorter the time period, the more liquid the asset. See WOELFEL, supra note 7, at 703. In the context of the foreign exchange market, it is the amount of time required for one currency to be exchanged for another. A key reason for the liquidity of certain currencies (e.g., dollar, yen, pounds, and marks) in the foreign exchange market is the large number of banks that trade those currencies. One observer estimates that the largest 8-10 banks account for only 30-40 percent of daily turnover, thus smaller institutions play a very prominent role in the market. D. Shirreff, \textit{Banks and Forex}, GLOBAL. FINANCE, June 1988, at 34. Naturally, trading in some currencies (like dollars, yen, and pounds) is more liquid than other currencies (like United Arab Emirates dinars, Indian rupees, and Turkish lira).
\textsuperscript{16} GRABBE, supra note 9, at 66.
\textsuperscript{16} The largest average daily turnover occurs in London ($300 billion), the
centralized exchange analogous to a stock market. The players are scattered across the globe, and the fastest growth rates in trading volumes are in nascent financial centers such as Madrid, Athens, and Copenhagen. Linked by fiber-optic telephone and computer lines and satellite communication systems, the bank principals and their agent brokers make full use of the products of the telecommunications revolution.

United States ($192 billion), and Japan ($126 billion). 1992 BIS SURVEY, supra note 8, at 13, Table IV at 14. See also James Blitz, All Change in Foreign Exchanges, FIN. TIMES, Apr. 2, 1993, at 15.

17. Between April 1989 and April 1992, turnover in Spain and Greece increased by more than 170 percent, and Denmark's growth rate was 112 percent. 1992 BIS SURVEY, supra note 8, at 13.

18. As one observer explains:

The foreign exchange market is an over-the-counter market. That is, there is no one physical location where traders get together to exchange currencies. Rather, traders are located in the offices of major commercial banks around the world and communicate using computer terminals, telephones, telexes, and other information channels. If a foreign exchange (FX) trader in a bank in New York deals dollars for pounds with an FX trader in London, the traders will, over the phone, agree on a price. Each trader will then enter the trade in the bank’s computer or other record system, and then get on with the business of trading. The mechanics of actually transferring the currencies are not the traders' concern, so a trade takes a few seconds at most. Later, however, the two banks will send each other [possibly by electronic means] confirmation messages concerning the details of the trade, and will make arrangements for settlement [i.e., performance of inter-bank payment obligations] of the traders' contract. The bank in New York will turn over a dollar deposit (at some New York bank) to the bank in London, and the bank in London will turn over a pound deposit (at some London bank) to the bank in New York. This exchange of currencies will take place entirely in the form of an exchange of electronic messages. The messages will be sent through established communications networks.

GRABBE, supra note 9, at 65-66 (emphasis supplied except for “settlement”). As Grabbe points out, the most widely used international financial communications network is the Society for Worldwide Interbank Financial Telecommunications (SWIFT), a Belgian not-for-profit cooperative organization which began in May 1977. As of 1990, 3,000 banks in 67 countries were connected and an average of 1.1 million messages were sent among the banks via SWIFT each day. These electronic messages, which concern the terms of foreign exchange and other cross-border financial deals, are transmitted through central, connected operating centers located in Brussels, Amsterdam, and Culpeper, Virginia. In turn, the centers are connected by data-transmission lines to regional processors, and individual banks are connected to such processors. GRABBE, supra note 9, at 66. For an entertaining account of life on a foreign exchange trading floor of a major trading institution, see J. MADURA, INTERNATIONAL FINANCIAL MANAGEMENT 111-22 (3d ed. 1992).

With respect to settlement of foreign exchange payment obligations, the Clearing House Interbank Payments System (CHIPS) (owned and operated by the
C. Organization

The argument for reinvigorating trade usages in global electronic markets is unveiled in five remaining parts to this article. Part II presents a telephonic brokered foreign exchange transaction. This Part highlights a credit risk problem and consequent need to switch counterparties.

Part III discusses the parsimonious approach often taken by courts and scholars to trade usages. The jurisprudential and textual bases for this role are considered and rejected. Part III argues that the narrow role is inconsistent with legislative intent and the law merchant.

Part IV offers the argument for using U.C.C. Section 1-205 as a legal foundation for the practice of switches. This Part shows that as a reinvigorated trade usage, a switch is a self-regulatory device that provides players in the global currency bazaar with certainty, protects their expectations, gives them flexibility, and fosters efficiency in trading. Part IV proposes a five-minute right of rescission usage as a refinement to the practice of switches to help resolve the Federal Reserve's concerns about that practice. Part IV also raises two lingering doubts about the argument.

Part V argues that alternatives to self-regulation through "beefed up" trade usages are unhelpful. The assignment and adequate assurances rules in Sections 2-210 and 2-609, respectively, are considered as means of regulating credit risk. Application of the as-

New York Clearing House) and Fedwire (owned and operated by the twelve Federal Reserve Banks) are most commonly used. See Raj Bhala, The Inverted Pyramid of Wire Transfer Law, 82 Ky. L.J. 347, 374 (1993-94).

19. Unless otherwise noted, all references to a "section" or "sections" are to the U.C.C.

20. There is a well-founded statutory basis for the Federal Reserve's regulatory authority over commercial banks that participate in the foreign exchange market. Under the Bank Holding Company Act of 1956, as amended, 12 U.S.C. §§ 1841-50 (1994), and the Federal Deposit Insurance Act, as amended, 12 U.S.C. §§ 1811-34 (1994), the Board of Governors of the Federal Reserve System (Board) is the appropriate federal banking agency with respect to (i.e., regulator of) bank holding companies (BHCs) and banks with state charters that are members of the Federal Reserve System (state member banks). The Federal Reserve, along with the other eleven regional Reserve Banks, exercises regulatory authority over BHCs and state member banks under authority delegated by the Board pursuant to the Federal Reserve Act of 1913, 12 U.S.C. §§ 221-522 (1994). See 12 U.S.C. §§ 248(a), (k), 1813(q)(2). Along with registered broker-dealers regulated by the Securities and Exchange Commission, commercial banks — virtually all of which are held by BHCs — are the most important U.S. players in the foreign exchange market.
assignment rule is rejected because it does not yield a potential Pareto improvement,\(^{21}\) and application of the adequate assurances rule is rejected because of attendant uncertainties. Domestic and international commercial law reforms also are evaluated as a possible solution to the credit risk problem. These are rejected because of their cumbersome and reactive nature.

Part VI presents a synopsis of the aforementioned arguments. It concludes that for the foreseeable future, trade usages may be the only means by which participants in global electronic markets can quickly and effectively resolve uncertainties in their transactions.

III. SWITCHES: AN ILLUSTRATION

A. The Attempt to Switch Counterparties

Suppose Bangkok Bank and Citibank\(^{22}\) seek to enter into a dollar-yen spot foreign-exchange transaction.\(^{23}\) Bangkok Bank wants to sell 5 billion yen in exchange for dollars, and Citibank wants to buy 5 billion yen against dollars. Neither Bangkok Bank nor Citibank is aware that each is a potential counterparty of the other, thus the critical initial problem is matching the buy and sell interests of the two parties. One matching method is for each bank to telephone a

\(^{21}\) See infra text accompanying note 185.

\(^{22}\) Bangkok Bank and Citibank each have offices all over the world. It is assumed that the Bangkok, Thailand office of Bangkok Bank and the New York office of Citibank are involved in the transaction detailed above.

Bangkok Bank and Citibank are active participants in the foreign exchange market not only through their Thai and U.S. offices, respectively, but also through offices located around the world. Thus, the hypothetical transaction deliberately simulates real-world conditions.

\(^{23}\) The most basic and significant foreign exchange transaction is a spot. 1992 BIS SURVEY, supra note 8, at 16-23. Spot contracts account for about half of all foreign exchange transactions. A spot contract involves a commitment by one party to deliver a specified quantity of one currency against the counterparty's delivery of a specified quantity of a second currency. The deliveries are made on the value date, which for most currencies is within two business days of the trade date (the date on which the contract terms were agreed). In other words, in spot foreign exchange transactions the settlement of payment obligations occurs on \("T\)\(^{2}\) (where \("T\) stands for the trade date). For spot contracts involving Canadian dollars and Mexican pesos, the value date may be one day after the trade date (\(T\)\(^{1}\)). Forward contracts, which are the same as spot contracts except that the value date is more than two days after the trade date, are the second most significant type of transaction. 1992 BIS SURVEY, supra note 8, Table V at 17.

Of the top ten currency pairs in spot transactions, dollar-mark is the most common type, accounting for 29.6 percent of average daily turnover. Dollar-yen deals are the second most common type, accounting for 15.7 percent of such turnover. 1992 BIS SURVEY, supra note 8, Table II at 10.
number of banks and inquire about interest in a 5 billion dollar-yen deal. But, direct dealing has two disadvantages. First, calling banks is time consuming and perhaps fruitless, particularly if the caller lacks comprehensive, up-to-date information about potential counterparties. Second, and more importantly, direct dealing does not allow for anonymity. As soon as Bangkok Bank asks for price quotes on 5 billion yen, other banks will learn it is about to incur a large long or short position in yen. The other banks may anticipate correctly that Bangkok Bank seeks to sell yen short. In turn, the oth-

24. Alternatively, Bangkok Bank and Citibank may be members of the same electronic direct-dealing system sponsored by a third-party vendor. See supra note 8 (discussing automated dealing systems).

25. See THE FOREIGN EXCHANGE COMMITTEE, ANNUAL REPORT 23 (1986) (stating that “[b]y providing participants anonymity until a transaction’s size and exchange rate is agreed to [sic], brokers contribute to the depth and breadth of the market.”). A “long” position results from buying a currency. See infra note 26 (discussing short selling).


26. Technically, short selling refers to the sale of an asset that the seller does not own at the time of sale. The seller must enter into a covering transaction whereby the asset is purchased before the seller is obligated to deliver the asset to the buyer.

Short-selling occurs frequently in the global currency bazaar. For an example of selling 400 million pounds short against the dollar, see KRieger, supra note 9, at 65-79. To be sure, if Bangkok Bank sells 5 billion yen short at 101 yen per dollar, then it will have to obtain 5 billion yen to cover its short position so that it has sufficient yen to deliver to Citibank on the value date.

Bangkok Bank may cover its short position in a number of ways. First, it may take a long position in another spot transaction, i.e., buy yen in the spot market. Bangkok Bank risks losing money if the spot rate for yen rises because the cost of the cover purchase may exceed the proceeds from the subsequent sale. For example, suppose the yen appreciates relative to the dollar in the spot market to 99 yen per dollar. Then, Bangkok Bank will have to buy 5 billion yen at that spot rate and sell them to Citibank at the previously agreed rate of 101 yen per dollar. The purchase will cost Bangkok Bank $50,505,050.51 but the sale will fetch only $49,504,950.50, resulting in a loss of $1,000,100.01. In general, Bangkok Bank will lose money on the short sale if the yen appreciates beyond 101 yen per dollar. Of course, Bangkok Bank would not short sell yen if it thought yen would appreciate. It expects to profit by buying 5 billion yen at, say, 103 yen per dollar and selling the yen to Citibank at 101 yen per dollar.

A second way to cover a short sale in the spot market is to enter into
er banks may take dollar-yen positions that undermine Bangkok Bank's strategy.\textsuperscript{27}

Consequently, Bangkok Bank and Citibank deal with each other through a foreign exchange broker.\textsuperscript{28} As agent for a bank, the broker specializes in matching parties quickly by using its network of contacts in the international banking community. The broker guarantees anonymity to its principal while the contract is being negotiated. The transaction may be initiated either by Bangkok Bank or Citibank. Suppose Bangkok Bank communicates with a foreign exchange broker in Bangkok known as the "Thai Broker."\textsuperscript{29} Undoubtedly, a satellite telecommunications system is used—the Bank and Broker communicate by telephone or an electronic messaging system.\textsuperscript{30}

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foreign currency option transaction. Bangkok Bank could buy a call option on yen. This option would entitle Bangkok Bank to obtain yen at a pre-set price. Using currency options to cover a short position is an example of employing a foreign exchange derivative product to hedge an underlying currency exposure. The reverse situation also is possible. Short sales can be used to hedge a position in options. See KRIEGER, supra note 9, at 65-79.

27. For example, banks may buy yen knowing that Bangkok Bank will have to cover its short position by purchasing 5 billion yen. These banks expect Bangkok Bank may buy the yen from them and hope that Bangkok Bank's covering purchases will cause the yen to appreciate relative to the dollar. Alternatively, the banks may sell yen anticipating that Bangkok Bank ultimately will dump yen, which will depress the price.

28. To be sure, no foreign exchange broker works for free. Use of a foreign exchange broker entails a commission. Bangkok Bank and Citibank will have to pay a commission to their respective brokers (the Thai and New York Brokers). The commission charged may be a percentage fee that is based on the volume of currencies transacted. Because the brokerage market is very competitive, the percentage is likely to be quite small. Brokerage fees do not affect the argument herein and, therefore, are not considered.

It is assumed that the agents have actual or apparent authority from their respective principals and there are no disputed issues as to their authority to enter into contracts on behalf of their principals. See RESTATEMENT OF AGENCY, supra note 8, at §§ 26-27 (regarding creation of authority), 50-51 (regarding authority to contract).

29. Undoubtedly, Bangkok Bank will have used the Thai Broker as its agent in the past and, therefore, an established principal-agent relationship exists. It is assumed that the Thai Broker acts as agent for Bangkok Bank but not Bangkok Bank's counterparty, Citibank. In reality, a single broker may act as the agent for both banks. For example, the Bangkok office of the Thai Broker may communicate with Bangkok Bank, while the New York office of the Thai Broker communicates with Citibank, and then the two offices of the Thai Broker will communicate with each other. Query whether it is appropriate for the same broker to serve as agent for two principals. An agent is a fiduciary with respect to matters in the scope of the agency and owes its principal a duty of loyalty, namely, to act solely for the benefit of its principal. See RESTATEMENT OF AGENCY, supra note 8, §§ 13, 387.

30. In many instances, telephone conversations between the banks and their
Bangkok Bank asks for a "spot dollar-yen" quote, and the Thai Broker provides Bangkok Bank with a two-way price. Because Bangkok Bank does not necessarily indicate to the Thai Broker whether it is a potential buyer or seller of yen, the Broker does not learn of the Bank's intentions until the Bank proposes a specific deal for the Broker to arrange at an exchange rate quoted by the Broker. 31 Modern telecommunications systems not only facilitate communication but also price discovery. The Thai Broker ascertains the spot rate by checking the electronic international financial news reporting services to which it subscribes. These services provide prices of virtually every currency on a computer monitor in the same way that Lexis provides opinions of virtually every U.S. and many foreign courts through a linked terminal. 32 In addition, the Thai Broker may call other foreign exchange brokers, or dealing banks, and ask for quotes.

Assume the quote is "101-100." 33 Bangkok Bank responds by brokers, and between brokers, are taped. Electronic messaging systems are direct computer-to-computer exchanges.

31. KRIEGER, supra note 9, at 31. To say that the Thai Broker quotes Bangkok Bank a "two-way rate" means that the Broker tells the Bank trader the (1) price at which an unnamed counterparty is ready, willing, and able to buy yen in exchange for dollars, the "bid price," and (2) price at which an unnamed counterparty is ready, willing, and able to sell yen in exchange for dollars, the "offer price." Because of uncertainty as to whether Bangkok Bank will buy or sell yen, it is not surprising that two-way rate quotations are the universal practice in the foreign-exchange market. Moreover, quoting two-way rates contributes to market liquidity. It indicates that the Thai Broker is willing to arrange either a purchase or sale of yen against dollars on behalf of Bangkok Bank.

There is a spread between the two quoted prices, known as the bid-offer (or bid-ask) spread. The bid price necessarily must be lower than the offer price. If it were not, then the counterparty to the transaction would perpetually lose money: it would buy yen at a higher price and be forced to sell the yen at a lower price. Thus, for example, the bid-offer spread quoted for spot dollar-yen by the Thai Broker to Bangkok Bank might be "101-100." This signifies a bid price of 101 yen per dollar, the price at which some counterparty whose identity is unknown to Bangkok Bank is willing to buy yen from Bangkok Bank. It also signifies an offer price of 100 yen per dollar, the price at which some counterparty whose identity is unknown to Bangkok Bank is willing to sell yen to Bangkok Bank.

At these rates, a 5 billion yen transaction implies that the undisclosed counterparty will pay $49.50 million (the exact figure is $49,504,950.50) for the yen, or receive $50 million for the yen. This assures the counterparty that if it bought the yen from Bangkok Bank, it could immediately re-sell the yen for a profit of $500,000 (the exact figure is $495,049.51) instead of incurring a loss for that amount if the bid-offer rates were reversed.

32. For a discussion of the prevalence of international brokering, see supra note 8.

33. In practice, exchange rates are quoted in more precise terms because finer movements are observed that result in large profits and losses. The dollar-
telling the Thai Broker that it wants to sell 5 billion yen at 101 yen per dollar for a total of $49.50 million. The Thai Broker immediately endeavors to find Bangkok Bank an acceptable counterparty. It does so by communicating with a foreign exchange broker in New York, called the "New York Broker." The communication is made via an established telephone or electronic link between the Brokers known as a "link line." The Thai Broker informs the New York Broker that its principal is ready, willing, and able to sell 5 billion yen at 101 yen per dollar and asks whether the New York Broker can find a counterparty to buy the yen. The identity of the Thai Broker's principal is not yet disclosed to the New York Broker. Therefore, at this juncture of the dealmaking process, a counterparty procured by yen rate is quoted in terms of hundredths of yen per dollar. For example, the rate on Friday, April 15, 1994 was 103.45 yen per dollar. Currency Trading — Exchange Rates, WALL ST. J., Apr. 18, 1994, at C15.

The price as quoted by a foreign exchange broker reflects the exchange rate at which the broker is ready, willing, and able to find a buyer or seller for a particular type of foreign currency. Because the broker is an agent and not dealing itself in the market, it cannot purchase or sell currency for its own account. Indeed, even recording a purchase or sale on its own books for a short period is not permitted.

