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Michael L. Manire

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NOTE

Foreign Exchange Sales and the Law of Contracts: A Case For Analogy to the Uniform Commerical Code

I. INTRODUCTION

The foreign exchange market[1] in the United States has expanded dramatically in recent years. According to a market survey by the Federal Reserve Bank of New York, the volume of foreign exchange trading in the United States increased from a daily turnover of five billion dollars in April 1977 to twenty-three billion dollars in March 1980.[2] Prior to this period of growth, the foreign exchange market was remarkably free of litigation.[3] A bank's reputation for fairness always has been important to other banks and foreign exchange customers in this market in which verbal telephone agreements govern transactions that often involve large sums of money. When the parties make mistakes, they share the loss rather than resort to legal action.[4] The startling lack of case law concerning miscarried foreign exchange deals supports Paul Einzig's observation in 1966 that "[m]ost dealers with very long experience have never had a single lawsuit arising from misunderstandings in respect of foreign exchange transactions."[5]

An examination of the mechanics of foreign exchange transactions reveals the necessity of each party's confidence in the reliability of the other. The characteristics that create this need for confidence, however, so invite human error that legal problems inevitably arise. Since exchange rates[6] may fluctuate from minute to

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1. Foreign exchange is the conversion of the currency of one country into that of another. R. CONINX, FOREIGN EXCHANGE TODAY 9 (1978). A party seeking to convert a particular currency will use that currency to purchase the desired currency.

2. Revey, *Evolution and Growth of the United States Foreign Exchange Market*, FED. RESERVE BANK N.Y.Q. REV., Autumn 1981, at 32.

3. P. EINZIG, A TEXTBOOK ON FOREIGN EXCHANGE 41 (1966).

4. *Id.*

5. *Id.*

6. This Note adopts the method of rate quotation that expresses the number of foreign currency units equivalent to one United States dollar. This exchange rate is the quota-

minute,[7] the parties often make their deals over the telephone so that a purchaser may take immediate advantage of a quoted rate.[8] The parties agree verbally to the rate, the amount purchased, the value date,[9] and perhaps, the payment instructions.[10] Upon the close of the conversation the parties have entered into an oral contract. The parties will mail or wire written confirmations of these terms to each other,[11] although one or both of the parties may take steps toward settling the deal before receipt of a confirmation.[12] What happens then when one party receives the other's confirmation of a different rate, a different amount, a different value date, or a different transaction altogether? One foreign exchange author writes, "There cannot be any market dealer anywhere who has never done a deal 'the wrong way round', or for the wrong amount, or the wrong value date, or some other major error at some time."[13]

The inevitability of these mistakes and their potential cost, given today's volatile exchange rates and the increasing volume of foreign exchange, makes litigation arising from these transactions much more likely than before. This Note briefly describes the foreign exchange market and explains simple versions of certain kinds

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tion method used in the European market and, since 1978, in the United States market. Revey, *supra* note 2, at 42.

7. For example, the exchange rate for the German mark underwent an average daily fluctuation of .706 per cent in the period from October 1979 through August 1981. *Id.* at 37.

8. N. HUDSON, MONEY AND EXCHANGE DEALING IN INTERNATIONAL BANKING 36 (1979). The parties also may make the deal by wire, through a broker, by cable, or through some other written instruction. *Id.*

9. The "value date" is the date on which the parties actually consummate the deal. *Id.* at 43-44. If the transaction is a "spot" transaction the value date may be the day the deal is made, but usually it is two days later to allow the parties time to effect payment and take care of any formalities that various foreign exchange control laws might require. J. HEYWOOD, FOREIGN EXCHANGE AND THE CORPORATE TREASURER 12 (2d ed. 1979); *see infra* text accompanying notes 19-28. If the transaction is a "forward" foreign exchange, the parties will fix a date in the future when they will consummate the deal at the rate agreed upon in the oral contract. J. HEYWOOD, *supra*, at 16-18; *see infra* text accompanying notes 29-41.

10. Payment instructions may state simply that the bank should pay the currency into the purchaser's account. For example, if the purchaser is to receive French francs he may instruct the selling bank to pay them into the purchaser's account in a French bank. Alternatively, if the purchaser of the francs is an American importer of French goods, he may instruct the selling bank to pay the francs into the French bank account of the French exporter from whom he has hought the goods. *See* C. CAMPBELL & R. CAMPBELL, AN INTRODUCTION TO MONEY AND BANKING 355-56 (1972); J. HEYWOOD, *supra* note 9, at 11.

11. J. HEYWOOD, *supra* note 9, at 12; N. HUDSON, *supra* note 8, at 38-39.

12. The selling bank, for example, may buy the currency for its own account so that it can deliver it to the purchaser on the value date, or it may enter into another foreign exchange deal to "cover" its resulting foreign exchange exposure. *See* J. HEYWOOD, *supra* note 9, at 12; *infra* notes 82-86 and accompanying text.

13. J. HEYWOOD, *supra* note 9, at 109.

of foreign exchange transactions. Next, the Note examines in detail the actual mechanics of a sample foreign exchange transaction between a bank and a corporate customer, which rests upon an oral agreement and an exchange of written confirmations. The Note then presents arguments for and against the applicability of Article 2 of the Uniform Commercial Code (U.C.C.) to these transactions and concludes that since foreign exchange transactions should be characterized as sales of choses in action rather than as sales of commodities, Article 2 does not apply. Next, the Note examines the consequences of applying the section 1-206 statute of frauds rather than the Article 2 provision. Finally, the Note focuses upon the effect of the written confirmations on a court's efforts to construe the terms of the contract and concludes that courts should apply the Article 2 parol evidence rule and section 2-207, the "battle of the forms" provision, by analogy to these transactions to achieve simplified and better-reasoned results.

The purpose of this Note is not only to benefit lawyers and judges who must confront these problems in litigation, but also to provide participants in the foreign exchange market with both an understanding of the legal significance of their procedures for making foreign exchange contracts and an appreciation of the possible legal consequences of the mistakes that inevitably result from following these procedures.

II. The Foreign Exchange Market

Three separate relationships define the structure of the foreign exchange market. First is the relationship between commercial banks that deal in foreign exchange and their customers, such as multinational corporations, that desire to exchange currency.[14] Second is the relationship between various commercial banks, which often transact "interbank" deals through foreign exchange brokers.[15] Last is the relationship between American commercial banks and banks in other countries.[16] This Note focuses its discussion upon the principal participants in the American market: nonbank foreign exchange customers and the banks that provide for-

14. C. Campbell & R. Campbell, *supra* note 10, at 354; Federal Reserve Bank of N.Y., *The Foreign Exchange Market in the United States*, in The International Market for Foreign Exchange 98, at 99 (R. Aliber ed. 1969).

15. C. Campbell & R. Campbell, *supra* note 10, at 354; Federal Reserve Bank of N.Y., *supra* note 14, at 99.

16. C. Campbell & R. Campbell, *supra* note 10, at 354; Federal Reserve Bank of N.Y., *supra* note 14, at 99.

eign exchange services to them.

A. Nonbank Participants

1. "Transaction" Foreign Exchange

Transaction[17] foreign exchange occurs when any two parties in different countries transact a sale of goods or services. Since the parties must invoice the sale in one country's currency, either the importer will purchase foreign currency from a bank to pay the exporter or the exporter will receive payment in foreign currency that he will want to convert into his local currency. The potential for loss or profit in these sales because of fluctuations in the exchange rates complicates these simple examples.[18]

a. Spot Exchange

The market for purchase of foreign currency for "immediate" delivery is the "spot" market.[19] Delivery generally is not immediate but occurs two days after the day the parties make the deal.[20] For example, assume that American company *A* contracts to purchase 5,000 widgets from German exporter *G* on January 10, payment to be made in 500,000 German marks on April 10. *A* believes that the mark will depreciate against the dollar, so it decides to "lag,"[21] that is, wait until the last possible moment to purchase the marks. On April 8, *A* telephones its bank in the United States to purchase the necessary marks. *A*'s bank will quote[22] a spot

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17. Brown & Day, *Federal Regulation of Foreign Currency Trading for Future Delivery on Interbank and Futures Markets,* 9 FLA. ST. U.L. REV. 69, 72 (1981).

18. *See id.; infra* note 29.

19. R. CONINX, *supra* note 1, at 82-83; J. HEYWOOD, *supra* note 9, at 12; N. HUDSON, *supra* note 8, at 12; Campbell & O'Connor, *Taxation of Foreign Exchange Activities of Commercial Banks,* 7 TAX ADVISER 541, 543 (1976).

20. *See supra* note 9.

21. By "leading" and "lagging," exporters and importers attempt to take advantage of an anticipated appreciation or depreciation of currency. If an importer who must pay a German exporter 500,000 marks on April 10 anticipates a depreciation of the mark, then by lagging (i.e., waiting to purchase the needed marks until April 8, or sooner if the mark shows signs of appreciating), he will spend fewer dollars than he originally contemplated. In effect he purchases the goods for a lower price. If, however, the mark appreciates, the importer pays more by waiting. An importer's best course of action is to purchase the marks immediately on the forward market. *See infra* notes 29-41 and accompanying text.

Similarly, an exporter will wait as long as practicable before demanding payment to attempt to profit from an anticipated appreciation of the currency in which he expects payment. If his sale is invoiced in the appreciating currency of the importer's country, he will postpone conversion so that he will receive a maximum amount of his local currency. *See* R. CONINX, *supra* note 1, at 73; P. EINZIG, *supra* note 3, at 95; N. HUDSON, *supra* note 8, at 16.

22. For a description of how a bank gives a quotation, see *infra* notes 88-89 and ac-

rate—the current rate—for marks, and assuming *A* accepts the quoted rate, a sale occurs. *A* probably will instruct its American bank to pay the 500,000 marks[23] into *G*'s account in a German bank, and upon doing so, *A*'s bank will debit *A*'s dollar account or otherwise collect from *A* the equivalent amount in dollars.[24]

If the same American company exported the widgets to the German company for payment in marks, upon payment—or as long as possible after payment if *A* were confident that the mark would appreciate against the dollar[25]—*A* would want to convert the marks into dollars. If *A* had an account of marks in a German bank, it could purchase the dollars[26] at the spot rate from its American bank and simply wire its German bank to transfer the marks from *A*'s account to the American bank's German bank account. The American bank would then credit *A*'s account in the amount of dollars that *A*'s marks would buy at the spot rate.[27] If *A* had no German bank account, it could enter into an agreement with its American bank to purchase the dollars before *A* received payment from *G* and simply instruct *G* to pay the marks into the German bank account of the American bank. Again, the American bank would credit *A*'s account for the dollar value of the marks.[28]

b. *Forward Exchange*

Importers and exporters who know that under a certain sales contract they are to pay or receive a fixed amount—the contract price—of foreign currency at a fixed date risk a loss if they choose to wait and utilize the spot market to exchange currency. For example, if an American importer who will pay marks for his German

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companying text. For a more detailed description of the mechanics of a foreign exchange transaction, see *infra* notes 87-105 and accompanying text.

23. The American bank already may have the marks in its own mark account in a German bank, or it may have to purchase the marks on the foreign exchange market. *See infra* notes 74-78 and accompanying text.

24. See C. CAMPBELL & R. CAMPBELL, *supra* note 10, at 356-57 for the basis of this hypothetical import transaction.

25. *See supra* note 21.

