Linklaters

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Eurozone Bulletin: Updating Contingency Plans

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Summary

In our December 2011 Eurozone Bulletin entitled "*Do I need a contingency plan?*" we recommended that, during any time of crisis, businesses should develop contingency plans to explore and prepare for events, even if unlikely, which may have a significant impact upon them. A critical challenge in relation to contingency planning is, of course, the uncertainty as to the nature and extent of what might happen. Indeed, it should not be forgotten that a eurozone exit is still considered unlikely. This Bulletin updates our thinking in the December Bulletin and, following reports that contingency plans for a Greek exit are being prepared, considers (as an example) the scenario of a Greek eurozone exit.

To that end, this Bulletin is made up of two parts:

> the first sets out the legal considerations surrounding an exit from the eurozone and the consequent legal risks and uncertainties;[1]

> the second seeks to identify the risks that a business could be exposed to in the event of a Greek exit.

Following an informal summit in Brussels on 23 May 2012, eurozone heads of state issued a message of support for Greece and stated a collective wish that Greece remain within the eurozone. The eurozone leaders also urged Greece to stay the course on austerity and to complete the reforms demanded under the terms of its bailout. In the wake of the summit, however, it was widely reported that eurozone leaders have been advised to prepare contingency plans in the event that Greece were to exit the single currency. This has been viewed by many commentators as an effective admission that Greece could abandon the euro – a concept unthinkable some months ago. The recent provision of aid to Spain to bolster Spanish banks, however, now sends a strong message of support to other countries in the eurozone.

The current political and economic uncertainty poses a significant threat to the financial stability of the euro. At this political crossroads there are a number of paths which could be taken. One such path leads to greater fiscal union of the eurozone member states, with centralised budgetary control and some ceding of sovereignty.[2] A second path (although eurozone leaders are intent on avoiding it) leads to an exit by Greece (and/or other member states) from the eurozone. The consequences of this on the rest of Europe would be severe. One certainty is that there are numerous legal, political and practical obstacles on each of these paths.

Key questions:

- What are the possible outcomes of the eurozone crisis?
- How could Greece exit the eurozone?
- How would a eurozone exit occur?
- Can a state change its currency overnight?
- What happens to euro denominated accounts and contracts after an exit?
- In the event of a Greek exit, would euro denominated contracts with a connection to Greece continue to be valid and binding?
- What is the continuity of contracts principle?
- How do you determine redenomination risk?
- What should I be more concerned about – redenomination risk or capital and foreign exchange controls?
- What is the principle of *lex monetae*?
- When would the redenomination of euro obligations occur and at what rate?
- Would additional terms need to be implied into a redenominated contract?
- Would the unilateral exit of Greece from the eurozone impact the redenomination risk analysis?
- How would TARGET2 be affected?
- How would enforcement of judgments be impacted?
- What key risks should I consider following a eurozone exit by Greece?
- How might I be exposed?
- How can I manage my risk of exposure?

[1] Part 1 substantially repeats the legal analysis in our December Bulletin, which has not changed. We have, however, updated the introduction to the Bulletin and paragraph 1 of Part 1 on the possible outcomes of the crisis. We have also inserted a consideration of the possible impact of a eurozone exit on the TARGET2 payment system (paragraph 7 of Part 1).

[2] It is also worth noting that very recent proposals relating to the development of a "European banking union" are reported to constitute a priority at European Union level and may lead to another path. These proposals involve a joint EU-level bank supervision authority, a joint deposit guarantee fund at EU level and a new fund dedicated to bailing-out systemically significant financial institutions. Such proposals may well require further amendments to the EU treaties and would significantly change the regulatory landscape for EU financial institutions.

Part 1 – Legal issues arising from a member state exit from the eurozone

1 What are the possible outcomes of the eurozone crisis?

A number of potential outcomes have been publicly discussed.

1.1 Resolution without a member state exit or default: There is a strong political will to find an orderly consensual solution in which the eurozone remains intact and no eurozone member state is in default. The informal summit in Brussels last May and the recent announcement regarding a Spanish bank bail out both affirm this position. The "Fiscal Compact" Treaty is intended to be a step towards closer fiscal integration - which many commentators have recognised is key to a successful monetary union. However, many are of the view that further and deeper measures in this regard are required. Four broad policies have been identified as essential for a successful monetary union: (i) greater fiscal unity, (ii) greater political unity, (iii) debt mutualisation, and (iv) structural reform. Implementation of these policies through a binding process is not something that can be done with speed. The negotiation, drafting, ratification and implementation process would be legally and politically complex. Politically, a very strong commitment and significant co-operation would be required. Legally, all EU member states, whether or not in the eurozone, are likely to be required to agree treaty changes to implement these policies. Some would need the consent of their national parliament and/or referenda.

1.2 No exit but member state default: A default by Greece would not preclude it remaining in the eurozone. In practice, however, a defaulting eurozone member state is likely to remain within the eurozone only with the support (financial and political) of the other EU member states and institutions such as the ECB and the IMF. A default would be expected to lead to a global debt relief arrangement and a form of restructuring proposal being offered to creditors of the defaulting state.

1.3 No exit but dual euro: Some commentators have suggested that the eurozone could develop two distinct but related currencies - a "hard" euro and a "soft" euro. One or more eurozone member states would form a "soft eurozone", enabling them to devalue their currency without devaluing the euro for the other eurozone member states. The "soft" euro would trade at a percentage of the "hard" euro. Once economies are stabilised, those member states in the "soft" eurozone" could return to the "hard eurozone". This would effectively introduce a new currency for the "soft" countries and would raise many legal, as well as political and financial, challenges.

