

Herbert Smith

The background of the page is a close-up, slightly blurred image of the European Union flag, showing the blue field with twelve golden-yellow stars arranged in a circle. The flag is draped, creating soft folds and shadows.

Potential Eurozone break-up:

Questions and answers

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1. Introduction

- 1.1 In this note, we consider some of the issues which would arise if a Member State were to decide to leave the Eurozone (or, indeed, be expelled). There are a number of potential methods by which a Member State could leave the Eurozone, with different consequences.
 - 1.2 In particular, we set out some of the key issues creditors would face recovering euro-denominated debts from borrowers based in countries leaving the Eurozone.
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2. What is the euro?

- 2.1 The euro is a “single currency” which was created as part of the economic and monetary policy of the European Union (the “**EU**”). Article 3 of the Treaty on European Union (the “**TEU**”) provides that: “[t]he Union shall establish an economic and monetary policy whose currency is the euro”.
 - 2.2 Further, in relation to the monetary policy of the EU, Article 119 of the Treaty on the Functioning of the European Union (the “**TFEU**”) provides that the activities of the Member States and the EU shall include a single currency, the euro. Member States are required to adopt the euro once they have met certain specified requirements. The only exceptions are the United Kingdom and Denmark, which have opt-out rights.
 - 2.3 The Eurosystem comprises the European Central Bank (the “**ECB**”) and the national central banks of the Participating Member States (the “**PMS**”) whose currency is the euro. Pursuant to Article 128(1) TFEU, the ECB has the exclusive right to authorise the issue of euro banknotes within the EU, and notes issued by the ECB and the national central banks of the PMS are the only euro banknotes to have the status of legal tender within the EU.
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3. If a PMS wanted to leave the euro, what would it need to do?

- 3.1 The EU treaties currently contain no provision for exit from the euro. However, there are at least five ways in which a PMS could leave the single currency.
 - 3.1.1 **Exit on the basis of the current treaty**

Although the EU treaties do not contain a specific provision for exit from the euro, Article 50 TEU does give a Member State the right to withdraw from the EU. Therefore, in principle, a PMS could leave the euro by exiting the EU. Under the terms of Article 50, exit is possible following the negotiation and conclusion of a withdrawal agreement or, failing that, two years after notification is provided.
 - 3.1.2 **Exit on the basis of a new procedure via an amendment to the current treaty**

In the absence of an express provision, the EU treaties could be amended to provide for such a provision. Article 48 TEU sets out an ordinary revision procedure and a simplified revision procedure for amendment of the EU Treaties.
 - 3.1.3 **Expulsion**

According to media reports of the Cannes G20 meeting, Greece was threatened with expulsion. However, there is currently no treaty mechanism to expel a PMS.
 - 3.1.4 **Unilateral exit**

As it is a sovereign state as well as a PMS, it could be argued that a PMS could unilaterally exit the euro. Unilateral withdrawal would, in principle, be contrary to EU law. If not viewed as permitted under international law or EU law, this would significantly increase the risk that the PMS’s decision would not be recognised by other EU member states. If such unilateral withdrawal were not to be recognised, then, as a matter of EU law, any associated redenomination of existing euro liabilities into local currency would also not be recognised.



3.1.5 **Collective exit**

Alternatively, outside the terms of the existing treaties, the PMSs (with the consent from the non-euro Member States) could decide to end the euro and revert to national currencies.

3.1.6 **Exit on the basis of a political compromise**

In the absence of any clear legal means to exit the euro on an urgent basis, *real politik* might simply lead to action even in the absence of a clear legal procedure. Therefore, even in the absence of a clear “legal basis”, practical arrangements for an orderly exit could still be sought. As part of any political compromise, agreement to mitigate the illegal effect of any such action could be taken. This could involve, for example, an agreement to amend the EU Treaties at a later stage or an agreement not to take action before the EU courts. This sort of negotiated solution could involve the relevant PMS leaving the EU and an associated redenomination of existing euro liabilities into local currency.

4. **If a euro-denominated loan or bond is made under English law, does English law decide the currency of account?**

4.1 The currency in which a debt is expressed (the “**currency of account**”) will be ascertained by construing the relevant agreement in accordance with the law applicable to it.