26. This transaction raises a difficult question of characterization that might prevent it from being considered along with other foreign exchange transactions as a possible sale of "goods" under Article 2 of the Uniform Commercial Code. Is the transaction a sale of "goods" in which the American company buys a commodity (here, dollars, the local currency), using the marks as the medium of exchange, or is it a purchase of marks by the American bank with dollars as the medium of exchange? *See infra* note 119 and accompanying text.

27. See C. CAMPBELL & R. CAMPBELL, *supra* note 10, at 355-56 for a presentation of this hypothetical export transaction.

28. *Id.*

widgets three months hence waits to purchase the needed marks hoping to take advantage of a depreciation of the mark against the dollar, he faces the obvious risk of an appreciation instead. If the mark appreciates, the importer must pay a greater amount in dollars than he had contemplated when he negotiated the sales contract.[29] This unexpected fluctuation could reduce or even eliminate the profit margin of an importer who resells the goods.[30] A company or individual who takes this risk is said to be in a position of transaction[31] or economic[32] "exposure." Unless an importer or exporter is confident that the exchange rate will fluctuate as he anticipates, he probably will "cover"[33] his transaction exposure in the forward exchange market.

By purchasing the desired currency in the forward foreign exchange market, an importer or exporter can know with certainty from the moment he enters into the forward exchange contract the precise amount he will pay or receive for the goods or services sold and the date on which this payment or receipt will take place.[34] If American importer *A* purchases widgets from German exporter *G* on January 1 with payment of 500,000 marks due on April 8, *A* will call his American bank on January 8 and request the ninety-day forward exchange rate[35] for marks. Assuming that the bank quotes

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29. For example, assume importer *A* will pay a contract price of 500,000 German marks for 50,000 widgets on April 10. On March 10, the contract date, the exchange rate for the mark is 2.2575 (meaning 2.2575 marks per one dollar). Thus, to purchase the widgets, *A* contemplates an expenditure of roughly $221,483.94, or less if he expects a depreciation of the mark. If, however, the mark appreciates so that the rate becomes 2.1782, he will pay $229,547.33, or an additional $8,063.39.

The extent of this hypothetical fluctuation of the mark rate is not unusual. In fact, it represents a 3.514 percent change, which was the average monthly fluctuation of the mark rate in the period from October 1979 through August 1981, according to data compiled by the Board of Governors of the Federal Reserve System. *See* Revey, *supra* note 2, at 37. For that same period, the Swiss franc rate changed at a monthly average of 3.791 percent, the Japanese yen at 3.789 percent, the Canadian dollar at 1.231 percent, and the British pound sterling at 3.388 percent. *Id.*

30. J. Heywood, *supra* note 9, at 21.

31. Brown & Day, *supra* note 17, at 72.

32. J. Heywood, *supra* note 9, at 53.

33. "Covering" is not the same as "hedging," which is defined *infra* note 49. While covering "ensures that the value of a trade or service transaction is definitely fixed," hedging "protect[s] tbe value of an asset or liability which cannot or may never be realized." R. Coninx, *supra* note 1, at 76. Hedging is a long-term device designed to protect a company from the risks of "translation" exposure by such means as restructuring the balance sheet or taking forward cover to match the exposure. *See* J. Heywood, *supra* note 9, at 149 & 152; *infra* notes 42-58 and accompanying text.

34. J. Heywood, *supra* note 9, at 21.

35. To calculate the forward exchange rate, take the spot rate at tbe moment the contract is made and either add or subtract the "forward premium," which is based on the

a rate of 2.2385,[36] *A* and the bank will agree that on April 8 the bank will debit *A*'s account[37] in the amount of $223,363.85[38] and pay 500,000 marks into *G*'s German bank account.[39] No money will change hands until April 8. *A* receives as a benefit not only insurance against fluctuation of the exchange rate but also the ability to control more accurately his pricing, cash flow, budgeting, and other financial concerns.[40]

If *A* is an American exporter who contracts on January 8 to sell widgets to German importer *G* with payment of 500,000 marks due on April 8, *A* can "presell" the marks on the forward market and assure himself of the amount of dollars he will receive on April

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interest differential between the two currencies. J. HEYWOOD, *supra* note 9, at 27-28. Nigel A. L. Hudson explains the calculation in N. HUDSON, *supra* note 8, at 17-23. Hudson uses the example of a British importer who buys goods from an American exporter with payment in dollars due in 90 days. The importer decides to purchase the dollars forward. The spot rate when he contracts to buy the goods is two dollars to one pound sterling. (The pound sterling is always quoted as the number of units of foreign currency that equals one pound. *Id.* at 12.) If the British bank from which the importer purchases the dollars borrows sterling to buy the dollars, it must pay interest for the 90-day period. Assuming the bank reinvests the purchased dollars for 90 days at a lower interest rate, it only will lose the interest differential. The bank adjusts the spot rate by subtracting a "discount" to make the dollars more expensive for the importer to compensate the bank for the loss. *Id.* at 19. The bank calculates the discount by multiplying the spot rate of exchange by the interest rate differential and by the period annualized. For example, if the differential is three percent and the spot rate of exchange is two dollars to one pound sterling, then the forward rate for 90 days is $1.985 to the pound ($2.00 x 3/100 x 90/360 = 0.015; $2.00 - 0.015 = $1.985). *Id.*

If the interest rate of the dollar had been higher than the pound rate, the interest differential would have resulted in a "premium," which the bank would add to the exchange rate. *See id.* If the interest rate of the pound is higher than the dollar rate, the pound is said to be "at a discount" to the dollar, and the dollar "at a premium" to the pound. *Id.*

36. This rate is the actual 90-day forward mark rate for 3 p.m. Eastern time, Friday, January 8, 1982, as listed in Wall St. J., Jan. 11, 1982, at 52, col. 5 (eastern ed.). Since the spot rate for marks at that same time was 2.2575, the dollar was at a discount to the mark. *See supra* note 35. The actual discount was 0.019 (2.2575 - 2.2385 = 0.019); hence, the interest rate on the dollar was 3.37% higher than the interest rate on the mark because 2.2575 x interest differential x 90/360 = 0.019; interest differential = 0.019 divided by (2.2575 x 90/360) = 0.0337. *See supra* note 35.

37. *See supra* note 24 and accompanying text.

38. If the spot rate on the date that *A* entered into the sales contract was 2.2575, see *supra* notes 29 & 36 and accompanying text, *A* might have contemplated spending only about $221,483.94. Indeed, if the mark actually depreciated between January 8 and April 8, the missed opportunity to pay even less might disappoint *A*. As one author observes, however, the premium paid for forward foreign exchange is analogous to a fire insurance premium paid by a factory owner; few factory owners seriously consider cancelling their insurance to save a "wasted" premium because a year has passed without a fire. J. HEYWOOD, *supra* note 9, at 19-20. The current volatility of exchange rates increases the risk of foregoing the "insurance" of forward foreign exchange. *See supra* note 29.

39. *See supra* notes 23-24 and accompanying text.

40. J. HEYWOOD, *supra* note 9, at 20.

8. If the ninety-day forward rate is 2.2385 on January 8, *A* will enter into a contract with his American bank under which on April 8 the bank will credit *A*'s dollar account in the amount of $223,363.85 while *A* either will wire his German bank to pay 500,000 marks into the German bank account of *A*'s American bank or instruct *G* to pay the 500,000 marks into the American bank's German account.[41]

2. "Translation" Foreign Exchange

Multinational corporations are the principal nonbank participants in this area of foreign exchange. The foreign subsidiaries of these corporations have assets and liabilities whose value in the foreign currency the corporation must "translate" into a value in local currency for purposes of consolidation on its balance sheet.[42] The difference between a corporation's assets and liabilities in a foreign currency represents the corporation's translation,[43] balance sheet,[44] or accounting[45] exposure. For example, if an American corporation owns assets in France valued at five million French francs yet carries liabilities of only three million francs, a depreciation of the franc against the dollar will create a loss,[46] which will appear on the corporation's balance sheet.[47] By matching its franc assets with its franc liabilities, the corporation can protect itself from such a fluctuation.[48] The volume of foreign exchange transactions

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41. *See supra* notes 26-28 and accompanying text.

42. J. Heywood, *supra* note 9, at 67; N. Hudson, *supra* note 8, at 109-10; Brown & Day, *supra* note 17, at 74.

43. J. Heywood, *supra* note 9, at 66; Brown & Day, *supra* note 17, at 74.

44. J. Heywood, *supra* note 9, at 66.

45. *Id.* at 67.

46. If the exchange rate applicable to the corporation's balance sheet for fiscal year 1981 was 5.7 francs to the dollar, the five million francs in assets would have appeared on the corporation's balance sheet as $877,192.98, and the three million francs in liabilities would have appeared as $526,315.78, so that the corporation's franc holdings would have shown a $350,877.20 surplus. If the applicable rate for the 1982 balance sheet changed to 5.8, representing a depreciation in the franc, that surplus would be reduced to $344,827.59. The corporation would show a "paper loss" of $6,049.61.

This example illustrates the accounting practices that take effect in 1982 with the Financial Accounting Standards Board's (FASB) Statement No. 52, which requires a corporation to translate all foreign assets and liabilities at current exchange rates. Present accounting practices under FASB Statement No. 8 require the application of "historical" rates in certain situations. *See infra* notes 52-58 and accompanying text.

47. The potential severity of the impact of translation exposure was demonstrated recently when IBM blamed much of its 12% drop in earnings for the fourth quarter of 1981 on "currency-translation losses." *See IBM Net Fell 12% for 4th Quarter, 7.1% for Full Year*, Wall St. J., Jan. 18, 1982, at 6, col. 1 (eastern ed.).

48. N. Hudson, *supra* note 8, at 110-11. If the corporation's foreign assets have the

by corporations seeking to "hedge"[49] against translation exposure has grown considerably in recent years,[50] partly because of the increasing volatility of exchange rates.[51] Another major cause[52] of the increase in corporate hedging has been the Financial Accounting Standards Board's (FASB) Statement No. 8.[53] Issued in 1975, the rule basically requires that corporations translate all balance sheet items representing cash or amounts receivable or payable denominated in a foreign currency into dollars at the current exchange rate as of the date of the report. The corporations, however, must translate items representing nonmonetary assets into dollars at historical exchange rates that prevailed on the date of the assets' acquisition.[54] Recently promulgated FASB Statement No. 52,[55] which requires that all balance sheet items be translated into dollars at current rates,[56] will supersede FASB Statement No. 8 for fiscal years beginning on or after December 15, 1982.[57] Nevertheless, corporations must continue to hedge in foreign exchange to prevent "paper" losses.[58]

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same value in francs as its French liabilities, upon depreciation of the franc against the dollar the reduction in dollar value of these assets would counteract directly the reduction in dollar value of the liabilities. The translation of the corporation's franc accounts would create no paper loss or gain.

49. One author has defined "hedging" as the "[a]ct of buying or selling the currency equivalent of a foreign asset or liability in order to protect its value against depreciation (appreciation) or devaluation (revaluation)." R. CONINX, *supra* note 1, at 157. For an explanation of the difference between "hedging" and "covering," see *supra* note 33.