1.4 Fragmentation of the eurozone: Eurozone member states are facing significant challenges in reducing public and private deficits and stimulating growth. In Greece, this has been combined with political instability which has led to widespread discussion as to whether or not Greece may exit the eurozone (whether in the short, medium or longer term). A Greek exit would undoubtedly increase the potential for sovereign and corporate defaults in Greece.[3] The legal uncertainties and practical risks that would flow from such an exit are discussed in this Bulletin.

1.5 Dissolution of the eurozone: Ignoring the economic and political ramifications, complex legal questions would arise if the eurozone were to be dissolved, the euro abandoned and new national currencies introduced in the eurozone member states. EU treaties would need to be amended, for which ratification by all EU member states would be required. In the event that the eurozone were to break up entirely, some solution on a pan-european level would be required to provide certainty as to euro denominated obligations. The form, scope and timing of any such solution are impossible to predict.

Barriers to eurozone exit:

- A member state cannot be expelled from the EU or the eurozone.
- The EU treaties do not currently allow a member state to exit the eurozone without also leaving the EU.

The remainder of this Bulletin focuses on the scenario in which a member state exits the eurozone and introduces a new national currency. For the purposes of this Bulletin (and because the possibility has been widely discussed), we have referenced Greece as the exiting state. As Greece is being used as a hypothetical example, this Bulletin does not consider or address Greek constitutional or legal issues.

2 How could Greece exit the eurozone?

Theoretical routes to exit:

- Voluntary withdrawal from the EU.
- Unilateral exit from the eurozone but not the EU in breach of the EU treaties.
- Obtain the unanimous consent of all 27 EU member states to an exit.

There are no specific provisions in the current EU treaties for the expulsion of a member state from the eurozone or the EU - even if a member state is in serious breach of its obligations under those treaties.[4] There is also currently no mechanism for a eurozone member state to leave the eurozone voluntarily without also leaving the EU. The intention was very clear that monetary union was intended to be an irrevocable process.[5] The lack of a pre-existing legal framework for an exit from the eurozone does not, however, make it impossible. There are three theoretical exit routes:

2.1 Voluntary withdrawal from the EU: The treaties do provide for a voluntary right of secession from the EU. Therefore Greece could voluntarily withdraw from the EU and thus also exit the eurozone.[6] However, this is not a speedy process.[7] There would be much detail to be worked out and negotiating an exit from the EU would be complex and lengthy.[8] In addition, most commentators take the view that a member state wishing to exit the

[3] Given the absence of an international legal framework for sovereign default, identifying the potential legal, political and economic ramifications of a eurozone member state insolvency is challenging.

[4] The EU treaties contemplate various sanctions which can be invoked against non-compliant member states; however, expulsion is not one of them. A right of expulsion would need all 27 countries of the EU (including the member state facing expulsion) to agree to amend the Treaty on European Union (the "**TEU**").

[5] Article 140 of the Treaty on the functioning of the European Union (the "**TFEU**") expressly refers to the "irrevocable" fixing of the conversion rates.

[6] Article 50 of the TEU, introduced by the Lisbon Treaty, provides for a voluntary right of secession from the EU.

[7] The European Council has to be notified of any intention to withdraw and an agreement setting out the terms for such withdrawal would need to be negotiated, approved by the European Parliament and then adopted by the Council of the European Union. The exiting member state is released from its obligations under the EU treaties at the earlier of the entry into force of the withdrawal agreement and the second anniversary of its withdrawal notification.

[8] Leaving the EU raises many legal questions as well as economic and political ones. EU law is an integral part of the law of every member state and an exiting member state would need to consider the effect of exit, not only on its legal rights and obligations as against other member states, but also on the rights and obligations of its domestic corporations, financial institutions, governmental entities and citizens.

eurozone is likely to want to remain in the EU. It is also theoretically possible for Greece to leave the EU (and the eurozone) and then reapply for admission to the EU - either seeking an opt-out from the eurozone or relying on the fact that it is unlikely to satisfy the criteria for admission to the eurozone.[9] Although this may sound like a simple solution, the financial and legal uncertainty that would arise in the considerable time period required to effect withdrawal and readmission means this is not generally regarded as a practical option.

2.2 Unanimous consent to a eurozone exit: If Greece wishes to exit the eurozone but remain in the EU, it could seek the consent of the other 26 EU member states for a eurozone exit. Again, this would be a time consuming, lengthy process that would require treaty amendments.

2.3 Unlawful unilateral exit from the eurozone: It would be possible for Greece to unilaterally exit the eurozone and introduce a new national currency without withdrawing from the EU. Such action, however, without the consent of the other 26 EU member states, would place Greece in breach of its obligations under the EU treaties.

3 How would a eurozone exit occur?

The sequence of events that would occur upon a eurozone exit is uncertain, but the following list is a good starting point:

3.1 Timing: A eurozone exit would most likely be announced overnight without any advance public warning. This would be with a view to preventing domestic and foreign citizens, corporations and financial institutions from withdrawing or transferring euro deposits from the Greek domestic banks, custodians and clearing systems (over and above any previous withdrawals made).[10]

3.2 Introduction of a new national currency and monetary laws: The Greek government is likely to pass legislation (the "**New Currency Law**") establishing (i) its exit from the eurozone and/or the EU, (ii) a new national currency (the "**New Drachma**"), (iii) the fixed exchange rate for automatic conversion of all existing euro payment obligations between the euro and the New Drachma, and (iv) the automatic redenomination of euro deposits, contracts and obligations into the New Drachma. The New Currency Law of Greece would be expected to address its scope and application by reference to factors such as: the identity and place of incorporation or residence of the depositor, parties or obligor; the location of the account; the governing law of the contract or obligation; and the place of payment under the contract or obligation.

Can a state change its currency overnight?

