

5 July 2012

The Eurozone. What Do You Really Need to Know?

Introduction

The euro and the European Economic and Monetary Union¹ (“**EMU**”) are facing an increasingly challenging period in their evolution. The dynamic situation, influenced by economics and politics, is evolving and will continue to evolve over the coming months and years.

As a firm, we have been monitoring the situation closely and advising our clients on contingency planning. Given the continuing uncertainty, we think now would be a prudent moment for our clients to take stock, ensure they are apprised of the relevant facts and, if they have not already done so, undertake analysis of their organisation to ensure that they have implemented an appropriate approach to contingency planning.

To assist with such analysis this briefing note outlines the current status of the Eurozone predicament, details some of the legal risk issues that may be considered as part of any contingency planning and summarises some ways in which institutions have been seeking to insulate themselves from any potential fallout.

The European Predicament

The euro was created as part of the economic and monetary policy of the European Union (the “**EU**”) pursuant to the 1992 Maastricht Treaty. The Maastricht Treaty did not contain a provision for a member state to exit from the euro (although the 2007 Lisbon Treaty² does provide for secession from the EU). On its creation, policymakers wanted the euro to be irrevocable³ and therefore did not include any procedure for, or consequences of, dealing with withdrawal so as to positively enforce the commitment of each participating member state to the project. Whatever the reason, legally, based on current EU law, there is no clear method of withdrawal.

The view of the early policymakers that adoption of the euro by a member state was irrevocable finds much support from many European politicians who are committed to its survival. The talk of such politicians has often been of there being “no alternative” and that they will do “whatever is needed” to ensure the continuity and membership of the euro. However, the inevitable question is at what cost? Currently the costs are significant. The European Financial

¹ The Economic and Monetary Union encompasses the set of policies and actions introduced by the Treaty on European Union (commonly known as the Maastricht Treaty) for the purpose of ensuring the gradual movement of the member states of the European Union towards full economic and monetary union with a single currency (the euro). The Maastricht Treaty made extensive amendments to the Treaty on the European Community by providing for a three-stage approach to introduce economic and monetary union by the end of the century. The Treaty came into effect on 1 November 1993, following the final ratification by Germany. The term “Eurozone” in this note refers to the 17 member states of the European Union that adopted the euro as their currency.

² The Treaty of Lisbon (the “**Lisbon Treaty**”) amending the Treaty on European Union and the Treaty establishing the European Community, signed in 2007.

³ The Maastricht Treaty uses the term “irrevocable” in relation to the fixing of the conversion rates of the national currencies into the euro at the starting date of the third stage of EMU.

Stabilisation Mechanism⁴, the European Financial Stability Facility⁵ and the European Stability Mechanism⁶, together create a temporary combined fundraising limit of €700 billion (less the approximately €300 billion already committed to Greece, Ireland, Portugal and Spain) available to help ailing member states – the so called “sovereign firewall”. In Greece, this has been leveraged by the restructuring of Greek bond debts governed by domestic law – incorporating a cram down process under a collective action clause⁷.

However, the “sovereign firewall” is just part of the multi-layered approach currently under way to enhance economic stability within the EMU. In addition, the Treaty on Stability, Co-ordination and Governance in the Economic and Monetary Union⁸ (once ratified) will focus attention of the member states on deficit reduction and the European Central Bank has sought to boost market liquidity through the issuance of €1 trillion of funding through Long Term Refinancing Operations⁹.

Although member states in a currency union with economic surplus might naturally be expected to undertake fiscal transfers to member states with economic shortfalls (which would seem to be an inevitable cost of economic union), citizens in the economic surplus member states may not find sustained subsidies of this nature acceptable. On the other hand, maintaining the Eurozone has required enormous fiscal policy adjustment by some member states in the periphery to the point where the combination of economic depression and unemployment is boosting support for political parties that openly support withdrawal.

Contingency Planning

As the times are therefore highly uncertain and there is currently no real visibility on what will be the outcome of the current challenges facing the Eurozone, it is prudent for institutions to make a rational and measured analysis of the implications of a potential Eurozone break-up, in its various possible forms, and associated contingency planning. Indeed, regulators have been requesting financial institutions and market associations to take such steps for some time now. In any event, the situation could present significant opportunities for prepared businesses.

