THE EUROZONE IN CRISIS
WHAT ARE THE RISKS FOR THE PARTIES IN CROSS BORDER TRANSACTIONS?
Despite the recent moves at the Mexico G20 summit in June 2012 pushing for greater fiscal union and common bank regulation within the Eurozone, and statements in July and August 2012 by Mario Draghi, President of the ECB, that he will do “whatever it takes” to save the euro, the global markets, and those in the Eurozone in particular, remain extremely nervous. Spanish and Italian government long term borrowing rates are still highly volatile and the risk of Greece leaving the Eurozone, or defaulting, remains a real one. It is hardly surprising then that we lawyers are being asked on a daily basis what effect the collapse of the euro or the unilateral withdrawal from European Monetary Union by a Eurozone country would have on contracts where the denominated currency of payment is euro. Unfortunately, while we are, of course, able to identify potential risks in relation to English law contracts based on assumed positions, the answer (truthfully, though rather unhelpfully) is “nobody knows”. This is only underlined by the fact that the Lisbon treaty, which set up EMU, contains no “how do we leave the euro?” provisions as the voluntary departure of any Eurozone country was not contemplated as being a possibility. However, the identification of the main likely risks, based on an English law analysis, at least assists the parties to new or proposed euro-denominated agreements to focus on those issues and to discuss a commercially acceptable allocation of those identified risks at the time negotiations are taking place.

In relation to pre-existing contracts, the position is that either:

(a) the issue of a euro collapse will have been specifically addressed (unlikely); or
(b) in the case of finance transactions, the relevant agreement will be on reasonably market standard terms (for example, a facility agreement with the Loan Market Association (“LMA”) style), which should at least contain some potentially helpful provisions around the Lenders having the ability to call a default (as for example the note posted to the LMA website in November 2011 on “The Eurozone Crisis and Loan Agreements” discusses). However, the potential effect on any such contract of the complete collapse of the euro as a currency or a euro exit by a Eurozone country, either by an exit agreed with the other Eurozone members or on a unilateral basis without agreement, is much less clear. That will be dependent on which of a range of (currently only hypothetical) situations actually occurs, particularly bearing in mind that non-commercial contracts are unlikely to address currency finance or default issues in as much detail as finance agreements.

WHAT TYPES OF AGREEMENTS SHOULD WE BE CONCERNED ABOUT?

The issues of concern to contracting parties generally arise in relation to multi-jurisdictional or cross border transactions which are either euro-denominated or have some euro payment valuation or reference requirements. However, a euro departure or the euro’s collapse could impact on a wide variety of those, wholly or partly, euro-denominated agreements such as:

- Hedging/Derivatives contracts
- Commercial supply contracts for goods or services
- Loan facility agreements – either with banks or within corporate groups
- Cash pooling agreements
- Share or asset sale and purchase agreements in corporate acquisitions
- Bonds
- Investment Agreements
WHAT AGREEMENTS SHOULD WE NOT BE CONCERNED ABOUT?

Where euro-denominated contracts are between entities which are both in the same Eurozone country, then a departure from the Eurozone by that country should not affect that contract (subject to the specific provisions of any necessary implementing legislation in that country and there being no provisions to the contrary in the contract itself).

In those circumstances, it is likely that the contract would, by virtue of the implementing legislation, simply be redenominated in the new currency of the relevant country at the rate that country has specified and the parties will simply continue to perform as usual, i.e. the contract will follow the “law of the money” (the “lex monetae”).

However, that does not, of course, provide much comfort to a contract party, for example, an importer which is relying on cross-border supply contracts to facilitate its performance under a wholly domestic contract which has been so redenominated. Assuming the relevant supply contract payments are denominated in euro, that party then has to look to the cross border issues.

THE HEART OF THE MATTER

Which brings us to the heart of the matter – either cross border or multi-jurisdictional transactions where the currency of payment under the contract, whether a facility agreement or a commercial contract, is euro.

Under English law there is no general reason (subject to specific legal issues such as exchange control or public policy) why parties to a contract cannot choose the currency they want to be the relevant currency for their contract.