- Ignoring the practical and political challenges, legally the answer is yes.
- Public international law recognises the sovereignty of every state over its own currency.
- If a member state exits the eurozone, all other countries and their courts would legally be obliged to recognise the new national currency and monetary policy of the exiting member state.
- The absolute monetary sovereign right of a state may be subject to international obligations entered into by that state (e.g. for a eurozone member state, this includes obligations under the TEU and the IMF Articles of Agreement (also known as the Bretton Woods Agreement)).
- If a eurozone member state exits the eurozone in breach of EU law, complex legal questions will arise.
- Any question over the legality of an exit is likely to have negative consequences for the recognition of the exiting member state's New Currency Law and its redenomination of euro assets, liabilities and obligations.

[9] Greece, having exited, would have to reapply as a new applicant to the EU and would have to meet the accession requirements, including fiscal requirements, applicable to any country seeking to join the EU. It may be difficult for Greece to satisfy all the necessary requirements in the short term. Another complicating factor is that the treaty requires member states to adopt the euro upon meeting the specified criteria (i.e. adoption of the euro is not voluntary for an EU member state unless, like the UK and Denmark, it negotiates an opt-out).

[10] Although it is acknowledged that there has been a flight of significant bank balances from many peripheral eurozone countries, most individuals and corporations in such countries still operate working balances locally. These local balances are significant in aggregate and it is expected that an exit would be timed to occur before such balances are withdrawn.

3.3 Capital and foreign exchange controls: Greece is also likely to announce various capital and foreign exchange controls and one or more bank holidays with a view to preventing a flight of funds[11] from, and the collapse of, its financial system. If Greece does not also leave the EU or obtain the consent of the other member states to treaty amendments, such controls may be in breach of EU treaties.[12] The impact of such legislation on contracts and the validity of such legislation under international law (particularly the IMF Articles of Agreement[13] and the EU rules on the freedom of payment and capital transfers) would need careful consideration.[14]

3.4 Import tariffs and controls: Import tariffs and controls on trade are not generally permitted within the EU. Therefore, unless Greece leaves the EU or obtains treaty amendments or the consent of the other member states, the imposition of import tariffs and controls would be in breach of EU treaties.

3.5 Restrictions on movement: There may also need to be restrictions on certain EU rights such as the freedom of movement, passporting and work permits to prevent people taking euros out of Greece into another state and a mass exodus of the work force.

4 What happens to euro denominated accounts and contracts after an exit?

In the event of an exit, many businesses may find that their euro deposits/accounts with banks in Greece (whether the national bank, domestic bank or domestic branch of a foreign bank) and the euro payment obligations under their financial and commercial contracts with entities connected with Greece (including its citizens, corporations and financial institutions), have been converted into New Drachma as a result of the application of the New Currency Law. This would give rise to numerous legal and practical difficulties. Creditors of euro denominated obligations that are converted into New Drachma are likely to suffer considerable losses as the new currency is expected to fall in value against the euro. Such creditors are likely to want to challenge the application of the New Currency Law and the conversion. If the redenomination of accounts, contracts and obligations becomes the subject matter of litigation (be it before the domestic courts or before foreign courts), complex conflict of laws questions are likely to arise.

I have a euro denominated contract with an obligor in Greece. If Greece passes legislation purporting to convert all euro obligations of obligors in Greece to New Drachma, will the obligations in my contract be converted?

- This would depend on the facts and the terms of the contract in question.
- The best scenario to avoid conversion would be if: (i) the Greek courts of the exiting member state do not have jurisdiction to decide the question; (ii) the contract is governed by a law other than Greek law; and (iii) the place of payment is outside Greece.
- In any event, the impact of any foreign exchange control legislation preventing flight of funds (in either currency) out of Greece would also need to be considered.

[11] For example, in the 2001 Argentine default, measures were adopted to the effect that the USD balances on accounts in Argentina could no longer be paid out in USD or transferred to a USD account outside Argentina.

[12] Article 63 of the TFEU contains a general prohibition on restrictions on the free movement of capital. There is a limited exemption in Article 65(1)(b) of the TFEU (the "public policy or public security" exemption). The applicability of this exemption in such circumstances is uncertain. However, it is noted that a similar exemption in the EEA Agreement to that contained in Article 65(1)(b) was interpreted homogeneously with Article 65(1)(b) by the EFTA Standing Committee and was held to exempt the controls imposed by Iceland in 2008 from the EEA Agreement's general prohibition restrictions on the movement of capital.

[13] Also known as the Bretton Woods Agreement.

[14] See also paragraph 3 of Part 2, which considers the possibility that member states other than Greece might impose capital and foreign exchange controls if Greece withdraws from the eurozone. Similar considerations to those considered in paragraph 3.3 above would apply in such a scenario.

5 In the event of a Greek exit, would euro denominated contracts with a connection to Greece continue to be valid and binding?

The exit of Greece from the eurozone and/or the EU, the introduction of a new national currency and the associated redenomination of euro denominated contracts with a connection to Greece into New Drachma are unlikely to affect the validity of such contracts for two reasons:

5.1 Where contracts are governed by Greek law, the continued validity of that contract is a matter of Greek law (i.e. the New Currency Law will apply). This new law is likely to apply the continuity of contracts principle and provide that all contracts governed by Greek law will continue to be valid and binding and that the change of currency shall not operate to frustrate or discharge any such contract.[15]

5.2 Whilst the doctrines of frustration or supervening changes in circumstances can, depending on the legal system, discharge parties from a contract or enable them to vary or terminate the contract if a sufficiently serious supervening event occurs, the redenomination of payment obligations will not necessarily be sufficient. In addition, provisions specifically contemplating a eurozone/EU exit and redenomination are not commonplace in domestic or international contracts. However, broadly drafted provisions (e.g. on material adverse change or force majeure) may apply and allow termination of the contract - such terms would need to be carefully considered and their application may be challenged. In general, it is therefore expected that contracts governed by a law other than Greek law[16] with euro obligations which are redenominated would continue to be valid and binding and not be frustrated simply because of the redenomination.