50. The Federal Reserve Bank of New York estimates that the volume of foreign exchange purchases and sales by nonbank participants increased from $10 billion a month in early 1977 to $42 billion a month in March 1980. Revey, *supra* note 2, at 38. Tbe 75% increase in international trade by American firms during the same period explains these figures only in part. *Id.*

51. *Id.*

52. N. HUDSON, *supra* note 8, at 109.

53. FASB, Statement of Financial Accounting Standards No. 8, Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements (Oct. 1975); *see supra* note 46.

54. *Id.* ¶ 7.

55. FASB, Statement of Financial Accounting Standards No. 52, Foreign Currency Translation (Dec. 1981).

56. *Id.* ¶ 12.

57. *Id.* ¶ 33.

58. *See Once More . . . With Feeling*, FORBES, Oct. 13, 1980, at 192 ("There will still be resultant gains and losses—any third-grader will tell you that when you multiply two numbers by the same number the difference between them changes—but the swings won't be as violent as under the old system.").

a. Spot Exchange

Assume[59] that American corporation *A* has a subsidiary, *S*, in France. If *S* borrows one million French francs from a French bank, then it creates a liability that *A* must translate into dollars on its consolidated balance sheet. If the franc appreciates against the dollar between the loan date and the close of *A*'s financial reporting period, the dollar value of the liability would increase and *A* would suffer a paper loss. To hedge against this translation exposure *A* can borrow the amount of dollars equivalent to one million francs, purchase one million francs with those dollars on the spot foreign exchange market, and invest the francs.[60] When *A* makes its report it will have assets in francs that will counteract any change in the value of its franc liability. The cost of this combined spot foreign exchange market and money market method of hedging, however, usually is greater for a corporation than is the cost of the forward foreign exchange method.[61] Consequently, *A* should only use this method when its need to hedge coincides with its need to borrow francs.[62]

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59. See Brown & Day, *supra* note 17, at 74-75 for the basis of this hypothetical.

60. *See* H. RIEHL & R. RODRIGUEZ, FOREIGN EXCHANGE MARKETS 184 (1977).

61. *Id.* Since in spot-exchange hedging the corporation borrows dollars to huy francs and then invests the francs, it will pay the interest rate charged on the borrowed dollars in dollars and collect the interest rate for the invested francs in francs. The cost of this transaction to the corporation is the difference in the interest rates. *Id.*

In a forward exchange situation, an American hank that sells francs forward to the corporation wishing to hedge against appreciation of its franc liabilities first would borrow the dollars with which to purchase the francs and for which it would have to pay interest. After purchasing the francs the bank would invest them until the value date of the forward contract and collect interest on them. *See supra* note 35. The cost to the bank is equal to the difference in the interest rates. The bank transfers that cost to the purchasing corporation through the computation of the forward exchange rate. *Id.* The cost to the corporation of the spot exchange hedge would he the same as the cost of the forward exchange hedge *if* the interest rates charged to the corporation and the hank for the initial dollar loans were identical. H. RIEHL & R. RODRIGUEZ, *supra* note 60, at 184. Those interest rates, however, will *not* be the same. A lending bank normally will cbarge a nonbank borrower a premium over the interest rate it would charge a borrowing bank. *Id.* To illustrate, assume that American corporation *A* desires to hedge against translation exposure in francs. If *A* chooses to use the forward exchange method, the bank from which it purchases the francs first borrows dollars at 12% interest. The cost to the hank, and thus to *A*, will bo the 3% interest differential, which will emerge in the exchange rate differential (assuming a 9% return on investment). If *A* chooses the spot exchange method, *A* must borrow dollars at a 13.5% interest rate, the interbank rate plus a 1.5% permium. *A* can invest the francs it purchases but will collect only the same 9% interest. The cost to *A* will be 4.5%.

62. H. RIEHL & R. RODRIGUEZ, *supra* note 60, at 185-86.

b. *Forward Exchange*

A can hedge against this same translation exposure situation in the forward exchange market. After *A*'s French subsidiary *S* borrows one million francs, *A* can purchase one million francs forward with a value date near the date on which *A* must make its financial report. The increase in the value of the purchased francs would offset any appreciation in the franc against the dollar and the resulting increase in the value of that franc liability.[63] *A* could use this same procedure to hedge against translation exposure of assets as well. If *S* had one million francs in assets not matched by franc liabilities, *A* could protect itself from a paper loss that would result from a depreciation of the franc by *selling* one million francs forward, with a value date near the date on which it must make its financial reports. If the franc depreciated, *A*'s gain from selling francs at a rate higher than the spot rate would offset *A*'s loss in value of its franc assets.[64]

B. *Bank Participants*

Banks that participate in the foreign exchange market have three main objectives.[65] First, they want to satisfy the needs of their customers.[66] Second, they must manage their own foreign currency exposure.[67] Last, they seek to create a profit for themselves.[68] The first objective has contributed to a growth in bank foreign exchange activity because the customers themselves have increased their demands.[69] But the primary area of banks' increased foreign exchange activity is in the "interbank" market,[70] in which banks trade among themselves. The second objective—management of the banks' exposure—has caused a considerable increase in interbank trading[71] as exchange rates have become more volatile.[72] As banks' foreign exchange departments have grown larger and more sophisticated in the pursuit of these first

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63. Brown & Day, *supra* note 17, at 75.
64. *Id.*
65. N. Hudson, *supra* note 8, at 31; H. Riehl & R. Rodriguez, *supra* note 60, at 13-14.
66. N. Hudson, *supra* note 8, at 31; H. Riehl & R. Rodriguez, *supra* note 60, at 14.
67. N. Hudson, *supra* note 8, at 31; H. Riehl & R. Rodriguez, *supra* note 60, at 14.
68. N. Hudson, *supra* note 8, at 31; H. Riehl & R. Rodriguez, *supra* note 60, at 14.
69. *See supra* note 50.
70. The Federal Reserve Bank of New York estimates that "fully one half of the $385 billion increase in foreign exchange turnover between 1977 and 1960 is accounted for hy 'pure' interbank positioning." Revey, *supra* note 2, at 33.
71. *Id.*
72. *Id.* at 36-37; *see supra* note 29.

two objectives, they have attained their third objective by becoming more adept at seizing the opportunity to profit from fluctuating exchange rates.[73]

1. Transactions with Customers

When a customer purchases foreign currency from an American bank, the bank will pay the customer with currency from its own account in a bank that is in the country of the currency.[74] These accounts are called "nostro" accounts.[75] If the American bank can pay the customer with the currency in its nostro account, the bank is "long" in that currency.[76] If the bank must purchase the currency itself to meet the customer's needs,[77] from the moment it contracts to sell the currency to the customer until it purchases the currency itself, the bank is "short" in that currency.[78] A bank that has long or short exposure in a currency will experience gains or losses from exchange rate fiuctuations. A bank's management of that exposure gives rise to more foreign exchange transactions, especially on the interbank market.[79] Banks profit from transactions with customers by charging a customer an exchange rate higher than the rate at which the bank acquires the currency,[80] although still keeping its rates competitive.[81]

2. Exposure Management

Increased exchange rate volatility has caused banks to resort to more spot trading to protect themselves from even overnight exposure.[82] Banks that find themselves short or long will rush to make a spot transaction to balance their position.[83] For example, a bank that sells five million French francs on the spot market to a customer or another bank immediately will purchase the francs on

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73. Revey, *supra* note 2, at 33.

74. P. Einzig, *supra* note 3, at 26; N. Hudson, *supra* note 8, at 32. The foreign bank is called the American bank's "correspondent." H. Riehl & R. Rodriguez, *supra* note 60, at 15. A bank that carries on a great amount of international business might have its own foreign branch as its correspondent. *Id.*

75. P. Einzig, *supra* note 3, at 26; N. Hudson, *supra* note 8, at 32.

76. R. Coninx, *supra* note 1, at 39.

77. *Id.*

78. *Id.*

79. *See infra* notes 82-85 and accompanying text.

80. N. Hudson, *supra* note 8, at 33.

81. *Id.*

82. Revey, *supra* note 2, at 37-38. Since 1978, exposure in a currency at the end of a trading day bas become more unusual for banks. *Id.* at 38.

83. *Id.* at 34.

the spot market from another bank or customer to prevent a loss in case the franc appreciates. Banks now are less willing to delay a purchase hoping for a depreciation of the franc.

Similarly, a bank that sells five million French francs forward for settlement in three months risks a loss by waiting to purchase the francs on the spot market at the date of settlement. The bank can cover its exposure by *buying* five million francs forward for settlement in three months.[84] The gain in the purchase of the francs would offset any loss to the bank that might result from selling the francs if they should appreciate.[85] Through careful management of these transactions, banks can take advantage of differing exchange rates, differing interest rates, and the strength of certain currencies to profit from these foreign exchange transactions.[86]

III. MECHANICS OF A SAMPLE FOREIGN EXCHANGE TRANSACTION

A, an American corporation, has subsidiaries in several countries. Its West German subsidiary, *G*, plans to borrow 22,575,000 German marks from a German bank on September 8, 1984.[87] *A* determines that to insure against an appreciation of the mark against the dollar and the balance sheet loss that this appreciation would create, on September 6, 1984 it should purchase 22,575,000 marks ninety days forward with settlement due on December 8, 1984, the final day of *A*'s fiscal year.

On September 6, *A*'s treasurer, Mr. Hamilton, telephones the foreign exchange department of the Fifth National Bank of New York, where a dealer, Ms. Cash, answers. Hamilton tells Cash that *A* needs 22,575,000 marks ninety days forward in exchange for dollars and asks for a quotation. Cash gives a quotation of "2.23 70/85,"[88] which Hamilton knows to mean that the bank will sell marks

84. N. HUDSON, *supra* note 8, at 52. The bank might also borrow the necessary dollars, purchase the francs on the spot market, and invest the francs for three months, or use the "swap" market by simultaneously purchasing francs on the spot market and selling the francs three months forward. *Id.* at 53-54. The "swap" is valuable because a gain in the spot purchase of the francs would offset any loss from the sale of the francs that would result from appreciation of the franc. H. RIEHL & R. RODRIGUEZ, *supra* note 60, at 83.

85. *See supra* note 63 and accompanying text.

86. For a discussion of methods a bank foreign exchange dealer can use to obtain profits from these transactions, see N. HUDSON, *supra* note 8, at 46-60.

87. This sample transaction takes place in the future so that FASB Statement No. 52 will apply and require *A* to translate both the loan liability and the forward purchased asset on its balance sheet into dollars at the rate prevailing at the time of the financial report. *See supra* notes 55-58 and accompanying text.