4.2 From an English law perspective, if the language of the document is not clear on its face, the objective will be to establish the intention of the parties. The key question is: when they designated the euro as the currency of account, did the parties mean the common, international currency of the euro or the national currency of one of the parties? This is a question the parties are unlikely to have addressed at the time the agreement was entered into. It may be necessary, therefore, to look at the wider background to the agreement.

4.3 If the agreement refers to the debt being “in euro” or payment to be made of an amount expressed “in euro”, then (in the absence of express contractual terms) the presumption will be:

4.3.1 that the parties intended to refer to the common, international currency of the euro rather than to the euro as the currency of a particular Member State (particularly in an agreement between international counter-parties);

4.3.2 reinforced where the form of agreement is one which is the standard form used in the international financial markets (such as, for example, the LMA documentation);

4.3.3 reinforced where the form of agreement is one of a suite of agreements in different common, international currencies (that is, for each of US dollar, sterling and euro); and

4.3.4 that the Euro will continue to exist, even if one PMS exits from the euro (the position is more complicated if there is ‘meltdown’ in the Eurozone such that the euro itself ceases to exist), and that English law will continue to recognise the euro as a currency in which private contractual obligations may be discharged irrespective of a change in the borrower’s own national currency.

4.4 As a general matter, the English courts will:

4.4.1 seek to uphold the efficacy of contracts and the commercial bargain struck between the parties at the time the debt agreement was entered into; and

4.4.2 be reluctant to accept that the withdrawal of a PMS from the euro has the effect of discharging or excusing performance of a private contractual obligation.

4.5 Given the express terms of most standard form loan documentation (and usual bond terms) and the factors set out above, it is to be hoped that there is no doubt left that euro means the common, international currency of the euro. However, as a matter of English law, if there is doubt as to the currency of account, then the parties are presumed to refer to the currency of the country with which the contract is most closely connected. This gives rise to much greater uncertainty and a number of different factors may be relevant:

4.5.1 if the parties agreed a place of payment, there is a presumption that they intended the currency of that place to be the money of account;

- 4.5.2 if the borrower is a public authority, there is an underlying presumption that it intends to contract in its own currency; and
 - 4.5.3 if debt is incurred in connection with property, the location of the property may be an important consideration.
 - 4.6 If an English court were to conclude that the parties intended their debt to be expressed in the national currency of a PMS, then this gives rise to some difficult issues surrounding the question of what is the legal tender of that PMS at the time the debt is scheduled to be repaid. For example, if a PMS were to withdraw from the euro, it would have to create a new monetary law and establish a new national currency. However, such actions would give rise to a conflict because by joining the euro (and replacing its national currency) that PMS:
 - 4.6.1 irrevocably and irreversibly ceded its monetary sovereignty to the EU; and
 - 4.6.2 adopted the relevant European legislation as its monetary law.
 - 4.7 Much would depend on the manner in which the relevant PMS exited the Euro because there is no prescribed mechanism by which a Member State may lawfully withdraw from the euro. Unless the withdrawal is lawful as a matter of EU law, the declaration of a new currency would amount to a breach of TFEU.
 - 4.8 In respect of a unilateral withdrawal, the exiting PMS would most likely attempt to re-denominate all debt in the country. This may be illegal as a matter of EU law but would be likely to be held by the national courts of the exiting PMS to be legal as a matter of domestic law.
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5. How could a creditor force a borrower to repay Euro? Would the English and local courts take the same approach?