6 How do you determine redenomination risk?

As the redenomination issues that would arise on an exit by Greece from the eurozone would be legally and historically unique, there is no definitive answer to this question. Where the euro continues to exist as the currency of the eurozone (or of one or more EU member states) and euro denominated payment obligations could continue to be settled in euro, it may not be the case that all euro denominated obligations under contracts with the Greek sovereign and entities connected with Greece (including its citizens, corporations and financial institutions) would be redenominated into New Drachma. Whether a particular euro denominated payment obligation under a commercial or financial contract or financial instrument would continue to be payable in euro or in New Drachma may depend on a number of factors:

What is the continuity of contracts principle?

- A generally accepted principle of law that provides that the validity of contracts and other legal instruments is not affected by the introduction of a new currency.

What should I be more concerned about – redenomination risk or capital and foreign exchange controls?

- Whilst redenomination risk is a considerable concern, capital and foreign exchange controls may amount to an even greater one, for the following reasons:
- Capital/foreign exchange control laws may prevent entities with assets in Greece from discharging foreign currency (including euro) obligations or making payments outside Greece.
- Therefore, even if your contract has not been redenominated, performance of it may not be possible where there are restrictions on payments out of Greece.
- Banks may face operational risks where transfers into or out of Greece may place them in breach of Greek law. See Part 2,

[15] When the euro was introduced, the continuity of contracts principle was included in Article 3 of Council Regulation No.1103/9 because of concern in some member states about the effect of a change in currency. Article 3 provided that the introduction of the euro would "*not have the effect of altering any term of a legal instrument or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate such an instrument*". This provision was, however, expressly subject to "anything which parties may have agreed".

[16] Including those governed by Belgian, Dutch, English, German, Italian, Japanese, Luxembourg, New York, Spanish and Swedish law.

6.1 Court of proceedings: Which court(s) any dispute may be submitted to would be expected to depend on the terms of the particular contract. This may be a Greek court or a court of any other country that has jurisdiction to decide upon the issue (e.g. because of the place of performance or a jurisdiction clause in the contract).[17] Each court will apply its own rules, including conflict of law rules (such as the rules of *lex monetae*), as applicable, to determine which laws should resolve the matter.

6.2 *Lex monetae*: Although the conflict of law rules that a domestic court may apply will vary from country to country, one of the rules that is likely to be considered is the principle of *lex monetae*. Under this principle, where a contract contains a reference to a particular national currency, there is an implicit choice of the law of that country to determine the identification of that currency and its relationship with other currencies (e.g. conversion rates). This is the case regardless of the governing law of the contract. For example, where a contract governed by French law requires payment in pounds sterling, English law would determine matters relating to the currency of payment. If, under English law, the currency of the UK were to change from pounds sterling to UK dollars, UK dollars would be the currency of payment under that French law contract.

The situation is more complex in the context of an obligation to make payment in euro because the euro is the currency for 17 countries, and not the currency of a single country. The *lex monetae* of the 17 eurozone member states is the EU legislation governing the euro and not the law of any particular member state.[18] Where all aspects of a contract (the parties, the performance, etc.) are based in an exiting member state and the governing law of the contract is that of the exiting member state, euro denominated payment obligations under such contract would be expected to be redenominated into that exiting member state's new national currency. However, where the contract has an international/foreign element (whether in terms of parties, place of payment/performance and/or governing law), euro denominated payment obligations under such contract may not be redenominated into that exiting member state's new national currency but

What is the principle of *lex monetae*?

- It is a conflict of law rule that is recognised in most developed jurisdictions under which any legal questions as to what constitutes the monetary unit of a particular country is governed by the law of that country (i.e. each currency is defined by the country that issues it).
- The law applicable to a particular monetary unit is its *lex monetae*.

When would the redenomination of euro obligations occur and at what rate?

- Where a euro denominated payment obligation is redenominated into the new national currency of Greece, it will be the New Currency Law of Greece which determines the timing and rate of conversion.
- The New Currency Law would be expected to provide that all conversions are deemed to occur on the date and at a rate prescribed under such laws, irrespective of the due date for payment under the contract.

[17] In international commercial and financing contracts, the courts that have (exclusive) jurisdiction will often be courts other than those of the exiting member state (e.g. the courts of another eurozone member state and commonly English or New York courts).

[18] In the context of the introduction of the euro, the relationship between the euro and the national currencies which it superseded was determined by European law that was directly effective in each member state. According to some legal views, European law became the *lex monetae* of each of the 17 participating member states as a result, as well as the *lex monetae* for contracts which are expressed to be payable in the single currency of the European Union (i.e. not the currency of any particular eurozone member state). The conventional legal view is that those 17 member states may change their *lex monetae*, even if this would be in breach of EU law, upon the introduction of a new currency, which would become the *lex monetae* for all contracts that implicitly or explicitly reference the currency of that member state as opposed to the single European currency. There is, however, uncertainty as to whether a court charged with construing the terms of a contract (whether governed by a eurozone member state law, a non-eurozone member state law (such as English law) or a non-member state law (such as New York law)) would recognise EU law as a separate *lex monetae.* If such a court refused to do this, it could recognise the *lex monetae* of the member state most closely connected to the contract as the applicable *lex monetae* or simply decide that payments should be converted into another currency at an exchange rate determined by the court. In any event, it is not possible to predict with certainty which legal approach would prevail and courts in different jurisdictions may apply different approaches.

remain denominated in euro.[19] An unlawful exit from the eurozone would also open the door to arguments as to validity of the New Currency Law for reasons of public policy.