88. J. HEYWOOD, *supra* note 9, at 27. The quoting dealer may use a shorthand version, for example, "70/85 on 3," which represents the last three digits of the buy and sell quota-

ninety days forward at a rate of 2.2370 to the dollar.[89] Hamilton states that *A* will buy 22,575,000 marks for value December 8.[90] Cash replies, "All right, we sell you German marks 22,575,000 and buy the dollars for value 8 December at a rate of 2.2370. Where do you want your German marks?"[91] Hamilton responds, "Please pay the German marks to Kreditbank, Frankfurt, for an account of *G*. We pay the dollars from our account at Fifth National Bank of New York. We will confirm the deal and payment instructions."[92]

When the conversation ends Cash immediately fills out a "deal ticket."[93] Cash records the name and location of *A*, the date of the deal, the value date of the transaction, the currency and amount sold, the currency and amount purchased, the agreed upon rate of exchange, the designation of forward rather than spot delivery, payment instructions, and Cash's own initials for the purpose of accountability.[94] Cash gives the ticket to the bank's "position keeper,"[95] who updates the bank's position in the appropriate currencies by recording the currency, the amount sold and purchased, the customer's name, the rate, and the value date.[96] The position keeper sends the ticket to the bank's "operations" or "servicing" department,[97] which prepares a confirmation of the deal.[98] The confirmation reads, "We hereby confirm the deal done with you by telephone earlier today in which we sold you German marks 22,575,000 against U.S. dollars for value December 8, 1984 at a rate

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tions (2.*2370* and 2.*2385*), assuming that the other party already knows the first two digits. *Id.* at 14. The dealer also may quote forward rates simply in terms of the forward premium; that is, the difference between the spot rate and forward rate. For example, if the full spot quotation were "2.25 55/65" and the full forward quotation were "2.23 70/85," the premium quotation would be "185/180" [(2.2555 - 2.2370 = 0.0*185*) and (2.2565 - 2.2385 = 0.0*180*)]. When the first figure in this "premium quotation" is greater than the second, the currency (here, the mark) is at a premium to the dollar; if the second is larger, the currency is at a discount to the dollar. *Id.* at 27; *see supra* note 35.

89. The quotation means that the bank will purchase marks against the dollar at a rate of 2.2385 and will sell at a rate of 2.2370. J. HEYWOOD, *supra* note 9, at 14; N. HUDSON, *supra* note 8, at 40; H. RIEHL & R. RODRIGUEZ, *supra* note 60, at 66.

90. Hamilton determines the value date for the forward transaction by adding the forward time (90 days) to the spot date appropriate for the dealing date (2 days after). *See* J. HEYWOOD, *supra* note 9, at 25. Since the dealing date is September 6, the spot date is September 8 and the value date is December 7.

91. Cash's reply is based upon an example in *id.* at 11.

92. Hamilton's response is based upon an example in *id.* at 11.

93. N. HUDSON, *supra* note 8, at 36.

94. *Id.* at 36-37.

95. *Id.* at 37.

96. *Id.*

97. *Id.*

98. *Id.*

of 2.2370. From Fifth National Bank of New York."[99] The operations department wires this confirmation to *A*, and mails a similar confirmation signed by an authorized officer that includes payment instructions and other information.[100] The operations department awaits *A*'s incoming confirmation and upon receipt compares the terms with its own record of the deal to ensure that both parties are in agreement.[101]

A's treasury staff similarly records the deal after the telephone conversation and wires a written confirmation that reads, "We confirm the deal done with you by telephone today in which we bought German marks 22,575,000 against U.S. dollars for value December 8, 1984, at a rate of 2.2370. From *A*."[102] *A* also mails a confirmation, signed by its treasurer, Hamilton, that includes payment instructions and other information.[103] The treasury staff checks the bank's confirmation upon receipt to ensure that the terms are the same.[104]

During these procedures, two events occur that highlight the risk of the transaction. First, Fifth National has matched the deal with a reverse transaction[105] by purchasing 22,575,000 German marks against dollars for value December 8 at a rate close to 2.2370. Second, the exchange rate has changed dramatically even since Fifth National's matching transaction. Consequently, a discovery by the parties of conflicting terms in the confirmations threatens the bank with an exposure loss attributable to its matching transaction, and *A* with an exposure loss from its now "unhedged" mark loan liability. What, then, are the legal positions of these parties if the terms set forth in the exchanged confirmations are not identical? This Note next discusses basic legal principles relevant to the determination of the rights of the parties to this transaction.

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99. This confirmation is based upon an example in J. HEYWOOD, *supra* note 9, at 88.

100. *Id.* at 88-89. The mail confirmation also might include the name and telephone number of the individual handling any inquiries about the transaction and the name of the person who made the deal by telephone. *Id.* at 89.

101. N. HUDSON, *supra* note 8, at 37.

102. *See supra* note 99.

103. *See supra* note 101.

104. J. HEYWOOD, *supra* note 9, at 89.

105. *Id.*

IV. Contract Law and the Foreign Exchange Transaction

A. *Is Article 2 of the U.C.C. Applicable?*

A difficult threshold question is whether contract principles embodied in the U.C.C. or the common law are applicable to foreign exchange transactions. Only one reported case since the promulgation of the U.C.C. has considered a foreign exchange transaction in the context of contract law litigation.[106] In that case, *United Equities Co. v. First National City Bank,*[107] both the New York Supreme Court[108] and the Supreme Court Appellate Division[109] applied various sections of Article 2[110] of the U.C.C. to a dispute over delivery of Japanese yen under a forward foreign exchange contract after the Japanese government, during the interim period between the contract date and the value date, imposed new regulations prohibiting delivery to certain nonresident Japanese accounts.[111] The parties apparently did not dispute the applicability of Article 2 and neither court questioned it. Thus, although the case serves as an example of how courts can apply Article 2 effectively to foreign exchange transactions, it offers no direct authority for the statute's applicability. Although a strong case could have been made for applying Article 2 in *United Equities*, a careful examination of both the scope of the statute and the nature of foreign exchange transactions leads to the conclusion that courts should apply the U.C.C. only by analogy, if at all.

Article 2 applies to "transactions in goods."[112] The statute defines "goods" as "all things . . . which are moveable at the time of

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106. The U.C.C. was promulgated in 1951 and first enacted by the state of Pennsylvania in 1953. *General Comment,* Uniform Commercial Code Official Text—1978, at xv (9th ed. 1978).

107. 52 A.D.2d 154, 383 N.Y.S.2d 6 (1976), *rev'g* 84 Misc. 2d 441, 374 N.Y.S.2d 937 (Sup. Ct. 1975), *aff'd,* 41 N.Y.2d 1032, 363 N.E.2d 1385, 395 N.Y.S.2d 640 (1977).

108. 84 Misc. 2d 441, 374 N.Y.S.2d 937 (Sup. Ct. 1975).

109. 52 A.D.2d 154, 383 N.Y.S.2d 6 (1976).

110. The Supreme Court cited §§ 2-503, -614, -713, and -715, 84 Misc. 2d at 442-45, 374 N.Y.S.2d at 939-42, while the Appellate Division cited §§ 2-503, -614, and -713, 52 A.D.2d at 158, 161-63, 383 N.Y.S.2d at 9, 11-13.

111. 52 A.D.2d at 155, 383 N.Y.S.2d at 7-8. The parties entered into a contract on April 12, 1971, for the purchase of 360,000,000 Japanese yen six months forward against $1,018,710 with delivery of the yen to take place in Japan on October 14, 1971. The purchaser of the yen, United Equities Co., had no yen bank account in Japan, and in the interim the Japanese government declared that nonresidents who had no yen account prior to September 6, 1971, could not open one subsequent to that date. *Id.* United Equities had no time to open a new account and thus had no way to receive delivery in Japan as the contract required. *Id.* at 156, 383 N.Y.S.2d at 8.

112. U.C.C. § 2-102 (1978).

identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action."[113] The Official Comment to this definition elab orates:

> The exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a comodity but not to include it when money is the medium of payment.[114]

The "Practice Commentary" of the New York codification of this definition adds that " 'money', other than the money in which the price is to be paid, is included in the definition of 'goods': thus a contract for sale of coins or of foreign currency is a contract for sale of goods."[115]

While no cases actually have held that foreign currency is a good for Article 2 purposes, a federal district court has held in *In re Midas Coin Co.*[116] that United States coins sold for profit are "goods" as defined in Article 9 of the U.C.C.[117] That definition of "goods" "includes all things which are moveable at the time the security interest attaches . . . but does not include money."[118] Although coins sold for their numismatic value are distinguishable from foreign currency, this case underscores the difference between money used as a medium of payment and money sold as a commodity. The court considered the Article 9 definition of goods in light of the Article 2 definition and concluded:

> The definition of "money" *as used in the Code,* to mean "a medium of exchange" etc. clearly has no reference to money *when treated as a commodity.* It is our view, therefore, that the exclusion of "money" in the definition of "goods" pertains solely to money when used as a medium of excbange and intended to be so used by the parties at the time of the transaction in question. When used or intended to be used and treated as a *commodity,* as were the coins here involved, they are to be considered "goods," just as are all other commodities.[119]

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113. *Id.* § 2-105(1).

114. *Id.* § 2-105 official comment 1.

115. N.Y.U.C.C. § 2-105 practice commentary n.2 (McKinney 1964).

116. 264 F. Supp. 193 (E.D. Mo. 1967), *aff'd sub nom.* Zuke v. St. Johns Community Bank, 387 F.2d 118 (8th Cir. 1968).

117. 264 F. Supp. at 197-98. *See also* Morauer v. Deak & Co., 26 U.C.C. REP. SERV. (CALLAGHAN) 1142 (D.C. Super. Ct. 1979) (applying Article 2 to sale of gold and silver foreign coins).

118. U.C.C. § 9-105(h) (1978).

119. 264 F. Supp. at 197. Most authority that supports the application of Article 2 to foreign exchange transactions mentions only foreign currency, not dollars, as a good. *See, e.g., supra* notes 114-15 and accompanying text. *Midas Coin,* however, demonstrates that

Early case law provides two arguably valid approaches for treating a foreign exchange transaction as the sale of a commodity.[120] One approach focuses on the purchaser's intended use of the currency: If the purchaser plans to resell the currency rather than use it as a medium of exchange, the courts would classify the money as a commodity. In *Richard v. American Union Bank*[121] a bank entered into a contract to sell 2,000,000 Romanian lei by cable transfer to the purchaser's account in a Bucharest bank. The issue before the New York Court of Appeals was whether the transaction represented the sale of a medium of exchange or a commodity for purposes of determining whether a delay in delivery had damaged the plaintiff purchaser.[122] Noting that at the time of the transaction both parties understood that the purchaser had planned to resell the lei in the United States rather than use it as as a medium of exchange in Romania, the court held that the contract was for the sale of a commodity.[123] In a Missouri case, *Liepman v. Rothschild*,[124] two individuals entered into a contract which provided that one party would purchase a sum of German marks and deliver half to the other. The court did not specify whether the parties contemplated physical delivery of mark notes, a cable transfer, or even delivery of a bank draft. In determining whether the contract fell within the statute of frauds, the court had to decide whether the transaction was for the sale of marks as

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United States "money" can have a value other than as a medium of payment, and U.C.C. § 2-105 official comment 1 is subject to an interpretation that allows treatment of United States dollars as a good: "Goods is intended to cover the sale of *money* when *money* is being treated as a commodity . . . ." *Id.* This discussion, however, might be purely academic since one can view any foreign exchange transaction from the other party's perspective and describe a corporation's purchase of dollars from a bank in exchange for French francs as a purchase of francs by the bank.

120. Zimmerman v. Roessler & Hasslacher Chemical Co., 211 A.D. 321, 207 N.Y.S. 370 (1925), offers support for the characterization of a foreign exchange transaction as a sale of goods, although to decide whether the New York Appellate Division's rationale for that classification is curious. The court had to characterize a contract for cable transfer of German marks as a sale of goods or a sale of "credit" to determine whether the state's Sales of Goods Act should apply. The court decided that the contract could not be for the sale of a credit because the parties had not specified a time and place for the establishment of the credit. *Id.* at 323, 207 N.Y.S. at 371-72. Without further explanation the court concluded that the contract was for the sale of marks as goods.