- 5.1 There is an important threshold question as to which courts would have jurisdiction in respect of an action for breach of the repayment obligation. So long as the relevant PMS has not withdrawn from the EU, this question is answered by reference to the provisions of Council Regulation No. 44/2001 to which national courts are required to give effect. Under the standard London LMA form of loan agreement (and usual bond terms), there is a one-way exclusive jurisdiction clause for the benefit of the lender in favour of the English courts to which both the English courts and the courts of the relevant PMS should give effect.
- 5.2 Choice of English jurisdiction (as well as the choice of English law as the applicable law) is key as there are obvious risks associated with foreign courts purporting to apply English law. The English courts would first address the issues of the applicable law of the contract and the currency of account.
- 5.3 If the loan or bond agreement is governed by English law and the currency of account is euro (and in the absence of national legislation which declares that domestic payments can no longer be made in euro), then there is nothing to prevent a borrower from repaying its debt in euro, even if the borrower's domestic currency is no longer euro.
- 5.4 However, if the relevant PMS was re-asserting monetary sovereignty and declaring a new monetary law, an English court would be reluctant to order specific performance (that is, payment by the borrower in euro to the bank account of the creditor) as it would not wish to expose a party to penal sanctions under its domestic law. However:
 - 5.4.1 English law would still govern the quantum of the debt to be re-paid (and would therefore determine the exchange rate to be used when converting the amount of the euro-denominated debt into domestic currency); and
 - 5.4.2 an English court may award damages for breach of the repayment obligation in euro (and the currency in which those damages should be calculated would also be determined by English law).
- 5.5 Assuming that the relevant PMS remained within the EU and subject to the Rome I Regulation, its courts should approach the issue of the applicable law of the loan debt agreement in the same way as the English courts, subject to the additional point that the local courts would be obliged to take into account overriding mandatory provisions of local law (which could potentially prohibit payments from being made in any currency other than local currency). Such provisions are provisions regarded by a country as crucial for safeguarding its public interests, which include its economic organisation.
- 5.6 If the exit from euro coincided with an exit from the EU, then a redenomination of euro obligations into local currency would be effective as a matter of local law, which would create great difficulties for any foreign creditor who attempted to enforce its euro-denominated claims in an exiting PMS. The local courts could also cease to recognise foreign judgments in euro.



6. If a PMS left the euro, would any EU law still apply to it? Could any court enforce it?

- 6.1 It is not open to an English court to determine that another Member State is in breach of its obligations under EU law. Such an issue is reserved to the European Court of Justice. Proceedings before the European Court of Justice would have to be brought by the European Commission or another Member State in national courts.
- 6.2 However, issues of EU law can be raised and determined in proceedings between two private parties.
- 6.3 Any attempt by a private party to bring a claim against a Member State for breach of its obligations under the EU legislation governing adoption of the euro appears doomed to fail. The relevant EU legislation does not confer rights on private parties. It cannot be said that in becoming a PMS, the relevant nation assumed any duty to compensate private parties who suffered a loss from any subsequent withdrawal from the euro. In defending any claim brought by a private party, the relevant PMS would in all likelihood be able to rely on sovereign immunity.

7. Could the exiting PMS introduce capital controls? A moratorium? Could the EU stop it?

- 7.1 If the PMS remained in the EU, it would in principle be prohibited from introducing capital controls or a moratorium on the movement of capital or payments.
- 7.2 While restrictions on the movement of capital and payments are normally prohibited, exceptions to the Article 63 TFEU obligation do exist. These include:
 - 7.2.1 the ability of Member States to continue to apply restrictions to third countries where the restrictions existed before a given date (for Italy this date is 31 December 1993); this might apply to contracts entered into before the exiting PMS adopted the euro, such as long-term debt or guarantees;
 - 7.2.2 the possibility for the Council to adopt safeguard measures (applicable for 6 months) in exceptional circumstances where capital movements to or from non-member countries cause, or threaten to cause, serious difficulties for the operation of the economic and monetary union; and
 - 7.2.3 the ability for a Member States to adopt the following:
 - (A) procedures for the declaration of capital movements for the purposes of administrative or statistical information; and
 - (B) measures which are justified on grounds of public policy or public security.
- 7.3 If the relevant PMS wanted to impose capital controls or a moratorium, it would likely want to impose them with respect to Member States and third countries.
- 7.4 In the context of a crisis related to euro matters, therefore, the relevant PMS would probably need to rely on the exception for measures justified on grounds of public policy or public security. Under EU law, measures adopted for such purposes would only be justified if they are non-discriminatory, in fact pursue legitimate public policy or public security aims and are proportionate to those aims (that is, they are not more restrictive than necessary to achieve public security or public policy goals). Traditionally, the Court of Justice has interpreted these exceptions and their related requirements restrictively. Therefore, whether EU law, as it currently stands, would permit the exiting PMS to adopt any particular capital control or moratorium would not be certain.
- 7.5 In terms of whether the EU could “stop it”, the main means to address such a situation would be via a legal challenge at the European Court of Justice. If the Court of Justice found that the relevant PMS imposed capital controls or a moratorium in a manner contrary to EU law, the relevant PMS would be obliged to revise its measures. Pursuant to Article 260 TFEU, if the Commission considers that a Member State has not complied with a judgment of the Court of Justice, it may request the Court to impose a lump sum or penalty payment to be paid by the Member State concerned which it considers to be “appropriate to the circumstances”. While this remedy is theoretically possible, whether it would have any deterrent effect in practice is questionable.
- 7.6 Another means for the relevant PMS to impose capital controls or a moratorium in accordance with EU law is via an amendment to the EU Treaties or as part of an exit agreement. Alternatively, a political compromise is also possible.
- 7.7 If the exit from euro were to coincide with an exit from the EU, it would be difficult for the EU, in practice, to prevent the relevant PMS from introducing capital controls or a moratorium.