But what if financial Armageddon arrives and the currency of the contract simply disappears? With the parties to the contract being situated in different jurisdictions who decides what happens? The parties can, of course, negotiate with each other to try and find a satisfactory solution. After all, in many contracts, what is important is not what currency the payer is paying in but whether:

(a) it can pay at all and

(b) it can pay in a currency and in an amount which, if it is convertible on the markets and so converted into the contract payment currency, is sufficient to satisfy its payment obligations in full.

However, there may be instances where the inability of the payer to pay in the currency of payment could lead to the contract being held to be frustrated. This would fall to be determined under the governing law of the contract and in the jurisdiction of choice. These choice of law and submission to jurisdiction clauses, which are often lumped in as part of the boilerplate of the contract and not considered in detail, have never been more important, bearing in mind it is the courts of the chosen country which will have to be making fundamental judgments about what should happen if the parties fail to agree and have to litigate.
TURNING TO MORE SPECIFIC SITUATIONS:
What if the euro ceased to exist as a currency?

If you have a situation where the euro ceases to exist and where the relevant contract is a euro-denominated contract with parties situated in two different countries which previously had the euro as their currency, then, in the absence of agreement between the parties as to what the substitute currency of payment should be, the English courts would first look at whether there was a definition of the currency of payment in the contract, i.e. referring to a currency of a particular country. This is highly unlikely in many contracts other than those used in finance transactions (for example, loans and bonds).

If a currency linked to a particular country is not specified in the contract, the court would consider whether the place of payment was within one of the parties’ jurisdiction and whether, therefore, the lex monetae of that place of payment was what the parties intended to apply, so that the applicable currency of payment would be the new currency of that place. However, that is merely a presumption, rebuttable by evidence to the contrary of the parties’ intentions. Given that many contracts also require payments to be made by both parties it would be highly unusual (though not impossible) for a court to decide that there are two separate currencies of payment under the contract (unless the contract specifically envisaged that occurring, for example under a hedging agreement).

Depending on who is the payer and who is the payee, there is also a chance that an English court would hold that the currency element of a euro contract when the euro has disappeared, goes to the root of the agreement between the parties and that the agreement has, accordingly, been frustrated unless the parties agree otherwise. That risk is, naturally, higher in contracts such as hedging agreements than in goods or services supply contracts.

What if there were a “two tier” (Northern) euro and (Southern) euro?

The European Central Bank and the governments of the Eurozone countries continue to back the euro very strongly. However, there have been occasional murmurings around the possibility, if it was vital for the survival of the euro, that there could be a “two tier” euro within the eurozone. That would involve a stronger (Northern eurozone countries) euro and a weaker (Southern eurozone countries) euro reflecting the differences in the debt positions between the stronger economies and the weaker ones, while still maintaining the concept of a Eurozone. Unlike the situation where one country may decide to leave the eurozone on a unilateral basis, where the currency situation would probably, of necessity, change literally overnight or over a weekend, any such “two tier” approach would have to be a consensual one and done on a managed timetable. That would give parties whose contracts are in euro more time to plan for what should happen in relation to payments under those contracts. It does, however, raise some interesting questions around what the term “euro” used in in an existing contract would actually refer to (even if there had been an attempt to define it as eg “the currency of a Participating Member State”) and, again, it is very difficult to think of any potential drafting solution to cover the point as there are too many imponderables as to how such a “two tier” system would work.
What if one of the parties is from a country exiting the euro?

Where the contract is euro-denominated and one of the parties is from an exiting country which has imposed its own currency, there are similar questions to address:

1. First, did the parties intend the euro always to be the currency of payment under the contract, with that not being dependent on whether either or both of their countries was in the Eurozone?

As mentioned above, in the absence of exchange control and similar issues, there is no barrier under English law to parties choosing a particular currency of payment, which may not be their own as the currency of their contract. As is the case where the euro disappears altogether, the English courts would look at the contract to see if there was a definition linking the currency to the Eurozone or to any particular country to try to determine if the parties intended the contract to remain denominated in euro or to follow the currency of a particular country.

In relation to LMA-based loan facility agreements that position will often be much clearer than it would be under a commercial contract since the standard LMA documents contain a “currency of account and payment” clause.

2. Second, even if the currency of payment is held by the English courts to be euro, are there any legal or practical problems around payment in euro by the payer?

Unfortunately, there are likely to be many, of which the following are the most important:

- Will the payer’s country allow it to pay in euros at all, notwithstanding that might be the intention of the parties or the English court’s view?