Legal risk analysis of a break-up is just one aspect of a multi-disciplinary approach that is required to effectively plan for contingencies. Legal risk will need to be assessed alongside other relevant institutional risks, such as credit risk, treasury and liquidity risk, reputational risk, operational risk, market risk and strategic risk. There would appear to be two main parts to any legal risk analysis: (a) relevant and targeted due diligence and (b) analysis of drafting options available to mitigate any potential impact of a Eurozone break-up.

⁴ Adopted by the Council of Europe 9 May 2010 based on Article 122.2 of the Lisbon Treaty and an intergovernmental agreement of euro area member states.

⁵ Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism.

⁶ A permanent rescue funding programme to succeed the temporary European Financial Stability Facility and European Financial Stabilisation Mechanism in the 17-member Eurozone. The ESM is due to be launched as soon as Member States representing 90% of the capital commitments have ratified it, which is expected in July 2012.

⁷ Collective action clauses will be mandatory in all domestic and international Eurozone government debt with a maturity of above one year issued on or after 1 January 2013.

⁸ A Treaty signed on 2 March 2012 by all EU member states with the exception of the United Kingdom and the Czech Republic.

⁹ Cheap, three-year loans funded by the European Central Bank, €529.5 billion of which most recently was funded to 800 lenders (Enrich, David and Forelle, Charles. “ECB Gives Banks Big Dollop of Cash.” The Wall Street Journal 1 March 2012. <http://online.wsj.com/article/SB10001424052970203986604577252803223310964.html>).

Targeted Due Diligence¹⁰

Redenomination Risk

One of the key diligence items stems from the concept of redenomination risk. From a legal risk perspective, it is key to try to understand to what extent any new currency would apply to existing contractual arrangements. However, there are currently no provisions in law which specifically deal with redenomination of the currency of an EU member state (that, in full compliance with the EMU, has adopted the Euro as its national currency) in the event of a partial or complete break-up of the euro or the departure, consensually or by expulsion, of a euro-participating member state from the EU (“DMS”). Any redenomination process could follow the relatively recent precedents set in 1992-1993 in the split of Czechoslovakia into the Czech Republic and Slovakia or in 1992 in the dissolution of the former USSR (dealing with, amongst other things, the introduction of the new currency and timing of announcements). Although helpful from a process perspective this still doesn’t give a clear and definitive answer to the redenomination risk issue. The facts and circumstances surrounding the individual contract will therefore be relevant and may require some degree of diligence. The following generally applicable concepts should be considered as part of any due diligence exercise:

Method of Exit

Although some commentators feel that the Lisbon Treaty could be used to facilitate exit or expulsion from the Eurozone¹¹, a unilateral exit from the EMU would in principle be contrary to EU law and this would significantly increase the risk that the exit would not be recognised by other EU member states such that any associated redenomination would also not be recognised. Therefore, to ensure recognition of both exit and redenomination, a negotiated political compromise would be preferable; potentially with some form of EU legislation to address some of the issues that could arise such as redenomination (as was seen on the introduction of the euro) and illegality of exit. However, there can be no assurance that such legislation would be forthcoming.

Governing Law

Due to the concept of *lex monetae* (explained below), an express choice of governing law will not necessarily insulate against redenomination risk. Redenomination risk is greater where the contract is governed by the law of a DMS. English courts would, pursuant to the Rome I Regulation¹², likely give effect to the redenomination of a DMS-located debtor’s euro liabilities by a DMS subject only to overriding mandatory principles of English law or incompatibility with public policy where a matter is governed by the law of the DMS. If the redenomination legislation of a DMS were passed in contravention of EU Treaties due to non-consensual withdrawal, this might be considered contrary to public policy.

Jurisdiction

In any proceedings, the courts hearing the proceedings will apply their own conflicts of law rules (including the Rome I Regulation, to the extent relevant) to determine the country whose domestic laws should resolve the matter, irrespective

¹⁰ For the purposes of the following section of this briefing note we assume that the euro will continue to exist in some form, there is a limited break-up scenario with the departure of a departing member state and there is the introduction of a new national currency in the departing member state.

¹¹ Some have suggested that the withdrawal mechanism provided by Article 50 of the Lisbon Treaty could be used to allow redenomination of the currency of a DMS. Additionally, Article 50 contemplates readmission of a DMS under Article 49 of the Lisbon Treaty. Therefore, under the Lisbon Treaty, an EU member state could conceivably withdraw from the EU, redenominate its national currency and subsequently rejoin the EU while retaining its new currency. Further, while expulsion has been discussed, commentators disagree on whether such action is even possible under the Lisbon Treaty.