8. Does the standard LMA documents wording contemplate all these potential outcomes?

8.1 Although the LMA wording does not deal specifically with a country leaving the Eurozone or a Eurozone break-up, the LMA documents do contain some helpful clauses, which lenders of euro-denominated loans might consider expanding to strengthen their position:

8.1.1 **Definition of Euro:** The LMA documents do not contain a definition of “euro”. Lenders may want to include provisions setting out:

- (A) what the currency of payment would be if the euro were no longer to exist, or if one or more countries were to leave the Eurozone; and
- (B) a redenomination rate or method for determining a redenomination rate from euro into a new currency.

8.1.2 **Change of currency clause:** This addresses two different situations:

- (A) first, where the central bank of a country recognises two currencies as lawful currency of the country, the agent may designate which currency unit it is to be paid in.
- (B) second, if a change in any currency occurs, the loan agreement will, to the extent the agent specifies to be necessary, be amended to comply with any generally accepted conventions and market practices in the relevant interbank market and otherwise to reflect the change in currency.

Although these provisions do not specifically deal with an exiting PMS redenominating euro debts, it would be problematic to challenge such a redenomination on the basis of these clauses. It would be dangerous to rely on these clauses to make amendments to other, more commercial terms of the loan, as generally accepted conventions and market practice would not be established in the immediate aftermath of a country leaving the Eurozone. It is also unclear, whether these clauses would be enforceable in any civil law country as they give the agent a wide discretion.

8.1.3 **Payment mechanics:** Lenders should ensure that they retain the provision for payments in euro to be made to such account in a financial centre in the Eurozone or London with such bank as the agent specifies. This gives the agent the flexibility to change the identity of the bank receiving payments, and (in relation to euro payments) the city or jurisdiction in which that bank is located.

8.1.4 **Currency Indemnity:** The LMA documents contain a currency indemnity which, if the euro continues to exist, may protect finance parties against losses incurred if they have to convert an amount into a different currency in order to make a claim or obtain or enforce a judgment against a borrower. However, the enforceability of this indemnity may be challenged, particularly in domestic courts of an exiting PMS. There is also an express waiver from the borrower of any right to pay in a currency other than that set out in the document.

8.1.5 **Events of Default:** There are no specific events of default which refer to the borrower's country leaving the euro or a break-up of the Eurozone. However the following events of default may be relevant in certain circumstances:

- (A) Non-payment: unless the change of currency clause has been triggered, or the parties agree otherwise, the LMA documents require payments expressed to be payable in euro to be made in euro;
- (B) Material adverse change: (depending on its terms and noting that establishing that a material adverse change event of default on the market drafted terms has occurred is highly unlikely);
- (C) Unlawfulness: if exchange controls were to be introduced which actually made performance illegal; or
- (D) Expropriation: this may be relevant if a relevant event of default is included and the government of a country that has left the Eurozone seizes foreign currency deposits of the borrower's group.

8.1.6 **Exit:** In standard form documentation, there is usually no specific event of default in respect of an exit from the Eurozone by the home jurisdiction of an obligor, but this is something which lenders should consider including.