Of course, the prices quoted by foreign exchange brokers ought to be the same as those quoted directly by dealers. The spot market for major currencies is nearly perfectly competitive, consequently profitable arbitrage opportunities are rapidly identified, exploited, and eliminated. Suppose the Thai Broker quotes Bangkok Bank a rate for buying yen that is cheaper than the rate prevailing in the market and quoted directly by Citibank. For example, Bangkok Bank might be told by the Thai Broker that it can buy yen at 106 yen per dollar but Bangkok Bank learns that the market bid price is 105 yen per dollar. It would be profitable for Citibank to buy 5 billion yen through the Thai Broker and resell the yen directly on the market. The Bangkok Bank trader would earn a profit of 120,000,000 yen divided by the rate differential of 1 yen per dollar, or $449,236.30. (This profit is the difference between the price of $47,169,811.32 paid for the yen at the 106 rate and the $47,619,047.62 earned upon resale at the 105 rate.)

Furthermore, an off-market rate quote ought to be an egregious one. Foreign exchange brokers all have access to the same information. The New York and Thai Brokers can survey dealers like Bangkok Bank and Citibank and thereby compile a list of exchange rates. Both Brokers undoubtedly subscribe to an electronic news service (such as Reuters) and can thereby ascertain current market exchange rates.

34. The exact figure that Citibank will be obligated to pay Bangkok Bank for the yen is $49,504,950.50. Payment of the dollars, and the reciprocal yen payment, will occur on the value date, which is two days after the trade date. See supra note 23.

35. See supra note 29.

36. Because the Thai Broker acts as an agent for a partially disclosed principal, the anonymity of Bangkok Bank's trading strategies is guaranteed until Bangkok Bank's identity is revealed at a later stage in the dealmaking process.
the New York Broker cannot ascertain the credit risk associated with the proposed transaction.

The New York Broker immediately endeavors to find an acceptable counterparty by communicating (again, either by telephone or an electronic messaging system) with potentially interested banks. While it may take the New York Broker several hours to find an agreeable bank, such a lengthy delay would be unusual. In general, brokered transactions take several seconds or a few minutes to conclude. Thus, after speaking with three or four banks, the New York Broker telephones Citibank which indicates that it agrees to buy 5 billion yen at 101 yen per dollar. In response, the New York Broker utters the word commonly used in the global currency bazaar—"yours"—and repeats the key terms of the deal, saying "5 billion yen at 101." Upon the utterance of "yours," Citibank agrees to enter into a spot foreign exchange contract to buy 5 billion yen for $49.5 million. However, it still does not know who its counterparty is and, therefore, cannot assess the credit risk associated with the contract.

Immediately after obtaining Citibank as a counterparty, the New York Broker notifies the Thai Broker, who then relays to Bangkok Bank the fact that a counterparty has been found. Here too, the New York Broker acts as an agent for a partially disclosed principal and does not reveal Citibank's identity to the Thai Broker.37 The Thai Broker repeats the terms of the transaction to Bangkok Bank. Bangkok Bank replies with the commonly used word—"mine"—to indicate its agreement to enter into a foreign exchange contract with the unknown counterparty. Bangkok Bank understands it has agreed to the sale of 5 billion yen against $49.5 million. Because Bangkok Bank does not yet know Citibank is its counterparty, it cannot ascertain the credit risk of the proposed deal.

The Thai Broker then calls the New York Broker to confirm the transaction, which does so with Citibank.38 At this juncture, a spot

37. The distinctions among a "disclosed," "partially disclosed," and "undisclosed" principal are as follows:
(1) If, at the time of a transaction conducted by an agent, the other party thereto has notice that the agent is acting for a principal and of the principal's identity, the principal is a disclosed principal.
(2) If the other party has notice that the agent is or may be acting for a principal but has no notice of the principal's identity, the principal for whom the agent is acting is a partially disclosed principal.
(3) If the other party has no notice that the agent is acting for a principal, the one for whom he acts is an undisclosed principal. RESTATEMENT OF AGENCY, supra note 8, at § 4 (emphasis supplied).
38. Ultimately, in many instances written confirmations of the terms of the spot deal are exchanged between the banks and their brokers, or between the
foreign exchange contract is formed.\textsuperscript{39} Furthermore, at this juncture, Citibank must find out the identity of its counterparty in order to record properly the transaction on Citibank's books and records and obtain settlement instructions for the delivery of $49.5 million on the value date.\textsuperscript{40} Bangkok Bank has the same need. Accordingly, the Thai and New York Brokers exchange the names of their principals and inform the respective principals of their counterparties. \textit{It is at this point that credit risk appraisal becomes possible.}

When the New York Broker tells its principal that its counterparty is Bangkok Bank, Citibank replies "fine." However, when the Thai Broker informs Bangkok Bank of the identity of the counterparty, Bangkok Bank balks. It replies with language sometimes heard in the global currency bazaar: "I can't do Citibank. I want a switch. Get me a new name." In other words, Bangkok Bank demands (1) to be released from the contract with Citibank and (2) a new counterparty to which to sell 5 billion yen at 101 yen per dollar. Bangkok Bank's demand for a switch of counterparties may arise for several reasons, one of which is its credit appraisal of Citibank.\textsuperscript{41} It forecasts that Citibank may be unable or unwilling to deliver 5 billion yen on the value date. Second, Bangkok Bank may have exhausted its trading limit for Citibank.\textsuperscript{42} Finally, Bangkok Bank may fear that completing the trade with Citibank would entail an unacceptably high level of Herstatt risk.\textsuperscript{43}

\textsuperscript{39} For a discussion considering the formation of spot foreign exchange contracts, see infra note 50.

\textsuperscript{40} Settlement instructions indicate the name of the counterparty's bank and the counterparty's bank account. The $49.5 million is delivered to the appropriate bank and account on the value date.

\textsuperscript{41} For a discussion of Herstatt risk, see supra note 7.

\textsuperscript{42} Like most banks, Bangkok Bank may have established for itself quantitative limits on the extent to which it will trade with particular banks. Such pre-established built-in trading limits are a credit risk management device. If not exceeded, the limits prevent undue exposure to a particular counterparty. Bangkok Bank's limit for Citibank already may be exhausted, or may be too small for a 5 billion yen transaction.

\textsuperscript{43} For a further discussion of Herstatt risk, see supra note 7. Bangkok Bank will be open for business before Citibank because of the time in Bangkok relative to New York. Accordingly, it will deliver 5 billion yen to the designated account of Citibank before Citibank delivers $49.5 million to Bangkok Bank's designated account. During the time gap between the yen and dollar deliveries, Bangkok Bank is exposed to Herstatt risk. If Citibank becomes insolvent or is closed by regulatory authorities before it is able to pay $49.5 million to Bangkok Bank, then Bangkok Bank will become a general unsecured creditor of Citibank. It is likely to receive the proverbial "ten cents on the dollar," or just $5 million.
Because of fierce competition among foreign exchange brokers for the business of dealing banks, the Thai Broker attempts to arrange a switch of counterparties for Bangkok Bank. Bangkok Bank notifies the New York Broker, which in turn notifies Citibank, that Bangkok Bank no longer wishes to perform the contract and will endeavor to find a new and acceptable counterparty. Bangkok Bank hopes that Fuji Bank eventually will agree to (1) buy 5 billion yen at 101 yen per dollar and (2) sell the yen to Citibank at the same rate. Bangkok Bank accepts Fuji Bank as its counterparty.

B. Reactions to the Attempt

Citibank may have one of three reactions to the switch of counterparties. First, it may assent to it and thus buy the yen from Fuji Bank in lieu of Bangkok Bank. This response is likely, if two conditions are satisfied: Fuji Bank represents an acceptable credit risk for Citibank; and the prevailing spot market rate remains at 101 yen per dollar between the time the transaction was initially proposed and the time Fuji Bank was proposed as a new counterparty.

However, if the acceptability condition is not satisfied, then a second reaction is likely. Citibank may insist that it has a contract with Bangkok Bank and refuse to agree to its removal from the deal.

44. Because the identities of the principals are known instantly in a direct dealing arrangement, the need to switch counterparties does not arise therein.

Even in a brokered transaction, it would appear that one alternative to switching would be for each bank principal to give its broker a list of counterparties with which the bank will not trade. However, this alternative raises two difficulties. First, it would be administratively cumbersome because the counterparties on each bank's list would change as trading limits and credit risk appraisals change. Every day, and perhaps several times a day, the names on the list might have to be changed.

Second, in some past instances where a bank has given a list of unacceptable counterparties to a foreign exchange broker, that broker has shared the list with other brokers and banks. The other brokers and banks sometimes accept the credit risk appraisal of the bank that prepared the list instead of doing their own analysis. The banks that appear on the shared list then find it difficult to trade at all. Ultimately, the brokers and banks who make decisions based on the list may be subject to antitrust liability for acting in a concerted way in refusing to deal with banks on the list. See, e.g., Sherman Act § 1, 15 U.S.C. § 1 (1994); RICHARD POSNER, ANTITRUST LAW 153-56 (1976) (discussing refusal to deal cases); RESTATEMENT OF FOREIGN RELATIONS LAW (regarding extraterritorial application of U.S. antitrust laws).

45. Fuji Bank is sometimes referred to as the "clearing bank" by market participants. See Letter from Lewis W. (Woody) Teel, Chairman, Foreign Exchange Committee, to foreign exchange market participants (Sept. 23, 1993) [hereinafter, Teel Letter], in ANNUAL REPORT 1993, supra note 25, at 23.
To be sure, it may be short-sighted for Citibank to attempt to disallow the switch. In a subsequent transaction it may be in Bangkok Bank's position and seek to avoid a bad credit risk. More generally, commercial parties may be repeat players with long-standing relationships. They may choose alternative dispute resolution mechanisms instead of litigation to preserve such relationships. Indeed, heretofore the players in the global currency bazaar have preferred direct negotiated settlements to lawsuits. In any event, insisting on performance of the original contract through litigation is an available strategy. Of course, this response would be problematical for the New York Broker. More seriously, litigation brought by Citibank to compel Bangkok Bank to honor the initial contract would be fraught with problems inherent in bringing suit in a foreign country, or enforcing a U.S. judgment in a foreign country, such as choice of law, choice of forum, and the like.

If the rate condition is not satisfied, then a third reaction is possible. Because of the short-term volatility of exchange rates, the dollar-yen spot rate may have changed from 101-100 to 100-99 yen per dollar. At a bid rate of 100 instead of 101 yen per dollar, Citibank must pay $50 million instead of $49.5 million for 5 billion yen. 46 Thus, Citibank may "stuff" the New York Broker with the transaction by insisting that the New York Broker persuade Fuji Bank (or some other counterparty) to deal with Citibank at the old, off-market rate of 101 yen per dollar. This response is problematical for the New York Broker because it may be difficult to persuade Fuji Bank to do so (or find another counterparty willing to do so). To induce a bank to enter into a spot contract at an off-market rate, it may be necessary for the New York Broker to bribe a trader at the bank. Such bribes, known as "points," may take the form of cash, cars, or cocaine and obviously raise ethical and legal problems—yet, they are not uncommon in the global currency bazaar. 47

46. The exact figures are $49,019,607.84 and $49,504,950.50, respectively.
47. Points have attracted the attention of government regulators such as the Federal Reserve Bank of New York. Acting through the New York Foreign Exchange Committee, it has issued several warnings to foreign exchange market participants against the use of points. THE FOREIGN EXCHANGE COMMITTEE, ANNUAL REPORT 5-6 (1991); THE FOREIGN EXCHANGE COMMITTEE, ANNUAL REPORT 28 (1990) [hereinafter, ANNUAL REPORT 1990]; FEDERAL RESERVE BANK OF NEW YORK, POLICY STATEMENT ON THE USE OF "POINTS" IN SETTLING FOREIGN EXCHANGE CONTRACTS (Aug. 1, 1989), in ANNUAL REPORT 28 (1990); THE FOREIGN EXCHANGE COMMITTEE, ANNUAL REPORT 4-6, 15-17, 23 (1989), [hereinafter, ANNUAL REPORT 1989]; Margaret L. Greene, Federal Reserve Bank of New York, Remarks on the Practice of Points in the Brokered Foreign Exchange Market, Address at the Forex USA, Inc. Senior Dealers' Seminar (Nov. 9-11, 1989), in ANNUAL REPORT 1989,
Which response from Citibank is appropriate depends on the legal foundation for the attempted switch of counterparties. If by means of a switch the Bangkok Bank-Citibank contract is rescinded and a new Bangkok Bank-Fuji Bank contract is formed, then assenting to the substitution of counterparties is appropriate. If there is no legal basis for a switch, then Citibank is entitled to reject the purported substitution of counterparties and insist on performance of the original contract, or to stuff the Thai Broker with the terms of the original transaction. Uncertainty about the legal foundation for switches creates uncertainty about which response is appropriate. In turn, the ability of Bangkok Bank and Citibank to regulate their credit risk exposure through switches is uncertain.

C. Regulatory Concerns About Switches

Government regulators, most notably the Federal Reserve, have expressed concern about the practice of switches on three grounds.

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supra, at 18-22; THE FOREIGN EXCHANGE COMMITTEE, ANNUAL REPORT 6-8, 22-36 (1988) [hereinafter, ANNUAL REPORT 1988]. Nevertheless, anecdotal evidence suggests that the payment of points continues. Moreover, the Bank of England expressly authorizes such payment among participants in London so long as adequate disclosures are made. BANK OF ENGLAND, THE LONDON CODE OF CONDUCT ¶ 88-89 (May 1992); ANNUAL REPORT 1989, supra, at 6.

48. Of course, without Citibank's assent, Bangkok Bank remains liable for Citibank's performance. See infra notes 176-78 and accompanying text.

49. If switches lack a well-founded legal basis, then Citibank knows it is impossible to obtain a new counterparty without the consent of the initial counterparty (here, Bangkok Bank) after the words "yours" or "mine" are uttered. Instead of switching counterparties, one means of managing credit risk exposure would be to defer the moment of contract formation. Accordingly, Citibank could postpone the moment of contract formation by attempting to defer the utterance of these terms until after it undertakes a credit risk appraisal of prospective counterparties.

This proposed solution poses two problems. First, it presumes Citibank knows or can ascertain the identity of the prospective counterparties. As indicated above, those counterparties may prefer to act as partially disclosed principals for as long as possible. See supra notes 23-27 and accompanying text. Second, deferring contract formation is undesirable because it means fewer wealth-generating brokered foreign exchange transactions are consummated.

50. Acting through the Foreign Exchange Committee, the Federal Reserve has caused a number of pronouncements about switches to be issued. See Teel Letter, supra note 45, at 23.

Contract formation is a fourth concern raised by the Federal Reserve. At various meetings of the Foreign Exchange Committee and its subcommittees, the Federal Reserve has asked whether in a case like the one illustrated above, a contract exists between the two initial bank principals.

On this point the Federal Reserve creates unnecessary confusion. Regard-
First, finding a substitute counterparty like Fuji Bank with which to consummate a new foreign exchange contract may take several hours. The Federal Reserve does not like a bank in the position of Bangkok Bank or Citibank to have an “open” foreign exchange position for an extended period of time. This position generates uncertainty as to the precise credit risk to which a bank is exposed and, in turn, is a catalyst for disputes if the bank fails or is closed while the position remains open. Second, because of exchange rate volatility,
a switched transaction may be executed at an off-market rate.\textsuperscript{52} The longer it takes to find a new counterparty, the more likely the exchange rate will change from the rate that had been agreed to in the initial contract that is the subject of the switch. Therefore, it will be difficult to consummate a new contract at the rate that had been established for the initial contract.\textsuperscript{53} Third, record-keeping associated with switches may be poor. Consequently, switches may be arranged by an individual foreign exchange trader without the knowledge of her senior management at the trader's bank.\textsuperscript{54} In effect, the trader may circumvent trading controls, like limits, or even defraud her own bank.

This Federal Reserve approach is unfortunate. It circumscribes the potential for trade usages to serve as a self-regulatory device. It may chill future innovations in trade usages. The five-minute right of rescission usage proposed below is designed to address the Federal Reserve's concerns.\textsuperscript{55}

\textsuperscript{52} For example, the Bangkok Bank-Fuji Bank transaction may be executed at a rate other than 101 yen per dollar, which is the prevailing market rate.

\textsuperscript{53} See text accompanying infra notes 46-47.

\textsuperscript{54} These concerns are evinced in the Federal Reserve's pronouncements (made through the Foreign Exchange Committee) about switches:

In recent [Foreign Exchange] Committee discussions . . . members have concluded that, while name substitution may enhance the efficiency of the brokered foreign exchange market, such transactions can entail risks that may undermine the sound operation of the foreign exchange market. Exchange rates continue to move between the time that a counterparty is rejected and the time that an acceptable clearing institution [i.e., substitute counterparty] is identified. As a result, switched transactions will usually be executed at rates not currently being quoted in the market and, therefore, must be treated with the same care as any off-market rate transaction. While in some cases the period between counterparty rejection and identification of an acceptable clearing institution may be only a few minutes, in other cases this period may extend to several hours. In addition, because name substitutions as currently arranged are an accommodation between traders and brokers and are not normally reflected as switches in the records of the institutions involved, they are sometimes accomplished without the knowledge or approval of management.

Teel Letter, supra note 45, at 23.

\textsuperscript{55} See infra IV.C.
D. Assumptions About Governing Law

Part of the reason for uncertainty about the legal foundation for switches is doubt about the legal regime that governs the performance of foreign exchange contract obligations. For two reasons, it is tempting to ignore the issue of governing law. First, the thesis of this article concerns self-regulation in a global market through reinvigorated usages of trade. Electronic commerce creates global markets which, by definition, transcend parochial jurisdictional boundaries. If trade usage is the governing "law," then choice of law questions are irrelevant.

There is no doubt that trade usages are a close substitute for cross-border law in a world in which there are few instances of multi-jurisdictional law. Indeed, this fact is perhaps the most persuasive reason for relying on trade usages in our increasingly global economy. Presently, trade usages may be the best means for achieving harmonization of rules. However, a "meta-law" is needed to provide a source of authority for trade usages, i.e., to condone their very use as a self-regulatory device. It is the meta-law situated behind and transcending trade usages that provides them with an irreducible minimum foundation.