121. 253 N.Y. 166, 170 N.E. 532 (1930).

122. If the purchaser intended to use the lei as a medium of exchange in Romania any change in the exchange rate that occurred while he awaited delivery would not affect the buying power of the lei. On the other hand, if the purchaser planned to resell the lei as a commodity the fiuctuation in the exchange rate could affect the value of the commodity.

123. 253 N.Y. at 175, 170 N.E. at 535.

124. 216 Mo. App. 251, 262 S.W. 685 (1924).

a commodity or as "money." The court found that since the United States was at war with Germany at the time of the transaction, the parties could not have intended to use the marks as money. Hence, the transaction was a sale of marks as a commodity and within the statute of frauds.[125] In *Reisfeld v. Jacobs*[126] a New York court held that a contract to sell Russian ruble notes in specific denominations fell within the New York Personal Property Law statute of frauds, which expressly excluded "money" from its coverage. The notes, which a government no longer in power had issued,[127] clearly were not usable as "money." The statute, however, did cover the sale of goods or choses in action, and the court's decision seemed to rest on its ambiguous characterization of the rubles, which the plaintiff purchased for resale, as either goods or choses in action.[128]

If a court today were to follow the reasoning of *Richard, Liepman,* and *Reisfeld,* Article 2 would govern the transaction of a purchaser who intended to resell the money on the foreign exchange market but not the transaction of an importer who purchased the foreigu money to pay his exporter. The definition of goods contained in Article 2, however, does not consider the purchaser's intended subsequent use of the subject of a sale. By excluding "money in which the price is to be paid,"[129] the definition focuses on the role of the money in the immediate transaction that is before the court. In an ordinary contract for the sale of a good, the "good" is the subject of the contract of sale while the money paid in exchange is the "medium of payment." In a foreign exchange transaction the customer's desired foreign money is the subject of the sale while the money he pays in exchange is the medium of payment.[130] Even if the customer later uses the purchased foreign money as the medium of payment in another transaction, that transaction is *entirely separate* from the initial purchase.

125. *Id.* at 255-56, 262 S.W. at 686.

126. 107 Misc. 1, 176 N.Y.S. 223 (Sup. Ct. 1919).

127. *Id.* at 3, 176 N.Y.S. at 224.

128. The court stated that the characterization of the rubles as choses in action offers "an additional reason for holding the Statute of Frauds applicable." *Id.*

129. U.C.C. § 2-105(1) (1978).

130. "Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment." U.C.C. § 2-105 official comment 1 (1978). If foreign currency in a foreign exchange transaction is called the medium of payment, then any commodity that is the subject of a purchase and sale also must be referred to as a medium of payment. Clearly, Article 2 does not contemplate this characterization but rather views a good as the subject of a sale in which the money paid for it is "the medium of payment." A sale can only have one medium of payment.

Clearly, then, the Article 2 exclusion of "money" from its definition of goods would not apply to the foreign money that a customer buys in a foreign exchange transaction.

Melzer v. Zimmerman[131] suggests the second and correct approach that courts should follow in determining the applicability of Article 2 to foreign exchange transactions. In *Melzer* the parties expressly contracted for an "over the counter"[132] sale of Austrian kronen rather than for a cable transfer of the money. The court distinguished carefully the transaction from a transfer of a "deposit account" and held that because the contract was for the actual delivery of currency it fell within New York's Personal Property Law as a sale of a commodity or goods.[133] In contrast, the foreign exchange transactions that this Note addresses concern the transfer of funds from one bank account to another rather than actual physical delivery of currency or notes.[134] The Article 2 definition of goods itself suggests that it applies only to transactions for the physical delivery of notes. Section 2-105(1) excludes from the definition of goods "things in action." The drafters of Article 2 surely must have intended "things in action," which the U.C.C. does not define, to have the same meaning as the more common "choses in action,"[135] of which bank accounts are one obvious example.[136] When a bank sells a purchaser foreign money, the purchaser generally receives not physical money but a credit to his foreign bank account,[137] which represents a chose in action against his foreign bank for that amount.[138]

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131. 118 Misc. 407, 194 N.Y.S. 222 (Sup. Ct. 1922).

132. *Id.* at 408, 194 N.Y.S. at 223.

133. *Id.*, 194 N.Y.S. at 223-24.

134. "A foreign exchange deal is a contract to exchange a bank balance in one currency for a bank balance in another currency at an agreed price for settlement on an agreed date." J. HEYWOOD, *supra* note 9, at 11.

135. A "chose in action" is defined as a "right of bringing an action or right to recover a debt or money." BLACK'S LAW DICTIONARY 219 (rev. 5th ed. 1979). Indeed, "chose" is the French word for "thing." Perhaps the drafters wished to modernize this traditional law phrase. For a discussion of the meaning of "things in action" in § 2-105(1), see Squillante, *Commercial Code Review*, 76 COM. L.J. 42 (1971).

136. *See, e.g.*, State v. Tauscher, 227 Or. 1, 360 P.2d 764 (1961).

137. *See, e.g.*, Samuels v. E.F. Drew & Co., 296 F. 882, 886 (2d Cir. 1924) ("Even when the obligation is performed and the credit established, the customer is only the owner of an obligation or chose in action and not of any actual foreign money.").

138. Several early cases characterized foreign exchange transactions as sales of choses in action. *See, e.g.*, Samuels v. E.F. Drew & Co., 296 F. 882 (2d Cir. 1924) (funds paid to bank for purchase of foreign credit held not a special deposit); Gravenhorst v. Zimmerman, 236 N.Y. 22, 139 N.E. 766 (1923) (contract for future creation of a foreign credit held an executory contract subject to rescission); Equitable Trust Co. v. Keene, 232 N.Y. 290, 133

The annoying and seemingly overly technical problem of whether to characterize a foreign transaction as a chose in action or as a good exists because the concept of a foreign exchange transaction differs from its effectuation. The purchaser wants a commodity such as French francs, but because the commodity is money the transaction is made through banking channels, in which application of the Article 2 concept of goods is inappropriate.[139] Clearly, the foreign money in these transactions cannot be goods because the money is not "movable at the time of identification to the contract."[140] Hence, the drafters of Article 2 must have intended that the statute cover only sales of foreign money in the form of hard currency.[141]

Yet courts should not hesitate to apply Article 2 to foreign exchange transactions "by analogy" whenever appropriate.[142] The drafters intended the U.C.C. "to simplify, clarify and modernize the law governing commercial transactions"[143] and "to make uniform the law among the various jurisdictions."[144] This Note next discusses various contract law problems that arise in foreign exchange transactions, and suggests that although common-law contract principles may be applicable, courts, lawyers, and the parties to these transactions all would benefit from the simplification and increased uniformity that an application of Article 2 by analogy would provide.

N.E. 894 (1922) (contract for future creation of a foreign credit held an executory contract and therefore not within applicable statute of frauds); Legniti v. Mechanics & Metals Nat'l Bank, 230 N.Y. 415, 130 N.E. 597 (1921) (foreign exchange transaction held a sale of a "credit" and no trust relationship existed between bank and foreign exchange customer).

139. *See supra* notes 129-30 and accompanying text.

140. U.C.C. § 2-105(1) (1978).

141. Professor Williston lends support to this conclusion in his critique of the *Equitable Trust* case in which he stated, "As it is evident that the English money was not to be transferred *in specie*, the contract was not for the sale of a commodity . . . ." S. WILLISTON, CONTRACTS § 520B n.9 (3d ed. 1969).

142. For a case in which a court applied the U.C.C. hy analogy to the sale of a chose in action, see Zamore v. Whitten, 395 A.2d 435 (Me. 1978). For discussion of other areas in which courts have applied the U.C.C. analogously, see Mallor, *Utility "Services" Under the Uniform Commercial Code: Are Public Utilities in For a Shock?*, 56 NOTRE DAME LAW. 89 (1980); Murray, *Under the Spreading Analogy of Article 2 of the Uniform Commercial Code*, 39 FORDHAM L. REV. 447 (1971).

143. U.C.C. § 1-102(2)(a) (1978).

144. *Id.* § 1-102(2)(c).

B. The Statute of Frauds

1. Article 2

Since parties to foreign exchange transactions often conduct their deals over the telephone, a discussion of contract law as applied to these transactions must hegin with the statute of frauds. Here the question of the applicability of Article 2 of the U.C.C. becomes crucial, for if these transactions were sales of "goods," section 2-201 would render unenforceable any foreign exchange contract with a price of $500 or more unless the transaction complied with one of two requisite formalities. Either the party enforcing the contract must produce an adequate written confirmation signed by the other party or, if both parties are "merchants," the enforcing party must have sent a confirmation to the other party and, within ten days of receipt by the other party, must not have received written notice of objection.[145] Since, however, an adequate confirmation need only "afford a basis for believing that the offered oral evidence rests on a real transaction"[146] and include the "quantity term,"[147] the confirmation normally sent by both parties[148] in a foreign exchange transaction should meet easily the statute's writing requirement.[149] Furthermore, the signature requirement poses no serious problem since even a printed or typed signature will suffice.[150]

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145. Section 2-201 states in pertinent part:

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sougbt or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.

Id. § 2-201.

146. *Id.* § 2-201 official comment 1.

147. *Id.*

148. *See supra* notes 97-104 and accompanying text.

149. For an example of a case in which a written confirmation removed an oral telephone contract from the § 2-201 statute of frauds, see Lambert Corp. v. Evans, 575 F.2d 132 (7th Cir. 1978).

150. U.C.C. § 1-201(39) (1978) defines "signed" as "any symbol executed or adopted by a party with present intention to authenticate a writing." Official comment 39 to § 1-201 elaborates: "Authentication may be printed, stamped or written; it may be by initials or by

Because foreign exchange transactions almost always will be "between merchants" for purposes of the statute of frauds,[151] a party may protect himself by always sending a signed confirmation to the other party after the two have reached an agreement[152] and by promptly sending written notice of objection if he receives a "confirmation" of a deal that he did not make. For further protection, an inexperienced party who might not qualify as a "merchant" should demand a written confirmation from the other party. The latter's refusal would entitle the demanding party to suspend performance of his obligation.[153] The other party's failure

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thumbprint." *Id.* § 1-201 official comment 39.

A court held a typed signature sufficient in A & G Constr. Co. v. Reid Bros. Logging Co., 547 P.2d 1207 (Alaska 1976).

151. Section 2-104(3) states that "'[b]etween merchants' means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants." U.C.C. § 2-104(3) (1978). Section 2-104 defines "merchant" as

> a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

Id. § 2-104. A transaction between banks almost always will be "between merchants." Even a bank or corporation that is inexperienced in foreign exchange may be a merchant for purposes of the statute of frauds provision according to official comment 2 to § 2-104.

> The term "merchant" as defined here roots in the "law merchant" concept of a professional in business. The professional status under the definition may be based upon specialized knowledge as to the goods, *specialized knowledge as to business practices*, or specialized knowledge as to both and which kind of specialized knowledge may be sufficient to establish the merchant status is indicated by the nature of the provisions.
>
> The special provisions as to merchants appear only in this Article and they are of three kinds. Sections 2-201(2), 2-205, 2-207 and 2-209 dealing with the statute of frauds, firm offers, confirmatory memoranda and modification rest on normal business practices which are or ought to be typical of and familiar to any person in business. *For purposes of these sections almost every person in business would, therefore, be deemed to be a "merchant"* under the language "who . . . by his occupation holds himself out as having knowledge or skill peculiar to the practices . . . involved in the transaction . ." [sic] since the practices involved in the transaction are non-specialized business practices such as answering mail. In this type of provision, banks or even universities, for example, well may be "merchants."