¹² Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

of the chosen governing law of the relevant contract. Arguably, the courts of a DMS are more likely to give effect to the redenomination legislation of that DMS. As a result, disputes heard in such courts would likely permit the satisfaction of payment obligations in the new currency rather than the euro. Practically speaking, timing on issuing proceedings could therefore become important. If proceedings are commenced in a DMS and the DMS does not decline jurisdiction then the likely outcome would be redenomination.

In some cases, a company may have its substantial operations and assets located in a DMS and normally a judgment obtained outside of a DMS would be enforceable within the DMS pursuant to an application to the courts of the relevant DMS. On a redenomination, the DMS courts would likely give effect to redenomination legislation and may not recognise or enforce a judgment for the euro amount or its economic equivalent. Asset location of a counterparty may therefore have significance in certain situations. It should be noted that firms that operate locally but have borrowed abroad could face particular solvency issues if their borrowing obligations are not redenominated.

We do not, however, recommend amending the choice of jurisdiction provisions to elect for disputes to be held in courts of countries which for other reasons are not frequently chosen in commercial contracts.

Lex Monetae

If no redenomination clause exists (which is the case in many contractual arrangements¹³) in applying its own conflict of laws rules it is likely that each domestic court would apply the principle of *lex monetae*. *Lex monetae* is the principle that where a contract refers to a national currency there is an implicit choice of law of that country to determine the identification of that currency and its relationship with other currencies. The application of this principle to the Eurozone is complicated by the fact that the euro is the currency for multiple countries, not a single member state. Clearly if all aspects of a contract, such as parties, performance and governing law, relate to a DMS then it is highly likely that euro-denominated payment obligations under that contract would be redenominated into the new currency. However, as international factors creep into the contract, such as parties, performance and governing law, euro-denominated payment obligations may avoid redenomination.

The key question is, whether the parties intend that the currency of payment should be that of a DMS (previously euro and now a new currency) or that of the remaining Eurozone members (euro)? As such the intentions of the parties, the location of the counterparty and the particular terms of the contract are likely to be factors in determining any redenomination. Appendix 1 (*Redenomination Risk*) discusses some concerns relating to provisions in standard LMA Loan Agreements, High Yield Bonds, ISDA Master Agreements and Eurobonds that may be considered as part of a legal diligence review to determine the risk of redenomination.

Continuity Risk

A commercial contract with a connection to a DMS where payment obligations are purported to be redenominated into a new currency is likely still to be a valid contract. It is a generally accepted principle, at least under English law, that the validity of a contract is not affected by the introduction of a new currency. In addition, under English law, a contract once made will not be vitiated or discharged except if there is a mistake or a frustrating event. As a matter of English law, mistake will not be found if the euro exists at the point of formation of the relevant contract. For frustration to be found

¹³ A standard provision in high yield bonds governed by New York law provides for redenomination of payment obligations of the issuer to bondholders with their consent. Please see Appendix 2 (*Continuity Risk*).

there would need to be a supervening event that made it unlawful, impossible or radically different to perform. It is unlikely that redenomination of the contractual currency could amount to this (particularly in view of the validity of contract principle explained above)¹⁴. Potentially, an exchange control imposition by a DMS could frustrate a contract but it should be noted that frustration is a notoriously difficult concept to prove under English law and possibly under other laws as well.

However, some contracts do contain provisions that could result in a disruption or termination following a partial break-up of the euro. Appendix 2 (*Continuity Risk*) discusses some provisions contained in standard LMA Loan Agreements, High Yield Bonds, ISDA Master Agreements and Eurobonds that could be relevant in analysing such continuity risk.

In addition, particular contracts or provisions may become meaningless following a partial or full break-up of the euro. Although there may be provisions that could be relied upon to instigate mechanical changes to the contract to reflect the new currency, those are likely to be insufficient to instigate commercial term variation. The underlying business case on which financial covenant and other protections are based could also become meaningless following a redenomination with resulting exchange control and other disruptions.