Second, if Article 1 of the U.C.C. is that meta-law, then why not at least ignore other Articles of the U.C.C.? After all, the thesis concerns Section 1-205, hence the outcome of the current controversy about whether Article 2 or 4A governs a foreign exchange transaction should be immaterial.\(^\text{56}\) To this suggestion the response must be that two severe repercussions follow from ignoring the problem of what law governs a global electronic market. First, the resolution of specific legal issues may differ depending on the applicable law. The potential for different outcomes creates uncertainty for market participants. Second, where the resolutions to an issue are the same regardless of the law applied, courts may be complacent and neglect to establish clearly the rationale for their choice of law. This complacency will generate sloppy commercial law jurisprudence that haunts future litigants and judges involved in cases where different results would be obtained depending on the applicable law. The lack of clear precedent on choice of law will cause uncertainty in such cases.

\(^{56}\) See Bhala, supra note 5; Stephen C. Veltri, Should Foreign Exchange Be "Foreign" to Article Two of the Uniform Commercial Code?, 27 CORNELL INT'L L.J. 343 (1994); Letter from Thomas C. Baxter, Jr., Chairman, American Bar Association Subcommittee on Payments, to Members of the Subcommittee, and attached proposal (Oct. 4, 1994) (on file with author).
Thus, the problem of governing law must be addressed in some manner. A threshold choice of law question in the case study is whether U.S. or Thai law governs. It is assumed that U.S. law governs simply because analyzing the implication of the alternative is beyond the scope of this article. Yet, this assumption hardly ends the matter. Insofar as foreign exchange is a "good" as that term is defined in Section 2-105(1) of the U.C.C., Article 2 applies. If Article 2 is inapplicable, then Article 4A may govern the performance obligations and, in addition, the common law of contract may apply.

Elsewhere I have argued that the scope of application of Article 2 with respect to foreign exchange transactions should be determined on pragmatic grounds.57 For present purposes, I assume that Article 2 applies to the Bangkok Bank-Citibank dollar-yen transaction and attempted switch. In the short term, this assumption is realistic for two reasons. First, the players in the global currency bazaar tend to choose well-developed bodies of law—namely, New York or English law—to govern their transactions.58 Second, already U.S. courts have applied Article 2 to foreign exchange transactions.59 Future applications at least by analogy may be expected because courts are wont to apply familiar law in unfamiliar contexts.

In the long term, three factors are likely to affect the applicability of Article 2 to foreign exchange transactions. First, courts may find that such application has undesirable consequences. One example concerns a seller’s right of reclamation under Section 2-702(2).60 Arguably, this right conflicts with the receiver finality rule set forth in Section 4A-405(c).61 In addition, reclamation could allow a creditor of a failed bank to circumvent a foreign insolvency proceeding.62

58. The choice of law clause in the International Foreign Exchange Master Agreement, a master standard-form contract recently developed by the Foreign Exchange Committee for spot and forward contracts, is an example. See International Foreign Exchange Master Agreement, Section 9.1 in THE FOREIGN EXCHANGE COMMITTEE, ANNUAL REPORT 49 (1993). A forward contract is one whose value date is longer than T 2. See supra note 23.
60. This Section allows a seller to reclaim goods upon demand within ten days after the seller discovers that the buyer has received goods on credit while insolvent.
61. See Bhala, supra note 5, at 18, n. 74. Receiver finality means that a credit of funds to the bank account of the beneficiary of a funds transfer is final and irrevocable. Any credit contingent on the beneficiary’s bank receiving settlement from the bank which sent it a payment order is unenforceable.
62. See Koreag, 961 F.2d at 355-58. In Koreag, a failed bank, Middle East Bank Corporation (MeBCo) was the subject of a Swiss insolvency proceeding. One of
Finally, reclamation could undermine regulatory efforts to develop systems for netting foreign currency delivery obligations between its creditors was Refco, with which Mebco had entered into foreign exchange contracts. The court recognized Refco's Section 2-702(2) right to reclaim currency delivered to Mebco. Hence, Refco did not have to obtain recovery through a foreign insolvency proceeding. *Id.*

In general, because the seller has ten days to recover foreign currency delivered to an insolvent buyer, the seller in effect is a preferred creditor for that period. By reclaiming the currency within the designated period, the seller need not make a claim through the insolvency proceeding to which the insolvent buyer is subject.

However, this potentially adverse consequence should not be overstated. Section 2-702(2) applies only where the delivery satisfied two conditions: it is made (1) on credit and (2) to a buyer who is insolvent. The presumption is that if these conditions are satisfied, the buyer has fraudulently misrepresented its financial condition to the seller. See Section 2-702 cmt. 2.

Arguably, neither of these conditions is satisfied, and the court in *Koreag* misapplied the law. First, it is difficult to see why a spot foreign exchange transaction involves an extension of credit. In the transaction, one bank's delivery of currency is not made on credit but rather in consideration of a reciprocal delivery on the same value date. Second, it is difficult to imagine an onslaught of cases involving deliveries of foreign currencies to insolvent bank buyers. In the global currency bazaar, banks generally are (or should be) well aware of the credit standing of other banks and, therefore, are unlikely to deliver currencies to failed banks.

63. "Netting" refers to "an agreed offsetting of positions or obligations by trading partners or participants. The netting reduces a large number of individual positions or obligations to a smaller number of obligations or positions." COMMITTEE ON PAYMENT AND SETTLEMENT SYSTEMS OF THE CENTRAL BANKS OF THE GROUP OF TEN COUNTRIES, BANK FOR INTERNATIONAL SETTLEMENTS, PAYMENT SYSTEMS IN THE GROUP OF TEN COUNTRIES 541 (Dec. 1993) [hereinafter, PAYMENT SYSTEMS]. See also Ebo A. Coleman, *Netting A Red Herring*, in 9 BUTTERWORTHS J. INT'L BANKING & FIN. L. 391 (1994); Stephen J. Phillips and Brian W.J. Rutherford, *Netting — The Shape of Things to Come*, in 9 BUTTERWORTHS J. INT'L BANKING & FIN. L. 174 (1994).

In a bilateral netting system for foreign exchange obligations, delivery obligations for the same currency denominations and value dates are netted between two trading parties where the parties have entered into two or more foreign exchange contracts. Presently, FXNET, "a limited partnership formed under English law and owned by the UK subsidiaries of twelve major banks," is the leading system for the bilateral netting of currency obligations arising from spot and forward foreign exchange contracts.

In a multilateral netting scheme, three or more foreign exchange traders net their delivery obligations for the same currency types and value dates. This netting is accomplished through parties known as settling participants which settle "(typically by means of a single payment or receipt) the multilateral net settlement position which results from transfers made and received by it, for its own account and on behalf of its customers or non-settling participants for which it is acting." PAYMENT SYSTEMS, *supra*, at 540. Presently, there is no scheme for netting currency obligations multilaterally. However, a group of international banks are develop-
ing the Exchange Clearing House Organization (ECHO) to net spot and forward foreign exchange contracts on a multilateral basis through a central clearing house located in London. PAYMENT SYSTEMS, supra, at 498. In addition, Multinet, developed by eight U.S. and Canadian commercial and investment banks, is a bilateral netting facility that should be operational in early 1995. Multinet is designed to accommodate multilateral netting. PAYMENT SYSTEMS, supra, at 497. See Steven Lipin, Eight Banks form Clearinghouse to Cut Cost of Foreign-Exchange Transactions, WALL ST. J., Aug. 1, 1994, at A2; Laurie Morse, Group plans clearing house for forex trades, FIN. TIMES, July 28, 1994, at 17. The Clearing House Interbank Payments System (CHIPS), owned and operated by the New York Clearing House Association, is a multilateral netting system for dollar payments which handles a large number of payment instructions arising from foreign exchange transactions. PAYMENT SYSTEMS, supra, at 449-50.

Bilateral and multilateral netting schemes potentially reduce the amounts of foreign currency that each party needs to deliver to the other, and the number of deliveries that must be made. Invariably, such deliveries are made by wire transfer. See Bhala, supra note 18, at 373-75. Bilateral netting can result in a 50 percent reduction in the value and volume of wire transfers, and multilateral netting can result in a reduction of 80 percent, from what would be needed for gross settlement. BANK FOR INTERNATIONAL SETTLEMENTS, REPORT OF THE COMMITTEE ON INTERBANK NETTING SCHEMES OF THE CENTRAL BANKS OF THE GROUP OF TEN COUNTRIES, ¶ 2.4 at 11, 2.12 at 13 (Nov. 1990). As a result of such reductions, systemic risk — the risk that a failure by one party to settle its payment obligations will lead to financial difficulties for and (possibly) failures of other parties that expected settlement from the failed party, and ultimately (perhaps) a market meltdown — is lowered.

64. As indicated above, the right of reclamation allows the seller of a foreign currency to reclaim that currency for ten days after the date the currency was delivered to the insolvent buyer. See U.C.C. § 2-702(2). Reclamation would require unwinding a net payment made by the seller to the buyer and reinstating the gross payment obligations, thereby undermining the netting system. However, this unwind — while perhaps administratively complex —is not inconceivable. U.C.C. Section 4A-405(e) condones an unwind of payment obligations made by wire transfer pursuant to a multilateral netting scheme (such as CHIPS) whose loss-sharing arrangement has failed to produce a final settlement. Id. § 4A-405. In other words, the law already specifies an important exception to the receiver finality rule of Section 4A-405(c) for multilateral netting systems.

More seriously, there is a practical distinction between a netting system, on the one hand, and a real-time gross settlement system (in which no netting occurs and payment orders are issued, received, and accepted or rejected in real time), on the other hand, with respect to the time at which receiver finality is achieved. In many instances, receiver finality in a funds transfer through a real-time, gross settlement system is achieved as soon as a credit is entered by the beneficiary's bank to the account of the beneficiary (which is maintained at the beneficiary's bank). See id. § 4A-404(a) (explaining that a beneficiary's bank is obligated to pay the beneficiary when the bank accepts a payment order), 4A-209(b) (defining when a beneficiary's bank accepts a payment order). In contrast, receiver finality cannot be guaranteed in a multilateral net settlement system until net net settlement payments (i.e., payments from net net debtors to net net creditors) are
Another example concerns the Section 2-201 statute of frauds. Elsewhere I have argued that the statute of frauds does not serve the needs of the players in the global currency bazaar because it calls into question the enforceability of their agreements. The players in the global currency bazaar do not necessarily write down their expectations, as the above case study illustrates. This fact makes the argument for self-regulation through trade usages even more compelling. In any event, Section 2-201 should be modified or deleted through the current Article 2 revision process. While the August 1994 revised draft of Article 2 wisely abolishes the statute of frauds, it could be reinstated as either a hub or spoke provision at the insistence of various interest groups such as the computer software industry. To eschew the issue of enforceability herein, it is assumed that a final decision is made to exclude the statute of frauds and that state legislatures enact Article 2 accordingly.

Second, the outcome of the Article 2 revision process is uncertain. As proposed in August 1994, the revisions to Article 2 have no effect on the argument in this article. No substantive changes have been suggested to the two principal provisions of Article 2 discussed below, Sections 2-210 and 2-609. However, a proposal has been offered regarding Section 2-102(a)(23) to expressly exclude foreign exchange from the definition of a "good." If this proposal were adopted, then the common law of contract—assuming the United Nations Convention on Contracts for the International Sale of Goods (C.I.S.G.) were inapplicable—would govern foreign exchange trans-

made through that system. Such payments occur at the end of the funds transfer business day. Only after such settlement occurs is it clear that the unwind scenario contemplated by Section 4A-405(e) will not occur. Id. § 4A-405. Thus, the Federal Reserve's concern that reclamation will undermine the development of netting systems must be tempered by the fact that receiver finality on such systems occurs in a qualified and deferred manner.

65. See Bhala, supra note 5, at 4-5, 24-52.
67. See infra IV.A.
68. See infra IV.B. Note that the American Bar Association Article 1 Task Force has proposed moving Section 2-208 (concerning course of performance) into Section 1-205 which, if done, would necessitate conforming amendments to Section 1-205.
69. By "common law" it is meant the law encapsulated in the Restatement, supra note 50.
actions. Of course, some courts still might look to Article 2 by analogy.

Third, regardless of the outcome of the Article 2 revision process, courts might apply the C.I.S.G.—which entered into force on January 1, 1988—to foreign exchange transactions. The application of the


Note that the C.I.S.G. does not contain a statute of frauds. To the contrary, it ensures the enforceability of oral contracts. See C.I.S.G. Article 11; THE CONVENTION, supra note 50, at 31. Note also that contracting states with a statute of frauds are permitted to take a reservation to Article 11, but the U.S. has not taken such a reservation. See C.I.S.G. Articles 12, 96; THE CONVENTION, supra note 50, at 31, 57.

71. Because of the similarity of the common law and Article 2 on the key issues discussed herein, application of the common law would have little effect on the argument. See infra notes 77, 95 (comparing Section 1-205 and Restatement Sections 219-222), 176-78 and accompanying text (comparing Section 2-210 and RESTATEMENT Section 317-320), 192 (comparing Section 2-609 and RESTATEMENT Section 251).


72. Because Thailand has not joined the C.I.S.G., and because of the U.S. reservation to Article 1(1)(b), the C.I.S.G. cannot apply to the case study. See United Nations Fax, supra note 70. While Article 1(1)(b) allows for the application of the C.I.S.G. when only one of the involved countries has joined if relevant choice of law rules would dictate such application, the U.S. has taken a reservation to this provision pursuant to Article 95. See THE CONVENTION, supra note 50, at 71.
C.I.S.G. in the foreign exchange context has not yet been tested.\textsuperscript{73} It is clear that the C.I.S.G. applies to a contract for the sale of goods between parties located in different countries if the countries have ratified or acceded to the C.I.S.G.\textsuperscript{74} But, to apply the C.I.S.G., a court must determine that foreign exchange is a "good" under Article 1(1),\textsuperscript{75} and that the C.I.S.G. governs notwithstanding the statement in Article 2(d) that it is inapplicable to sales of money. The outcome of the debate on this issue in the context of Article 2 could influence the outcome in the C.I.S.G. context. A vexing choice of law problem could arise if foreign exchange is considered a "good" under both laws.\textsuperscript{76}


One solution to the problem of defining the scope of the C.I.S.G. is to apply the pragmatic strategy I have suggested elsewhere, \textit{i.e.}, to make use of the same test proposed for determining the scope of Article 2. See Bhala, \textit{supra} note 5, at 4-6, 52-53.

\textsuperscript{74} See C.I.S.G. Article 1(1)(a).

\textsuperscript{75} The C.I.S.G. does not define the term "good."

\textsuperscript{76} One factor in determining whether Article 2 or the C.I.S.G. would apply is a choice of law (if any) made by the parties. Article 6 of the C.I.S.G. allows the parties to choose to exclude the application of the C.I.S.G. Thus, for example, parties could elect not to apply the C.I.S.G. by signing the International Foreign Exchange Master Agreement and expressly choosing New York (or English) law as applicable. An interesting question is whether a court would consider the choice of New York law to be a trade usage in a case where the parties had not signed this Agreement.

A second factor is whether the countries in which the bank principals are located have ratified or acceded to the C.I.S.G. This factor raises thorny questions about the location of bank principals which are treated in Article 10 of the C.I.S.G.
IV. THE NARROW ROLE FOR TRADE USAGES: INTERPRETIVE DEVICE

Ostensibly, it is not problematic for players in the global currency bazaar to regulate their credit risk uncertainties through a practice like switches. This practice should qualify as a "usage of trade" under Section 1-205. Unfortunately, however, usages often are cast in a narrow role thereby rendering them less efficacious than first thought. What foreign exchange market participants require is not just the establishment of switches as a trade usage, but also the reinvigoration of the very concept of a usage.

A. The Brooding Omnipresence

Pervasive direct and indirect references to the term "usage of trade" are found in Article 2. The definition of "usage of trade" in Section 1-205(2) is expansive, and the term is used in various pro-

77. Section 1-205(2) states that:
A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court.
U.C.C. § 1-205(2).

The RESTATEMENT definition of "usage of trade" closely resembles that in Section 1-205(2):
A usage of trade is a usage having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to a particular agreement. It may include a system of rules regularly observed even though particular rules are changed from time to time.
RESTATEMENT, supra note 50, at Section 222(1). See also id. at § 219 (defining "usage").

Like Section 1-205(2), Section 222(2) of the RESTATEMENT provides that the existence and scope of a usage of trade are questions of fact, and if it is embodied in a written trade code, then its interpretation is to be determined by a court. Section 222(3) of the RESTATEMENT indicates that a usage of trade of which the parties know or have reason to know may supplement or qualify an agreement. The "supplement or qualify" language is repeated in Section 1-205(3). While no knowledge test is set forth in Section 1-205, local usages of trade are dealt with in Section 1-205(5). See id. at § 222, cmt. c.

One distinction between the U.C.C. and RESTATEMENT definition pertains to the term "usage." Unlike the U.C.C., the RESTATEMENT distinguishes between a "usage" and "usage of trade" and defines the latter as a species of the former. A "usage," defined in Section 219, is a generic term encompassing any "habitual or customary practice." See infra note 95.

The C.I.S.G. does not contain the term "usage of trade." Rather, it distin-
visions of Article 2. Moreover, the term is contained in the definition of "agreement" in Section 1-201(3), which in turn is used in several provisions of Article 2. Also, the definition of "contract" in Section 1-201(11) incorporates the term "agreement" and, therefore, "trade usages." Not surprisingly "contract" is used throughout Article 2. Finally, Section 1-102(1) specifies that the U.C.C. should be "lib-

guishes between two types of "usages." First, Article 9(1) of the C.I.S.G. indicates that "[t]he parties are bound by any usage to which they have agreed. . ." See CONVENTION, supra note 50, at 31. Second, Article 9(2) provides that unless otherwise agreed, "[t]he parties are considered . . . to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned." See CONVENTION, supra note 50, at 31.

One reason Article 9 of the C.I.S.G is less satisfactory than U.C.C. Section 1-205 is that no definition of "usage" is provided in the C.I.S.G. A second problem is that it is not clear whether parties might agree to a usage by means other than express contractual agreement. See infra note 95.

78. See U.C.C. §§ 2-202 (parol evidence rule), 2-316 (exclusion or modification of warranties), 2-504 (shipment by seller), 2-723 (1991) (proof of market price).