Id. § 2-104 official comment 2 (Emphasis added). Since § 2-201(2) requires only that the parties have experience in answering mail, any foreign exchange transaction will fall within this subsection.

152. Under § 2-201(2) the party must send the confirmation "within a reasonable time. What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action." *Id.* § 1-204(2). A reasonable time in the foreign exchange market may be shorter than in other industries because of fluctuating exchange rates. *See* Lish v. Compton, 547 P.2d 223 (Utah 1976) (twelve days not a reasonable time in fluctuating wheat market).

153. "When reasonable grounds for insecurity arise with respect to the performance of

to sign a written confirmation after promising to do so, may estop him from pleading the statute of frauds as a defense.[154]

Article 2 also provides for satisfaction of the statute of frauds through partial performance. A contract that fails to meet the writing requirement nevertheless is enforceable "with respect to goods for which payment has been made and accepted or which have been received and accepted."[155] The difficulty of applying Article 2 to transactions in "nonmovable" items, such as foreign exchange transactions is particularly apparent in this instance because the parties effect delivery and payment by cable transfer and bank account adjustments.[156] Section 2-606, however, which describes acceptance of goods, offers some guidance by declaring that a buyer accepts goods when he "does any act inconsistent with the seller's ownership."[157] A purchaser who sells, invests, or spends money delivered to his account by the seller accepts that money and removes the contract from the statute of frauds. An examination of the purchaser's financial records should reveal any such act. A seller, however, who has delivered foreign money into the account of a foreign exporter according to the instructions given by a purchaser who seeks merely to pay the exporter for purchased goods cannot demonstrate acceptance in this way. Can a bank's delivery of German marks into the account of a German exporter according to the importer's instructions constitute delivery to the purchaser? Does the exporter's acceptance of delivery, however manifested, represent an acceptance by the purchaser? These actions hardly constitute an "unambiguous overt admission by both parties that a contract actually exists."[158] Consequently, a bank that sells foreign money to an importer or exporter who needs the money to effect payment would have to rely on written confirmations to remove the foreign exchange contract from the statute of frauds.

If, however, a court determines, as indeed it should, that sec-

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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." U.C.C. § 2-609(1) (1978). "After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract." *Id.* § 2-609(4). *See* RESTATEMENT (SECOND) OF CONTRACTS § 141 comment b (1981).

154. *See* Rockland Indus. v. Frank Kasmir Assoc., 470 F. Supp. 1176 (N.D. Tex. 1979).

155. U.C.C. § 2-201(3)(c) (1978).

156. *See* C. CAMPBELL & R. CAMPBELL, *supra* note 10, at 355-56; N. HUDSON, *supra* note 8, at 39; *supra* notes 19-28 and accompanying text.

157. U.C.C. § 2-606(1)(c) (1978).

158. *Id.* § 2-201 official comment 2.

tion 2-201 is not applicable to foreign exchange transactions because they are sales of choses in action, then it should not apply that provision even by analogy. Rather, the court should apply the section 1-206 statute of frauds, which covers sales of choses in action.[159]

2. Section 1-206

Section 1-206 of the U.C.C. requires a writing for a contract for the sale of "personal property" to be enforceable beyond $5,000.[160] Unlike the various state statutes of frauds, which generally do not cover contracts for sales of choses in action,[161] the Official Comment to section 1-206 reveals that the drafters clearly intended this statute to cover sales of bank accounts.[162]

Section 1-206 does not offer the same guidance as the Official Comment to section 2-201 on the sufficiency of written memoranda, although section 1-206 does require that the writing indicate a "defined or stated price" and that it "reasonably identif[y] the subject matter."[163] Thus, signed confirmations should satisfy the section 1-206 statute of frauds if, as section 2-201 requires, they "afford a basis for believing that the offered oral evidence rests on a real transaction," include a quantity term,[164] and, in addition, reasonably identify the foreign money that is the subject matter of the sale and state the price. The confirmations traditionally sent by both parties to foreign exchange transactions easily

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159. *See infra* notes 161-62 and accompanying text.

160. U.S.C. § 1-206 (1978) provides:

(1) Except in the cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars in amount or value of remedy unless there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent.

(2) Subsection (1) of this section does not apply to contract for the sale of goods (Section 2-201) nor of securities (Section 8-319) nor to security agreements (Section 9-203).

161. *See* RESTATEMENT (SECOND) OF CONTRACTS § 110 (1981).

162. The Official Comment to § 1-206 states that the section's purpose is to "fill the gap left by the Statute of Frauds provisions for goods (Section 2-201), securities (Section 8-319), and security interests (Section 9-203). . . . [T]he principal gap relates to sale of the "general intangibles" defined in Article 9 (Section 9-106) and to transactions excluded from Article 9 by Section 9-104." Section 9-104(l) provides that Article 9 does not apply to "a transfer of an interest in any deposit account." A "deposit account" includes "a demand, time, savings, passbook or like account maintained with a bank." *Id.* § 9-105(e).

163. *Id.* § 1-206(1).

164. *See supra* notes 145-50 and accompanying text.

should satisfy these requirements.[165]

Because section 1-206 omits the 2-201(2) provision for merchants a party who seeks to enforce the contract must rely on the other party to draw up and sign a confirmation. The enforcing party should demand that the other party send a signed confirmation. A refusal by the other party would entitle the demanding party to suspend his own performance and obtain restitution for any performance he already may have rendered.[166] Failure by the other party to sign a confirmation after he has promised to do so may estop him from pleading the statute of frauds as a defense.[167]

Unlike section 2-201, section 1-206 does not allow satisfaction of its requirements by partial performance or even by the other party's admission that a contract exists.[168] If a party fails to meet the strict writing requirements of section 1-206, however, the consequences are lenient. For example, a contract within the 1-206 statute of frauds would be enforceable up to $5,000 in damages.[169] Moreover, the difficulty of proving partial performance in foreign exchange transactions[170] reduces the likelihood that a party could take advantage of the provision in any case.

C. *The Confirmations' Effect on the Terms of the Contract*

1. The Oral Contract

Under both the common law and the U.C.C., the sample transaction described in Section III of this Note, like most foreign exchange transactions, rests on an oral contract. The nature of the foreign exchange market dictates that the parties to the transaction are bound as soon as they make a deal over the telephone. In a spot transaction the bank and the customer or other bank may take steps to effect payment[171] or enter into a second transaction

165. *See supra* notes 97-104 and accompanying text.

166. *See supra* note 153 and accompanying text.

167. *See supra* note 154 and accompanying text.

168. *See* Note, *The Uniform Commercial Code, Section 1-206—A New Departure in the Statute of Frauds?*, 70 YALE L.J. 603, 609-10 (1961).

169. The natural reading of the section is that the $5,000 figure merely limits the extent to which the courts will enforce the contract. *See* Olympic Junior, Inc. v. David Crystal, Inc., 463 F.2d 1141, 1145 (3d Cir. 1972) (1-206 "would be no bar to enforcement of the contract to the extent of $5,000, regardless of the value of the property to be sold under the contract"). *But see* Cohn, Invers & Co. v. Gross, 56 Misc. 2d 491, 289 N.Y.S.2d 301 (Sup. Ct. 1968).

170. *See supra* notes 155-58 and accompanying text.

171. *See* J. HEYWOOD, *supra* note 9, at 11-12.

to cover exposure that the previous transaction created[172] before the parties send confirmations of the deal. In a forward transaction, to cover their exposure the parties may match the deal with its reverse in a second transaction before they exchange any written forms of the agreement.[173] If a bank must wait from the time the parties agree upon a rate until they exchange written confirmations to determine whether it must cover the transaction, the bank could suffer considerable losses from rate fluctuations.[174]

Although foreign exchange contracts often rest upon telephone conversations,[175] sometimes one side may argue that because the parties later prepared written confirmations they had not intended to bind themselves until they had reduced the terms to a writing, signed it, and exchanged copies. In *Schwartz v. Greenberg*[176] two parties met to negotiate a sale of stock, signed individual counterparts of a written proposed contract, but did not exchange the counterparts because the plaintiff refused to accept an uncertified check as payment.[177] The next day the defendant refused to complete the transaction, and the plaintiff sued for breach of contract.[178] The New York Court of Appeals found "no evidence of an intention of the parties to be bound by any mere oral understanding," and held that "the parties did not intend to be bound until a written agreement had been signed and delivered."[179] The court found that since the parties had not exchanged the signed counterparts of the proposed contract, no actual agreement existed upon which to sue. This argument in the foreign exchange context, however, would create a swearing contest, that the party who claimed that no contract existed would have difficulty winning because of the conventions of the foreign exchange market.

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172. *See* Revey, *supra* note 2, at 37-38.

173. J. HEYWOOD, *supra* note 9, at 89.

174. *See* Revey, *supra* note 2, at 37-38.

175. Section 2-204(1) states that "[a] contract for sale of goods may be made in any manner sufficient to show agreement. . . ." U.C.C. § 2-204(1). The Official Comment to § 2-204 observes that the provision "continues without change the basic policy of recognizing any manner of expression of agreement, oral, written or otherwise." *Id.* § 2-204 official comment. See 3 S. WILLISTON, *supra* note 141, § 82A for a discussion of the common-law recognition of telephone contracts.

176. 304 N.Y. 250, 107 N.E.2d 65 (1952).

177. *Id.* at 253, 107 N.E.2d at 66.

178. *Id.*

179. *Id.* at 254, 107 N.E.2d at 67.

2. Confirmations of the Oral Contract and the Parol Evidence Rule

At the conclusion of a foreign exchange transaction a court could examine two sources of evidence to ascertain the agreed terms of the contract. First, the parties could testify about the oral contract terms that they agreed upon in their telephone conversation. Second, the parties could introduce their written confirmations of that oral contract. Assuming the availability of these confirmations, however, the court might face some difficult evidentiary decisions. Should the court allow testimony by one of the parties that the terms agreed upon over the telephone do not appear in the confirmations, or that certain terms which appear in the confirmations differ from those originally agreed upon? The parol evidence rule governs these decisions, and again the question of the applicability of Article 2 is particularly significant. The court's decision under the common-law parol evidence rule very well might differ from a decision under the Article 2 rule. This Note compares various common-law interpretations of the parol evidence rule with the Article 2 rule and concludes that courts should apply the Article 2 provision by analogy not only because of its greater clarity and simplicity, but also because of its better-reasoned treatment of written confirmations of oral contracts.

a. The Common-Law Parol Evidence Rule

The parol evidence rule generally prohibits the introduction of extrinsic evidence that conflicts with a writing or any expression that the parties intend as the final expression of their agreement.[180] A writing that expresses the parties' final agreement is an integrated writing.[181] No evidence is admissible that contradicts the integrated portions of a completely or partially integrated writ-

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180. Professor John Murray explains the rule as follows:

> [I]f the parties to a transaction have embodied that transaction either in whole or in part, in a single memorial, sucb as a writing or writings, and if they have come to regard that memorial as the final expression of their intentions as a whole, or of a part thereof, then all other utterances that have taken place in connection with that transaction, prior to or contemporaneous with the making of the memorial, are immaterial for the purpose of determining what the terms of the transaction are or at least so much of it as is embodied in the memorial. Reduced to its simplest terms, this is a statement of the usual principle of the substantive law of contracts that, if the parties so intend, their final expression will prevail over any antecedent expression of agreement.