6.3 Jurisdiction: Where there is a question as to the applicable *lex monetae* and/or the scope or application of the New Currency Law of Greece, a greater likelihood of redenomination would be expected where the Greek courts, rather than a foreign court, have jurisdiction.

6.4 Contractual terms and parties' intention: The particular terms of the contract containing the euro denominated payment obligations and the intention of the parties to the contract would also be expected to be a factor in the determination of any redenomination, including:

6.4.1 Definition of euro: Where, for example, a contract defines the euro to mean "*the lawful currency of the member states of the European Union that adopt the single currency in accordance with the Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community…*", the intention of the parties is clear and the risk of redenomination would be expected to be lower.[20] Where, however, a contract defines the euro to mean "*the lawful currency of Greece, as this currency may change from time to time*", the intention of the parties is equally clear and euro payment obligations would be expected to be redenominated into the new national currency. Unfortunately, in many contracts "euro" is not defined. In such cases, the other factors listed here will be of increased importance.

6.4.2 Place of payment: If a contract specifies a place in Greece as the place of payment, there may be a presumption that payments should be made in New Drachma.[21] Where the contract provides for a place of payment outside Greece or multiple places of payment in more than one country, this presumption may be rebutted.[22]

6.4.3 Date of contract: Where a contract was entered into before Greece joined the eurozone (i.e. 1 January 2001) and referred to Greece's former currency, that reference would be expected to be construed as a reference to New Drachma.[23]

6.4.4 Governing law: Where the governing law of the euro obligation is the law of Greece, there may be a higher risk of redenomination than where the governing law is a foreign law, such as the law of a different eurozone member state, English law or New York law.

6.4.5 Currency related terms: A contract or financial instrument may contain currency related provisions or include currency related events of default, termination events and/or disruption events which may be relevant to

[19] Outside the EU, different rules may need to be considered. For example, *lex monetae* is not a mandatory conflict of law rule under New York law.

[20] See, however, footnote 21 below.

[21] In addition, if the place of payment is in Greece, the New Currency Law and any capital/exchange controls will be applicable and performance of the obligation to pay in euro may not be permitted or may be redenominated, despite any definition of the euro.

[22] There may be no such presumption under the laws of certain jurisdictions (e.g. Japanese law).

[23] An exception to this principle is derivatives documentation to which the ISDA EMU Protocol applies.

Would additional terms need to be implied into a redenominated contract?

- Yes, it is likely that certain terms of that contract will need to be amended, e.g. any EURIBOR-based interest rate fixing mechanics will cease to be appropriate.
- It will be necessary to consider what additional terms can (pursuant to the law applicable to the relevant contract) be implied into that contract in order for that contract to function with business efficacy. This will depend on the governing law of the contractual obligations.
- Under many systems of law, the test for implied terms looks at the following factors: the parties' intention at the time of contracting (e.g. in English law); the manner in which the parties have performed their contractual obligations (e.g. in Belgian law); and/or other external factors that demonstrate the intention of the parties.
- If the obligations are governed by Greek law, its New Currency Law may include provisions for implying additional terms into redenominated contracts.

Would the unilateral exit of Greece from the eurozone impact the redenomination risk analysis?

- It may well complicate the analysis. This is because, where questions are brought before a court outside Greece, such court may be obliged, as a matter of policy, not to apply Greece's New Currency Law due to the fact that Greece has breached its international obligations. It may even complicate the analysis where the question is brought before a court in Greece. Where Greece remains a member of the EU, the Greek courts may also have regard to any conflict between the New Currency Law and applicable EU law.
- If a unilateral exit were to be accompanied by supporting statements from the other EU member states and agreements or assurances to recognise and ratify (through treaty changes and referenda) Greece's exit from the eurozone, the legal analysis would not be expected to be impacted.

the determination of the parties' intention as to the currency of payment obligations.

6.4.6 Obligor: The identity of the obligor would also be expected to affect the risk of redenomination. For example, a presumption exists under the laws of many jurisdictions that a sovereign is presumed to have contracted in its own currency, unless the terms of the contract in question can be used to challenge this position. The New Currency Law of Greece would be also expected to purport to redenominate all euro denominated obligations of Greece itself. In addition, where the obligor under a euro denominated contract is an entity incorporated or resident in Greece, this connection with Greece could bring such contracts within the scope of the New Currency Law and, subject to the terms of the relevant contract, a higher risk of redenomination would be expected. The risk of redenomination may be lower where there are multiple obligors (with joint and several liability) from varying jurisdictions.

7 How would TARGET2 be affected?

TARGET2 is the payment settlement platform of the Eurosystem for large-value payments in euro in central bank money[24]. Legally, TARGET2 consists of separate national payment systems and the payment system of the ECB that are connected to the single platform, with a combination of mainly eurozone-wide harmonised rules and, residually, domestic rules that are applicable to these systems. Each national system is a separate payment system that has been designated under its national law as a system in the meaning of the EU Settlement Finality Directive ("**SFD**")[25]. In accordance with the SFD and the harmonised rules, payment orders are deemed entered into the respective TARGET2-component system of a central bank at the moment that the relevant participant's account with that central bank in the payment module of TARGET2 is debited. Similarly, payment orders may be revoked until they have entered into the respective TARGET2-component system within the aforementioned meaning. Thus, for the purposes of TARGET2, the key moment for the enforceability and irrevocability of a payment order is the moment that the account of a participating commercial bank that gives the payment instruction (the payor) with its respective central bank is debited.