79. Section 1-201(3) states: "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances including the course of dealing or usage of trade or course of performance as provided in this Act (Sections 1-205 and 2-208).

U.C.C. § 1-201(3) (1993) (Emphasis supplied.) "Agreement" is used in Sections 2-106 (definitions), 2-202 (parol evidence rule), 2-204 (formation in general), 2-209 (modification, rescission and waiver), 2-303 (allocation of risks), 2-305 (open price term), 2-311 (options and cooperation respecting performance), 2-718 (liquidation or limitation of damages), and 2-719 (contractual modification or limitation of remedy).

80. See U.C.C. §§ 2-106, 2-107 (goods to be severed from realty), 2-201 (statute of frauds), 2-203 (seals inoperative), 2-204, 2-206 (offer and acceptance), 2-207 (additional terms in acceptance or confirmation), 2-208 (course of performance), 2-209, 2-210 (assignment and delegation), 2-301 (general obligations of the parties), 2-302 (unconscionability), 2-305, 2-306 (output and requirements contracts), 2-207 (delivery in single lot), 2-308 (place of delivery), 2-309 (time of delivery and performance), 2-311, 2-312 (warranty of title and infringement), 2-314 (implied warranties of merchantability and usage of trade), 2-321 (CIF and C&F contracts), 2-326 (sale on approval, sale or return, and consignment sales), 2-327 (special incidents of sale on approval and sale or return), 2-401 (passing of title), 2-402 (rights of seller's creditors against unsold goods), 2-501 (insurable interest in goods), 2-502 (buyer's right to goods on seller's insolvency), 2-503 (seller's tender of delivery), 2-504 (shipment by seller), 2-505 (seller's shipment under reservation), 2-509 (risk of loss), 2-510 (effect of breach on risk of loss), 2-512 (payment before inspection), 2-513 (buyer's right of inspection), 2-601 (buyer's rights on improper delivery), 2-607 (effect of acceptance), 2-609 (adequate assurance of performance), 2-610 (anticipatory repudiation), 2-611 (retraction of anticipatory repudiation), 2-612 (installment contracts), 2-613 (casualty to identified goods), 2-615 (excuse), 2-616 (notice claim-
erally construed and applied to promote its underlying purposes and policies.” One such purpose and policy is “to permit the continued expansion of commercial practices through . . . usage . . . of the parties.”

While “usage of trade” is a brooding omnipresence in Article 2, the role typically played by usages in commercial litigation is narrowly confined to that of an interpretive or translation device. A review of recent trade usage cases indicates that Section 1-205 usually is implicated when there is a dispute as to the interpretation of one or more of the terms of a contract. One litigant proposes to define the term according to a trade usage, while the other litigant opposes the use of the usage to interpret the contract, or disputes the existence of the usage. In such cases, the court views the trade usage as noth-

81. Id. § 1-102(2)(b).

82. The distinction between a usage of trade serving as a translation versus additional device is discussed in Note, Custom and Trade Usage: Its Application to Commercial Dealings and the Common Law, 55 COLUM. L. REV. 1192, 1195-98 (1955). As used herein, “interpretation” is meant to capture two processes: ascertaining the meaning of the parties expressed in a contractual term, and giving legal effect to the words used. The latter process is sometimes referred to as “construction” and “(t)he construction placed upon an agreement will not necessarily coincide with the meaning of the parties (footnote omitted).” See J. CALAMARI AND J. PERILLO, CONTRACTS 165 (3d ed. 1987) [hereinafter, CALAMARI & PERILLO].


Often Section 1-205 operates in tandem with the parol evidence rule of Section 2-202. Usage of trade is mentioned in the latter provision, which provides that where a dispute arises as to the interpretation of the terms contained in confirmatory memoranda or a final agreement, a commercial party may explain or supplement the writing with a trade usage. See, e.g., Edwards v. Kent Rentals, Inc., Civ. Ac. No. 83C-OC10, 1989 Del. Super. LEXIS 373, at *14 (Sup. Ct. Del., Sept. 20, 1989) (concerning a dispute as to the usage of trade in a contract for
ing more than a source of meaning in the absence of an express contractual provision and finds it inconceivable that a usage could be a source of obligation for market participants. Indeed, even distinguished commentators circumscribe the role of a trade usage to that of interpretive device.

B. Reasons for the Narrow Role

1. Austinian Positivism

Vestiges of Austinian positivism may account for the narrow role. This jurisprudence suggests that a trade usage cannot be "law." To be sure, the usage is habitually followed, and traders

setting up a mobile home); Conmar Intl. Trading Corp. v. Wearever-Proctor Silex Corp., No. 86 Civ 8691, 1987 U.S. Dist. LEXIS 5328, at *8-9 (S.D.N.Y. June 19, 1987) (indicating that evidence of usage of trade, if it exists, is admissible to explain or supplement terms in the written memoranda or final agreement of the parties); U.S. Industries, Inc. v. Semco Manufacturing, Inc., 562 F.2d 1051, 1068-69 (8th Cir. 1977) (concerning a dispute about the term for delivery and the interpretation of "as released" in a contract to furnish ductwork); and Blue Rock Indus. v. Raymond Intl., Inc., 325 A.2d 66, 73-76 (Me. Sup. Jud. Ct. 1974) (concerning a dispute about the term "truck measured" cubic yard in a contract for sand). See also E. FARNSWORTH, CONTRACTS 509 (1982). Because the Bangkok Bank - Citibank contract is oral, this line of cases is irrelevant.

84. See, e.g., Latex Glove Co. v. Gruen, 497 N.E.2d 466 (Ill. App. Ct. 1986) (stating that a usage of trade can fill gaps in a contract but not create "a new obligation for [the delivery of] separate goods").

85. See, e.g., Elizabeth Warren, Trade Usage and Parties in the Trade: An Economic Rationale for an Inflexible Rule, 42 U. PITT. L. REV. 515, 516, 545-46, 580 (1981) (discussing a usage of trade only as a basis for interpreting a contractual term); Roger W. Kirst, Usage of Trade and Course of Dealing: Subversion of the UCC Theory, 1977 U.I.L.L. L.F. 811, 815 1977) (discussing the introduction of a usage of trade to define a term in a written agreement or establish an additional term); Joseph H. Levie, Trade Usage and Custom Under the Common Law and the Uniform Commercial Code, 40 N.Y.U. L. REV. 1101, 1107 (1965) (stating that the U.C.C. "views trade usage as a way of determining the parties' probable intent" and "does not consider it an independent source of obligation or authority. . . ."). Note that Chen appears to take a somewhat broader approach to trade usages than the aforementioned commentators. See Jim C. Chen, Code, Custom, and Contract: The Uniform Commercial Code as Law Merchant, 27 TEX. INT'L L.J. 91, 111-17 (1992) (stating that "[t]rade usage assumes three roles in contractual interpretation: (1) to define jargon, clarify ambiguities, and explain technical terms; (2) to add terms to the agreement; and (3) to allow commercial meanings to control contrary lay definitions" (footnote omitted)). See also 1 STATE OF NEW YORK LAW REVISION COMMISSION REPORT — STUDY OF THE UNIFORM COMMERCIAL CODE, 14-15, 79-80 (1955) (hereinafter, N.Y. LAW REVISION COMMISSION STUDY) (stating that Section 1-205 "is intended to provide for the introduction in evidence . . . of trade usages, as aids in the interpretation of contracts and other transactions within the scope of the [Uniform Commercial] Code. . . .") (emphasis supplied).

86. See John Austin, The Province of Jurisprudence Determined (1832), in
may treat it as if it were binding on them. But, a trade usage lacks the imprimatur of a sovereign whose commands are backed by threats of punishment. 87

By many of the admirers of customary laws . . . they are thought to oblige legally (independently of the sovereign or state), because the citizens or subjects have observed or kept them. Agreeably to this opinion, they are not the creatures of the sovereign or state, although the sovereign or state may abolish them at pleasure. Agreeably to this opinion, they are positive law . . . inasmuch as they are enforced by the courts of justice: But, not withstanding, they exist as positive law by the spontaneous adoption of the governed, and not by position or establishment on the part of political superiors. Consequently, customary laws, considered as positive law, are not commands. And, consequently, customary laws, considered as positive law, are not laws or rules properly so called. . . .

At its origin, a custom is a rule of conduct which the governed observe spontaneously, or not in pursuance of a law set by a political superior. The custom is transmuted into positive law, when it is adopted as such by the courts of justice, and when the judicial decisions fashioned upon it are enforced by the power of the state. But before it is adopted by the courts, and clothed with the legal sanction, it is merely a rule of positive morality: a rule generally observed by the citizens or subjects; but deriving the only force, which it can be said to

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87. AUSTIN, supra note 86, at 338. See also BERNARD SCHWARTZ, MAIN CURRENTS IN AMERICAN LEGAL THOUGHT 339-40 (1993) (discussing the imperative character of Austinian doctrine); HARRIS, supra note 85, at 32 (stating that "Austins defines the sovereign as a person or body of persons who receives habitual obedience within a political society . . . and who renders habitual obedience to no one else" and that "[l]aw are defined as the sovereign's general commands.").
possess, from the general disapprobation falling on those who transgress it.\textsuperscript{88}

At best, Austinian positivists might concede that Section 1-205 is a conditional command subject to the force of nullity.\textsuperscript{89} If foreign exchange traders want to develop a trade usage, then they must comply with Section 1-205, or the practice will not be a usage. However, this argument bespeaks a parsimonious approach to what law is, and a greater concession is required. Even in an Austinian context it can be argued that Section 1-205 is positive law because it is an enforceable command issued by a sovereign (namely, a state legislature).\textsuperscript{90} While Section 1-205 does not specifically identify usages like switches, this generality should not bar their recognition as positive law.

The argument that usages are law pursuant to Section 1-205 is even stronger when H.L.A. Hart's critique of Austinian positivism is considered. First, formal enactment by a sovereign is not the only way to create law.\textsuperscript{91} Thus, a particular trade usage like switches need not obtain the sovereign's imprimatur to be law. Second, and more fundamentally, many laws are power-conferring rules that enable private parties to engage in certain practices and thereby regulate themselves.\textsuperscript{92}

\begin{itemize}
\item \textsuperscript{88} \textit{Austin, supra} note 86, at 342. \textit{See also} H.L.A. \textit{Hart, The Concept of Law} 24-25 (1961) (stating that Austin's command theory requires "some persons or body of persons issuing general orders backed by threats which are generally obeyed, and it must be generally believed that these threats are likely to be implemented in the event of disobedience").
\item Under the Austinian approach, it also might be argued that a usage of trade is not a command because it lacks generality (it is addressed only to foreign exchange traders, for example) as well as a sanction. \textit{See Harris, supra} note 86, at 28 (noting that for Austin every command that is a law has the feature of generality); \textit{Hart, supra}, at 21 (stating that legal control involves general directions).
\item \textsuperscript{89} \textit{See Harris, supra} note 86, at 30.
\item While Austin's command theory implies a personal sovereign (e.g., a king or President), in fact Austin looked to the Constitution to identify the sovereign. He concluded that the sovereign was the "combined members of the electors of all the states' governments" because the states had the power to change the Constitution. \textit{See Harris, supra} note 86, at 33.
\item \textsuperscript{90} \textit{See Hart, supra} note 88, at 26 (stating that "[s]urely not all laws are enacted nor are they the expression of someone else's desire. . . ."), 43-48 (arguing that the legal status of custom is not based on judicial enforcement of that custom).
\item \textsuperscript{92} \textit{See Hart, supra} note 88, at 26 (stating that "[s]urely not all laws order people to do or not do things" and that some laws "confer powers on private individuals to make wills, contracts, or marriages. . . ."). \textit{See also Harris, supra} note
\end{itemize}
[T]here are important classes of law where this analogy with orders backed by threats altogether fails, since they perform a quite different social function. Legal rules defining the ways in which valid contracts or wills or marriages are made do not require persons to act in certain ways whether they wish to or not. Such laws do not impose duties or obligations. Instead, they provide individuals with facilities for realizing their wishes, by conferring legal powers upon them to create, by certain specified procedures and subject to certain conditions, structures of rights and duties within the coercive framework of the law.

The power thus conferred on individuals to mould their legal relations with others by contracts, wills, marriages, &c., is one of the great contributions of law to social life; and it is a feature of law obscured by representing all law as a matter of orders backed by threats. 93

Plainly, Section 1-205 is a power-conferring law insofar as it authorizes foreign exchange traders to develop usages. In sum, then, the vestiges of Austinian positivism that limit trade usages to translation devices should be ignored.

2. Textual Overemphasis

Two questionable textual interpretations may underlie the narrow role ascribed to trade usages. First, Section 1-205(3) is prone to misreading. 94 Courts and scholars may overemphasize the phrase "give particular meaning" at the expense of the words "supplement" and "qualify." 95 In truth, it is not a distortion of Section 1-205 to

86, at 30.
94. Section 1-205(3) states that "[a] course of dealing between the parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify the terms of an agreement." U.C.C. § 1-205(3) (Emphasis supplied).
95. A distinction between the RESTATEMENT and U.C.C. definitions concerns the extent to which a "usage of trade" can serve as a legal rule. The RESTATEMENT provides that "[a]lthough rules of law are often founded on usage, usage is not in itself a legal rule but merely habit or practice in fact." RESTATEMENT, supra note 50, at § 219 cmt. a. See also id. § 221 cmt. c (indicating that "if the rule of law is one which overrides contrary agreement, it also overrides usage; but if the law merely supplies a term in the absence of contrary agreement, usage can have the same effect as contrary agreement"). The role of a "usage" is constrained to an interpretive device if each party knows or has reason to know of the usage, and the usage may supplement or qualify an agreement. See
cast a trade usage in a broad role whereby it is a legal foundation for a practice and thereby a device for self-regulation by those engaged in the practice. To the contrary, as Professor Kastely suggests, there is a textual basis for a broad role:

The Code embodies the beliefs that the reasonable practices and standards of the commercial community are an appropriate source of legal obligation and that these practices create

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id. §§ 220(1) cmt. a, 221.

Similarly, a "usage of trade" may supplement or qualify an agreement if the parties know or have reason to know of the usage of trade. See id. § 222(3). Arguably, because a "usage of trade" is defined in terms of a "usage," the role of the former cannot exceed that of the latter, thus a "usage of trade" cannot serve as a legal rule. See supra note 77. Indeed, in illustrations 1-6 in Section 222 of the RESTATEMENT, a usage of trade serves as an interpretive device. While U.C.C. Section 1-205 repeats the "supplement or qualify" formulation, it does not suffer from the proscription regarding service as a legal rule.

The treatment of usages in the C.I.S.G. is unsatisfactory in part because no indication is given as to whether a usage can serve as a source of legal obligation in addition to an interpretive device. See C.I.S.G. Articles 8(3), 9 in THE CONVENTION, supra note 50 at 32-33. In fact, Article 4(a) states that the C.I.S.G. is not concerned with the validity of any usage. See generally Michael B. Devine, The Export of Iowa Products and the U.N. Convention on Contracts for the International Sale of Goods, 39 DRAKE L. REV. 689, 695 (1990) (suggesting that the C.I.S.G. gives legal effect to the practices of parties).

96. See supra note 95 and accompanying text; FARNSWORTH, supra note 83, at 509 ("the Code’s use of the words supplement or qualify makes clear that more may be involved than merely interpretation of contract language, although many cases involve no more than that" (citation omitted)); JAMES J. WHITE AND ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 121 (3d ed. 1988) (usages of trade “are relevant not only to the interpretation of express contract terms, but may themselves constitute contract terms [and] these sources may not only supplement or qualify express terms, but in appropriate circumstances, may even override express terms.”).

Professors White and Summers suggest three legal effects of a usage of trade in addition to giving particular meaning to the language of a contract: adding express terms to a contract; subtracting terms from a contract; and superseding or varying the effect of U.C.C. provisions that are variable by agreement and which would govern in the absence of a usage of trade. Id. at 122-24. However, whether a usage of trade can contradict the plain meaning of express contractual language is uncertain. On the one hand, official comment 2 to Section 2-202 states that a writing is to be read on the assumption that the parties took a usage of trade for granted and the usage is an element of the contract unless carefully negated. On the other hand, Section 1-205(4) indicates that an express term controls usage of trade where the two are inconsistent. See Kologel Co. v. Down in the Village, Inc., 539 F. Supp. 727, 728-29 (S.D.N.Y. 1982) (holding that under Section 1-205(4), a usage of trade that delivery of goods pursuant to an airway bill of lading is made to a “notify party” cannot overrule express language in the bill of lading that delivery must be made to the consignee).
actual expectations which should be given full effect in the law. The treatment of trade usage as a part of the agreement in section 1-205 provides a foundation for these principles.97

Interestingly, the first significant case decided under Section 1-205 illustrates the point. In *Provident Tradesman's Bank & Trust Co. v. Pemberton*,98 a bank financed a car dealer and the dealer's customer in connection with the customer's purchase of a new car.99 According to the security agreement between the bank and dealer, neither party was required to provide a notice of any kind to the other party. However, a trade usage existed whereby a bank would notify a dealer if the insurance policy of the dealer's customer lapsed so that the dealer could get its own insurance coverage. The bank did not provide notice of the lapse in the customer's policy, and after lapse the car was wrecked in an accident. The dealer refused to pay for the car, and the bank sued the dealer. The bank conceded the existence of a trade usage calling for notices, but it relied on the wording of the security agreement to the contrary.

The court held for the dealer, allowing a trade usage to qualify the security agreement and thereby establish an independent legal obligation, notwithstanding contrary language in the agreement. The court based its reasoning on the official comment to *Section 2-202* which indicates that "the usages of the trade were taken for granted when the contract was phrased [and] [u]nless carefully negated they have become an element of the meaning of the words used."100 Going forward, banks, car dealers, and customers could be certain that notices would be required. The usage was a legal foundation for giving notice that superseded even a contrary express contractual provision. Therefore, the usage was a means of regulating the risk of default on a financing loan.

