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Briefing note May 2015

The Greek debt crisis and eurobond documentation

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 bond 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 bond issued by a private company incorporated in Greece. If Greece leaves the euro area and re-establishes new drachma, would the issuer 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

Key issues

The key provisions in bond documentation when analysing a potential Grexit are:

- **Jurisdiction**
- **Governing law**
- **Currency definitions**
- **Place of payment**
- **Events of Default**

Greek capital controls could render a Greek issuer's repayment obligations under an English law bond unenforceable in some circumstances

The key provisions in bond documentation when analysing the effects of a potential Greek sovereign default are the Events of Default

EU consensus and over-arching EU 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 bond 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 bond terms and conditions that are relevant to determining the currency in which the debt is to be paid: (a) the submission to jurisdiction provision; (b) the governing law of the bonds; (c) the way in which the obligations to pay in a particular currency are drafted; and (d) the place of payment stipulated in the terms and conditions.

We discuss each of these below:

- **(a) 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 issuer would be able to pay in new drachma and not in euros. On the assumption that Greece remains in the EU, then 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.

- **(b) Governing law** – If the bond 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 governing law of the bond is English law, and is subject to the exclusive jurisdiction of the English courts, Greece's redenomination legislation would affect the issuer's obligations under the bond only if they required payment in Greece's currency from time to time, as discussed next.

- **(c) Currency of payment** – If the bond 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 bonds 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 terms and conditions – or, where the definition is not definitive, by reference to any other relevant circumstances, including the place of payment and any other evidence as to the issuer's intentions. Absent special circumstances, a definition of "euro" by reference to the currency adopted on monetary union (or pursuant to European treaties or similar references), rather than by reference to Greece's currency from time to time, should operate to make clear that the intention is for the currency of payment to be the single European currency.

- **(d) Place of payment** – The place of payment could be relevant for two main reasons. First, if there is no currency definition in the terms and conditions, 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 the bonds require payment in the currency from time to time of Greece and Greece changes its currency from the euro to new drachma, the payment obligation under the bonds 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 issuer intended 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 issuer 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 bonds. If so, for contracts 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 contracts 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 issuer's assets located in Greece?**

Answer: Obtaining an English court judgment against the issuer is one thing. Enforcing against assets in Greece following a Grexit is something else. If the issuer has substantial operations and assets in Greece, a bondholder 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 issuer. As a consequence, enforcement against Greek assets would be difficult.

***Question:* I have a euro-denominated bond issued by a private company incorporated in Greece. Would a Grexit trigger an event of default under my bonds?**

Answer: Typically, bond terms and conditions 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. It is therefore unlikely that terms and conditions would do so, 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 issuer's payment obligations are denominated in euro but the issuer tries to pay in new drachma, this would likely constitute a payment event of default. Indeed, the issuer may be in financial difficulties occasioned by the withdrawal and redenomination, and not be able to make any payment regardless of currency.

Unlawfulness: If Greece were to withdraw from the euro area, it is highly likely that it would impose capital controls and that the issuer would only be allowed to (re)pay euros if it first obtained consent (likely to be administered through the Bank of Greece or the Greek Ministry of Finance). If such consent were not granted and 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. However, this would require careful consideration of exactly what the capital control law provided. This is also a point to bear in mind in Loan Participation Note (LPN) structures where the underlying borrower is based in Greece.

Other events of default: Any ensuing financial difficulties might also mean other events of default or any insolvency event of default would apply or that financial covenants might be breached.

***Question:* If my bond contains a change of currency provision or a currency indemnity, might this help?**

Answer: At the height of concern over redenomination in 2011-12, there was occasional consideration of providing a contractual redenomination framework to give the option to redenominate an issuer'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 the terms of any bonds, 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.

A currency indemnity is often included to cover potential currency losses of the bondholders in relation to a judgment of a court which is given in a currency other than the contractual currency. Such an 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 bond which is guaranteed by a guarantor in Greece. Would 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 euro payment obligations were to be in euro or in the national currency of Greece from time to time.

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

Answer: For a sovereign issuer, 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 Grexit?**

Answer: Yes. Even if obligations under the bond issue remain denominated in euro and no events of default were triggered by Grexit, the issuer could be party to other agreements or underlying credit support or swap 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 hold bonds 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 the bonds I hold satisfy 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 issuer was apparently able and willing to pay, could be blocked or delayed by the capital controls which would be likely to be implemented prior to or alongside any currency redenomination. Of course, the fundamental difficulty with achieving repayment would relate to whether, given the economic circumstances, the issuer 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 hold a euro-denominated bond issued by a private company incorporated in Greece. If Greece keeps the euro but introduces a second currency would the issuer 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 bond. 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 hold a euro-denominated bond issued by to a private company 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 bond 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, an investor's main concern will be that a sovereign default is likely to precede a downturn in the fortunes of a Greek issuer and the key question will be whether it could trigger an event of default. It is unlikely that typical bond terms and conditions will contain events of default 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 one of the other events of default (relating to its financial condition) will be the most relevant provision.

Capital controls

Greece may need to introduce capital controls as part 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 restrict buying and selling of national currency or 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 issuers 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 bond. Their significance lies in the fact that they might render the issuer'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 bond. English law would give effect to certain types of Greek capital control 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 bonds would be consistent with the IMF framework only if the IMF consented to those capital controls. IMF consent, although more than a formality, may not be difficult to obtain: 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 bond 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 payments under a bond 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.

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 bond 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.

Authors

David Dunnigan
Partner

T: +44 20 7006 2702
E: david.dunnigan
@cliffordchance.com

Stewart Dunlop
Partner

T: +44 20 7006 2787
E: stewart.dunlop
@cliffordchance.com

Kate Gibbons
Partner

T: +44 20 7006 2544
E: kate.gibbons
@cliffordchance.com

Simon James
Partner

T: +44 207006 8405
E: simon.james
@cliffordchance.com

Jonathan Lewis
Partner, Paris

T: +33 14405 5281
E: jonathan.lewis
@cliffordchance.com

Julia Machin
Managing Senior PSL

T: +44 20 7006 2370
E: julia.machin
@cliffordchance.com

Simon Sinclair
Partner

T: +44 20 7006 2977
E: simon.sinclair
@cliffordchance.com

Deborah Zandstra
Partner

T: +44 20 7006 8234
E: deborah.zandstra
@cliffordchance.com