English courts have the power to give judgments in a foreign currency in contractual matters¹⁵ and tort matters¹⁶. In cases involving unliquidated damages for breach of contract or damages for tort, the English court will attempt to identify the “appropriate currency” for the award of damages. In contractual cases, the court will see if the parties have chosen a “currency of the contract” in which all the obligations of the parties, including any secondary obligation to pay unliquidated damages for breach of contract, are to be denominated. It should be noted that the appropriate currency for the award of unliquidated damages may not necessarily be the same currency as the one in which the parties’ other obligations (such as the obligation to pay the price in a sale of goods contract) are denominated. It is therefore important for contracts connected to the euro or the Eurozone to make provision for the appropriate currency for unliquidated damages and also damages in tort.

Mitigation

Given the uncertainty and the potential risks outlined above, there has been much discussion about how best to mitigate the possible effects of a redenomination by a DMS and the associated risks of an exit from the Eurozone.

The exit could be with or without pan-European legislation and there is no definite visibility as to when an exit may occur and/or which countries would be affected. Any attempt therefore to minimise the risks is uncertain and subject to multiple possible outcomes, including legislation that could undo any provisions put in place by individual counterparties. However, there have been ad hoc attempts by providers of market standard documentation and individual parties to mitigate and some examples are set out in detail below:

¹⁴ A possible exception to this could be a “pure” FX transaction where the euro is one of the two currencies in a situation where the euro ceased to exist.

¹⁵ *Miliangos v George Frank (Textiles) Ltd.*, [1976] AC 443.

¹⁶ *The Despina R.* [1979] 1 All ER 421.

Euro means euro

One way to achieve clarity of currency may be to specify that euro means the single currency from time to time and shall remain so notwithstanding any changes to Eurozone membership. However, even if there is a valid claim for euro, it may be of limited use if it cannot lawfully be performed or enforced in euro, due to, for example, location of assets or exchange controls.

In January 2012, the Loan Market Association added a footnote to each of its recommended forms of facility agreement, reminding users that they do not contain currency definitions.

Redenomination Framework

For some counterparties, increased certainty could be gained from having an option to redenominate obligations on a specified trigger and at an appropriate exchange rate. A provision could be built into the documentation that addresses currency conversion on a euro break-up in accordance with exchange rates adopted by competent authorities either relating to a replacement currency or, where one does not exist, a basket of national currencies. Alternatively, a counterparty could be empowered to specify an alternative currency and exchange rate. None of these approaches are failsafe, however, as they may well be overridden by relevant redenomination legislation and could be at risk of being construed as unenforceable as contrary to exchange control restrictions¹⁷. For the borrower counterparty under a loan, such a provision could result in a significant mismatch between assets and liabilities.

Governing Law and Jurisdiction Clause

As discussed earlier, parties who have elected to litigate under the laws of a DMS are highly likely to be impacted by any exchange control and redenomination legislation passed in that state (subject to any public policy issues). The option is therefore open to counterparties to change and/or put in place a governing law and jurisdiction clause that would take them outside of the vulnerable DMS. For example, parties could choose the law of a non-EU member state to govern a contract, such as the law of the state of New York. If a relevant redenomination was sanctioned and controlled by EU legislation, then in theory that legislation would have to be followed by EU courts, such as English courts, but New York or certain other non-EU courts would not necessarily be so bound.

The place of performance may also require consideration. The Rome I Regulation¹⁸ primarily provides that the courts of member states will apply to a contract, the law chosen by the parties, subject to overriding mandatory provisions of law of the “country where the obligations arising out of a contract have to be or have been performed insofar as those ... provisions render performance of the contract unlawful.”¹⁹ This gives rise to numerous questions and therefore if trying to insulate through this protection, it would be advisable to ensure that the contractual place of performance is outside of vulnerable jurisdictions.

¹⁷ Article VIII (2)(b) of International Monetary Fund Agreement – “Exchange contracts which involve the currency of any member state and which are contrary to the exchange control regulations of that member shall be unenforceable in the territories of any member”.

¹⁸ Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

¹⁹ Article 9(3) of Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

Obligor location

If at all possible in a structure, the obligor (and its assets) could be located outside of a perceived vulnerable country or outside of the Eurozone or the EU as a whole. Alternatively any credit support for an obligor could be deposited or held outside of the Eurozone or the EU. If that credit support were in the form of a guarantee, then it might be necessary to amend the standard form to ensure that the guarantee covered, as an independent obligation, any loss following redenomination of a borrower's payment obligations and that the extent of such guarantee would not be in any way avoided or reduced by redenomination (i.e. the guarantor's liability would remain in euro).

