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Briefing note

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The Greek debt crisis and loan agreements

The Greek debt crisis has once again raised the possibility of Greece leaving the euro area (whether as a result of a Greek sovereign debt default or otherwise) as the escalating stand-off between Greece and the euro area, ECB and IMF shows little indication of dissipating. The analysis of implications of a so called "Grexit" under market standard loan documentation remains much as we outlined in 2011. However, concerns evolve over time and although probably the most extreme, a full Grexit is now just one of several potential scenarios. In light of regulatory requests to update contingency planning, this briefing republishes and updates our answers to key questions concerning a potential Grexit and touches on the implications of the more intermediate possibilities of sovereign default and imposition of capital controls.

Grexit

***Question*: I have a euro-denominated loan to a private company borrower incorporated in Greece. If Greece leaves the euro area and re-establishes new drachma, would the borrower still be obliged to pay in euro?**

Answer: One of the challenges with analysing a Grexit is that the manner and legal basis upon which Greece might leave the euro area would impact substantially on the analysis. There are a number of ways in which it is possible to foresee such an event occurring, ranging from a European Union (EU) approved withdrawal from the EU and the euro area or an approved withdrawal from the euro area but not the EU (although there is no mechanism in the EU Treaties for the latter), to Greece's unilateral withdrawal from one or both on a non-consensual basis, in each case with the likelihood of the imposition of capital controls. Accordingly, a complicated set of possible legal considerations arises, in particular based on whether or not any Grexit is agreed by EU member states and facilitated by supporting EU legislation (and if so on what terms) and whether, as is likely, capital controls are imposed (again, if so on what terms). Indeed there could be wider controls imposed on the movement of funds or assets. Also the conflict of laws position would further complicate matters, as would the approach adopted in any monetary legislation to redenomination.

For the sake of simplicity, therefore, assume that Greece passes a law establishing monetary sovereignty, redenominating all debts owed by and to its nationals from euros into new drachma and that it does so without EU consensus and over-arching EU

Key issues

- The key provisions in loan documentation when analysing the effects of a potential Grexit are:
  - Jurisdiction
  - Governing law
  - Currency of payment
  - Place of payment
  - Events of Default
- Greek capital controls could render a Greek borrower's repayment obligations under an English law facility agreement unenforceable in some circumstances
- The key provisions in loan documentation when analysing the effects of a potential Greek sovereign default are the Events of Default

legislation. (We will not complicate the analysis by considering the impact of any capital controls here but see the box headed *Capital controls* for a discussion of the issues involved.) If you have a typical euro-denominated syndicated loan with an English governing law provision, submission to the exclusive jurisdiction of the English courts and a payment obligation in the single European currency with payment outside Greece – and assuming that no consensual protocol is established by the EU to permit a Grexit, then the English courts should hold that payments are to be made in euro and, if they are not made in euro, there will be a payment event of default. However, where any of these factors are missing, then the analysis becomes more complicated.

There are four main areas in facility agreements that are relevant to determining the currency in which the debt is to be paid: (a) the submission to jurisdiction; (b) the governing law; (c) the way in which the obligations to pay in a particular currency are drafted; and (d) the place stipulated in the contract for payment.

We discuss each of these below:

- **Jurisdiction** – If the jurisdiction submission provision permits the Greek courts to have jurisdiction then, whatever the governing law, those courts would, in all likelihood, give effect to the Greek redenomination legislation. So it would be likely to mean that the borrower would be able to pay in new drachma and not in euros. On the assumption that Greece remains in the EU, EU law (the recast Brussels I Regulation) would, prima facie, oblige English courts to recognise and enforce a judgment of the Greek courts, unless to do so would be "*manifestly contrary*" to English public policy.
- **Governing law** – If the facility agreement is governed by Greek law, the English courts would give effect to Greece's redenomination legislation pursuant to EU law (the Rome I Regulation). The English courts could decline to do so only if necessary to give effect to overriding English mandatory laws or if giving effect to Greece's redenomination legislation was manifestly incompatible with English public policy. This would be the case only in unusual circumstances. If, however, Greece passed its redenomination legislation in breach of an EU Treaty, it is possible that the English courts would consider enforcement of that redenomination legislation to be contrary to English public policy. If, on the other hand, the facility agreement is governed by English law, and is subject to the exclusive jurisdiction of the English courts, Greece's redenomination legislation would affect the borrower's obligations under the facility agreement only if they required payment in Greece's currency from time to time, as discussed next.
- **Currency of payment** – If the facility agreement is governed by English law and is subject to the exclusive jurisdiction of the English courts, the main question is whether the contractual intention was for the currency of payment to be (i) the single European currency, in which case the loan would remain payable in euros or (ii) the currency of Greece from time to time. This should be determined by the specific currency definition in the facility agreement or, where it is not definitive, by reference to any other relevant circumstances, including the place of payment and any other evidence as to the parties' intentions. A definition of "*euro*" such as that used in current LMA facility documentation should, absent special circumstances, operate to make clear that the intention is for the currency of payment to be the single European currency.
- **Place of payment** – The place of payment could be relevant for two main reasons. First, if there is no currency definition in the facility agreement but the place of payment is within Greece, that creates a rebuttable presumption that the currency of payment was intended to be the currency of Greece from time to time. If an agreement requires payment in the Greek currency from time to time and Greece changes its currency from the euro to new drachma, the payment obligation under the agreement will similarly be converted into an obligation to pay new drachma (converted at the rate set out in Greece's redenomination legislation) (this is often referred to as the *lex monetae* principle). The presumption that the parties intend the currency and place of payment to be aligned is, however, rather weak, and the courts will look at all the circumstances in order to ascertain whether the parties intended the currency to be that of the euro area or that of Greece. Secondly, Greece's

redenomination legislation could render payment in euros illegal regardless of the requirements of the agreement. If so, for agreements concluded on or after 17 December 2009, the English courts have a discretion under EU law (the Rome I Regulation) to give effect to that legislation if (i) the place of payment is Greece and (ii) as would probably be the case, that legislation represents an "*overriding mandatory provision*" of Greek law. For agreements concluded before that date the supervening illegality in the place of payment would render the obligation to pay in euros in Greece unenforceable as a matter of English law.

***Question*: I have obtained a judgment from an English court. If Greece has left the euro area, can I enforce it against the borrower's assets located in Greece?**

Answer: Obtaining an English court judgment against the borrower is one thing. Enforcing against assets in Greece following a Grexit is something else. If the borrower only has substantial operations and assets in Greece, a creditor would normally (assuming Greece remains in the EU) enforce against those assets by asking the Greek courts to enforce the English judgment. In the case of a Grexit, Greece's courts would almost certainly be required to give effect to Greece's redenomination legislation and would, therefore, be unlikely to recognise, or enforce, an English judgment for euro-denominated debt against the borrower. As a consequence enforcement against Greek assets would be difficult.

Capital controls

Greece may need to introduce capital controls in the event of any Grexit or sovereign default. They might also be imposed as a stand-alone measure to stem deposit outflows.

Question: What are they and why are they important?

Answer: Capital controls (sometimes also called exchange controls) are national laws which broadly aim to restrict buying and selling of national currency or to preserve currency within a country. They can take many forms but most relevant for these purposes would be a Greek law having the effect of restricting Greek borrowers from making payments to their lenders.

Greek capital controls are unlikely to be directly relevant when determining the extent to which a Grexit might impact the denomination of a euro-denominated facility agreement. Their significance lies in the fact that they might render the borrower's obligations unenforceable in some circumstances. This is because they are an exception to the general rule that foreign legislators are unable to change the terms of an English law governed facility agreement. English law would give effect to certain types of Greek capital controls by rendering unenforceable payments which conflict with the requirements of those capital controls.

Question: When would English law give effect to Greek capital controls?

Answer: The international effect of capital controls is governed by treaty (the IMF's articles of agreement). In essence English law is likely to give effect to Greek capital controls which (i) are imposed in a manner consistent with the IMF's framework and (ii) relate to "*exchange contracts*".

Although not totally clear, it is likely that capital controls affecting payments in connection with loan facilities would be consistent with the IMF framework only if the IMF consented to those capital controls. Obtaining IMF consent, although more than a formality, is not unusual where there is an agreed IMF Programme in place: it was granted in respect of certain types of transaction to both Iceland in 2008 and to Cyprus in 2013.