Second, official comment 4 to Section 1-205 is equally prone to misinterpretation. This comment takes a schizophrenic approach toward usages. On the one hand, the comment distinguishes between mandatory rules of law and rules that the parties can vary by agree-

99. *Id.* at 173 A.2d 780, 781-83. For Levice, Provident stands for the proposition that a usage of trade may establish that a contract does not accurately reflect the intention of the parties. See Levice, supra note 85, at 1112. However, as suggested above, a different but compatible view of the case is that recognized usages are a source of independent legal obligation.
100. Provident, 173 A.2d at 784.
ment. The latter type of rules "fill in points which the parties have not considered and in fact agreed upon." Plainly, trade usages can take precedence over variable rules:

The latter rules [those that can be abrogated by agreement] hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding. 101

On the other hand, the comment says that a trade usage is "a factor in reaching the commercial meaning of the agreement which the parties have made." The comment also indicates that by choosing the term "usage of trade" instead of "custom" the U.C.C. "expresses its intent to reject those cases which see evidence of 'custom' as representing an effort to displace or negate 'established rules of law.'"

Courts and scholars may overemphasize these aspects of the comment at the expense of the emphasized portions in the above-quoted passage. Yet, such overemphasis is unwarranted. The comment plainly invites market participants to develop their own governing law in the form of trade usages, and the U.C.C. fulfills an interstitial function. Thus, in a world of reinvigorated usages, express contractual terms and even U.C.C. provisions are gap-fillers, not trade usages. 102

101. U.C.C. § 1-205, cmt. 4 (emphasis supplied).
102. This approach is intimated by some court decisions that accord great weight to usages of trade in the absence of express contractual terms or in the face of potentially conflicting terms. See, e.g., Barry Gilberg, Ltd. v. Craftex Corp., 665 F. Supp. 585, 591 (N.D.II. 1987) ("[w]here no stipulation is included in a parties' contract, the . . . usages of trade are presumed to form a part of the contract, provided the same are known to the parties or provided the parties are chargeable with knowledge thereof"); Nanakuli Paving & Rock Co. v. Shell Oil Co., 664 F.2d 772, 795 (9th Cir. 1981) ("only if [usages of trade] cannot be reasonably reconciled with the express terms of the contract are they not binding on the parties"). For a discussion of Nanakuli and judicial interpretations of Section 1-205(4), see Kastely, supra note 97, at 782-96. This approach also is suggested by certain scholars. See Richard Danzig, A Comment on the Jurisprudence of the Uniform Commercial Code, 27 STAN. L. REV. 621, 629-31 (1975); John E. Murray, Jr., The Realism of Behaviorism Under the Uniform Commercial Code, 51 OR. L. REV. 269, 299 (1972); Eugene F. Mooney, Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of Our New Commercial Law, 11 VILL. L. REV. 213, 250-53 (1966).
C. Toward a Broad Role and Self-Regulation

1. Legislative Intent

Whatever the reason for the narrow interpretive role, it is unsatisfactory because it ignores both legislative intent and the relationship between trade usages and the law merchant. As discussed above, trade usages are omnipresent in Article 2.103 From this fact it may be inferred that the drafters of the U.C.C. envisioned a greater role for trade usages than the narrow textual interpretations criticized above would admit.104 As Professor Kastely's above-quoted observation suggests, Section 1-205 was designed in part to elevate the importance of trade usages from gap fillers to essential ingredients of a contract.105

More generally, the drafters surely wanted a flexible commercial code that would accommodate new commercial practices, not a rigid one that would soon become antiquated.106 Thus, in 1955 the New York Law Revision Commission suggested a broad role for usages, stating that "usage affects not only terms but the over-all legal relations of the parties, and it would seem that this idea might well be expressed in the proposed [Uniform Commercial] Code."107 The Commission further noted that:

[T]he "adoption" of . . . a usage as a rule of law is not a mere duplication or reiteration; something is added to it by giving it legal consequences. Therefore, the lawmaker's problem is not merely whether the usage is a good one for those subject to it, but also whether it is appropriate for implementation by the heavy hand of the law.108

If the U.C.C. is to have any relevance in governing high-technology, cross-border transactions of the 21st century, and if it is to respond suitably to the needs of participants in those transactions, then a trade usage will have to be more than a passive post hoc device for

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103. See supra notes 77-81 and accompanying text.
104. See supra III.B.2. Indeed, under pre-U.C.C. contract law, the common practices of a trade were used to fill gaps left in an express contract. See Kastely, supra note 97, at 778.
105. See Kastely, supra note 97, at 779.
106. See, e.g., U.C.C. § 1-102(2)(b); N.Y. LAW REVISION COMMISSION STUDY, supra note 85, at 14-15, 79-80.
107. N.Y. LAW REVISION COMMISSION STUDY, supra note 85, at 325.
108. N.Y. LAW REVISION COMMISSION STUDY, supra note 85, at 77. But see supra note 84 (suggesting that usages are interpretive aids).
disputants to interpret contractual ambiguities. It will have to be acknowledged as a legitimate pro-active *a priori* tool of self-regulation for non-disputants.

It is interesting to observe that the broad role for trade usages advocated herein is consistent with certain international standards regarding usages. For example, Article 1.8 of the UNIDROIT Principles on International Commercial Contracts states that “[t]he parties are bound by a usage that is widely known to and regularly observed in international trade by parties in the particular trade concerned except where the application of such a usage would be unreasonable.” In contrast to Section 1-205, the Principles eschew potentially problematic formulations like “give particular meaning” or “supplement or qualify.” Thus, their broad language gives legal effect to trade usages.

2. The Law Merchant

Confining trade usages to the role of an interpretive device ignores the potential relationship between Sections 1-205 and 1-103. Section 1-103—in addition to legislative intent and appropriate textural interpretation—is a possible basis on which to justify a broad self-regulatory role for usages. This Section, which “is probably the most important single provision in the [Uniform Commercial] Code,” recognizes the continuing vitality of the law merchant. Indeed,

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112. Section 1-103 states:
for centuries the law merchant has been a source of legal obligation and thereby a means of self-regulation:

As a general rule "merchant law" embodied a respect for "merchant" practice as a primary source of regulation and the "law" as a secondary control over commerce. . . . The ordinary undertakings of merchants were binding because they were "intended" to be binding, not because any law compelled such performance. Mandatory law was not to impede the self-sufficient pacts of the merchants.

As a predominant rule, the agreement remained an overriding force in regulating mercantile conduct. All else was subservient to its dominating function as a regulator of behavior. The merchant himself was to be master of his own destiny.113

Thus, a usage of trade that qualified as law merchant not only would have a legal foundation in Section 1-103 but also would serve as a self-regulatory device precisely because it is law merchant.114
The problem is one of delineation: when does a usage of trade become part of the body of the law merchant? Is it sufficient that the Section 1-205 standard is met, i.e., a practice that qualifies as a usage of trade automatically is admitted to the body of law merchant? Or, should additional tests—perhaps concerning the length of time the practice has been used and the extent to which the practice is used in markets in different countries—be imposed? To be sure, reinvigorating a usage of trade is facilitated by eliminating or minimizing legal formalities that block the usage from becoming law merchant. Yet, if no additional tests are imposed, then there is no meaningful distinction between a usage of trade and the law merchant. In turn, the integrity of the law merchant may be questioned as critics decry the entry into the law merchant of trade usages that have not “stood the test of time” or lack adequate notoriety.

One possible solution is based on the jurisprudence of Section 1-103. That Section implicitly delegates power to merchants to establish their own legally cognizable rules. If merchants can establish the rules, then possibly they should be allowed to establish certain rules

was applied by courts composed of merchants convened to pass on disputes that arose at the fairs that were the centers for much of early trade. . . . In controversies between merchants, [Lord Mansfield, Chief Justice of the King's Bench] . . . made it a point to ascertain and apply the usages of the trade, sometimes using a special jury of merchants to advise him on commercial practices.

Farnsworth, supra note 83, at 26 (emphasis supplied). See also Morton J. Horowitz, The Transformation of American Law, 1780-1860, 155-59 (1977) (discussing the use of merchant juries in the U.S. in the late 1700s). Of course, Professor Llewellyn's recommendation that juries comprised of merchants should decide commercial cases was rejected by the National Conference of Commissioners on Uniform State Laws in 1942 because it was thought to be inappropriate for laypersons to create legal rules. See Zipporah B. Wiseman, The Limits of Vision: Karl Llewellyn and the Merchant Rules, 100 Harv. L. Rev. 465, at 512-13, 527-29 (1987). There seems little reason why this link should be ignored today. Usages of trade developed by parties in global electronic markets can and should be considered part of an evolving body of law merchant. See Trakman, supra, at 3-4, 45-60 (observing that the international law merchant continues to evolve and arguing that usages in the international crude oil market adapt to meet the changing needs of that market).

115. This question appears to have received relatively less attention than the question of when the law merchant became part of the common law. See, e.g., Wyndham Anstis Bewes, The Romance of the Law Merchant 17-25 (1923).

116. A related question is what the law merchant adds in light of the fact that the U.C.C. expressly allows trade usages to be a component of an agreement. One answer is that the law merchant is a system that encompasses not only the terms of an agreement but also rules for its enforcement and remedies for breach. In contrast, usages pertain only to a particular practice associated with the agreement.
about rules. That is, merchants should decide when a trade usage becomes law merchant and thereby imposes legally enforceable obligations. Naturally, the delineation rules established for the global currency bazaar by trade associations like the New York Foreign Exchange Committee\textsuperscript{117} may differ from those established by associations in other global electronic markets. Consequently, each market can reinvigorate trade usages in the manner best suited to its needs.\textsuperscript{118}

V. REINVIGORATING TRADE USAGES

A. Advantages of Self-Regulation

Four compelling reasons justify broadening the role of Section 1-205 so that participants in global electronic markets can engage in self-regulation through their trade usages. First, a usage reduces uncertainty by conferring legal authorization to participants to engage in a practice. Second, a usage protects the participants' expectations. Third, a usage fosters efficiency in the foreign exchange market. Fourth, the concept of a usage is particularly flexible and participants can develop usages to adjust to new technological conditions.

1. Reducing Uncertainty

A "usage of trade" can be a powerful tool for reducing uncertainty by serving as a source of legal obligation and thereby an instrument of self-regulation. If a practice satisfies the minimal U.C.C. criteria for a "usage of trade," then parties engaged in that practice should be entitled to view the practice as legally authorized. In sum, if it is a usage, then \textit{ipso facto} it should be permissible.

To achieve this result, a change is needed in the way Section 1-205 is interpreted in theory and used in practice. The link between "supplementing" or "qualifying" an agreement and "developing a common framework of understanding," on the one hand, and reducing uncertainty, on the other hand, must be reexamined. The \textit{sine qua non} of this link is authority. A practice that is a trade usage provides authorization to engage in, and legal support for, a particular market practice. Authority is certainty. Market participants can be certain as to the legal permissibility of the practice. By supplementing and qualifying their agreement through trade usages, they effectively write their own law.

\textsuperscript{117} See supra note 25.
\textsuperscript{118} See generally TRAKMAN, supra note 113, at 40-43 (discussing the evolving international law merchant through trade associations, codes, and conventions).
In the global currency bazaar, switches can gain a legal foundation as a trade usage that supplements and qualifies an oral foreign exchange contract. In turn, the players can be certain of their ability to avoid unwanted credit risks. Thus, in the Bangkok Bank-Citibank transaction, where there is no dispute as to the terms of the agreement, the question is whether the players are bound to a contract that one does not like because of the attendant credit risk. Each player needs to know whether a right to a switch supplements or qualifies their oral agreement. Section 1-205 can provide an affirmative answer. With reinvigorated usages, Bangkok Bank and Citibank can confidently and correctly assume that in a brokered foreign exchange transaction neither will be required to assume an unwanted credit risk. Cloaked with the authority of a usage of trade, switches will reduce uncertainty as to the avoidance of undesirable credit risk exposures.119

119. Of course, switches do not entirely eliminate uncertainty. A switch of counterparties cannot eliminate completely Herstatt risk because there is a possibility (however remote) that the new counterparty, Fuji Bank, will be closed or become insolvent. However, insofar as credit risk is lowered through a switch, so too is Herstatt risk.

Herstatt risk would be eliminated completely if settlements could occur in the same time zone. A centralized foreign exchange clearinghouse that includes a settlement facility might allow for simultaneous, single-time zone settlement.

Herstatt risk also would be avoided if a twenty-four hour, multi-currency payments system existed. Yet, thus far, this system does not exist, and the spot deal above illustrates the use of current single-currency payments systems. The yen will be delivered by Bangkok Bank to a yen-denominated account of Bangkok Bank in Japan because yen payments are made through the Japanese payments system. Conversely, dollars will be delivered by Bangkok Bank to a dollar-denominated account of Bangkok Bank in the U.S. Dollar payments are made through the U.S. payments system, namely the Federal Reserve wire transfer network (Fedwire) or CHIPS. See supra note 63.

The principal barriers to the development of multi-currency systems appear to be political and economic, not technological. The U.S. is not prepared for dollar transfers to be handled through a network that it does not own, operate, or at least regulate in some fashion. Such an arrangement would imply a diminution of sovereignty insofar as control over one's own currency is an important manifestation of independence and authority. Moreover, it might have untoward monetary policy effects. If overdrafts could be created in dollar-denominated accounts held at, for example, the Bank of Japan as part of a Tokyo-based multi-currency system, then a foreign central bank effectively would have the power to grant credit in the U.S. currency. Presently, that power remains with the Federal Reserve and U.S.-regulated commercial banks.
2. Protecting Expectations

No bank trading foreign exchange wants to be stuck with a poor credit risk exposure, and every bank wants the ability to regulate its own exposures. Before they learn the identity of their counterparty, Bangkok Bank and Citibank have two expectations upon entry into a brokered foreign exchange transaction. First, each player expects that its counterparty will perform its central obligation, namely, deliver the appropriate amount and type of currency on the value date. Second, each player expects that it will not exceed a counterparty trading limit as a result of the new transaction. If, after learning the identity of the counterparty, a doubt exists as to the fulfillment of either expectation, then a credit risk problem persists. Switching counterparties is the means for handling a failure of either of these expectations.

As a vehicle for private credit risk regulation, switches are consistent with the key purpose of giving legal effect to trade usages, namely, the preservation of expectancy interests. This purpose is apparent from the definition of "usage of trade" in Section 1-205(2), which speaks of a "regularity of observance" that "justifies an expectation" that the practice in question will be observed. Indeed, "[t]he reasoning behind section 1-205 is straightforward: if a contract can be defined by shared expectations, and if those expectations were created by trade usage, then the contract should be defined by trade usage." Giving legal effect to switches as a trade usage protects the expectations that Bangkok Bank and Citibank have about the right to switch.

3. Flexibility

A trade usage is an attractive device for self-regulation because of its flexibility. This flexibility is evident from the ease with which a usage comes into existence and the ease with which it can be proved in court. One reason for this ease lies in the contrast between a
trade usage and the old English law concept of a "custom." As Professor Warren explains:

Through the first quarter of this century, a common law concept of custom governed the use by courts of trade practices to interpret disputed contracts. A litigant who asserted that a trade practice should govern interpretation of a disputed contract would have to meet well-established, exacting requirements. Not only did the custom have to be reasonable, continuous, notorious, certain, universal, and legal—the common law required that it must have been of such duration that "the memory of man runneth not to the contrary."123

Today, virtually every market in the cross-border financial services industry experiences rapid changes in technology—the global currency bazaar is only one case in point. Consequently, the concept of a custom is antiquated and unworkable because technological shifts compress the time period in which new practices develop. To require ten or twenty years before a practice becomes a legally cognizable custom is nonsensical. In that period, several generations of "customs" will have come and gone.

The drafters of the U.C.C. wisely eschewed the inflexibility associated with the concept of a custom. As official comment 5 to Section 1-205 states:

A usage of trade under subsection (2) [of Section 1-205] must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial," "universal" or the like. Under the requirement of subsection (2) full recognition is thus available for new usages and for usages currently observed by the great

asserts the existence and seeks the benefit of the usage. See, e.g., Wright v. Commercial & Sav. Bank, 464 A.2d 1080, 1083 (Md. Ct. App. 1983) ("obviously, the party asserting the practice would be required to carry the burden of proof"). See also WHITE & SUMMERS, supra note 96, at 128.

123. Warren, supra note 85, at 518-19 (citations omitted). See also Chen, supra note 85, at 95-98 (discussing pre-U.C.C. cases on usages); Levy, supra note 85, at 1103 ("to be enforceable at common law a custom had to be: (1) legal, (2) notorious, (3) ancient or immemorial and continuous, (4) reasonable, (5) certain, (6) universal and obligatory."); Note, supra note 82, at 1198-1203 (discussing the English requirements for a custom). See also N.Y. LAW REVISION COMMISSION STUDY, supra note 85, at 43-46, 76-78, 321-22 (discussing custom as law and trade usages).
majority of decent dealers, even though dissidents ready to cut corners do not agree. 124

In addition, the drafters did not preserve other traditional requirements. For example, the statute does not require that a usage of trade be certain or precise. 125 Nor does it require that a usage be well-known, much less universal. 126 Accordingly, modern courts recognize that proof of repeated, long-standing applications is not the only way of establishing the existence of a trade usage. 127 Regularity of observance—"the recognition and acceptance within [an] . . . industry sufficient 'to justify an expectation that [a practice] . . . will be observed. . . . "—is an equally acceptable way to establish a usage. 128 Because of this alternative, the concept of a trade usage is

124. U.C.C. § 1-205 cmt. 5. (emphasis supplied)
125. See Levie, supra note 85, at 1107. Official comment 9 to Section 1-205 states that a usage need not be certain or precise. U.C.C. § 1-205 cmt. 9. See also RESTATEMENT, supra note 50, § 222 cmt. b (indicating that even under the common law many of the traditional requirements have been eliminated).

Of course, a usage of trade cannot vary a rule of law that the parties could not otherwise vary by agreement. See, e.g., Farmers Coop. Assn. v. Cole, 239 N.W. 808 (N.D. 1976) (disallowing an enlargement of the exceptions to the statute of frauds by a usage of trade).

126. See Levie, supra note 85, at 1107-08. Section 1-205(2) implicitly says that a usage need not be universal by requiring that a usage be observed by the "great majority of decent dealers." U.C.C. § 1-205(2). See also RESTATEMENT, supra note 50, § 222 cmt. b (indicating that even under the common law many of the traditional requirements have been eliminated).