Termination/Prepayment events

Termination/prepayment events specific to a Eurozone break-up could be negotiated into a contract, perhaps even including some sort of sovereign risk-based event of default. There are obviously commercial and political sensitivities to this, particularly for state-based banks in the Eurozone. Any protection also needs to ensure that the trigger occurs before an exit i.e. at some point when a country is taking steps to leave the Eurozone. Otherwise a Eurozone termination event/prepayment event could be triggered too late to be effective.

Dual law structures

For some lenders there are inherent tensions in choosing a law in order to potentially insulate from redenomination risk or alternatively having local law obligations that can be eligible as collateral under European Central Bank liquidity facilities. Some transactions have reflected this tension with dual law optionality for the lenders involved.

Approach to M&A

Where the risk and rewards are commensurate, the current depressed equity and asset values in some Eurozone jurisdictions may provide opportunity for acquisitions. Any transactions connected with a vulnerable jurisdiction will require analysis of certain issues specific to the current Eurozone predicament, including: enhanced due diligence of the impact of any worsening of the current conditions across the Eurozone on the target group and its assets; and specific evaluation of country and currency risks relevant to the particular transaction, for example, who are the key counterparties and suppliers, where are they located, what are the future funding requirements of the target and how can these be serviced in the future if there is a Eurozone break-up? In this context, parties may look to including break-up or redenomination-specific MAC clauses, completion conditions and possible price adjustment mechanisms to address any possible changes in the market conditions surrounding the target.

Conclusion

Citigroup's top economist, Michael Sanders, has predicted that there will be a "Grexit" on 1 January 2013²⁰. Others have been less convinced that a Eurozone break-up will occur. What is clear is that these are uncertain times for the Eurozone and although an exit may arguably still be unlikely, the consequences could be severe. On that basis, it would be prudent, as a matter of good risk management, that our clients analyse the potential risks, legal and otherwise, to their businesses

²⁰ Investment Week 25 May 2012.

of a Eurozone break-up and install, to the extent the findings of their analysis deem necessary, reasonable and targeted contingency plans.

Appendix 1 Redenomination Risk

	LMA Loan Agreement	Typical New York Law High Yield Bond	Standard English Law ISDA Master Agreement ²¹	Typical English Law Eurobond
Jurisdiction	<ul style="list-style-type: none"> Contains a submission to the exclusive jurisdiction of a court in favour of the finance parties. Finance parties would be entitled to bring a court action in either the courts contained in the submission clause or other relevant courts (including those of the DMS) but the obligors would be contractually (if not practically) limited to bringing court proceedings in the submission clause courts only. 	<ul style="list-style-type: none"> Contains an irrevocable but non-exclusive submission to jurisdiction of the courts of New York City 	<ul style="list-style-type: none"> Provides that the English courts are to have jurisdiction, exclusive in situations where the Brussels I Regulation²² applies and non-exclusive otherwise 	<ul style="list-style-type: none"> Contains a submission to the exclusive or non-exclusive jurisdiction of a court for the benefit of the noteholders, trustee and/or agents but often contemplate that these parties may also bring proceedings in other courts of competent jurisdiction. The typical position is that the documents envisage that noteholders, trustee and/or agents may bring proceedings in the specified court or other relevant courts (including those of the DMS) but that the issuer or guarantor would be limited to bringing court proceedings in the specified court only (if submission refers to exclusive jurisdiction).
Contractual Provisions	<p>Place of Payment</p> <ul style="list-style-type: none"> Does not designate a single country as the place for euro payments. All payments are required to be made through the Agent to such account in the principal financial centre of the country of that currency (or, in relation to euro, in a principal financial centre in a participating member state or London) with such bank as the Agent specifies. 	<p>Place of Payment</p> <ul style="list-style-type: none"> A specific place of payment is not designated. Payment is required to be delivered to the designated paying agent, a party the identity of which can be redesignated. <p>Contractual Currency of Payment</p> <ul style="list-style-type: none"> The currency of payment is the currency of issuance and contains a clause that the funds paid are legal tender for all debts public and private at the time of 	<p>Place of Payment</p> <ul style="list-style-type: none"> If payments are to be made through an account located in the DMS, there may be a rebuttable presumption that the parties intended the currency of payment to be the currency for the time being of the DMS. Where the 2000 or the 2006 ISDA Definitions are used (they are often incorporated into a Master Agreement), the ISDA definition of euro will apply and probably be effective so as to rebut this 	<p>Place of Payment</p> <ul style="list-style-type: none"> Payments through a paying agent/bank account located in DMS create rebuttable presumption that intended currency of payment is currency of DMS. Presumption may be rebutted if the documents provide for payment outside DMS or in more than one place. Eurobonds in global form are usually deposited with and held by a common depository on behalf of the clearing systems. In

