Linklaters

30 June 2015

Eurozone Bulletin:
Legal implications of the Greek debt crisis

After months of political stalemate in negotiations with its creditors to unlock access to bailout funds, the Greek government has announced a referendum on proposed bailout conditions, an extended bank holiday and the imposition of capital controls. Greece now appears unable to meet scheduled payments to the IMF and other international creditors following termination of its second economic adjustment programme on 30 June 2015. These developments were triggered by substantial depositor withdrawals from Greek banks over recent weeks and have led to the ECB's Governing Council restricting Greek banks' access to further central bank funding through Emergency Liquidity Assistance and to speculation about what all this means for these banks and Greece's continued participation in the eurozone.

The European macro-economic picture is now more positive than it was a few years ago, and businesses have taken steps to manage their exposures to risks associated with Greece, but the uncertainty arising from recent developments still raises many, often complex, legal issues.

This Bulletin is made up of three parts:

> Part I analyses the Greek capital controls, the practicalities of their implementation and enforcement, and their legality under the applicable legal frameworks;

> Part II discusses the practical impact the Greek measures may have on the enforceability of contracts and the performance obligations of contractual counterparties; and

> Part III considers the issues surrounding potential payment defaults by the Greek government, the possibility of IOUs being issued, the future of Greek banks and the potential for Greece exiting the eurozone.

Part I – The introduction of capital controls

This is not the first time that capital controls have been introduced by a eurozone Member State since entering monetary union. In March 2013, Cyprus introduced capital controls in connection with its €10bn bailout which have since been lifted. We considered the legality and impact of those capital controls in our April 2013 Eurozone Bulletin: Capital and Exchange Controls. There are also many other examples of capital controls being imposed in the

Summary of key developments in 2015

- **25 January**: Greece's parliamentary election results in the left-wing anti-austerity Syriza party forming a coalition government with the Independent Greeks.
- **11 February**: ECB's Governing Council lifts its waiver of minimum credit rating requirements for marketable instruments issued, or fully guaranteed, by the Greek government in connection with eurosystem monetary policy operations. Meeting of eurozone finance ministers fails to reach agreement on Greece's reform proposals.
- **19 February**: Greece submits formal request for loan extension to eurozone finance ministers, subsequently rejected.
- **24 February**: Eurozone finance ministers approve four month loan extension following approval of reform plans.
- **5 June**: Greece fails to make scheduled payment of €300m to the IMF and states that it will aggregate all four IMF payments due in June into a single payment at the end of the month; Greek government and creditors fail to reach agreement on reforms which would unlock €7.2bn in bailout funds.
- **26 June**: Greek government announces referendum for 5 July on the institutions' bailout proposals and requests bailout extension.
- **27 June**: Eurozone finance ministers decline to extend bailout programme beyond 30 June.
- **28 June**: ECB maintains Emergency Liquidity Assistance at 26 June level of €89bn; Greek government announces bank closures until 7 July, closure of the Athens stock exchange and the introduction of capital controls.
- **30 June**: Approx. €1.5bn aggregated payment due to the IMF; second bailout programme ends.

past, including in Iceland, Ukraine and Argentina. Taken together they provide useful examples of the wide scope that such measures can take in different contexts and how they can develop after their introduction as the economic situation changes.

What are capital controls?

Capital controls are measures taken by a government, central bank or other regulatory body of a country to regulate or limit the flow of foreign capital into, and/or out of, the domestic economy. 'Exchange controls' are a sub-set of capital controls which seek to control the relationship between domestic and international currency markets – that is, they control the purchase and sale of foreign currencies by residents and/or the purchase and sale of local currency by non-residents.

The Greek capital controls

Capital controls were imposed in Greece by the 'Legislative Act of 28 June 2015 imposing a short term bank holiday'. This decree imposed controls with effect from 29 June together with a number of measures aimed at restricting market activity until after the bailout referendum that has been called for 5 July 2015. See the box for details of the key measures imposed. To date, these do not consist of any exchange controls – reflecting, instead, the principal aim of the Greek government to prevent further substantial withdrawals from Greek banks.

Banks in Greece, including branches of foreign banks, are to remain closed until at least Tuesday 7 July and the Athens stock exchange will not open for the duration of the bank holiday period. The decree allows for this period to be extended, or shortened, by the Greek finance minister – in practice this is likely to depend largely on the outcome of the referendum.