Payments in TARGET2 are effected through electronic book entry and also record a euro liability (debit) of the transferor's central bank and a corresponding euro claim (credit) of the recipient's central bank. To the extent that these liabilities are not offset against payments in the other direction, the net amount of these claims and liabilities gives rise to the TARGET2 balances between the national central banks and the ECB that have been reported on. If Greece were to exit the eurozone, whether or not the balances of Greek

If a euro denominated payment obligation owed to me is redenominated into New Drachma, and before payment is due there is deflation of the New Drachma, would I be able to claim compensation for the depreciation?

- The answer to this question may vary depending on the governing law of the contract in question.
- Under certain systems of law (e.g. English law), a party would not generally be entitled to claim compensation for monetary depreciation between the date of monetary conversion and the date of effective payment.
- By contrast, certain civil law systems (incorporating notions of "fairness" and "good faith" or acquired rights) may require an obligor, in effect, to "top up" payment obligations to compensate a creditor against the risk of currency conversion.

[24] In 2011, TARGET2 processed 89.6 million payments, with a total value of €612,936 billion. This translated into a daily average of 348,505 payments, with an average daily value of €2,385 billion. The value of the payments settled in TARGET2 in some three and a half working days corresponded to the total annual GDP of the eurozone.

[25] Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (as amended in 2009 and 2011). TARGET2 is an example of interoperable payment systems as referred to in Articles 3 and 5 of the SFD in the context of the enforceability and irrevocability of transfer orders.

financial institutions with the Greek central bank that exist at that time remain expressed in euro (i.e. so that they are not converted into New Drachma) is also dependent upon how the New Currency Law is drafted. See Part 2, paragraph 10.

8 How would enforcement of judgments be impacted?

If a question relating to the exit of Greece from the eurozone and the impact on particular euro denominated obligations were to be brought and determined by the courts (be it a Greek court or a court of another country), that court's decision may have to be recognised and enforced in the country where the debtor has assets that can be seized. While the applicable rules for the recognition and enforcement of foreign decisions may vary from jurisdiction to jurisdiction, these rules are harmonised in EU member states. These rules will, for instance, be relevant if a court decision rendered in Greece converts, in accordance with its New Currency Law, an obligation in euro to the New Drachma.

However, as mentioned above, Greece would be expected to impose capital and foreign exchange controls. Therefore, even if a favourable judgment in euro in relation to euro denominated payment obligations under a particular contract were to be obtained in a court of competent jurisdiction, there may very well be practical difficulties with enforcement. For example, if the majority of the obligor's assets are located in Greece, then (i) the value of such assets may be substantially reduced as a result of redenomination and deflation of the new national currency, (ii) the obligor may be insolvent and subject to the insolvency laws of Greece and (iii) the enforcement of a favourable judgment in euro in the Greek courts may not be possible under Greek law by reason of capital or foreign exchange controls or for legal or public policy reasons.

Part 2 – Contingency planning – key risks to consider following a eurozone exit

Following a Greek exit from the eurozone, businesses are likely to have both direct and indirect exposure to the fall out. For example, potential exposure may result from the holding of debt issued by the Greek state or from having operations in Greece (whether through branches, subsidiaries or collaborative arrangements). In addition, businesses may be exposed as a result of financial or commercial relationships with borrowers, customers, counterparties or suppliers located in Greece. Alternatively, a business which does not have operations in Greece or direct dealings with Greek counterparties may have significant dealings with others who themselves have significant exposure to Greece (directly or indirectly). In addition, economic, financial and political turbulence are likely to lead to broader systemic risks. Recognising the pace at which the eurozone landscape is changing, contingency plans should be reviewed frequently.

Set out below is a non-exhaustive list of issues that may affect your business in the aftermath of a Greek exit. In addition, Appendix 1 contains some high level questions that may assist with the identification of potential areas of exposure. Once any risk or area of exposure has been identified, practical steps can be taken to manage and minimise its potential impact. These steps may include reviewing key contracts, renegotiating or terminating contracts, moving accounts and investments, examining funding arrangements and credit risk mitigation and the inclusion of protective provisions in future contracts. Further examples are contained in Appendix 2. Finally, considerations for operational readiness are set out in Appendix 3.

1 Redenomination risk

A key risk is that financial assets or receivables payable to your business in euros are redenominated into the new currency. See Part 1, paragraph 6 for an analysis of when the risk of redenomination is higher. In particular, to the extent that your business is a party to euro denominated contracts governed by Greek law, or contracts with a connection to Greece which are silent as to governing law, the risk of redenomination is likely to be higher.

2 Mismatches

A particularly noteworthy risk connected with redenomination is where a redenomination may have an asymmetrical effect on the assets and liabilities or income and expenses of a business, where one, but not the other, is redenominated. This can lead to mismatches and magnified losses. This risk will depend upon the nature of the assets, liabilities, income and expenses of the particular business. Existing hedging arrangements that your business has in place should also be reconsidered in light of redenomination risk. It should not be assumed that the redenomination treatment of hedges will necessarily follow the asset or liability that they hedge.[26]

[26] For example, hedging arrangements may not be documented under local law and may therefore be less at risk of redenomination.

3 Capital and foreign exchange controls

Despite the principle of freedom of movement of capital under EU law, if Greece exits the eurozone, it is expected to announce various capital and foreign exchange controls. This will severely restrict the ability of debtors to make payments outside Greece. It is therefore important to assess the impact that capital and foreign exchange controls, import tariffs and controls would have on contractual arrangements. There is also a significant risk that a Greek eurozone exit might trigger emergency capital and foreign exchange controls in other eurozone states concerned about the possible contagion risks of a Greek exit on their own financial systems. If these capital and foreign exchange controls are not recognised by other jurisdictions, some entities may find themselves in a difficult position whereby compliance with these controls may place them in breach of their contractual obligations in such other jurisdictions.

