

Telephone Briefing

Euro crisis: When a country exits the Eurozone –
Possible scenarios and countermeasures in
commercial and M&A contracts

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I. Possible Scenarios for exit of Member State from EMU (1)

- Possible Scenarios:
 - Eurozone exit by one individual Member State (X)
 - Unilateral withdrawal from European Monetary Union (EMU) by Member State X (violation of EU law)
 - By consensus of all Eurozone members
 - Technically: exit from the EU (art. 50 TEU) and negotiations to rejoin with dispensation concerning Eurozone
 - Break-up of EMU (not addressed)

I. Possible Scenarios for exit of Member State from EMU (2)

- Specific form of exit from Eurozone is decisive:
 - Which Euro debt is converted into new domestic currency (NX) (connection – *Anknüpfung*)
 - Currency conversion effective date (Cut-off date)
 - Exchange rate
 - Accompanying provisions

I. Possible Scenarios for exit of Member State from EMU (3)

- Which monetary claims are converted?
 - Connecting provisions (domestic / EU law) determine which former Euro debt shall now be denominated in new currency (connection)
 - Historically most probable: Place of payment / residence or place of business of the debtor (in case of devaluation conversion is especially targeted at nationals)
 - Also possible: Choice of law, citizenship of debtor, location of assets used for payment of debt
 - Choice of applicable law (*Vertragsstatut*) does not protect against conversion (e.g. bonds issued under UK law)
 - Place of jurisdiction outside exiting Member State does not *per se* provide protection

II. Impact of currency conversion for creditors and debtors (1)

- Currency conversion concerns all creditors of converted debt (independent of individual debtor's solvency)
- Risk of devaluation of new currency
- Traditional bad debt / credit insurance mechanisms fail
- If connection (*Anknüpfung*) is not the law of the underlying contract: Divergence of applicable law and currency statute (*Währungsstatut*) possible
 - Potentially significant ramifications, e.g. regarding set-off, enforcement, etc.

II. Impact of currency conversion for creditors and debtors (2)

- Advantages for debtors:
 - Payment in (devaluated) new currency, not in Euro
- Exchange rate scenarios:
 - Exchange rate identical to the rate at Eurozone entry (with subsequent free devaluation by the market)
 - Immediate devaluation by way of determination of lower exchange rate stipulated in Withdrawal Act

II. Impact of currency conversion for creditors and debtors (3)

- Practical issues:
 - Time to print “New currency”-notes
 - Banknotes denominated in Euro could still be used, but must be stamped (regardless of issuing national central bank)
 - Many residents might not have their Euro-notes stamped
- Potential long-lasting legal uncertainty after Eurozone exit:
 - No judicial authority dealing uniformly with worldwide occurring questions of law

II. Impact of currency conversion for creditors and debtors (4)

- Doctrine of “lex monetae”
 - Parties choose lex monetae for currency issues, regardless of (different) lex causae: partial (implicit) choice of law
 - With respect to currency issues contract follows a state’s currency’s fate (Problem: € = currency of different countries)
 - Applicable by courts in EU-Member States and third countries to determine whether payments have to be made in € or NX
 - Interpretation of agreement
 - No conversion in case of significant disturbance of the balance between performance and consideration (*Äquivalenzstörung*)

II. Impact of currency conversion for creditors and debtors (5)

- Unilateral exit
 - Violation of EU primary and secondary law
 - Consequence: *Per se* no application of Withdrawal Act by courts (including by the courts of the exiting State); due to *lex monetae* not applicable in third countries, either
 - Treaty violation proceedings, government liability
 - Applicability for new claims (disputed)
 - Enforcement of precedence of EU law in exiting State?
 - Legal challenges

II. Impact of currency conversion for creditors and debtors (6)

- Agreed exit by way of amendment of EU law (Alternative: exit under art. 50 TEU and re-entry with dispensation from Eurozone membership)
 - Under *lex monetae*, a currency conversion in conformity with EU law is effective for and against the parties as a result of the currency statute (*Währungsstatut*)
 - Possible protection:
 - *ordre public* (disputed; possibly in case of complete inadequacy of conversion rate),
 - doctrine of frustration (disputed)
 - Anglo-American understanding of currency law

II. Impact of currency conversion for creditors and debtors (7)

- Summary
 - Agreed exit by way of amendment of EU law or other sanctioned alternatives more likely
 - Courts in Continental Europe will most likely apply *lex monetae*
 - Effectiveness of unilateral currency conversion
 - Accompanying stipulations in amicable currency conversion could lead to opposing contractual stipulations (especially in EU member states) having no effect

III. Excursus: Doctrine of frustration (*Wegfall der Geschäftsgrundlage*), Sec. 313 German Civil Code

- German law
 - Currency redenomination: fundamental change of contract basis, but unilateral reference impossible (Art. 3 Regulation No. 1103/97); contract not likely to be rendered impossible to perform
 - Degree of devaluation
- Existing contracts: was currency reform foreseeable?
 - if yes, Sec. 313 German Civil Code is not applicable!
 - Foreseeability not unlikely for contracts concluded since mid 2011; recommendable to include rules concerning foreseeable events
- Preclude application: add appropriate Force Majeure and/or illegality provisions (full and complete)
- Payment in € made illegal in State X: performance frustrated

IV. Possible countermeasures in commercial and M&A contracts (1)

- Commercial contracts
 - Explicit agreement on currency (and subsequent currency) valid in certain jurisdiction, place of payment, choice of law, place of jurisdiction (may not protect against amicable exit from Eurozone)
 - Advisable: Use specific definitions to clarify parties' intent
 - Thresholds for doctrine of frustration
 - Alternative: Common law (lex causae) jurisdiction (no assurance of effectiveness)
 - Contractual allocation of devaluation risk in case of conversion effects, damage claims (problem: circumvention)

IV. Possible countermeasures in commercial and M&A contracts (2)

- Tightened termination clause; contract reversal provisions
- Payment terms, set-off provisions, re-negotiation clauses, currency conversion clause (third currency)
- Joint and several liability of foreign affiliates in case of contracts with parties located in critical states; letters of credit, tailored insurance policies or group company guarantees
- Place of payment not in critical states (in order to avoid connection)
- Specific clauses

IV. Possible countermeasures in commercial and M&A contracts (3)

- M&A contracts
 - Express inclusion of **MAC-clause** in loan agreements, share purchase or business purchase agreements:
 - Cancellation if *material adverse change* in debtor's (or target company's) economic situation occurs, i.e. debtor's performance will be impossible
 - Not necessary: recourse to statutory cancellation rules
 - Shifting of risks (price variation risk)
 - Right to renegotiate purchase price; damages or rescission

IV. Possible countermeasures in commercial and M&A contracts (4)

- **Eurozone exit = *material adverse change*?**
 - Definition up to the parties: buyer will prefer broad, seller narrow definition; unlikely to be included in pre-existing contract
- Triggered by one party: other party can demand additional collateral or performance assurance, terminate contract
- Specific, objective and/or more broadly drafted triggers
- **Scope and extent!** → thresholds, definitions, inclusions (foreseeable events at the time of conclusion of contract), carve-outs (exceptions)

Thank you for your attention.



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