128. Id. at 409 n.3.

129. See, e.g., B.F. Hirsch, Inc. v. Enright Refining Co., 577 F. Supp. 339 (D. N.J. 1983), aff'd in part, vacated in part, 751 F.2d 628 (3d Cir. 1984), on remand 617 F.Supp. 49 (D. N.J. 1985) (holding that use of a retainage assessment on deliveries of scrap gold to a jewelry manufacturer was not so prevalent to be a usage of trade); Sun Oil Co. v. M/T "Mercedes Maria", C.A. No. 80-4862 (E.D. Pa. Dec. 29, 1982) (renumbered No. 81-1033, 81-1083, and 81-4021) (holding that there is a regularity of observance as to a 0.5 percent transit loss allowance in the carriage of oil).

To be sure, usages provide greater certainty for parties as to how their agreements will be interpreted if tested in court. In the narrow interpretive role, there is no a priori test for determining exactly how much evidence is needed to establish a usage of trade. It is a question of fact to be determined on a case-by-case basis. Not surprisingly, disputes arise as to whether a usage exists. See, e.g., Pennzoil Co. v. FERC, 789 F.2d 1128, 1143 (5th Cir. 1986) (discussing whether a usage of trade exists regarding authorization for the collection of stripper well gas rates in natural gas sales contracts); Wright v. Commercial & Sav. Bank, 464 A.2d
better suited to parties in technologically sensitive markets seeking a legal foundation for new practices that meet their changing needs. In fact, already, switches may satisfy the test for recognition as a trade usage. Every day there are many instances of switches, hence demonstrating repeated applications should not be difficult. Moreover, participants in the foreign exchange market are well aware of, and generally accept the practice, hence there is regularity of observance.

A second reason that proving the existence of a trade usage is straightforward is the guidance provided by official comment 7 to Section 1-205. That comment indicates that "usages may be either general to trade or particular to a special branch of trade." Hence, even if a practice is limited to a particular geographical area or kind of activity, it still may qualify as a usage. It is not necessary for switches to occur in every foreign exchange trading center around the

1080 (Md. Ct. App. 1983) (finding that removal of a name from a joint bank account was not a usage of trade in light of the lack of testimonial evidence to the contrary); Carl Wagner & Sons v. Appendagez, Inc., 485 F. Supp. 762, 771-72 (S.D.N.Y. 1980) (discussing whether acceptance of a salesman's orders at a company's home office is a condition precedent to the establishment of a contract is a trade usage).

It is clear that to establish a usage of trade, testimonial evidence — typically, expert testimony — is needed. See e.g., Western Indus. v. Newcor Canada Ltd., 739 F.2d 1198, 1201-03 (7th Cir. 1984) (finding that the district court improperly excluded testimony about an alleged trade usage from lay witnesses who readily could qualify as experts); In re Barney Schogel, Inc., 12 B.R. 697, 709 (S.D.N.Y. 1981) (rejecting a claim of a trade usage in the absence of expert testimony); Ralston Purina Co. v. McFarland, 550 F.2d 967, 971-72 (4th Cir. 1977) (using deposition testimony to establish a trade usage). See also CALAMARI & PERILLO, supra note 82, at 179; FARNsworth, supra note 83, at 510.

130. See, e.g., Posttapes Assocs. v. Eastman Kodak Co., 450 F. Supp. 407, 409 n.3 (1978) (discussing the economic rationale for a trade usage in the film industry whereby a film manufacturer's liability is limited to the replacement of faulty film).

131. The acceptance of the practice is clear from anecdotal evidence and the numerous public statements about switches issued by the Federal Reserve through the New York Foreign Exchange Committee. See, e.g., Teel Letter, supra note 45 (discussing the current practice); SUBCOMMITTEE ON TRADING PRACTICES OF THE FOREIGN EXCHANGE COMMITTEE, INTERIM REPORT ON LEGAL ISSUES REGARDING SWITCHES (Jan. 27, 1993) (on file with author); ANNUAL REPORT 1993, supra note 25, at 7, 73-74 (concerning guidelines for trading practices); Suggested Approach to Brokers' Switches, Paper distributed at meeting of Trading Practices Subcommittee of the Foreign Exchange Committee (Sept. 3, 1992) (on file with author).

Ideally, the relevant foreign exchange trading associations, such as the New York Foreign Exchange Committee and the British Bankers' Association, should develop a handbook which expressly condones switches as a trade usage. See text accompanying infra note 150.
world, or that they occur in every type of foreign exchange transaction, in order for the switch from Citibank to Fuji Bank to be legally permissible as a usage.

Finally, proving the existence of a trade usage is easy because it is not necessary for an affected market participant to have actual knowledge of a usage of trade to be bound by that usage. As the statutory language indicates, constructive knowledge suffices: “any usage of trade in the vocation or trade in which [the parties] are engaged or of which they are or should be aware” can impart “particular meaning to and supplement or qualify terms of an agreement.” The disjunctive language indicates that constructive knowledge can take one of two forms: either the participant should have known of the usage, or the participant engages in the trade and thus knowledge can be presumed. Plainly, new participants in a global electronic market have an incentive to master promptly trade usages in their market.

The ease with which the current practice of switches can be recognized as a usage of trade has an important future implication. It must be anticipated that Bangkok Bank, Citibank, and other players in the global currency bazaar will develop new methods for managing counterparty credit risk in foreign exchange transactions. These methods might supersede or refine the practice of switches. Such

132. U.C.C. § 1-205(3) (emphasis supplied). See Warren, supra note 85, at 515 (providing a rationale for this rule).

133. See, e.g., Foxco Indus., Ltd. v. Fabric World, Inc., 595 F.2d 976 (5th Cir. 1979) (holding that the term “first quality goods” was specifically defined in the relevant association standards guidebook and was a usage of trade even though the buyer was unaware of this definition).

The U.C.C. appears to give broader scope for usage of trade than the common law. Under the common law, a commercial party is bound by a usage of trade of which he either knows or has reason to know. Flower City Painting Contractors, Inc. v. Gumina Construction Company, 591 F.2d 162, 165 (2d Cir. 1979) (citing RESTATEMENT (FIRST) OF CONTRACTS, § 247 cmt. b (1928)).

However, as explained above, under Section 2-105(3) there are two tests to determine whether a commercial party is bound by a trade usage. First, as under the common law, a party is bound if it “knew or had reason to know.” See Posttape Assoc. v. Eastman Kodak Co., 537 F.2d 751, 756-57 (3d Cir. 1976) (indicating that even if a party does not expressly negotiate a provision to which a trade usage is applicable, the party is bound by that usage if the party should have been aware of the usage). Second, unlike the common law, a party is bound by a usage of trade in the trade in which it is engaged, whether or not it actually knew or should have known of the usage. See Marion Coal Co. v. Marc Rich & Co. Intl., 539 F. Supp. 903, 905-06 (S.D.N.Y. 1982) (concerning an agreement to arbitrate in a contract for coal).

methods should provide the parties with at least as much legal certainty as switches afford. Because of the ease of establishing a practice as a usage, this goal can be realized.

4. Efficiency

It is widely understood that a clear aim of the U.C.C. is to promote efficiency in commercial transactions:

A primary purpose of commercial law is to provide the rules that protect the stream of commerce by allowing it to function as efficiently as possible. The Code is infused with an idea about how goods and services are distributed throughout the economy. Section after section of the Code is clearly designed to make transactions less costly, thereby encouraging allocative efficiency. 135

Trade usages are an efficient means of self-regulation. They make contract formation, interpretation, and performance efficient by reducing transaction costs, i.e., the costs associated with negotiating, consummating, and executing a deal. 136

As repeat players, banks in the global currency bazaar grow accustomed to short-hand expressions by which billions of dollars, yen, pounds, marks, ringgit and rupiah are bought and sold every day. These expressions are particularly significant because profits depend in part on completing a large volume of transactions where the profit margin on each transaction is thin. Images of global electronic markets presented every night on any business news television program accurately depict foreign exchange or other financial market players reacting instantaneously to sudden price changes brought about by fresh economic and political data. For them, nothing—not even lunch!—ought to impede the flow of deals. There is a direct relationship between reducing transaction costs and lowering opportunity costs. 137 Every second of delay in completing one transaction is an opportunity cost because it represents an impediment to the entry and execution of another deal. 138

135. Warren, supra note 85, at 535 (citations omitted).
136. For an economic analysis of the reason why Section 1-205(3) presumes knowledge of a usage of trade by a party engaged in the trade, see Warren, supra note 85, at 535-46.
137. The latter concerns foregone opportunities, that is, for example, a cost to Bangkok Bank and Citibank of lost trading possibilities created by the rapidly changing dollar-yen exchange rate.
138. The foregoing analysis should not imply that usages of trade lead to unmitigated economic benefits. For example, usages of trade can raise costs of
The gains accruing to two players trading foreign exchange that result from reducing transaction costs are shown in the graph below. The graph is a static snapshot of the global dollar-yen market on a particular day. The price of yen bought and sold is expressed in millions of dollars and measured on the vertical axis. The quantity of yen bought and sold is expressed in billions and measured on the horizontal axis. The downward-sloping curve represents the total demand for yen of all banks playing in the foreign exchange market that are willing and able to sell yen. The upward-sloping curve represents the total supply of yen of all banks playing in the foreign exchange market that are willing and able to sell yen.

entry into the foreign exchange market because potential new entrants must learn those usages. This result is particularly likely when new entrants are charged with constructive knowledge of the usages pursuant to Section 1-205(3). See Warren, supra note 85 at 557-69. However, Professor Warren's example of this possibility in illustration VII at pp. 563-67 is incorrect. Contrary to her explanation, party A will enter the market with total production costs of A1 or A2 (because these costs are below expected revenue), whereas party C will not enter the market with total production costs of either C1 or C2.

More generally, Professor Warren's explanation that the parties compare total production costs, amortized over time, to anticipated revenue, is oversimplified. In the short run (the period during which some factors of production are fixed), a seller will enter a market only if it can cover its variable costs of production (the costs that vary with the level of output). If it can, then it will produce along its marginal cost curve where this curve intersects the bottom of the seller's average variable cost curve. Hence, the "shutdown point" for the seller is where the market price of the good is so low that neither variable nor fixed costs are recouped. (The latter are costs associated with fixed commitments to invariable factors of production.) It would be economically irrational to produce a good if it results in a loss greater than fixed costs incurred when the seller produces nothing. See PAUL A. SAMUELSON, ECONOMICS 431-32 (11th ed. 1980).

In the long run (the period during which all factors of production can be changed), the "break-even" equilibrium is where price and marginal cost are equal and the marginal cost curve intersects the bottom of the average total cost curve. At that point (and above), all costs are recovered. A seller will decide whether to enter (or exit) a market by comparing the price that can be earned for the good sold with the marginal cost of producing the good. So long as price equals or exceeds marginal cost, entry is economically rational. See id. at 445-46.

The demand curve is sloped downward because of the inverse relationship between the price of the yen (measured in dollars) and the quantity of yen demanded by banks.

The supply curve slopes upward because of the direct relationship between the price of yen (again, measured in dollars) and the quantity of yen banks offer for sale. The demand and supply curves are based on the implicit ceteris paribus assumption, i.e., the price of all other currencies, income of Citibank and Bangkok Bank, and preferences of the two banks for different currencies remain constant. For a complete overview of demand and supply curves, see SAMUELSON, supra note 138, at 52-64.
The Relationship Between Transaction Costs and Foreign Exchange Traders' Surpluses

Price of yen (in yen per dollars)

Supply curve for yen

Demand curve for yen

Quantity of yen bought and sold (in billions)

Highlights:

1. ABDI is Citibank's buyer's surplus with no transaction costs.
2. ABCJ is Citibank's buyer's surplus with $2 million transaction costs.
3. GFDI is Bangkok Bank's seller's surplus with no transaction costs.
4. GFEH is Bangkok Bank's seller's surplus with $2 million transaction costs.
Suppose Citibank is willing and able to pay 90 yen per dollar for the 5 billion yen, i.e., a total cost of $55.56 million.\textsuperscript{141} If Citibank could purchase the yen for a lower total cost (requiring an exchange rate of greater than 90 yen per dollar), then the difference between what Citibank actually paid and $55.56 million would be “buyer’s surplus” that would accrue to Citibank.\textsuperscript{142} Conversely, suppose Bangkok Bank is willing and able to receive 110 yen per dollar, i.e., a total revenue of $45.45 million.\textsuperscript{143} If Bangkok Bank could sell the yen for a greater total revenue (which would imply an exchange rate of less than 110 yen per dollar), then the difference between what Bangkok Bank actually received and $45.45 million would be “seller’s surplus” that accrued to Bangkok Bank.\textsuperscript{144}

Buyer’s and seller’s surpluses are maximized simultaneously in an environment of no transaction costs. With no such costs, the equilibrium exchange rate is 100 yen per dollar. This rate implies Citibank pays $50 million and earns a surplus of $5.56 million,\textsuperscript{145} and Bangkok Bank receives $50 million and earns a surplus of $4.54 million.\textsuperscript{146} These surpluses are shown by the figures denoted by the points ABDI and GFDI, respectively.

Of course, Citibank deals with potential sellers through the New York Broker which receives a commission for successfully finding a counterparty with which Citibank agrees to deal. Moreover, Citibank must pay overhead costs associated with foreign exchange transactions—the telephone bill, electronic database fees (i.e., the cost of the Reuters screen), subscriptions to financial market research journals, etc. These facts are true for Bangkok Bank as well. Assume the transaction costs for each player are $2 million. The existence of such costs does not change the ability and willingness of Citibank to pay $55.56 million or Bangkok Bank to receive $45.45 million, but it does reduce their respective buyer’s and seller’s surpluses by $2 million each.

\begin{itemize}
  \item[141.] The exact figure is $55,555,555.56.
  \item[142.] The technical economic term is “consumers’ surplus.” See SAMUELSON, supra note 138, at 412-14; M. BLAUG, ECONOMIC THEORY IN RETROSPECT 374-88 (3d ed. 1978). In general, consumers’ surplus is the excess of the price which a consumer would be willing to pay for a good rather than go without that good over the price the consumer actually pays. \textit{Id.} at 375.
  \item[143.] The exact figure is $45,454,545.45.
  \item[144.] The technical economic term is “producers’ surplus.” In general, producers’ surplus is the excess of actual earnings from selling a good over the amount the seller would accept rather than refuse to offer the good altogether. See BLAUG, supra note 142, at 404-09.
  \item[145.] The exact figure is $5,555,555.56.
  \item[146.] The exact figure is $4,545,454.55.
\end{itemize}
each. In effect, transaction costs raise the price Citibank pays and lowers the sum Bangkok Bank receives because each bank must absorb such costs. In the figure, transaction costs raise Citibank's effective price to 96.15 yen per dollar and lowers Bangkok Bank's effective price to 104.17 yen per dollar. Consequently, the buyer's surplus is reduced to $3.56 million,\textsuperscript{147} and seller's surplus is reduced to $2.54 million.\textsuperscript{148} The reduced surpluses are shown in the graph by the figures ABCJ and GFEH, respectively. Plainly, the total loss of buyer's and seller's surplus is $4 million, or the figure JCDEH.\textsuperscript{149} In the extreme case, where transaction costs rise to roughly $5 million, the deal is aborted because the buyer's and seller's surpluses are entirely wiped out.

Legal recognition of trade usages helps minimize the reduction of buyer's and seller's surpluses and ensures the deal remains economically viable. Through usages, Citibank and Bangkok Bank, and New York Broker and Thai Broker, avoid reinventing the wheel with each new agreement. To convey intricate information they use shorthand verbal expressions which are quickly and exactly articulated and immediately and unequivocally understood. Absent such expressions the players would need several minutes to explain their meanings to each other—or worse, several pages of paper to write down these meanings. Moreover, the precision of the expressions minimizes the probability of costly disputes. There is no conceptual difference between expressions like "yours" and "mine," on the one hand, and a practice like switches, on the other hand. Both are—or ought to be considered—trade usages with critical effects on buyer and seller surpluses. In sum, because transaction costs are minimized through trade usages, the 5 billion yen transaction is completed or switched in minutes, and Citibank and Bangkok Bank move onto another potentially lucrative deal.

One caveat to this analysis should be noted. Although reinvigorating trade usages may increase buyer and seller surpluses, its effect in a particular transaction should be distinguished from its aggregate effect. For example, if Citibank were disadvantaged by the switch of counterparties, then its surplus would be reduced (or even eliminated).\textsuperscript{150} Nonetheless, Citibank may accept this diminution

\textsuperscript{147} The exact figure is $3,555,555.56.
\textsuperscript{148} The exact figure is $2,545,454.55.
\textsuperscript{149} Of this total, $2 million or JCDI is the loss of Citibank's buyer's surplus, and $2 million or HEDI is the loss of Bangkok Bank's seller's surplus. In reality, each bank might incur different transaction costs, thus changing the exact amounts by which the surpluses are reduced.
\textsuperscript{150} That is, if the switch is not a Pareto improvement, then Citibank's sur-
because it knows that in future transactions it will be in the position of demanding a switch. Accordingly, for Citibank the right to a switch applicable in all transactions increases its surplus by a magnitude that more than offsets the reduction in its surplus associated with any particular transaction.

B. Why Not a Five Minute Right of Rescission Usage?

1. The Proposal

The hesitant approach to switches taken by the Federal Reserve and discussed above may reflect legitimate concerns about the integrity of the global currency bazaar and the safety and soundness of players therein. Nevertheless, this approach is undesirable. Because of this overhang on the bazaar, the prospects for switches to be accepted as a reinvigorated trade usage and thereby a self-regulatory device are dim. In addition, future market-based innovations to switches may be chilled. To encourage a fresh Federal Reserve approach, the current usage could be modified to address regulatory concerns.

In this regard, a five-minute right of rescission usage—the “5 RR usage”—could be established. Under a 5 RR usage, each bank that had entered into a foreign exchange contract would have five minutes from the time it learned of the identity of its counterparty to demand a switch, and any switch would have to be completed within that same five minute period. If such a demand were made during the five minute period, then the contract with the initial counterparty automatically would be rescinded. Any demand for

plus would be reduced. See text accompanying infra notes 186-87.