It is highly likely that any country exiting the euro will impose exchange control restrictions on any payments being made out of the country in euro. While, for example, the LMA documents include a provision stating that “an Obligor waives any right it may have in any jurisdiction to pay any amount under the Finance Documents in a currency…other than that in which it is expressed to be payable” that clearly can only deal with the situation where the payer may have an option under its local law to pay in another currency, not the situation where it would be illegal for it to pay in that currency in breach of the exchange control laws. That illegality may, in itself, have further consequences under the relevant agreement, potentially rendering the contract frustrated because of that illegality. Even in the absence of illegality, depending upon how broadly force majeure is defined, the introduction of exchange controls prohibiting a payment may qualify and relieve one or both parties of their payment or offer obligations.

- Where the instrument concerned requires payments to be calculated by reference to euro-based price sources, e.g. EURIBOR, issues may also arise depending upon whether those indexes for sources continue to operate as normal and/or on the terms of any applicable exchange controls, giving rise to similar issues as those described above.

- As mentioned above, often what the payee party will generally be more concerned about is not whether it receives payment in the correct currency but that it is receiving sufficient funds in an easily convertible currency to ensure that, once converted, the sum received is sufficient to pay in full the obligations of the payer (notwithstanding any currency of account provisions and the fact that such a payment may amount to a technical event of default since the recipient usually is under no obligation to accept any payment not made in the correct currency).
However, given that an exit from the euro may well see the currency of the exiting country being rapidly devalued (or, less likely, appreciating) against the euro, the payer having to pay a sufficient amount in its own currency to fund an amount equal to the euro payment, which it was due to make under the contract, is likely to give rise to substantial cash flow, and, potentially, insolvency issues for the payer, particularly if it has no source of euro income. At the same time, it is running the risk of being found to be in default under the contract for not paying in the correct currency.

Meanwhile, a disgruntled payee may wish to sue the payer for non-payment and enforce any guarantees or security it holds against the payer’s liability, only to find, even if the currency of payment is confirmed to be euro and it obtains a euro judgment, that it is impossible to enforce that judgment, even under the Brussels Regulation (EC Regulation 44/2001 dealing with the reciprocal enforcement of judgments), because the local courts in the payer’s jurisdiction whose assistance will be necessary for enforcement are prevented either by legislation or public policy issues from recognising as valid or enforcing judgments which are not in its new replacement currency.

So, you may think you have security over substantial assets in the payer’s country or a valuable parent company guarantee but you can’t get access to them through your external court judgment.
What can I do to protect my position?

The impact on contracts of a euro collapse or exit by a Eurozone country is a potential minefield, with there possibly being (at least) 17 different approaches, one for each Eurozone country, as to how that would be dealt with as well as, potentially, overarching EU-wide legislation being put in place to cover exit by a particular country.

None of those approaches can be anticipated until planning for the exit actually occurs when the parties to the affected contracts will, effectively, be firefighting to save their contracts. However, we do have some recommendations as to some initial steps which can be taken now as protective measures:

- With respect to loan facility agreements, the LMA is not currently recommending any changes to these agreements, although it has recommended parties consider if/how to define “euro”.
- However, Lenders under facility agreements either in the pipeline or currently being negotiated (or where amendments to other aspects of existing facility agreements are being put in place as they often are) should consider whether any of the standard provisions of the facility agreements should be amended or clarified. For example, to make it clear that all references to the euro are to the currency of the Eurozone from time to time or by inserting specific provisions dealing with the withdrawal of an Obligor’s country from the Eurozone and/or the inability of an Obligor to pay in the correct currency because of exchange control provisions in the exiting country, rather than relying on general events of default such as a MAC or the non-payment or insolvency default provisions.
- These changes may allow Lenders the flexibility to deal with the situation more quickly where there might otherwise be a delay in other events of default being triggered, and, at the very least, get the parties to the table more quickly to discuss the position.
- Given that delays (often lengthy) can occur between signing and completion, parties to corporate share or asset sale and purchase transactions where the price is denominated, in whole or in part, in euro should consider specifically addressing what would happen if the euro disappeared or one of the parties’ countries exited the euro prior to completion. Should there, for example, be a re-valuation of the shares/assets/business or a move to completion in a fallback fiat currency?
- Should the relevant amounts simply be converted into another currency?
- Issues may also arise where deferred consideration is payable over a period of time (e.g. by way of an earn-out which can often run for over two years).
- Equally, parties to contracts for goods and services should consider what sort of protective provisions should be inserted to head off some of the risks identified above.
  - For example, do they want to ensure that the euro is always the currency of payment? That might seem a good idea at the time the contract is entered into. However, given the uncertainties surrounding the Eurozone, might not turn out to be the best solution for either party in those circumstances.
  - If the euro is always to be the currency of payment, then appropriate provisions should be inserted to make that clear, both in relation to an appropriate definition of the currency being inserted and by making it clear that the euro is the currency of payment, come what may, unless it ceases to exist entirely.
  - If the parties want the contract to continue notwithstanding that one party’s country has withdrawn from the Eurozone (or the euro has disappeared altogether), they should consider inserting requirements to consult with each other if such an event occurs to deal with issues around currency exchange provisions. Those provisions would have to be drafted carefully to ensure no unenforceable “agreement to agree” issues arose and also to allow the parties sufficient flexibility so they are not forced into taking any particular position in difficult circumstances.
An equivalent provision to that included in the LMA facility agreements, where each party waives any right it may have under its applicable domestic law to pay in anything other the currency specified by the contract, may also be useful.

In any type of agreement, robust choice of appropriate law and submission to jurisdiction provisions should be considered in detail and inserted in the contract. As most loan facility agreements, bonds and hedging documents should already deal with this point, this concern is particularly relevant for commercial contracts where commoditised/standard documents may be being used or standard provisions incorporated by reference which may not properly address the current issues. However, it is worth bearing in mind that those provisions, while providing some degree of protection to a party seeking payment from a party in an existing country, may not provide complete protection. A member state exiting the euro may enact protective laws which seek to restrict the operation of the Brussels Regulation (EC Regulation 44/2001 dealing with jurisdiction and mutual enforcement of judgments) so as to require all money claims to be brought in its domestic courts. In addition, or alternatively, a member state unilaterally leaving the EU may consider itself to be no longer bound by (among other things) the Brussels Regulation. That could lead to potential difficulties in an innocent party either enforcing any judgment which it has managed to obtain in the courts specified in the contract but which are outside the exiting country or bringing an action for payment in euro before the courts of the exiting country.

Derivatives contracts could be significantly impacted by a euro collapse or by a country leaving the Eurozone. Depending on the circumstances, such events could trigger an ISDA termination event (especially if exchange controls were imposed by the departing country) or may result in a disruption event with respect to particular ISDA products. Equally, such an event could affect the efficacy of any payment or close-out netting provisions.

When the euro was introduced, ISDA published a euro protocol to effect a smooth transition in the market as adherence by parties to the protocol ensured that all necessary amendments were automatically made to their ISDA documentation without further bilateral amendments. We anticipate ISDA would proceed with an equivalent protocol in the event of a euro collapse or Eurozone country departure. However, we would recommend, should a euro collapse or country departure occur, that parties review their derivatives contracts carefully to ensure that such a protocol did what was required, or appropriate additional amendments are made, particularly if those contracts were not documented under the ISDA architecture.

Finally, as a general precaution, consideration should be given to including terms in contracts which give flexibility to terminate or amend on a euro exit or Eurozone break up, including illegality and MAC and force majeure provisions.

CONCLUSION

Our recommendations are clearly not exhaustive, nor, given the current uncertainties in the Eurozone, definitive, since all that can be done at the moment is to try to reduce the most obvious risks in a situation which is fluctuating daily. Hopefully, consideration of the above identified risks should help to reduce those uncertainties. If you would like to discuss any specific concerns, please contact us. Details are provided on page 10 of this document.
SUPPORTING OUR CLIENTS DURING THE EUROZONE CRISIS

We have offices across the Eurozone, and beyond, staffed by experts in a number of key specialisms relevant to the Eurozone Crisis including Corporate, Banking, Capital Markets, Derivatives, Financial Regulation, Restructuring and Litigation, and Arbitration.

Our Brussels office lies at the heart of decision-making within the EU where we have European law specialists at hand who are in touch with day-to-day developments.