SQUIRE PATTON BOGGS

# UPDATE: DO WE NEED TO FEAR A GREXIT?

## The Legal Side

"Is it legally possible that Greece ceases to be a member of the Eurozone without exiting the EU and without changing the treaties which establish the European Union and which consequences would this have for existing contracts and outstanding bonds? Can such an exit be done on a temporary basis?"

### Introduction

On 30 June 2015 the availability period under the EFSF Master Facility for Greece for further drawings thereunder expired. At the same time the Managing Director of the IMF notified the Executive Board of the IMF that the SDR1.2 billion repurchase due at that date was not made. As a consequence, the Board of Directors of the EFSF declared on 3 July 2015 that such missed repayment to the IMF triggered an Event of Default under the terms of the EFSF Facility and reserved EFSF's rights. The Board of Directors of the EFSF did not (yet) accelerate the entire EFSF Facility. On 5 July 2015, the Greek Referendum on the proposed conditions for final drawings under the EFSF Facility resulted in a "no" vote.

These events raise a number of questions: Is it legally possible that Greece ceases to be a member of the Eurozone without exiting the EU and without changing the treaties which establish the European Union and what consequences would this have for existing contracts and outstanding bonds? Can such an exit be done on a temporary basis?

Such questions have already been discussed in previous weeks and months.

On 26 May 2015, our Frankfurt office hosted a combined Committee Meeting of AmCham Germany's Policy Committees Financial Services and Corporate & Business Law. The topic of the combined meeting was "Do We Need to Fear a Grexit? – Options for the Greek Economy and Its Effects on International Partners". Jens Rinze, partner at Squire Patton Boggs and head of the Financial Services Practice Group in Germany, presented on whether it was legally possible for Greece to cease being a member of the Eurozone without exiting the EU and without changing the treaties which establish the EU, and the consequences such "Grexit" would have for existing contracts and outstanding bonds.

The starting point of the discussion is that the so-called second rescue package is no longer available and there is the legal right to accelerate all outstanding amounts. Taking this into account, in principle three solutions are being discussed in the public sphere: (i) a third rescue package, (ii) another debt restructuring, and (iii) a (temporary) exit of Greece from the Euro.

A third rescue package for Greece under the terms of the ESM would require pursuant to Article 136 (3) of the Treaty on the Functioning of the European Union (TFEU) that it is indispensable to safeguard the stability of the Euro area as a whole and that the granting of any required financial assistance would be made subject to strict conditionality. Further, any ESM Facility would require the consent of a number of Parliaments of Member States of the Eurozone, in particular the consent of the German Parliament, the *Bundestag*.

Insofar as a further debt restructuring is concerned, a major legal issue will be whether such debt restructuring would infringe Article 123 of the Treaty on the Functioning of the European Union (TFEU) which prohibits a state financing through the European Central Bank (ECB) or the National Central Banks (NCBs). In that respect it needs to be noted that the German Constitutional Court (*Bundesverfassungsgericht*) proposed in its OMT decision of 14 January 2014 – which is unrelated to the Greek Debt crisis, but contains statements of general application – that a haircut of Member State debt owed to the Eurosystem would infringe Article 123 of TFEU.

Further, Advocate General Cruz Villalon stated, in his opinion of 14 January 2015, in relation to the OMT proceedings "*Moreover, the ECB has stated in its written observations that, in the context of a restructuring subject to CAC [Collective Action Clauses] it will always vote against a full or partial waiver of its claims.*" This statement was not rejected but implicitly confirmed by the European Court of Justice in its OMT Judgement of 16 June 2015. Accordingly, a restructuring of the Greek debt would be difficult from the legal perspective.

In respect of Greece exiting the Euro, it is understood that such exit could only be a real solution if the currently outstanding Greek debt was no longer payable in Euro, but could be serviced and repaid in a new Greek currency ("New Currency").

An exit of Greece from the Eurozone had already been discussed in 2011/2012 during the first Greek debt crisis. At that time, however, the main focus of the relevant market participants was on what consequences a unilateral exit of Greece would have in case of a Greek Act of Parliament providing for an introduction of a new currency combined with a unilateral redenomination of debt and capital controls. The analysis for such scenario in principle was that a Greek Act of Parliament providing for a redenomination could only interfere with Greek law-governed contracts and instruments, but would in principle not directly change contracts and instruments governed by laws other than Greek law.

However, a redenomination through EU Council Regulation was not the focus of market participants at that time. For example, the 2014 ISDA Credit Derivative Definitions contain a rule in respect of a redenomination effected by a Governmental Authority of a Member State of the EU, but not by a governmental authority of the European Union like the Council.

If an exit of Greece from the Eurozone and a redenomination of Euro denominated debt into New Currency denominated debt was effected by EU legislation, then the currency to be paid under bonds, loans, derivatives, other contracts and other instruments governed by a law of another Member State of the EU other than Greek law (e.g. German law or English law) could be changed from Euro into New Currency. This is because EU legislation would be binding in all Member States of the EU and would – if done in the form of an EU Regulation – be directly applicable in all Member States with priority over the domestic laws of the Member States.