151. See supra notes 50-55 and accompanying text.

152. Fortunately, an international infrastructure exists to promulgate the proposal as a usage of trade—namely, foreign exchange trading associations like the New York Foreign Exchange Committee and the British Bankers' Association. Representatives of these bodies could meet, perhaps along with officials from relevant bank regulators, to draft and publish an acceptable 5 RR usage proposal.

153. Section 2-309(1) provides that the time for delivery or any other action under a contract, if not expressly specified in Article 2 or agreed upon by the parties, is a “reasonable time.” U.C.C. § 2-309(1). Section 1-102(3) empowers the parties to determine the standards by which performance is measured, as long as those standards are not “manifestly unreasonable.” U.C.C. § 1-102(3). Thus, the players in the global currency bazaar are fully capable under the U.C.C. to promulgate the 5 RR.

154. The five-minute span does not, therefore, affect the contract formation process. Rather, it serves as a “cooling off” period akin to a condition subsequent where the condition is the acceptance of an ordinary credit risk exposure.
a switch after the five minute period would be rejected automatically by a foreign exchange broker. A substitute counterparty would have to be found and determined to be acceptable to the banks within that period.

The concept of a “suspended animation period”—which is, in effect, what the five minutes represent—is not unprecedented in commercial law. For example, in markets for certain goods and services, contracts negotiated by a representative of a company who is not located in the headquarters of that company are subject to the approval of the home office. Under such a home office approval clause, the contract is not binding until the approval has been received.\textsuperscript{155} The home office might demonstrate its approval by returning a signed or initialled written contract, beginning performance, or allowing a specified time period to elapse without taking any action inconsistent with formation and performance of the contract. As another example, the Federal Trade Commission (FTC) provides for a limited right of rescission with respect to contracts concluded as a result of door-to-door sales. In effect, a three day cooling off period is required during which rescission is permissible.\textsuperscript{156} Like the proposed 5 RR usage, in these two instances, the key idea is that there is a short period during which neither party to a contract is really bound.

It would be important to prevent excessive use or abuse of the 5 RR usage. Accordingly, the only justification for the demand could be the necessity to avoid an extraordinary credit risk exposure. “Extraordinary” would be defined to mean that entry into the contract would constitute an unsafe and unsound banking practice. In effect, the contract would be unsafe and unsound where credit limits or account caps are exceeded. Hence, a switch could not be made for merely reasonable credit risk concerns because banks are in the business of accepting and managing such risks.

2. Meeting Regulatory Concerns

A key advantage of the 5 RR usage would be the repercussions of the time constraint. The parties to a contract—and their cautious regulator—would be uncertain for just five minutes as to whether the initial contract will be performed. Thus, the usage would assuage the Federal Reserve’s first two concerns—those identified above certain-

\textsuperscript{155} See \textsc{Farnsworth, supra} note 83, at 127. Professor Farnsworth discusses these clauses from the perspective of contract formation and suggests that a proposal subject to home office approval is not an offer. Thus, the making of the contract is delayed until approval is obtained.

\textsuperscript{156} See 16 C.F.R. § 429.1(a)-(c) (1994).
ing to open positions and off-market transactions—because a substitute counterparty must be found, and risks must be specifically ascertainable and quantifiable, within a discrete period.

Interestingly, there is an alternative possible trade usage that would eliminate completely the possibility of an open position, and at the same time preserve the right to switch. A bank initiating a foreign exchange transaction could tell its broker that the proposed deal is “subject to switch.” The broker could reiterate this caveat to prospective counterparties. Those counterparties that do not want to entertain the possibility of a switch could reject the proposed deal at the outset.

The 5 RR usage also would address the third regulatory concern identified above regarding record-keeping and disclosure. The 5 RR usage would obligate foreign exchange brokers to keep track of the five minute time period. Each broker would be responsible for informing an appropriate senior manager at the bank for which the broker acts as agent that one contract has been rescinded and another contract has been substituted in its place. This allocation of duties would efficiently resolve the concern about recordkeeping and disclosure because the broker is in the best position to perform these tasks. It is necessarily the broker that informs a bank of the identity of its counterparty and handles a demand for a switch of the counterparty.

3. Four New Issues

In spite of these advantages, there are some difficult issues raised by the proposal. First, what notice or evidentiary obligations should be incumbent on a bank attempting to exercise the 5 RR usage of trade? In the hypothetical case study, suppose Citibank does not receive notice from the New York Broker about the switch, perhaps because of a telecommunications failure. Would the switch be effective?

Second, what should be the legal standard for determining an “extraordinary” credit risk? An objective standard of dissatisfaction with the potential credit risk exposure obviously would be consistent

157. See supra notes 51-53 and accompanying text.
158. See supra note 54 and accompanying text.
159. With respect to disclosure, each broker could require that banks for which it acts as an agent must provide a list of names of a senior manager to be notified in the event the 5 RR usage is exercised. Further, the broker could transmit confirmations electronically to the banks involved in the initial, rescinded contract and those involved in the new, substituted contract.
with the pervasiveness of objectivism in contract law jurispru-
dence. Yet, credit risk evaluations are innately subjective, as any
mortgage applicant can attest. What a “reasonable” bank manager or
Federal Reserve bank examiner thinks about delivering 5 billion yen
to Citibank and a reciprocal delivery of $49.5 million is a silly inqui-
yry. For Bangkok Bank, but not Fuji Bank, the transaction involves
an imprudent risk, and the inquiry should end with these subjective
evaluations. In fact, a subjective standard may promote certainty in
the exercise of the 5 RR usage. Arguments about reasonableness
would be immaterial, and the only relevant issue would be whether
the credit risk posed was “extraordinary” to the particular bank that
sought the switch. To be sure, however, the only way to eliminate un-
certainty would be to have an absolute right of rescission for any
reason.

Third, what if the true reason for a demand to switch
counterparties is opportunistic? For example, may Bangkok Bank
take advantage of a favorable exchange rate movement? The
underlying issue here is enforcement of the “extraordinary” credit risk
standard. Presumably, the obligation to act in good faith would apply
and limit opportunistic behavior. Demanding a switch to take ad-
vantage of a favorable exchange rate movement would be considered
bad faith. More generally, the answer must be that the market
will police itself. After all, that is what self-regulation through trade
usages means in practice. Reputational concerns should prevent a
bank from switching for illegitimate reasons. If a bank behaves
opportunistically, then it will be ostracized from the global currency
bazaar as brokers and traders alike quickly learn of the bank’s un-
scrupulous practice. Of course, it must be conceded that self-regula-

160. See, e.g., MORTON HORWITZ, THE TRANSFORMATION OF AMERICAN LAW:
1870-1960 35-39 (1992); FARNSWORTH, supra note 83, at 114. Illustrative of the
objectivist influence is the reasonableness criterion in the definitions of “good faith”
in Sections 2-103(1)(b), 3-103(a)(4), and 4A-105(a)(6). In these Sections, “good faith”
is defined as “honesty in fact and the observance of reasonable commercial stan-
dards of fair dealing.” U.C.C. §§ 2-103(1)(b), 3-103(a)(4), 4A-105(a)(6). Section 2-
103(1)(b) refers to “the case of a merchant” and “fair dealing in the trade.” U.C.C.
§ 2-103(1)(b). This definition is to be contrasted with that in Section 1-201(19)
which states that “good faith” is “honesty in fact in the conduct or transaction
concerned.” U.C.C. 1-201(19).

161. See supra note 46 and accompanying text (illustrating that Bangkok
Bank would benefit from a change in the dollar-yen spot rate to 100-99 yen per
dollar).

162. See text accompanying supra notes 157-58.

163. See Steven J. Burton, Breach of Contract and the Common Law Duty to
Perform in Good Faith, 94 HARV. L. REV. 369 (1980).
tion will not stamp out all opportunistic behavior—nor would external policing mechanisms.

Finally, exactly how should the players in the global currency bazaar move from the current practice of switches, which lacks any time constraint or record-keeping and reporting requirements, to the 5 RR usage, which has these features? The answer must be that the players themselves, acting through their trade associations, should refine the current practice. They have two incentives to do so. First, they may be able to pre-empt Federal Reserve regulation. Second, they may be able to avoid adverse judicial decisions.

If the players do not act, then the Federal Reserve may address its three concerns by seeking to bar switches. Certainly, the players would resent this strong-arm attempt to stamp out the practice. Its probable effect would be to drive some foreign exchange business offshore—beyond the reach of the Federal Reserve's regulatory grasp—to jurisdictions where switches are permitted.

In the absence of such regulation, courts may be asked to rule on the legitimacy of switches. They may hold that the practice of switches is unreasonable and that switches are unenforceable because they are against public policy (namely, the policies espoused by the Federal Reserve). Or, they may hold that while the practice is not unreasonable, the lack of constraints on it is contrary to public policy. Accordingly, courts may limit the ability of the players to switch counterparties in certain ways. The limitations devised by judges may not serve the needs of the players. Moreover, the uncertainty associated with leaving the matter to the courts does not serve their needs.

C. Lingering Reservations: Disharmony and Morality

Encouraging self-regulation in global electronic markets through reinvigorated trade usages raises the specters of international disharmony in trade usages and the reign of the morality of the marketplace. With respect to disharmony, heretofore it has been assumed implicitly that switches are practiced not only in the major foreign exchange trading centers of London, New York, and Tokyo, but also in emerging financial centers such as Singapore, Kuala Lumpur, and Rio de Janeiro. In reality, there may be disharmony in trade usages across different centers. For instance, suppose the proposed 5 RR usage is established in major but not emerging centers. If Bangkok Bank trades dollars for yen with the Singapore office of the Overseas Chinese Banking Corporation (OCBC), then should the 5 RR usage apply to the transaction? Global adoption of it would harmonize trading practices, but foreign exchange players in Singapore—or their
regulators—may object to the usage.

Section 1-205 does not provide guidance in the event of a "choice of trade usage" problem. Yet, conflicts among trade usages could lead to an outright confrontation between banks from developed countries, on the one hand, and banks from newly industrialized countries (NICs) and less developed countries (LDCs), on the other hand. Should trades between a bank from an LDC and a bank from a developed country be subject to the 5 RR usage? Perhaps this is a matter for express agreement between the banks. In any event, as a matter of fairness, a usage in the developed country trading centers should not be thrust upon players in centers located in NICs and LDCs. If it is, then those players will rightly bemoan the imperialism of developed country usages. Instead, appropriate consideration must be given to unique local market conditions.

With respect to marketplace morality, Section 1-205 allows market participants to dictate usages notwithstanding the moral content or implications of those usages. The players in the global currency bazaar can follow their inherent instincts, namely, to develop usages that directly or indirectly contribute to the maximization of profits from trading foreign exchange. Bazaar morality triumphs. Further, courts lack a statutory standard by which to judge the moral dimensions of a new usage in the context of the bazaar. The result may be inconsistent judicial opinions about the same or similar usages.

The solution to the moral dilemma cannot lie with the players themselves because they supposedly lack a moral compass. Other safeguards against morally offensive usages must be found. One such safeguard exists in Section 2-302. Plainly, a usage that is unconscio-

164. See Zipporah B. Wiseman, The Limits of Vision: Karl Llewellyn and the Merchant Rules, 100 HARV. L. REV. 465, 505 (1987) (expressing concern about "a vision of merchant reality devoid of any normative component or at least devoid of any normative component other than speed and efficiency in the marketplace"); Danzig, supra note 102, at 627-31 (1975) (arguing that the morality of the marketplace is accepted in the U.C.C. without criticism). For a critique of Danzig's article, see Kastely, supra note 97, at 815-17.

165. Thus, for example, to some courts the practice of switches may be morally offensive because it effectively allows parties to break promises. When Bangkok Bank asks for a switch, it retracts its promise to sell yen and buy dollars. Even if Bangkok Bank's communication to sell yen is viewed merely as a revocable offer and not a promise, the fact that Bangkok Bank's request for a switch comes after the acceptance by Citibank may make the request morally dubious. If indeed contracts must be enforced because they represent mutual and reciprocal promises, then providing a legal foundation for switches through trade usages is potentially inconsistent with such enforcement.
nable will be struck down.166 However, a court may determine, for example, that a switch is not terribly one-sided, nor does it lead to oppression or unfair surprise.167 More fundamentally, the concepts of a trade usage and unconscionability may be inconsistent. Arguably, no usage should result in oppression or unfair surprise, otherwise it would not be a usage in the first place.

Yet, it also can be argued that the power dynamics in a switch situation are likely to be particularly important. Perhaps certain financial institutions from developing countries—for instance, those that are new to foreign exchange trading and lack the maturity and sophistication that comes with experience—may be vulnerable. In any event, even if unconscionability is a meaningful concept in the global currency bazaar, cases where morally questionable trade usages are not so egregious as to be unconscionable may slip through the cracks and undermine the integrity of the bazaar.

A second safeguard is a reasonableness requirement. Official comment 6 to Section 1-205 makes clear that one of the ancient requirements of custom carried forward into the U.C.C. is that a usage of trade be "reasonable."168 The bulk of scholarly analysis supports the conclusion that unreasonable trade usages are not binding.169 But, like the first proposed safeguard, a reasonableness requirement may provide little protection. As official comment 6 to Section 1-205 explains, "[t]he very fact of commercial acceptance makes out a prima facie case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable." Hence, the threshold for establishing reasonableness is low: insofar as switches are practiced by a large number of players in different foreign exchange trading centers, there is an immediate but perhaps unwarranted presumption that switches are reasonable. An even greater shortcoming of this supposed safety mechanism is the fact that regardless of any presumption, reasonableness is not necessarily coex-

166. While Section 2-302 uses the term "contract," as explained above this term incorporates "usage of trade." See supra notes 78-81 and accompanying text. Moreover, official comment 6 to Section 1-205 explains that Section 2-302 is applicable to implicit contract clauses that are based on usage of trade. U.C.C. § 1-205 cmt. 6.

167. One-sidedness, oppression, and unfair surprise are indicia of unconscionability. See id. 2-302 cmt. 1.

168. Id. § 1-205 cmt. 6.

tensive with moral worth. Conceivably, a usage could be reasonable on commercial grounds but not comport with certain systems of morality.

Communal norms are a third safeguard against morally offensive trade usages. Professor Kastely argues that "[i]f trade usages operate as communal norms, then the value of a trade usage can be determined by the quality of the community it helps to create. . . . What is needed . . . is a language of communal value: terms and concepts that can equip courts to consider the quality of communities." The difficulty with this argument is that courts are not in the best position to evaluate the quality of financial market communities. Most judges know little about international financial matters, and the higher the court, the more profound the ignorance. It may be better to entrust the evaluation of communal norms to a sophisticated regulatory authority.

Regulatory intervention in private contract affairs certainly is not a novel idea. The question for global electronic markets is whether authorities such as the Federal Reserve are the appropriate guardians of market integrity. Certainly, such intervention must be infrequent and constrained or it will stifle the development of new trade usages. Regulators have a nasty tendency to become part of the problem instead of part of the solution when they flex their regulatory muscles too aggressively. In the face of technological change they must avoid attempting to maintain the status quo.

In addition, no regulator can be the sole guardian of the integrity of a global electronic market. The Federal Reserve, for example, requires the assistance of regulators of foreign exchange players from other countries—most notably the Bank of England and Bank of Japan. Yet, here too, the reservation about disharmony and a rich country-poor country dispute is relevant. Regulators in major trading centers are unlikely to agree on what behavior is morally acceptable. The probability is near zero when the views of regulators in .

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170. Kastely, supra note 97, at 817.
172. Certainly, the Securities and Exchange Commission plays this role in domestic securities markets and the Commodity Futures Trading Commission plays this role in domestic futures and options markets.
173. For example, the Bank of England authorizes points with adequate disclosure, while the Federal Reserve opposes the use of points under any circumstances. See supra note 47.
emerging financial markets are considered. Their concern is certain to be the growth of the players and markets they regulate. If global market activity is not increasing at a healthy pace, then regulators in emerging centers may adopt a zero-sum view: their players and markets are in head-to-head competition with players and markets in developed countries. Accordingly, regulators from NICs and LDCs may look suspiciously at a moral condemnation of a usage of trade emanating from a regulator like the Federal Reserve. The condemnation could be an attempt to increase the percentage of global market share of trading activity held by U.S. banks and the New York market.

VI. ALTERNATIVES TO SWITCHING COUNTERPARTIES

Why should participants in a global electronic market be permitted to regulate themselves through trade usages when commercial codes exist to referee the participants' transactions? Reservations about disharmony and morality, as well as concerns of regulators, may lead courts and scholars to advocate rule-based regulation rather than self-regulation. Yet, in contrast to trade usages, these rules do not always meet the participants' needs. When the rules are applied, some are left worse off than others, and uncertainties surrounding the transaction are exacerbated.

A. The Assignment Approach: Not a Pareto Improvement

Bangkok Bank's attempt to switch out of a foreign exchange contract could be characterized as an attempt to assign its right to receive $49.5 million from, and delegate its duty to deliver 5 billion yen to, Citibank. Article 2 establishes a permissive regime for assignment and delegation. Section 2-210 makes clear that "[a] party

174. For example, Bank Negara (the central bank of Malaysia) actively trades foreign currencies for profit. Most regulators would argue that central banks, because of their inside information about monetary policy, should not engage in such activity.

175. See U.C.C. § 2-210 cmt. 1. See generally CALAMARI AND PERILLO, supra note 82, at 735, 760 (stating that "[i]n contrast with the earlier law the modern view is emphatically to the effect that ordinarily rights are assignable" (citations omitted) and that "[t]oday . . . the general proposition is that, subject to exceptions, duties are delegable"); FARNSWORTH, supra note 83, at 748 (stating that "[t]oday most contract rights are freely transferable").

The relevant RESTATEMENT provisions on assignment and delegation are similar to Section 2-210. See RESTATEMENT, supra note 50, at §§ 317-20. No provisions on assignment or delegation are set forth in the C.I.S.G., thus applicable local law, such as the U.C.C., would govern an attempted assignment and dele-
may perform his duty through a delegate...," 176 and that "[u]nless otherwise agreed all rights of either seller or buyer can be assigned...." 177 However, assigning the entire contract is not a practical solution.