J. MURRAY, MURRAY ON CONTRACTS § 105, at 227 (2d rev. ed. 1974) (footnotes omitted).

181. *Id.* at 228-29; 4 S. WILLISTON, *supra* note 141, § 633, at 1010.

ing.[182] If a writing is only partially integrated, the parties intended it as the final expression of only a portion of their agreement,[183] and extrinsic evidence of additional terms that are not inconsistent with the integrated portion may be admissible.[184]

The obvious threshold question in the foreign exchange context is whether the written confirmations constitute an integration of the agreement. An integrated writing will prohibit consideration of evidence even of a prior agreement.[185] Thus, if a court finds that a written confirmation of a sale of 50,000 French francs is an integration of the agreement, a party may not introduce evidence of the oral agreement that would vary the written version. Courts and commentators, however, disagree about how a court should determine whether a writing is integrated. Unless the writing itself indicates tbat it does or does not represent the final and definite expression of the parties' agreement, a court must sift through a variety of suggested tests for determining integration.[186] A party to a telephone foreign exchange transaction rarely will intend to be

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182. J. MURRAY, *supra* note 180, § 106, at 229; 4 S. WILLISTON, *supra* note 141, § 633, at 1014.

183. J. MURRAY, *supra* note 180, § 104, at 226; 4 S. WILLISTON, *supra* note 141, § 636, at 1035.

184. *Id.*

185. RESTATEMENT (SECOND) OF CONTRACTS § 215 (1981).

180. Professor Murray notes that although all courts and commentators agree that the basic issue is the "intention of the parties," they disagree on how to determine that intention. J. MURRAY, *supra* note 180, § 106, at 229. For example, Murray describes Professor Williston's test, which focuses

> not on whether the extrinsic agreement was in fact made, but, whether reasonable parties, situated as were the parties to this contract, would have naturally and normally included the extrinsic matter in the writing. If parties might naturally form a separate agreement as to such extrinsic matter, the writing was not integrated as to that matter.

Id. at 231 (citing 4 S. WILLISTON, *supra* note 141, §§ 638-39). Murray compares this test to that of Professor Corbin who

> insists upon a test which would have the trial judge (in most cases) consider the extrinsic evidence for two purposes: (1) to determine whether there is "respectable" evidence to show that the antecedent agreement was made, and (2) to determine whether such an antecedent agreement has or has not been discharged by the subsequent writing whicb one of the parties contends is the sole repositery of the agreement.

J. MURRAY, *supra* note 180, § 106, at 231 (citing 3 A. CORBIN, CORBIN ON CONTRACTS § 582 (1960)) (footnotes omitted). Finally, Murray manages to identify a trend in the confused case law:

> The myriad approaches to the parol evidence rule problem suggested by the writers, the new Restatement and the [Uniform Commercial] Code are reflected in the case law which has been generally ineffective in articulating a workable rationale though the results of the cases may not be viscerally unacceptable. There is a movement toward a Corbin position and away from a Williston position evident in the case law, probably because the reasons underlying the parol rule are no longer compelling.

J. MURRAY, *supra* note 180, § 107, at 235-36 (footnote omitted).

bound solely by the terms of a confirmation sent by the other party. The parties merely rely on the confirmations to ensure that no misunderstanding exists about the terms of the transaction to which they agreed over the telephone. Professor Wigmore suggests that a writing intended "merely to furnish an aid to the writer's recollection or a written admission for the other party's satisfaction" is not an integration.[187] Furthermore, several cases have held that a memorandum upon which the parties rely to remove a contract from the statute of frauds is not integrated and, hence, not subject to the parol evidence rule.[188] In *Nathan v. Spector*[189] the court admitted parol evidence showing that a memorandum of a sale of real property did not contain all of the essential terms of the contract that the applicable statute of frauds required. The writing failed to satisfy the statute, and the court held the contract unenforceable.[190] The more liberal writing requirements under the U.C.C. statute of frauds, which arguably covers foreign exchange transactions likely will prevent this harsh consequence.[191] *Spector,* however, offers clear authority for an argument that a mere memorandum or confirmation of a contract is not an integration. In that case the court ruled expressly that the memorandum of sale was not an integration; had it found otherwise, it might not have admitted the parol evidence that rendered the contract unenforceable.

Since the parties' confirmations in a foreigu exchange transaction would not constitute an integration, a court would admit testimony concerning the original oral agreement. In a genuine dispute the parties probably would tell conflicting versions of what terms they agreed upon over the telephone. If one party introduced a confirmation, it would sway the fact-finder only if it conflicted with the other party's testimony.[192] If both parties introduced confirmations and each writing corroborated its respective party's testimony, the fact-finder would not find either particularly helpful. If,

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187. 9 J. WIGMORE, EVIDENCE § 2429, at 95-96 (3d ed. 1940).

188. *See, e.g.,* Donald Friedman & Co. v. Newman, 255 N.Y. 340, 174 N.E. 703 (1931); N.E.D. Holding Co. v. McKinley, 246 N.Y. 40, 157 N.E. 923 (1927); Nathan v. Spector, 281 A.D. 451, 120 N.Y.S.2d 358 (1953); Duncan v. Wohl, South & Co., 201 A.D. 737, 195 N.Y.S. 381 (1922); Southern States Dev. Co. v. Robinson, 494 S.W.2d 777 (Tenn. Ct. App. 1972). *But see* Moran v. Thurman-Davis Grain Co., 226 S.W. 84 (1920).

189. 281 A.D. 451, 120 N.Y.S.2d 358 (1953).

190. *Id.* at 454, 120 N.Y.S.2d at 361.

191. *See supra* notes 145-69 and accompanying text.

192. For a discussion of whether the different term might modify the contract, see *infra* notes 206-08 and accompanying text.

however, both parties' confirmations agreed on the disputed terms, the evidence would be almost conclusive that the testimony provided by the confirmations was accurate. Yet under the common law, even if the two confirmations agreed on the disputed terms, the court nevertheless must admit evidence that the parties originally agreed to different terms. Since both parties rarely would prepare their confirmations with identical but incorrect terms, this admission of conflicting testimony would be a waste of the court's time.[193]

b. *The Article 2 Parol Evidence Rule*

The Article 2 parol evidence rule, codified at section 2-202,[194]

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193. In the unlikely event that hoth parties make identical mistakes in recording their agreement, they could argue for reformation of the confirmations under the equitable doctrine of "mistake." Mistake as applied to written confirmations of an oral contract would be characterized as "an expression of agreement which differs from the agreement intended by the parties." 13 S. WILLISTON, *supra* note 141, § 1541, at 67.

New York courts, however, twice have refused to allow reformation of written confirmations that the parties relied upon to remove oral contracts from the statute of frauds. *See* Donald Friedman & Co. v. Newman, 255 N.Y. 340, 174 N.E. 703 (1931); Kobre v. Instrument Systems Corp., 54 A.D.2d 625, 387 N.Y.S.2d 617 (1976), *aff'd,* 43 N.Y.2d 862, 374 N.E.2d 131, 403 N.Y.S.2d 220 (1978). These New York cases are distinguishable from the foreign exchange situations in which the applicable statute of frauds would be U.C.C. § 1-206 or perhaps U.C.C. § 2-201. *See supra* part IV(B). The court in *Friedman* noted that the applicable statute of frauds in that case, 1909 N.Y. LAWS ch. 45 (repealed 1964), required that a memorandum "shall completely evidence the contract which the parties made." 255 N.Y. at 343, 184 N.E. at 704 (quoting Poel v. Brunswick-Balke-Collender Co., 216 N.Y. 310, 314, 110 N.E. 619, 620 (1915)). The *Kobre* court applied the statute of frauds as codified in N.Y. GEN. OBLIG. LAW § 5-701 (McKinney 1978 & Supp. 1982) and stated that the "memorandum must contain substantially the whole agreement and all its material terms and conditions. . . ." 54 A.D.2d at 626, 387 N.Y.S.2d at 618-19 (quoting Mentz v. Newwitter, 122 N.Y. 491, 497, 25 N.E. 1044, 1046 (1890)). While these New York cases were governed by statutes of frauds which required that confirmatory memoranda express *entirely* the terms of a contract, the U.C.C. statutes of frauds require only that the memoranda "afford a basis for helieving that the offered oral evidence rests on a real transaction." U.C.C. § 2-201 official comment 1 (1978). Section 2-201(1) declares that "[a] writing is not insufficient hecause it omits or incorrectly states a term agreed upon," *id.* at § 2-201(1), and the language of § 1-206 implies that the same policy applies in that section. *See supra* notes 160-62 and accompanying text. Thus, a reformation under the U.C.C. would not give a confirmation "an effect forbidden by the statute," 255 N.Y. at 347, 174 N.E. at 705, and, therefore, a court should allow it. *See* U.C.C. § 1-103 (1978) (providing that the doctrine of mistake applies under the U.C.C.). *See also* Luria Bros. & Co. v. Pielet Bros. Scrap Iron & Metal, 600 F.2d 103 (7th Cir. 1979) (allowing reformation of memorandum under § 2-201).

194. Section 2-202 provides:

> Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

simplifies considerably the judicial task of interpreting contracts with confirmations. Like the common law, section 2-202 properly allows oral evidence of conflicting terms if only one confirmation exists, except in the unlikely event that the confirmation is integrated.[195] If both parties issue confirmations that agree on certain terms, section 2-202 construes the writings as integrated with respect to their common terms without requiring any such determination by the court.[196] Extrinsic evidence that conflicts with the terms common to both confirmations is inadmissible.[197]

Courts should apply this far more sensible treatment of confirmations analogously to foreign exchange transactions.[198] The remainder of section 2-202 parallels the common law, except that section 2-202 emphasizes construing terms by "course of dealing or usage of trade" or "by course of performance,"[199] and rejects any presumption that an integrated writing is final on "all the matters agreed upon."[200] A finding of partial integration would allow evidence of "consistent additional terms"[201] under section 2-202, just as it would at common law. Furthermore, application of this section by analogy to foreign exchange contracts would provide the courts with the additional advantage of a consistent starting point, as described in the Official Comment to 2-202, for determining par-

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(a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

U.C.C. § 2-202 (1978).

195. Some courts have misapplied U.C.C. § 2-201(2), which provides that a single confirmation will satisfy the statute of frauds if the other party does not send notice of objection, by incorporating the terms of the confirmation into the contract without first applying the § 2-207 materiality test. *See infra* notes 215-16 and accompanying text. *See, e.g.*, Campanelli v. Conservas Altamira, S.A., 477 P.2d 870 (Nev. 1970); 3 R. DUESENBERG & L. KING, SALES AND BULK TRANSFERS UNDER THE UNIFORM COMMERCIAL CODE (MB) § 3.09, at 3-98 to 3-99 (1982).

196. *See, e.g.*, Luria Bros. & Co. v. Pielet Bros. Scrap Iron & Metal, 600 F.2d 103 (7th Cir. 1979).