## Legal Basis for an Exit of a Participating Member State from the Euro and a Redenomination of Euro Denominated Debt into New Currency Denominated Debt

TFEU Article 128 (1) provides that the Euro bills are the only legal tender within the EU. TFEU Article 139 provides for certain exemptions for so-called Member States with a derogation – the EU Council adopted a resolution (2000/427) on 19 June 2000 which states that Greece does not belong to the Member States with a derogation.

The legal question whether a participating Member State could exit from the Euro other than through exiting the EU as such (which could be accomplished on the basis of Article 50 of the European Union Treaty) is subject to debate between legal scholars and others. Accordingly, there is no clear or binding official answer to such question.

The points of view range from the third stage of EMU and the membership therein being irreversible in general to the Council of the Member States which participate in the Euro being able to adopt a resolution as *actus contrarius* to the original resolution 2000/427 which declared Greece to be a Member State for which no derogation applies (with the consequence that after such resolution Greece would be a Member State to which a derogation applies within the meaning of Article 139 TFEU) and such Council adopting the resulting amendments to the Euro Introduction Regulation on the basis of Article 140 or Article 352 TFEU.

Leaving aside such legal debate, it is widely assumed that if there is the political intention of all relevant parties that Greece shall leave the Euro, then legal instruments would be adopted for such exit irrespective of the unresolved legal debate in relation to the admissibility thereof.

## Potential Contents and Consequences of an EU Council Regulation

Hypothetically, and assuming that there is a corresponding political intention of all involved parties, a Council Regulation might be adopted which provides for:

(i) an authorisation of Greece to introduce a New Currency as parallel currency;

(ii) the revocation of EU Council Regulation 2596/2000 of 27 November 2000, pursuant to which Greece was added to the list of Member States who participate in the Euro, so that Greece would be removed from the list of participating Member States;

(iii) after some time, a redenomination of all then current Euro denominated debt owed by all or specified Greek debtors, i.e. any private or public debtor which is resident in Greece (including the Hellenic Republic, Greek banks, branches of EU/non-EU banks in Greece, Greek companies, Greek public entities, Greek private persons, Greek pension schemes, etc.), into New Currency denominated debt at an exchange rate determined by the EU Council or any other relevant authority and fixed on the basis of the market rates which would have been established after a certain period of time; and

(iv) a freezing of debt owed by Greek debtors for the time period until the redenomination and the fixing of the exchange rate.

## Legal Consequences of Grexit

The legal consequences of such hypothetical EU Council Regulation providing for the redenomination of Greek debt would be very different from a unilateral exit and redenomination based on Greek domestic law only. This is because an EU Council Regulation would be EU law and would, because of its supranational character, have priority over the domestic laws of all relevant Member States of the EU. Such EU Council Regulation would be directly applicable in all relevant Member States and would directly change any instruments or contracts governed by any of the laws of the Member States (and not only contracts and instruments governed by Greek law). Accordingly, even the English law-governed debt of Greece, which is denominated in Euro, would cease to be denominated in Euro and could be repaid and serviced in the New Currency.

However, even though such an EU Council Regulation would have direct effect in all relevant Member States and would need to be recognised by all courts in all Member States, it would not automatically be binding on courts of countries outside of the EU, and would not necessarily change contracts governed by a law which is not the law of a Member State.

In addition to the foregoing it needs to be noted that specific rules apply pursuant to Article 65 TFEU and pursuant to the IMF Treaty in relation to the introduced Greek controls on capital movements and the recognition thereof by the courts of the Member States of the European Union and the Member States to the IMF Treaty. Further, a number of issues under the approximately 40 Bilateral Investment Treaties to which Greece is a party may arise.

## Steps to temporary Grexit

The procedural steps which may be taken in case of a Grexit could include inter alia:

1. Proposal by the European Commission to abrogate Council Decision 2000/427 of 19 June 2000 which abrogated the derogation for Greece.
2. Consultation of the European Parliament.
3. Discussion in the European Council.
4. Decision of the Council with a qualified majority of the Member States whose currency is the Euro to abrogate Council Decision 2000/427, thus Greece becoming a Member State to which a derogation applies.
5. Introduction of a New Currency, electronically and physically.
6. Proposal by the European Commission of a Redenomination Regulation.
7. Consultation of European Central Bank.
8. Adoption of the Redenomination Regulation by (i) the Council acting with unanimity of Member States whose currency is the Euro or, depending on the legal basis (ii) unanimity of all Member States with the consent of the European Parliament.

Such Grexit would be of a temporary nature, because Greece could re-enter the Euro in future in the course of the same procedure which has be used in the past for other Member States acceding to the Euro once Greece fulfills the convergence criteria for such accession to the Euro.

## Contact

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