4 Credit/Solvency risk

Businesses located in Greece may struggle to make payments in a timely fashion, if at all. This could be due to their own financial position and/or liquidity difficulties. Alternatively, they may be prevented under Greek law from making payments in the aftermath of an exit. In addition, Greek businesses and those with a significant direct or indirect exposure to Greece may find that the value of their assets has substantially reduced as a consequence of the exit. It is possible that some of these businesses will become insolvent. If subject to a Greek insolvency process, it is also likely that such a process would involve redenominating all claims against the insolvent party into the new currency.

5 Operations in Greece

In addition to other risks discussed in this Bulletin, branches, subsidiaries and joint ventures located in Greece (or indeed those located in other member states that impose capital and foreign exchange controls) may need to operate more independently from their group operations. In addition to requiring local funding, their interests may conflict with the interests of the broader group. This may place directors in the position of having duties or obligations that conflict with their responsibilities to the wider group. These duties could be imposed by new laws or by regulatory requirements or may simply exist as the fiduciary duties of directors.

6 Legal uncertainty

As discussed in Part 1 of this bulletin, an exit by Greece from the eurozone may in certain circumstances be unlawful, i.e. where the exit has occurred in breach of EU law. By the same reasoning, the validity of any New Currency Law may also be questionable. Capital and foreign exchange controls imposed as a consequence of the exit may or may not be lawful, depending on their terms and the availability of relevant exemptions in the EU treaties and IMF Articles of Agreement. Therefore, there is likely to be a considerable period when legal certainty as to these measures is absent. More practically, the scope of the redenomination provisions in the New Currency Law may be unclear as regards certain types of contractual arrangements. Any New

Currency Law would be introduced in accordance with an expedited timetable and would be likely to focus on domestic/retail assets and liabilities and not necessarily focus on complex financial and/or international or cross-border contracts. Lack of certainty as regards contractual obligations is likely to result in delayed performance of those obligations, which in itself could have significant knock-on effects.

7 Delay in the court systems

Lack of legal certainty regarding contractual obligations is likely to lead to a slew of disputes with a consequent impact on litigation. This, in turn would lead to significant delays in the relevant court systems. In addition to disputes regarding contractual provisions and the applicability of the New Currency Law, there may well be questions regarding the competent courts of jurisdiction.[27] Delay in determining which court has jurisdiction could, therefore, be a significant risk and parties should consider taking pre-emptive action in the contractually agreed courts.

8 Collateral and margin risks

If collateral/margin posted to a party in respect of a transaction is redenominated but the underlying liability is not redenominated, there may be commercial implications for the parties to that transaction. The value of the cash or securities posted as collateral/margin may be affected. The relevant collateral/margin may cease to be eligible collateral/margin for the purpose of the transaction. Securities comprising the collateral/margin may be suspended or otherwise blocked from being transferred through the clearing systems, potentially resulting in the parties being required to post more collateral/margin or a different type of collateral/margin to each other. Collateral posting obligations may also be affected by a widening of spreads/fall in asset values (which is likely to be systemic) following a eurozone exit. In addition, a eurozone exit might negatively affect an entity's credit rating, which could trigger collateral posting obligations.

9 Operational readiness

Entities with on-going business relationships with, or operations in, Greece will need to consider their operational readiness to continue those relationships despite the introduction of the new currency, the application of redenomination provisions and the imposition of exchange controls. This will include IT and accounting systems needing to be reprogrammed to deal with a new currency and ensuring that operations and staff located within Greece can continue to be funded.

10 Payments in TARGET2

Whilst it is possible that the New Currency Law could leave the balances of Greek financial institutions with the Greek central bank denominated in euro,

[27] As a result of ECJ judgments on the effect of the Brussels Regulation (on jurisdiction and recognition and enforcement of judgments), the courts in which a claim is first brought must decide upon their jurisdiction to hear the claim before the courts of the agreed jurisdiction can proceed. Unfortunately, this has resulted in parties engaging in "forum shopping" to cause significant delay in the determination of the dispute in the contractually agreed forum. The length of such delay will be determined by local procedures for resolving jurisdictional issues in the court "first seised". These procedures vary between EU member states.

this view is contrary to general assumptions that a New Currency Law would redenominate local bank accounts as much as possible. Assuming such a redenomination were to take place or that the Greek central bank is disconnected from TARGET2 upon Greece's exit from the eurozone, it might no longer be possible to transfer euros out of Greece using TARGET2 and firewalls might need to be established between the Greek national payment system and the remainder of TARGET2. If there is a redenomination, however, the greatest uncertainty is likely to arise in relation to unsettled cross-border transfers of euros out of Greece, as parties may have difficulty ascertaining whether or not payment has been made effectively.

11 Risk of contagion

Contagion and other systemic issues will be a major concern for all businesses. Other economies may be severely and adversely affected by a Greek exit, which could have a damaging domino effect throughout much of Europe. At worst, other member states may also leave the eurozone. Even if this does not happen, as mentioned in "Capital and foreign exchange controls" above, those states may need to impose capital controls, whether or not in breach of EU law.

Appendix 1

How might I be exposed?

Below is a non-exhaustive list of questions that may facilitate the identification of potential exposures a business may have if a eurozone member state were to exit the eurozone and/or the EU.