A key purpose of Section 2-210 is to protect the non-assigning party and ensure that its expectations and obligations are not materially disrupted. 178 From the moment the New York Broker informs Citibank of the identity of its counterparty and Citibank assents, Citibank prepares to exchange foreign currencies with Bangkok Bank, not Fuji Bank. Citibank develops specific expectations about Bangkok Bank's ability to perform and its own reciprocal duties. It may anticipate that the purported assignee cannot meet these expectations, or find that performance rendered to the purported assignee would be more burdensome than to the purported assignor.

Accordingly, Section 2-210(1) precludes Bangkok Bank from delegating its duty to deliver 5 billion yen to Fuji Bank if Citibank "has a substantial interest in having [its]... original promisor perform...." 179 Moreover, Section 2-210(5) provides that a delegation of performance is reasonable grounds for insecurity and a basis for demanding adequate assurance of future performance under Section 2-609. Finally, Section 2-210(2) does not allow Bangkok Bank to delegation.

176. U.C.C. § 2-210(1).

177. Id. § 2-210(2). Section 2-210 also establishes a presumption that general terms used to assign a contract include both an assignment of rights and a delegation of duties. Formalities are minimized in that under Section 2-210 an assignment need not be in writing and specific words or phrases need not be used. See CALAMARI & PERILLO supra note 82, at 728. Similarly, Section 2-201 does not require an assignment to be written. U.C.C. § 2-201. In any event, by assumption, Section 2-201 is abolished. See supra note 50 and accompanying text. The statute of frauds set forth in Section 1-206 is irrelevant because, as sub-paragraph (2) thereof indicates, that Section is inapplicable to a contract for the sale of goods.) Thus, Bangkok Bank could simply assign its contract orally to Fuji Bank. Of course, official comment 7 to Section 2-210 states that the Section is not a "complete statement of the law of delegation and assignment" and recognizes that other sources of law may impose requirements on the form of an assignment or the need for notice of assignment. Id. § 2-210 cmt. 7.

178. See FARNSWORTH, supra note 83, at 761 (the restrictions on assignment in Section 2-210(2) rest "not on any antipathy toward assignment as such, but on a concern for the justifiable expectations of the obligor when making the contract.").

179. The rule applies even though the delegation would not relieve Bangkok Bank of a duty to perform, or liability for breach, absent the consent of Citibank or performance by Fuji Bank. Section 2-210(1) provides that "[n]o delegation of performance relieves the party delegating of any duty to perform or any liability for breach." See FARNSWORTH, supra note 83, at 798.
assign its rights to receive $49.5 million if "the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance."

To be sure, the extant jurisprudence about assignments indicates that "in practically every case a right to payment of money is assignable." The expected receipt of 5 billion yen plainly involves payment of money, albeit of a foreign currency, from a foreign obligor to an offshore bank account. Moreover, a duty to pay money is "generally delegable" and "[i]t is immaterial if the delegate is less creditworthy than the delegant because . . . the delegant continues to remain liable."

Nevertheless, the exceptions in Section 2-210(1)-(2) generate uncertainty as to the effectiveness of the assignment of the complete dollar-yen contract. With respect to the attempted assignment, Citibank could argue its burden is materially increased and its chance of obtaining reciprocal performance is materially impaired. As for the burden, Citibank may have exhausted its trading limit with Fuji Bank. Raising that limit would be a material change in Citibank's duties because of the extra risk to which it would be exposed. As for the return performance, Citibank may doubt Fuji Bank's ability to deliver 5 billion yen on the value date and worry about the attendant Herstatt risk. With respect to the attempted delegation, Citibank could argue it has a substantial reason for believing that delegated performance is not as satisfactory as performance by Bangkok Bank. First, Citibank may contend it must rely on the integrity, reputation, and skill of its counterparty, thereby effectively rendering performance by Bangkok Bank personal. Second, it may claim Bangkok Bank would not exercise any supervision or control over its purported delegate.

In sum, the central thrust of Citibank's argument is that the purported assignment compels it to assume imprudent risks. An ag-

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180. CALAMARI & PERILLO, supra note 82, at 735.
181. CALAMARI & PERILLO, supra note 82, at 761.
182. See CALAMARI & PERILLO, supra note 82, at 760-6; FARNSWORTH, supra note 83, at 798-800. Of course, Citibank is entitled to demand adequate assurance from Fuji Bank of its ability to perform pursuant to Section 2-210(5).
183. See CALAMARI & PERILLO, supra note 82, at 762; FARNSWORTH, supra note 83, at 800.
gressive but not implausible extension of the argument is that exposure to these risks is an "unsafe and unsound practice" in violation of federal banking law. The violation subjects Citibank to a civil enforcement action brought by federal regulators. 184

Now a genuine conundrum exists: Bangkok Bank needs to assign the contract to avoid a bad credit risk, and Citibank needs to prevent assignment to avoid a bad credit risk and possibly a lawsuit. Application of the assignment rule becomes a zero-sum game. Herein lies a key reason against relying on rule-based regulation. Its application leaves one party clearly worse off than under the original contract, hence the rule does not yield an efficient outcome. It is not a Pareto improvement, because one party is made better off only by making the other party worse off. 185 In contrast, a switch is a potential Pareto improvement insofar as at least one party is made better off and no one is made worse off. 186 Bangkok Bank is made better off by dealing with Fuji Bank. Citibank is not compelled to accept Fuji Bank as a counterparty but rather is free to pursue through the New York Broker another counterparty. (Of course, depending on exchange rate movements, Citibank could be made worse off by losing the contract with Bangkok Bank. 187)

In this zero-sum game, the identity of the winner cannot be predicted accurately. It is unclear whether a court would agree with Citibank that the purported assignment and delegation materially alters either its risk of return performance or its own obligations. The test for whether a performance is nondelegable is "necessarily imprecise," 188 and the same is true for the test regarding assignments.

184. The Office of the Comptroller of the Currency is statutorily empowered to bring cease and desist, removal and prohibition, and civil money penalty actions for engaging in unsafe and unsound practices against national banks like Citibank. Likewise, the Board of Governors of the Federal Reserve System can bring such actions against bank holding companies like Citicorp (Citibank's holding company). See 12 U.S.C. §§ 1813(q)(1)-(2), 1818(b)(1), (c)(1), (e)(1)(A)(ii), (i)(2)(B)(i)(II), (i)(2)(C)(i)(II).

185. See ROBERT COOTER AND THOMAS ULEN, LAW AND ECONOMICS 50 (1988).

186. See id. Note that "[a] potential Pareto improvement allows changes in which there are both gainers and losers, but requires the gainers gain more than the losers lose." Id. at 50-51. If this condition occurs, then the gainers can compensate the losers and still have leftover surplus for themselves. Thus, application of the assignment rule could be a potential Pareto improvement if Bangkok Bank compensated Citibank after assigning the contract to Fuji Bank. As a practical matter, however, the form and amount of the compensation is unclear, and administration of the compensation scheme may be complicated.

187. See supra note 46 and accompanying text.

188. FARNSWORTH, supra note 83, at 798. See also CALAMARI & PERILLO, supra note 82, at 760 (stating that the test regarding non-delegable duties is "most
Thus, uncertainty as to whether Bangkok Bank or Citibank will be left worse off buttresses the conclusion that the assignment rule is an unattractive means of regulating credit risk problems.189

B. The Adequate Assurances Approach: Uncertainty

Instead of avoiding an undesirable credit risk by switching counterparties, why not require Bangkok Bank to demand adequate assurance of future performance from Citibank? Pursuant to Section 2-609, failure to provide adequate assurances would be a repudiation of the dollar-yen contract by Citibank, and Bangkok Bank would be entitled to rescind the contract.190 The answer is that—like the ap-
plication of Section 2-210—using Section 2-609 does not satisfy the needs of the parties. That Section fails to provide Bangkok Bank with the certainty it requires.

First, it is not clear whether "reasonable" grounds for insecurity exist in the context of a brokered transaction where the identification of the counterparties is made after a contract is formed by agents acting for partially disclosed principals. First, it is not clear whether "reasonable" grounds for insecurity exist in the context of a brokered transaction where the identification of the counterparties is made after a contract is formed by agents acting for partially disclosed principals.191 This question is one of fact,192 thus delineating the term in the abstract is impossible.193

In Section 2-609, the limiting factor is "reasonableness." U.C.C. § 2-609. See also text accompanying infra notes 191-97. Second, unlike Section 2-609(1), RESTATEMENT Section 251 does not require the demand for adequate assurances to be in writing. See infra note 188. Third, in contrast to Section 2-609(4), RESTATEMENT Section 251(2) does not impose a 30-day limit on the time for providing adequate assurance. Fourth, also in contrast to Section 2-609(4), RESTATEMENT Section 251(2) provides the obligee the choice of treating failure to provide adequate assurance as a repudiation.

The C.I.S.G. does not provide a right to demand adequate assurances of future performance. It allows a party to suspend performance of its obligations if:

1. It becomes apparent that the other party will not perform a substantial part of his obligations as a result of:
   a. a serious deficiency in his ability to perform or in his creditworthiness; or
   b. his conduct in preparing to perform or in performing the contract.

C.I.S.G. Article 71(1), in THE CONVENTION, supra note 49, at 51. This standard for suspending performance is narrower than the Section 2-609(1) "reasonable grounds" standard for demanding adequate assurance and suspending performance. See Harry M. Flechtner, Remedies Under the New International Sales Convention: The Perspective from Article 2 of the U.C.C., 8 J.L. & COM. 53, 96 (1988). Because Article 71(1)(a) expressly refers to a deficiency in creditworthiness as a grounds for suspension, applying this provision to the Bangkok Bank-Citibank transaction would not involve the same degree of uncertainty as applying Section 2-609(1).

191. Section 2-609(1) states that "[w]hen reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return." (Emphasis supplied.)

While the rule contains a writing requirement, certainly a fax should suffice. Indeed, courts have not insisted on the formality of a written demand in every circumstance. See, e.g., AMF, Inc. v. McDonald's Corp., 536 F.2d 1167 (7th Cir. 1976) (excusing the buyer's failure to put its demand in writing where the seller clearly knew the buyer had suspended performance until the seller provided adequate assurances). Thus, application of the rule is feasible in global electronic markets wherein profits are generated through a large volume of transactions executed in a short period of time.

192. See WHITE & SUMMERS, supra note 96, at 234-35; FARNSWORTH, supra note 83, at 643-44.

193. The difficulty is illustrated by Farnsworth's own statements. On the one hand, "[m]ere doubts by one party that the other party will render his perfor-
Citibank could argue reasonable grounds do not exist because no change in circumstances—specifically, its creditworthiness—occurred at or after the moment of contract formation. Bangkok Bank could argue that the revelation of Citibank by the Thai Broker is itself a change in circumstance.

The guidance provided by Section 2-609(2) that refers merchants to “commercial standards” may be of little help other than to expand the universe of events beyond those directly related to the dollar-yen transaction that might justify Bangkok Bank’s demand for adequate assurances. Must Bangkok Bank actually have done a credit analysis on, or have established a trading limit for, Citibank before making a demand? Or, can Bangkok Bank act on rumors that Citibank’s financial condition is “shaky” or it may default on a payment owed to holders of its commercial paper?

Second, even if “reasonable” grounds exist, it is not clear what assurance of performance would be “adequate.” Here again, the requirement that “the seller must exercise good faith and observe commercial standards” may be unhelpful. No doubt Bangkok Bank can insist upon more than what the dollar-yen contract would have given it, but it is equally clear that Bangkok Bank’s demand cannot be excessive. Hence, in practice it is difficult to know a priori whether Bangkok Bank’s dissatisfaction is based upon reason and not...
arbitrary or capricious. Must Citibank post $49.5 million in liquid collateral with an escrow agent? Must Citibank obtain a standby letter of credit, performance bond, or other guarantee in favor of Bangkok Bank? In the fast-paced global currency bazaar, there is no time for Bangkok Bank to contact other players (or perhaps even its own attorneys) to ascertain whether such actions by Citibank would be adequate. Finally, Section 2-609 addresses only the problem of a "shaky" bank as a counterparty. What if the basis for requesting a switch is that credit limits or account caps have been reached? Thus, whether Bangkok Bank's determination of adequacy is unlawful is a matter for post hoc adjudication.

C. Commercial Law Reform: An Apostasy

If rule-based regulation cannot meet the needs of participants in global electronic markets, and regulators are skeptical about self-regulation through trade usages, then why not rewrite the rules in the U.C.C.? Surely two expert, centralized bodies, the American Law Institute (ALI) and National Conference of Commissioners on Uniform State Laws (NCCUSL), can devise new rules to help the likes of Bangkok Bank and Citibank and thereby ensure that the U.C.C. retains its vitality in high-technology, cross-border contexts. The answer is that the participants have immediate needs to be addressed in the short term, but the ALI and NCCUSL are helpful, if at all, only in the long run. In the meantime, the domestic commercial law reform process is rather irrelevant to the participants.

This apostasy runs counter to the American commercial law experience of the 1950s and 1960s. Through the coordinated action of the ALI and NCCUSL, disparate state laws were harmonized and certainty was promoted. Not surprisingly, courts, scholars, and regulators still place their faith in the domestic commercial law reform process and urge market participants to find certainty in the resultant rules. Indeed, the regulators have become part of the machinery, as evidenced by the high profile role of the Federal Reserve in the current projects to revise U.C.C. Articles 2, 5, and 9, recent revisions of Articles 3, 4, and 8, and recent drafting of Article 4A. Unfortu-
nately, however, the positive historical experience cannot be gene-
ralized to modern markets whose central features are the (1) use of
advanced constantly evolving technology and (2) participation of
parties scattered across the globe. In truth, the continuing relevance
of the American experience for America itself is dubious and a fortio-
ri for the world.

Consider the rapid technological developments in the domestic
computer software industry in relation to the on-going epic struggle
to promulgate a hub-and-spoke arrangement for Article 2.\textsuperscript{200} In the
international arena, consider the evolution of the mechanics of for-
""
Globalization of markets compounds the challenge faced by the ALI and NCCUSL. The domestic commercial law reform process tends to operate with geographic ethnocentrism. Yet, in global electronic markets, participants located from Atlanta to Athens and Williamsburg to Wellington audaciously ignore national boundaries in their search for profitable transactions. They confront the central fact of commercial law in the international economy: most rules of domestic commercial law have little or no extraterritorial effect, but the resultant void is not always filled with harmonizing rules because no world legislature exists to pass commercial statutes binding on all parties. Indeed, in 1955 the New York Law Revision Com-

205. For instance, the only effect of codifying mercantile terms is to freeze their meanings. Thus, the Article 2 Drafting Committee wisely has decided tentatively to scrap the current Sections 2-319 to 2-324. See § 2-319, Reporter's Notes (Draft Aug. 1994).

206. Obviously, there is no General Agreement on Commercial Law (GACL) administered by a World Commerce Organization (WCO), akin to the General Agreement on Tariffs and Trade (GATT) and the new World Trade Organization (WTO). To be sure, organizations such as the United Nations Commission on International Trade Law (UNCITRAL) make valiant contributions like the C.I.S.G. toward harmonizing commercial law. However, the legal force and effect of even UNCITRAL's efforts is limited.

First, the process of international commercial law reform is even more cumbersome than that of domestic commercial law reform. Indeed, the origins of the C.I.S.G. date to the 1930s when efforts to adopt an international sales law commenced and resulted in the unsuccessful Convention Relating to a Uniform Law on the International Sale of Goods, July 1, 1964, 834 U.N.T.S. 106 and Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods, July 1, 1964, 834 U.N.T.S. 169. The C.I.S.G. drafting effort lasted from 1969 to 1980. See THE CONVENTION, supra note 50, at 3-4. (For a comparative analysis of the treatment of usages of trade in the C.I.S.G. and the 1964 Conventions, see Stephen Bainbridge, Note, Trade Usages in International Sales of Goods: An Analysis of the 1964 and 1980 Sales Conventions, 24 Va. J. INT'L L. 619, 638-40 (1984)). Thus, like the policeman that arrives at the scene of a crime to find the victim, when UNCITRAL agrees on the text of a new convention, model law, or code, it may be long after market participants developed usages of trade to handle particular problems.

Second, when the new international legal texts finally enter into force, it is impossible to make the rules therein binding on all parties in a global electronic marketplace. Obviously, many countries do not adopt the texts. Even for those countries that do, the texts contain authorizations for contracting states to take reservations to important provisions. For example, as a result of reservations taken to Article 1(1)(b) of the C.I.S.G. pursuant to Article 96 thereof by the U.S., China, and other contracting states, the C.I.S.G. has a reduced scope of application. See supra note 72. See also THE CONVENTION, supra, Table 1 at 65-67 and 70, 93, 95-96. As another example, under Article 92(1), a contracting state can take a reser-
mission contemplated a "world commercial code,"207 yet the world is not much closer to one now than it was when the Commission studied the U.C.C. Rather, the void is—or can be—filled efficiently by self-regulation through trade usages developed by those in the best position to manage their uncertainties.

VII. SUMMARY

Trade usages should be reinvigorated to accommodate self-regulation in global electronic markets. If a practice qualifies as a usage, and if the concept of usages is expanded beyond a mere translation device for interpreting disputed terms in a contract, then the practice should acquire a firm legal foundation. In turn, market participants should know they are authorized to engage in the practice and that it creates legal obligations. Armed with this knowledge, they should be able to regulate themselves through their trade usages. Switches and the 5 RR usage in the global currency bazaar clearly illustrate the potential for reinvigorated usages.

Self-regulation through reinvigorating usages is justified on three grounds. First, trade usages not only reduce uncertainty, but also protect expectations, provide flexibility, and promote efficiency. Second, rule-based regulation generates uncertainties and makes certain parties worse off. Third, well-intentioned efforts at reforming commercial law do not meet the pressing needs of parties such as banks trading foreign exchange, at least in the short- and medium-term, because of the reactive, cumbersome nature of the reform process. Thus, courts and scholars should accredit the foundational role of trade usages, and regulators should welcome innovative usages. Indeed, as commerce increasingly relies on high technology and de-
velops cross-border dimensions, courts, scholars, and regulators will have little choice to do otherwise.