²¹ These comments relate to an English-law-governed Master Agreement, in standard form. They do not examine actual transactions, which may contain separate protections, give rise to different risks (for example, Sovereign CDS, where redenomination might (or might not) constitute a restructuring credit event) and require further diligence and examination.

²² Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

²³ There may also be no such presumption under laws of certain jurisdictions.

LMA Loan Agreement	Typical New York Law High Yield Bond	Standard English Law ISDA Master Agreement ²¹	Typical English Law Eurobond
<ul style="list-style-type: none"> The place of payment is therefore not conclusive. If payments are made through an account located in the DMS, there may be a rebuttable presumption that the parties intended the currency of payment to be the currency for the time being of the DMS. This presumption may be rebutted if payments are made outside the DMS or in more than one place or jurisdiction²³. In addition, if the redenomination legislation of the DMS were passed in breach of the EU Treaty or the relevant DMS departed on a non-consensual basis in breach of the EU Treaty then as a matter of public policy the presumption may be rebutted. <p>Contractual Currency of Payment</p> <ul style="list-style-type: none"> No definition of euro. There is a provision designating a base currency of account and payment for sums payable under the finance documents and if this base currency is euro then arguably this provides evidence that the parties intend the <i>lex monetæ</i> to be the Eurozone states but this creates the issue that there is no single state to refer to. <p>Settlement Mechanics</p> <ul style="list-style-type: none"> The LMA Loan Agreement with a euro base currency is drafted to provide for euro payments operating in the European inter-bank market. For example (i) monetary amounts are denoted by EUR or “€”; (ii) interest on euro loans is payable by reference to EURIBOR or euro LIBOR; and (iii) the applicable interest rate and payment conventions are set up so as to reflect euro 	<p>payment.</p> <ul style="list-style-type: none"> The currency is a defined term: an equivalent such as “euro equivalent” or “US dollar equivalent” may also be defined, but whether that means the indenture contemplates payment obligations being satisfied in equivalent amounts depends on the provisions in which the defined term appears. <p>Settlement Mechanics</p> <ul style="list-style-type: none"> Settlement is affected by the legal requirements for payment in the particular currency and likely the policies of the designated trustee or settlement agent. 	<p>presumption (see below).</p> <ul style="list-style-type: none"> Under the 1992 and the 2002 ISDA Master Agreements, a party is allowed to change its account for receiving a payment by giving 5 local business days’ notice, unless the other party gives timely notice of a “reasonable objection” to such change. It is likely therefore that parties may look to develop a “reasonable objection” argument that a party should not move an account to a jurisdiction of a eurozone member which is a potential DMS. <p>Contractual Currency of Payment</p> <ul style="list-style-type: none"> Contains a definition of euro pursuant to the 2000/2006 ISDA Definitions, if incorporated. Such definition broadly defines the Euro as the currency of the states that adopted it. It is not clear what happens where a state adopted it becomes a DMS, so that the Euro is no longer the currency of that state (which had adopted it). It is clearly arguable that English courts would interpret the ISDA definition of euro to mean the single European currency established under EMU not that the currency of the DMS from time to time. It might be more difficult to conclude that references to the euro mean the single European currency established under EMU if multiple states departed from the euro: at a certain point a court might be unwilling to require payment in Euro on the basis that the currency would no longer be the same currency as was originally contemplated by the contracting parties. 	<p>practice, payments are made to the common depository, transmitted to the clearing systems and finally to accountholders. Therefore, payments are likely made through the eurosystems and therefore supportive of the intention that payment obligations are euro.</p> <ul style="list-style-type: none"> If the bonds are in definitive form, a different result may arise if payments are to be made by presentation of the relevant bond at, or payment through, the offices of a paying agent/bank account and that paying agent/bank account are located in DMS. Common to provide that “all payments in respect of the bonds are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment”. If the redenomination legislation in the DMS renders payments in euro illegal in the DMS, then this could result in euro payments to be made through a paying agent/bank account in the DMS becoming unenforceable. Often there is an ability to change paying agent and bank account locations. <p>Contractual Currency of Payment</p> <ul style="list-style-type: none"> Generally provide for payments to be made in euro. A common definition for euro would be, “the single currency introduced at the start of the third stage of European economic and currency union pursuant to the treaty establishing the European Community as amended by the Treaty on European Union, as amended”. This definition is helpful as it indicates the parties’ intention that