Direct exposure:

- What is the extent of my financial investments and/or bank accounts in the exiting member state?
- Do I have or hold any debt incurred or issued by the exiting member state or a borrower or issuer incorporated in the exiting member state?
- What is the extent of my non-financial assets in the exiting member state?
- Would the introduction of the new currency result in any mismatches in respect of my assets and liabilities, income and expenses, cross-border trades and related hedging transactions?
- What are the terms of my contracts with counterparties within the exiting member state:
  - Are they domestic or international? What is the governing law?
  - What courts have jurisdiction to hear disputes?
  - What is the specified place of payment?
  - What is the defined currency in which payments will be made? How is this currency defined?
  - Do they contain any force majeure or material adverse change provisions?
  - Do they contain any termination events, events of default or disruption events that may be relevant?
  - Do they contain a currency indemnity?[28]
  - Do they contain provisions relating to downgrade and/or insolvency?
  - Are there provisions in place to reduce counterparty credit risk, for example, collateral or other credit support, security arrangements, guarantees, payment netting and rights of set-off?
  - Will existing collateral or security have sufficient value if it is redenominated into the new national currency?
- Is my exposure adequately hedged? How would my hedges (e.g. credit default swaps and currency swaps) be impacted in the event of a eurozone exit?
- What impact would capital and foreign exchange controls, import tariffs and controls and restrictions on movement imposed by the exiting member state and the revocation of all passported rights have on my business?
- What impact would a severe devaluation of the exiting member state's new national currency have on my business and/or on my lenders, counterparties, custodians, customers and suppliers?
- How robust are my funding arrangements and liquidity facilities?
- What impact would rating downgrades and/or the insolvency of my lenders, counterparties, custodians, customers and suppliers in the exiting member state have on my business?

Indirect exposure:

- Which of my counterparties will suffer greatest exposure in the event of a eurozone exit? This could be in terms of increased capital controls which affect their ability to perform or otherwise.
- How many of my trade counterparties (e.g. on high-value, high-frequency commercial contracts for the provision of goods and services) will suffer significant exposure in the event of a eurozone exit?

[28] Reliance upon a currency indemnity is not without risk and the enforcement of any such indemnity may be challenged.

Appendix 2

How can I manage my risk of exposure?

Below is a non-exhaustive list of practical steps that may be used to manage and minimise the potential impact of eurozone exposure. This may assist with, or form the basis of, your contingency plan, which should be under constant review.

Reviewing key contracts:	Assess redenomination risk, check hedging and related contracts to identify potential mismatches and consider whether the terms of such contracts can be amended or renegotiated. If so, consider seeking amendments in relation to the: - timing of payments – this will provide protection if the local contract is at spot rates and payment can be demanded before supply; - price; - indemnity provisions – to include currency indemnities;[29] - termination events, events of default and/or disruption events, so as to cover a eurozone exit; - definition of currency – how is "euro" defined?; - place of payment – e.g. consider changing the facility office for loans booked with an entity/branch in a eurozone member state which is considered an exit risk. This could be changed to a branch in another eurozone member state which is perceived to be less at risk of an exit or in another EU member state or country, or to another entity within the lender's group; and - governing law and jurisdiction provisions.
Branches, subsidiaries and collaborative arrangements:	Consider the impact of an exit on any existing branches, subsidiaries, joint ventures, outsourcing or other collaborative arrangements. Will parties be in a position to perform their obligations?
Termination of contracts:	Consider whether any of your "at risk" contracts can be terminated in accordance with their terms and whether that makes good financial sense.
Renegotiate contracts:	Where possible, renegotiate contracts with counterparties, suppliers and customers whose creditworthiness may suffer in the event of a eurozone exit.
New contracts and pro forma contracts:	Consider including protective provisions in new contracts and amending standard form or pro forma contracts to include protective provisions for arrangements going forward. Where issuing or arranging the issue of financial instruments, consider whether the inclusion of appropriate risk factors in the prospectus/offer document may be appropriate.
Funding arrangements:	Consider whether committed financing would remain committed (e.g. if force majeure provisions, events of default or termination events could be triggered), whether existing financing would become repayable (e.g. for breach of financial covenants) and whether uncommitted financing/liquidity would be available.
Credit risk management:	Consider other forms of hedging, such as diversification of suppliers/customers, other funding sources, derivatives and limited recourse financings.
Location of investments and accounts:	Consider the location of financial investments and/or bank accounts and the impact of any redenomination and capital and foreign exchange controls. Is it appropriate to move these?
Redenomination risk and enforcement:	Consider the likelihood of the assets of key debtors being converted into a new national currency and whether difficulties might arise when seeking to enforce a domestic or foreign court judgment against the debtor's assets.
Addressing mismatches:	Consider localising funding by member state, where possible, to reduce cross-border asset/liability mismatches.
Operational readiness:	Consider developing a contingency plan addressing operational readiness – see Appendix 3.

[29] Reliance upon a currency indemnity is not without risk and the enforcement of any such indemnity may be challenged.

Appendix 3

Operational readiness

Below is a non-exhaustive list of measures to consider that may facilitate achieving operational readiness in the context of a eurozone exit.

Availability of resources for crisis management
- senior management - key support staff - ability to convene meetings at short notice - information/reporting/monitoring/due diligence - identification of key issues/decisions during disruptions - IT systems and accounting systems (ability to handle one or more new currencies)
Ability to cope with disruptions/closures/delays to
- supply chain/logistics - cash flow/liquidity - asset valuations (fluctuations due to high volatility, wider bid/offer spreads, increased collateral posting obligations) - settlement systems
Ability to cope with high volumes of
- default/close outs - renegotiations/waivers of contracts - margin calls - distressed counterparties
Communications
- prepare forms of internal and external communications, for example to group entities and customers/suppliers/employees/bankers - ensure appropriate dialogue with relevant regulators - assess whether disclosure in public documents should be amended to reflect the impact of political developments - market-wide communications may be required for regulatory purposes (e.g. pursuant to listing rules/securities laws) where the impact of an exit is significant

Contacts

For further information please contact your regular Linklaters contact or click here for a list of Linklaters lawyers in various jurisdictions who will be able to help with your eurozone related queries.

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