9. Do the standard MTN programmes or euro bond documents contemplate these potential outcomes?

- 9.1 There are no standard form documents in the bond markets, however, the documents used for most recent MTN Programmes and stand-alone euro denominated bond issues are generally fairly similar. The comments set out below are therefore general in nature and issuers and investors will need to review their actual documentation.
- 9.2 Euro denominated drawdowns off MTN Programmes or stand-alone euro bond issues do not deal with a country leaving the Eurozone or a Eurozone break-up. Generally the bond documentation does not contain a definition of the euro, has no provisions for a change of currency, does not contain a currency indemnity and no events of default are likely to be triggered solely upon any exit from the euro or a break-up of the euro.
- 9.3 In relation to new issues, arrangers, investors and issuers might consider adding a definition of “euro” to reflect the parties’ intention as to what the payment obligation should be and consider setting out:
- 9.3.1 what the currency of payment would be if the euro were no longer to exist, or if one or more countries were to leave the Eurozone; and
 - 9.3.2 a redenomination rate or method for determining a redenomination rate from euro into a new currency.

We are obviously conscious that the level of uncertainty as to what may happen in the future is such that drafting provisions which provide for the above is extremely difficult, however, these are issues which need to be considered given the current uncertainty surrounding the euro.

Herbert Smith LLP

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For further information please contact:

John Balsdon
john.balsdon@herbertsmith.com
+44 20 7466 2288

Adam Johnson
adam.johnson@herbertsmith.com
+44 20 7466 2064

Alexander Currie
alexander.currie@herbertsmith.com
+7 495 78 37592

Sonya Leydecker
sonya.leydecker@herbertsmith.com
+44 20 7466 2337

Simon Clarke
simon.clark@herbertsmith.com
+44 20 7466 2508

Dorothy Livingston
dorothy.livingston@herbertsmith.com
+44 20 7466 2061

Malcolm Hitching
malcolm.hitching@herbertsmith.com
+44 20 7466 2687

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Abu Dhabi

Herbert Smith LLP
Suite 302, 3rd Floor
Al Bateen Towers C2 Building
Al Bateen
PO Box 106178
Abu Dhabi UAE
T: +971 2 412 1700
F: +971 2 412 1701

Amsterdam

Stibbe
Stibbetoren
Strawinskylaan 2001
PO Box 75640
1070 AP Amsterdam
T: +31 20 546 06 06
F: +31 20 546 01 23

Bangkok

Herbert Smith (Thailand) Ltd
1403 Abdulrahim Place
990 Rama IV Road
Bangkok 10500
T: +66 2657 3888
F: +66 2636 0657

Beijing

Herbert Smith LLP
28th Floor Office Tower
Beijing Yintai Centre
2 Jianguomenwai Avenue
Chaoyang District
Beijing PRC 100022
T: +86 10 6535 5000
F: +86 10 6535 5055

Belfast

Herbert Smith LLP
3 Cromac Quay
Ormeau Gasworks
Belfast BT7 2JD
T: +44 28 9025 8200
F: +44 28 9025 8201

Berlin

Gleiss Lutz
Friedrichstrasse 71
10117 Berlin
T: +49 30 800 979-0
F: +49 30 800 979-979

Brussels

Herbert Smith LLP
Central Plaza
Rue de Loxum 25
1000 Brussels
T: +32 2 511 7450
F: +32 2 511 7772

Gleiss Lutz
Central Plaza
Rue de Loxum 25
1000 Brussels
T: +32 2 551 1020
F: +32 2 551 1039

Stibbe
Central Plaza
Rue de Loxum 25
1000 Brussels
T: +32 2 533 5211
F: +32 2 533 5212

Budapest

Bán, S. Szabó & Partners
Gleiss Lutz associated firm
József nádor tér 5-6
1051 Budapest
T: +36 1 266-3522
F: +36 1 266-3523

Dubai

Herbert Smith LLP
Dubai International Financial
Centre
Gate Village 7, Level 4
PO Box 506631
Dubai UAE
T: +971 4 428 6300
F: +971 4 365 3171

Stibbe
Dubai International Financial
Centre
Gate Village 7, Level 4
PO Box 506631
Dubai UAE
T: +971 4 428 6300
F: +971 4 365 3171

Düsseldorf

Gleiss Lutz
Bleichstrasse 8-10
40211 Düsseldorf
T: +49 211 54061-0
F: +49 211 54061-111