LMA Loan Agreement	Typical New York Law High Yield Bond	Standard English Law ISDA Master Agreement ²¹	Typical English Law Eurobond
<p>conventions i.e.: the definitions of Quotation Day and Business Day.</p> <ul style="list-style-type: none"> Arguably these are all indications that the parties intended payment obligations to be satisfied in euro. 		<p>However, it seems unlikely that there would be multiple DMS without consequential treaty changes and accompanying EU legislation addressing continuity of contract issues.</p>	<p>payment obligations are to be satisfied in euro (if it continues to exist as a currency) rather than the lawful currency from time to time of the DMS.</p> <p>Settlement Mechanics</p> <ul style="list-style-type: none"> Likely to reflect those required for payments in euro, and will include conventions for euro payments (such as the euro day/interest rate conventions). These are helpful indications of the parties' intention that payment obligations are to be satisfied in euro, although the provisions are often generic in nature.

Appendix 2 Continuity Risk

	LMA Loan Agreement	Typical New York Law High Yield Bond	Standard English Law ISDA Master Agreement	Typical English Law Eurobond
Events of Default/Termination	<ul style="list-style-type: none"> If obligations remain in euro and due to exchange control restrictions the obligor is unable to perform payment in euro as only the new currency is available, there could at some point be a payment event of default. 	<ul style="list-style-type: none"> There could be cross defaults or defaults under credit support and derivatives documentation. Even if obligations under the bond issue remain denominated in euro and no events of default would be triggered by a DMS leaving the Eurozone or redenominating its currency or imposing exchange controls, the issuer could be party to other agreements or underlying credit support or swap agreements which may be defaulted by these events. 	<ul style="list-style-type: none"> The Master Agreement does not include a Specific Termination Event or Event of Default based on a Eurozone break-up. However specific Termination Events or Events of Default could be triggered (see illegality and payment default below). 	<ul style="list-style-type: none"> A typical eurobond is unlikely to have provisions which make an exit from the eurozone a specific event of default. If obligations remain denominated in euro, an event of default is more likely to arise in circumstances where an issuer/guarantor tries to make payment in the new currency or are unable to make payments in euro as only the new currency is available. For an issuer/guarantor in a DMS, due to the consequences on their revenues (if redenominated into the new currency) and financial stability, MAC clauses (if any), insolvency events of default, cross default and cross acceleration provisions and illegality may become relevant.
Illegality/Unlawfulness	<ul style="list-style-type: none"> Exchange control implementation could lead to performance being illegal and unlawful. This could apply to obligors and finance parties. The right under the LMA Loan Agreement for cancellation and prepayment or replacement of a lender due to an illegality is subject to a limited obligation to mitigate the effects of the illegality, e.g. by changing its facility office. The costs are recoverable from the obligors. 	<ul style="list-style-type: none"> If the bond terms and conditions contain "unlawfulness" as an event of default, it is arguable that a default under the bonds might be triggered if exchange controls were implemented and consent to make payments in euro was not available. However, this would require careful consideration of exactly what the DMS' law provided. 	<ul style="list-style-type: none"> If, due to a change in applicable law in a DMS due to, for example, the imposition of exchange controls, it would become unlawful for a party to meet its obligations to make or receive payments under the Master Agreement, a Termination Event for Illegality might arise. If the unlawfulness is due to a failure to comply with an obligation to obtain authorisations, an Event of Default might arise instead. Force Majeure, Illegality and Events of Default need examination in some detail in the light of different scenarios affecting a DMS and a counterparty. 	See above.