197. For a discussion of the possibility of reformation because of mutual mistake in recording the terms, see *supra* note 193.

198. Courts have applied U.C.C. § 2-202 to transactions in "nongoods" in the following cases: Stern & Co. v. State Loan & Finance Corp., 238 F. Supp. 901, 911 (D. Del. 1965) (sale of stock); Interstate Indus. Uniform Rental Serv., Inc. v. F.R. Lepage Bakery, Inc., 413 A.2d 516, 522 (Me. 1980) (contract for goods and services); Hunt Foods & Indus., Inc. v. Doliner, 26 A.D.2d 41, 42-43, 270 N.Y.S.2d 937, 939-40 (1966) (sale of stock).

199. U.C.C. § 2-202(a) (1978).

200. *Id.* § 2-202 official comment 1(a).

201. *Id.* § 2-202(b).

tial integration.[202]

3. Confirmations of the Oral Contract and the "Battle of the Forms"

a. *The Common Law*

At common law, the "mirror image rule" requires that an acceptance not vary the terms of an offer if the acceptance is to be effective.[203] A purported acceptance that does not match the offer acts as a counteroffer, which the original offeror must accept to form a contract.[204] This common-law doctrine, however, makes no provision for confirmatory memoranda of prior contracts. Thus, if the parties to a foreign exchange transaction send conflicting confirmations, a court faced with establishing the terms of the contract would admit evidence of the prior oral agreement in addition to the confirmations.[205] In this manner, the fact-finder could choose between the terms suggested in oral testimony and those recorded in the two differing confirmations. This process could produce results that are unpredictable and confusing to lawyers, courts, and parties to these transactions.

Courts face a similar problem if the parties exchange confirmations and a term in one confirmation is absent from the other or conflicts with a term in the original agreement. Again, the fact-finder would have to determine whether the term is a part of the contract by considering evidence of the oral agreement in addition to the confirmations. If the court determines that the original agreement did not include the term or included a conflicting term, the court would construe it as an "offer" to modify the already-existing contract.[206] The court will modify the contract to include the term if the other party assents to or "accepts" the offer of modification.[207] The party's silence will operate as acceptance if he enjoys the benefits of that modification or if he has indicated somehow that his silence signifies an acceptance.[208] Thus, a party

202. The Official Comment provides, "If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact." *Id.* § 2-202 official comment 3.

203. J. MURRAY, *supra* note 180, § 54, at 111.

204. *Id.*

205. This conclusion assumes, of course, that the confirmations do not integrate the agreement. *See supra* notes 185-91 and accompanying text.

206. *See, e.g.*, Suitter v. Thompson, 225 Or. 614, 358 P.2d 267 (1960).

207. *Id.*

208. RESTATEMENT (SECOND) OF CONTRACTS § 69 comment a. *See* Suitter v. Thompson,

who receives a confirmation that includes a different or additional term should protect himself by notifying the other party either that he accepts or rejects that term.

Yet, the problems of the mirror image rule still may persist because parties may use standard confirmation forms that differ and may not notice inconsistent or additional terms.[209] Furthermore, a party may attempt to employ the "last shot"[210] advantage by adding a favorable term in his confirmation and then trying to show somehow that the other party assented to it. Clearly, application of common-law rules to foreign exchange transactions would subject the parties, their lawyers, and the courts to the infamous problems of the "battle of the forms."[211]

b. *Section 2-207*

The purpose of section 2-207 is to solve the problems that the mirror image rule creates.[212] Although often criticized as poorly drafted,[213] the section could be applied appropriately by analogy in the foreign exchange context because it offers explicit guidelines for treatment of confirmations of prior oral contracts.[214]

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225 Or. 614, 358 P.2d 267 (1960).

209. Davenport, *How to Handle Sales of Goods: the Problem of Conflicting Purchase Orders and Acceptances and New Concepts in Contract Law*, 19 BUS. LAW. 75, 78 (1963).

210. J. MURRAY, *supra* note 180, § 54, at 113.

211. *Id.*

212. Section 2-207 provides:

> (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
>
> (2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
> (a) the offer expressly limits acceptance to the terms of the offer;
> (b) they materially alter it; or
> (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.
>
> (3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

U.C.C. § 2-207 (1978).

213. The Kansas Supreme Court, for example, has described § 2-207 as a "murky bit of prose." Southwest Eng'g Co. v. Martin Tracter Co., 205 Kan. 684, 694, 473 P.2d 18, 25 (1970).

214. The Official Comment explains the scope of § 2-207:

> This section is intended to deal with two typical situations. The one is the written confirmation, where an agreement has been reached either orally or by informal corre-

Section 2-207 directly solves the problem of the term that appears in the confirmation but not in the original agreement. It provides that "[t]he additional terms are to be construed as proposals for addition to the contract."[215] Although this provision is the same as at common law, its guidelines for adding terms to the contract simplify considerably the common-law rules and reduce the danger of the "last shot." If the parties are merchants,[216] "such terms become part of the contract unless . . . they materially alter it . . . or . . . notification of objection to them has already been given or is given within a reasonable time after notice of them is received."[217]

Although the requirement that a party expressly agree to the addition of a term that materially alters the contract offers little guidance on what the courts will or will not construe as a material alteration, at least the provision gives the courts a mandate to soften the blow of the "last shot." The arbitration term is the most frequently litigated example of a term that parties attempt to add, and courts generally deem the provision sufficiently "material" to prevent its inclusion in the contract.[218]

Notwithstanding this protection against material alteration, parties must read confirmations carefully to protect themselves from the addition of unfavorable terms that a court might not consider material. The "reasonable time" that a party has to object to additional terms begins as soon as the confirmation arrives.[219]

> spondence between the parties and is followed by one or both of the parties sending formal memoranda embodying the terms so far as agreed upon and adding terms not discussed. The other situation is offer and acceptance. . . .

U.C.C. § 2-207 official comment 1 (1978).

215. *Id.* § 2-207(2).

216. *See supra* note 151. In the unlikely event that the two parties are not merchants for purposes of § 2-207, the common law will determine whether the terms will become part of the contract. *See* U.C.C. § 1-103 (1978).

217. U.C.C. § 2-207(2) (1978). Subsection (a) of § 2-207(2), which prevents the additional terms from becoming part of the contract if "the offer expressly limits acceptance to the terms of the offer," *id.* § 2-207(a), simply is inappropriato in the context of confirmations to an already existing contract, *see* American Parts Co. v. Arbitration Ass'n, 8 Mich. App. 156, 154 N.W.2d 5 (1967); 3 R. DUESENBERG & L. KING, *supra* note 195, § 3.08, at 3-92 to 3-93.

218. *See, e.g.*, Lounge-A-Round v. G.C.M. Mills, Inc., 109 Cal. App. 3d 190, 166 Cal. Rptr. 920 (1980); American Parts Co. v. American Arbitration Ass'n, 8 Mich App. 156, 154 N.W.2d 5 (1967); *In re* Marlene Indus. Corp. v. Carnac Textiles, Inc., 45 N.Y.2d 327, 380 N.E.2d 239, 408 N.Y.S.2d 410 (1978); *In re* Tunis Mfg. Corp., 40 A.D.2d 664, 337 N.Y.S.2d 150 (1972); Application of Doughboy Indus., Inc., 17 A.D.2d 216, 233 N.Y.S.2d 488 (1962).

219. Section 1-201(27) explains "notice" as follows:

> Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brougbt to the attention of the

Moreover, given the volatility of exchange rates, a "reasonable time" for purposes of the foreign exchange industry likely will be shorter than in most industries.[220]

Section 2-207 does not resolve the problem of different terms as clearly as it does that of additional terms because it does not expressly provide that different terms be treated as proposals for addition to the contract. The Official Comment to section 2-207, however, states that "[w]hether or not additional or different terms will become part of the agreement depends upon the provisions of subsection (2)."[221] Courts are split on this question.[222] The better solution is to interpret section 2-207(2) to include different terms. In the case of two confirmations whose terms conflict, the Official Comment to section 2-207 provides a simple resolution that further supports this view: "Where clauses on confirming forms sent by both parties conflict each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself."[223] The drafters, then, intended that differing confirmations be within the ambit of the section 2-207(2)(c) objection provision.[224] This interpretation eases considerably the task of a court faced with this situation. The court need look only to the original contract and the terms on which the confirmations agree to construe the agreement, without considering additional terms.[225]

> individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting tbe transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

U.C.C. § 1-201(27) (1978). Thus, the organization sbould bring a confirmation to the attention of the appropriate officer immediately upon its arrival.

220. "Wbat is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action." U.C.C. § 1-204(2) (1978). In Lish v. Compton, 547 P.2d 223 (Utah 1976), the court held that 12 days was not a reasonable time for objection to a written memorandum under § 2-201 because of the fluctuations of the wheat market.

221. U.C.C. § 2-207 official comment 3 (1978).

222. *Compare, e.g.*, American Parts Co. v. Arbitration Ass'n, 8 Mich. App. 156, 154 N.W.2d 5 (1967) (§ 2-207(2) applies only to additional terms) *with* Steiner v. Mobil Oil Corp., 20 Cal. 3d 90, 569 P.2d 751, 141 Cal. Rptr. 157 (1977) (§ 2-207(2) applies both to additional and different terms).

223. U.C.C. § 2-207 official comment 6 (1978).

224. Official Comment 6 explains further that conflicting confirmations "do not become a part of the contract" because the conflict satisfies "the requirement that there be notice of objection wbich is found in subsection (2)." *Id.* § 2-207 official comment 6.

225. The Official Comment relies on the § 2-202 parol evidence rule's treatment of con-

When faced with only one confirmation form that includes a term different from its counterpart in the oral agreement, a court should treat the original contract term as an objection which "has already been given"[226] to the different term under section 2-207(2)(c). This result is appropriate, for the parties have entered into a binding contract that they can change only through express consent. Unfortunately, however, since one cannot assume that a court will follow this reasoning, a party who receives a confirmation changing the terms of the original agreement should always notify the other party in writing of his objection to the different terms to assure himself of protection.

V. Conclusion

Time is precious and trust indispensible in the burgeoning foreign exchange market. Deals must be made *now*, often over the telephone, and the details of checking the terms of those deals against the other parties' understanding of them must wait. The prospect of continued growth in foreign exchange increases the likelihood of litigation arising from the necessarily rapid and abbreviated system employed by banks and their customers of recording the terms of these transactions.

Although one may argue that Article 2 of the U.C.C. applies to these transactions, closer examination reveals that the statute is not applicable since the transactions actually are sales of choses in action. Thus, courts probably will apply the more lenient statute of frauds provision of section 1-206 to these transactions rather than section 2-201. Traditional confirmation forms should satisfy the statute, and a party should demand that the other party send a confirmation if he does not offer to do so.

Courts should apply the Article 2 parol evidence rule and the Article 2 provision for the battle of the forms by analogy to foreign exchange transactions. Because these sections specifically address confirmations of prior oral contracts, their application would simplify considerably the court's task of construing these agreements and would provide more consistent and appropriate results.

Michael Latham Manire

firmations that agree, *see supra* note 194, in explaining what terms a court should include in the contract: "The contract then consists of the terms originally expressly agreed to, terms on which the confirmations agree, and terms supplied by this Act, including subsection (2)." U.C.C. § 2-207 official comment 6.

226. U.C.C. § 2-207(2)(c) (1978).