Frankfurt

Gleiss Lutz
Mendelssohnstrasse 87
60325 Frankfurt/Main
T: +49 69 95514-0
F: +49 69 95514-198

Hamburg

Gleiss Lutz
Hohe Bleichen 19
20354 Hamburg
T: +49 40 460017-0
F: +49 40 460017-28

Hong Kong

Herbert Smith
23rd Floor, Gloucester Tower
15 Queen's Road Central
Hong Kong
T: +852 2845 6639
F: +852 2845 9099

Jakarta

Hiswara Bunjamin and
Tandjung
Herbert Smith LLP
associated firm
23rd Floor, Gedung BRI II
Jl. Jend. Sudirman Kav. 44-46
Jakarta, 10210
T: +62 21 574 4010
F: +62 21 574 4670

London

Herbert Smith LLP
Exchange House
Primrose Street
London EC2A 2HS
T: +44 20 7374 8000
F: +44 20 7374 0888

London (continued)

Stibbe
Exchange House
Primrose Street
London EC2A 2ST
T: +44 20 7466 6300
F: +44 20 7466 6311

Luxembourg

Stibbe Luxembourg, Avocats
Rue Jean Monnet 6
2180 Luxembourg
T: +352 26 61 81
F: +352 26 61 82

Madrid

Herbert Smith Spain LLP
Paseo de la Castellana 66
28046 Madrid
T: +34 91 423 4000
F: +34 91 423 4001

Moscow

Herbert Smith CIS LLP
10 Ulitsa Nikolskaya
Moscow 109012
T: +7 495 363 6500
F: +7 495 363 6501

Munich

Gleiss Lutz
Karl-Schamagl-Ring 6
80539 Munich
T: +49 89 21667-0
F: +49 89 21667-111

New York

Stibbe
489 Fifth Avenue, 32nd floor
New York, NY 10017
T: +1 212 972 4000
F: +1 212 972 4929

Paris

Herbert Smith Paris LLP
66, Avenue Marceau
75008 Paris
T: +33 1 53 57 70 70
F: +33 1 53 57 70 80

Prague

Kubánek & Nedelka v.o.s.
Gleiss Lutz
associated firm
nám. Republiky 1a
110 00 Prague 1
T: +420 225 996-500
F: +420 225 996-555

Saudi Arabia

Al-Ghazzawi Professional
Association
Herbert Smith LLP
associated firm
Jeddah Commercial Centre,
3rd Floor, Al Maady Street
Corniche Al Hamra
P.O. Box 7346
Jeddah 21462
T: +966 2 6531576
F: +966 2 6532612

Saudi Arabia (continued)

Al-Ghazzawi Professional
Association
Herbert Smith LLP
associated firm
Arabian Business Centre
Prince Muhammad Street
PO Box 381
Dammam 31411
T: +966 3 8331611
F: +966 3 8331981

Al-Ghazzawi Professional
Association
Herbert Smith LLP
associated firm
King Faisal Foundation
North Tower, 4th Floor
K. Fahd Road
PO Box 9029
Riyadh 11413
T: +966 1 4632374
F: +966 1 4627566

Shanghai

Herbert Smith LLP
38th Floor, Bund Centre
222 Yan An Road East
Shanghai 200002
T: +86 21 2322 2000
F: +86 21 2322 2322

Singapore

Herbert Smith LLP
50 Raffles Place
#24-01 Singapore Land Tower
Singapore 048623
T: +65 6868 8000
F: +65 6868 8001

Stuttgart

Gleiss Lutz
Maybachstrasse 6
70469 Stuttgart
T: +49 711 8997-0
F: +49 711 855096

Tokyo

Herbert Smith
41st Floor, Midtown Tower
9-7-1 Akasaka, Minato-ku
Tokyo 107-6241
T: +81 3 5412 5412
F: +81 3 5412 5413

Warsaw

Pietrzak Siekierzynski
Bogen Sp. k.
Gleiss Lutz
associated firm
ul. Złota 59
00-120 Warsaw
T: +48 22 22242-00
F: +48 22 22242-99

www.herbertsmith.com
www.gleisslutz.com
www.stibbe.com