	LMA Loan Agreement	Typical New York Law High Yield Bond	Standard English Law ISDA Master Agreement	Typical English Law Eurobond
Currency Indemnity	<ul style="list-style-type: none"> Technically this could provide protection to the finance parties where they are owed an amount in euro but have a judgment in the new currency. However, it would probably not be easy to enforce such an indemnity, if necessary, in the courts of the DMS and there is some doubt as to the effectiveness of such indemnities generally. It does not provide protection against redenomination risk. 	<ul style="list-style-type: none"> A currency indemnity may be relevant where judgment is given in the new domestic currency but the payment provisions remain denominated in Euro. However, there are some doubts as to the effectiveness of such indemnities generally. It does not provide protection against redenomination risk. 	<ul style="list-style-type: none"> A currency indemnity is included to cover potential currency losses of a party in relation to a judgment of a court which is given in a currency other than the contractual currency, noting that a judgment in a DMS (and potentially also an order for the enforcement of a judgment obtained elsewhere – but this may depend on how much of the remaining EU infrastructure still applies within the DMS) is likely to be given in its new domestic currency. However, there are some doubts as to the effectiveness of these indemnities generally and it would probably not be easy to enforce such an indemnity, if necessary, in the courts of the DMS. The currency indemnity does not provide protection against redenomination risk. 	<ul style="list-style-type: none"> Documentation may or may not contain a currency indemnity. The currency indemnity is usually drafted to cover potential losses due to recoveries being made in a currency other than the specified currency. However, there are some doubts as to the effectiveness of such indemnities generally.
Material Adverse Change/ Force Majeure	<ul style="list-style-type: none"> Arguably there could be a Material Adverse Change depending on the drafting of the clause and the factual circumstances at the time. In addition it could trigger a default under any covenants or repeating representations that are qualified by Material Adverse Effect language, thereby resulting in a further event of default. 	<ul style="list-style-type: none"> While MACs and force majeure clauses may be included in the purchase agreements governing the initial sale and purchase of bonds, standard indentures do not provide for MACs or force majeure events. However, provisions exist for legal and covenant defeasance, although any defeasance would not necessarily disabuse an issuer of its responsibility to pay bondholders in the specified currency. Additionally, indentures contain provisions for modification, waiver or amendment of their terms. For example, the standard indenture contemplates the possibility of changing the coin or currency in which payment obligations are satisfied under the indenture upon the consent of at least 90% of bondholders. 	<ul style="list-style-type: none"> The 2002 ISDA Master Agreement contains language on force majeure covering situations which do not cause an obligation to be illegal but which make performance impossible. It is unlikely that the fact that one state has ceased to use the euro makes performance in euro impossible. 	<p>See Events of Default/Termination above.</p>

	LMA Loan Agreement	Typical New York Law High Yield Bond	Standard English Law ISDA Master Agreement	Typical English Law Eurobond
Others	<p>Market Disruption</p> <ul style="list-style-type: none"> Conceivably, certain lenders may experience funding difficulties as a result of a redenomination. If sufficient members were unable to fund themselves this could trigger the market disruption provisions and the borrowers would be obliged to match actual funding costs. <p>Costs Claim</p> <ul style="list-style-type: none"> It could be argued that increased costs to a finance party resulting from a change of law and ensuing currency loss are recoverable under the increased cost clause subject to a limited obligation to mitigate as discussed above. The other indemnity provisions may also be relevant depending on the factual circumstances. 	<p>Payment Default</p> <ul style="list-style-type: none"> If the issuer's payment obligations are denominated in euro but the issuer tries to make payment in a new domestic currency or alternatively is unable to make any payment this would likely constitute a payment event of default. This may give rise to insolvency events also. 	<p>Payment Default</p> <ul style="list-style-type: none"> There may be a failure to pay or deliver Event of Default under the Master Agreement (subject to relevant grace periods) if payment obligations denominated in euro were paid in the new currency. The Master Agreement permits (but does not oblige) a payee to accept payment in the wrong currency, provided that, on conversion into the right currency, it adds up to the right amount. If the relevant party was facing financial difficulties following the re-denomination then an insolvency event of default could also be relevant. If the counterparty defaults on any other debt payment obligations then, if the "Cross Default" Event of Default applies under the Master Agreement (subject to various thresholds as agreed), this could result in a "Cross Default" Event of Default under the Master Agreement. 	<p>Payment Default</p> <p>See Events of Default/Termination above.</p>

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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