The meaning of "*exchange contract*" under the IMF articles of agreement is difficult to nail down. Different countries take different approaches. Some countries (e.g. France and Luxembourg) take a wide view and consider that any contract affecting the exchange resources of the relevant state is an "*exchange contract*". On this view any facility agreement would be an "*exchange contract*". Other countries (e.g. the UK, the US and Belgium) take a narrow view and consider that only foreign exchange contracts are "*exchange contracts*". As a result if litigation were to take place in a jurisdiction that takes the wide view, there is greater chance of payment obligations under a facility agreement being rendered unenforceable under English law by Greek capital controls than if litigation took place in courts taking the narrow view.

Question: Are capital controls consistent with the EU Treaties?

Answer: The EU Treaties prohibit capital controls but allow measures which are justified on grounds of public policy or public security. This sets a high hurdle but is what enabled Cyprus to introduce capital controls in 2013.

See our briefing entitled *The euro area and capital controls* for further discussion of the issues involved.

***Question*: I have a euro-denominated loan to a private company borrower incorporated in Greece. Would a Grexit trigger an event of default under my facility agreement?**

Answer: Typically facility agreements did not include events of default addressing either general sovereign risk or euro area exit. There was some discussion at the height of concern over redenomination in 2011-2012 of making these circumstances express events of default, but they seemed to gain little traction. Accordingly, it is possible but not likely, that the facility agreement will incorporate such an express event of default but you should check. However, depending on the circumstances, some of the more common events of default might be relevant, for example:

Non-payment: If the borrower's payment obligations are denominated in euro but the borrower tries to pay in new drachma, this would likely constitute a payment event of default. Indeed, the borrower may be in financial difficulties occasioned by the withdrawal and redenomination (see the discussion on material adverse change below) and not be able to make any payment regardless of currency. This might also mean that any insolvency event of default would apply.

Material adverse change: Grexit would impact a borrower's revenues from Greek sources. If a borrower is heavily dependent on Greek revenues (now in new drachma) to repay and service the loan in euros, it might be that a Grexit itself would trigger a material adverse change (MAC) event of default, particularly if the MAC is expressed by reference to the borrower's ability to perform its obligations under the loan agreement.

Unlawfulness: If Greece were to withdraw from the euro area, it is highly likely that it would impose capital controls and that the borrower would only be allowed to (re)pay euros if it first obtained exchange control consent (likely to be administered through the Bank of Greece or the Greek Ministry of Finance). If such consent were not granted, it could be argued that any illegality event of default in the loan documentation would be triggered. However, this would require careful consideration of exactly what capital control law provided. If the loan were revolving and only theoretically repaid and re-advanced for each interest period, questions of practice and estoppel might also be relevant.

There may also be repeating representations which are breached, for example relating to non-conflict with law or regulation; the introduction of legislation making payment under the loan agreement unlawful; or Greece refusing to recognise the express choice of law in the loan agreement.

***Question*: I have a change of currency provision in my loan agreement. Does that help if a Grexit occurs?**

Answer: The market standard provision was not intended to address a situation where a member state leaves the euro area and is likely to be largely irrelevant on a Grexit. It does two things: (a) if a country has two valid currencies, it allows the Agent to specify the currency in which amounts owing "*in the currency of that country*" are to be denominated for the purposes of the agreement; and (b) it allows the Agent to specify changes to the agreement it considers necessary to reflect a country's change in currency. As a practical matter, it is very unlikely that the clause could be used either to redenominate euro-denominated obligations into new drachma or to reverse a redenomination arising by operation of law.

At the height of concern over redenomination in 2011-12, there was occasional consideration of providing a contractual redenomination framework to give lenders the option to redenominate a borrower's euro-denominated obligations into (for example) US dollars on a Grexit or similar event. There was little take-up of this option but it is likely to be worth checking in your facility agreement, especially if it was entered into in or after 2011-12. However, it is important to note that even if included, such a mechanic is not without obstacles as it could well be overridden by the relevant redenomination legislation.

***Question*: If my loan agreement contains a currency indemnity, might that help if a Grexit occurs?**

Answer: A currency indemnity is often included to cover potential currency losses of the lenders in relation to a judgment of a court which is given in a currency other than the contractual currency. This indemnity may be relevant where judgment is given in new drachma but the payment provisions remain denominated in euro. However, there are some doubts as to the effectiveness of such indemnities generally.

***Question*: I have a euro-denominated loan which is guaranteed by a Greek guarantor. Would a Grexit impact the guarantee obligations?**

Answer: The effect on the guarantee would be a matter for the governing law of the guarantee. The points

referred to in answer to the previous questions would also be relevant here. Most important would be whether the intention was that the guarantor's payment obligations were to be in euro or in Greece's currency from time to time.

***Question*: What if my borrower is Greece itself?**

Answer: In addition to looking at English governing law and submission to the jurisdiction of the English courts, it would also be important to consider whether there is a waiver of immunity provision because typically there is immunity under domestic law from attachment of a sovereign's assets. Even if there is a waiver of immunity, it might remain difficult in practice to enforce a judgment against Greece in Greece itself.

***Question*: Could there be cross defaults or defaults under related credit support and derivatives documentation as a result of a Grexit?**

Answer: Yes. Even if obligations under a loan agreement remain denominated in euro and no events of default were triggered by a Grexit, the borrower could be party to other agreements which may be defaulted by these events.

***Question*: Are there any other steps I should take to prepare for a Grexit?**

Answer: The essential thing will be to establish whether you have loans which are potentially affected, to locate all relevant documentation (including any credit support, guarantees, security, hedges, insurance etc) and to analyse how robustly they deal with the issues discussed above. "Forewarned is forearmed", and you may need to be in a position to act rapidly if circumstances demand.

***Question*: If my loan satisfies the conditions as to governing law, submission to jurisdiction, currency and place of payment so that (absent any overarching EU legislation) it is likely that an English court would give a euro-denominated judgment on its terms, notwithstanding a Grexit, is that an end to my concerns?**

Answer: No. Future overriding EU legislation could impact the analysis. As explained above, enforcement against assets located either within Greece or outside England could be a concern. Additionally, receipt of payments, even if the borrower was apparently able and willing to pay, could be blocked or delayed by the capital controls which would be likely to be implemented alongside any currency redenomination. Of course, the fundamental difficulty with achieving repayment would relate to whether, given the economic circumstances, the borrower actually has sufficient resources to pay in whatever currency and, indeed, whether it is insolvent. Therefore you may have done your best to preserve your position, but achieving actual repayment in volatile and uncertain times would still be an achievement.

***Question:* I have a euro-denominated loan to a private company borrower incorporated in Greece. If Greece keeps the euro but introduces a second currency would the borrower still be obliged to pay in euro?**

Answer: It will depend largely on the nature of that second currency and the extent to which any legislation purported to allow euro-denominated debts to be payable in any second currency. At one end of the spectrum, the issuance by the Greek government of a form of negotiable instrument to Greek institutions in exchange for those institutions' euro-denominated assets would be likely to have a minimal effect on the denomination of a euro-denominated loan. At the other, an adoption of a second currency deemed by law to be equivalent to euro for all purposes would be much more akin to a Grexit, and it is likely that the above analysis would be relevant.

Stand-alone sovereign default

***Question:* I have a euro-denominated loan to a private company borrower incorporated in Greece. What are the implications if Greece remains in the euro area but defaults on its government debt or its arrangements with the IMF and/or the euro area?**

Answer: The implications of a Greek payment default are likely to be less fundamental than those of a Grexit. By itself a Greek payment default is unlikely to affect either the extent to which the loan is denominated in euro or the enforceability of an English judgment in Greece (although any accompanying capital controls will be important, see the box headed *Capital controls*). Leaving aside capital control questions, a Lender's main concern will be that a sovereign default is likely to precede a downturn in the fortunes of a Greek borrower and the key question will be whether it could trigger an event of default. It is unlikely that a typical facility agreement will contain credit protections expressly linked to sovereign risk, but this should be checked. Even an event of default expressly linked to a Greek payment default will require careful consideration as it may be triggered

only by defaults on private sector borrowings and not by Greece defaulting on its arrangements with the IMF and/or the euro area. In the absence of a specific event of default it is likely that any MAC event of default will be the most relevant provision.

The wider context

The above simply gives a flavour of some of the issues generated by the Greek debt crisis. There are likely to be many more questions and concerns regarding its impact on finance documentation particularly in relation to any Grexit. As with any hypothetical situation, it is difficult to foresee how a Grexit might be implemented from a legal perspective and there would be many political, economic and practical barriers to such an event. There is no existing mechanism under the EU Treaties for a state to depart from the euro area and therefore Greece would either be exiting on a non-consensual basis or on a consensual basis with the support of other euro area states pursuant to a treaty or other legal framework which does not currently exist. The manner of implementing any exit route would have substantial implications in relation to the analysis as to the legal consequences on contractual arrangements, especially in the context of any conflict of laws analysis.

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