Practical issues: implementation and enforcement

The economic uncertainty accompanying the introduction of capital controls has, as expected, led to increased runs on bank deposits within the permitted daily limits. With numerous ATMs reported to have run out of banknotes, the co-ordination of international and governmental bodies may be needed to ensure the availability of physical cash required to meet continued demands. It was reported, for example, that the ECB delivered additional banknotes to Cypriot banks in anticipation of their reopening following their closure from 13 to 18 March 2013.

The Greek controls seek to be comprehensive in controlling not only the withdrawal or transfer of cash, but also the making of electronic transfers to accounts held outside of Greece and the cashing of cheques issued on accounts held with financial institutions falling within the scope of the measures. However, whilst electronic payment transfers to accounts held outside of Greece are subject to restrictions, the Greek legislation does not, at this time, seek to restrict transfers of physical cash outside of Greece.

It is unclear from the wording of the decree whether the control measures are intended only to stop customers withdrawing or transferring amounts from accounts held with Greek banks, or whether the decree is also intended to

Summary of capital controls introduced in Greece

A decree was passed in Greece on 28 June 2015 pursuant to which all banks (as defined below) are to be shut from Sunday 29 June 2015 until Tuesday 7 July 2015 (the "**bank holiday period**").

In summary, the key provisions of the decree are as follows:

- The decree applies to **all credit institutions operating in Greece** in whichever form, including any branches of foreign banks and any branches or representatives of any payment institutions or any electronic money institutions that are based in other EU member states and which are operating in Greece (the "**banks**").
- **Cash machine withdrawals are capped** at €60 a day per bank card. However, any credit or debit cards issued outside Greece will not be affected by such restrictions. Tourists and other visitors should therefore still be able to withdraw the full amounts permitted by their respective overseas institutions (depending on the availability of cash).
- **Transfers of money** to accounts held outside of Greece are, subject to certain limited exceptions, prohibited. Exceptions may be made in individual cases by the newly-established bank transactions approval committee (described below).

  Transfers of money into accounts held in Greece should, however, continue to operate as normal without restriction. The restrictions do not extend to any international transfers into accounts held in Greece nor to any domestic payments made using either pre-paid, debit or credit cards, or transfers between Greek bank accounts made through telephone or online banking.

  The restrictions will not apply to any transactions which were recorded in central payment systems (TARGET2-GR, EURO01 and DIAS) or central clearance systems (such as the Central Depository of Athens and the securities settlement system of the Bank of Greece) prior to announcement of the capital control measures. Such transactions will therefore be cleared/settled without restriction.

prevent those banks themselves making payments of amounts owing to their own contractual counterparties.

When imposing capital controls, it is necessary to determine how financial transactions, payments and/or transfers that have not been completed will be affected. The Greek legislation is drafted by way of an outright prohibition on transactions, subject to certain specified exemptions. The decree explicitly provides that transactions recorded in the central payment systems (including TARGET2-GR, EURO01 and DIAS) and central clearance systems (including the Central Depository of Athens and the Bank of Greece's clearance system) prior to issuance of the decree are permitted to be settled/cleared without restriction. However, it remains unclear at this time whether other instructions made, but not completed or settled, prior to issuance of the decree are affected by the restrictions and limits imposed by it.

The imposition of capital controls within the eurozone is complicated by the fact that the euro is the lawful currency of many other states because controls based on the currency of transactions will not work. Whilst capital control rules rarely attempt to impose the controls solely within the jurisdiction of the imposing-state and instead generally seek to apply the controls extraterritorially, the Greek measures are currently limited to credit institutions operating within Greece. The Bank of Greece and the Hellenic Republic are expressly excluded from the scope of the measures and, as such, are not directly affected by the restrictions imposed.

Methods of enforcement

The means by which measures are enforced depends largely upon the nature of the capital controls imposed. Historically, enforcement has generally been achieved by a combination of both civil and criminal sanctions ranging from fines or increased supervision by state entities to the removal of banking/trading licenses or even imprisonment for those persons involved.

The Greek measures at this time provide only that credit institutions may be subject to a civil fine, levied by the Bank of Greece, of up to 10% of the amount of any transaction in breach of the control restrictions. Any credit institution which undertakes or facilitates a prohibited transaction is also required to report any officers or employees involved in that transaction – although the resulting consequences for any such individual are not specified. Significantly, the measures do not make it unlawful for the relevant entities or individuals to breach the control restrictions in the same way that many previous examples of capital controls have.

The legality of capital controls

The legality of capital controls under international treaties is significant for a number of reasons. Where the introduction of capital controls is not permitted, the imposing state may be sanctioned in the international courts (such as the ECJ or the International Court of Justice). The technical legality of the controls may also impact upon the enforceability of private contracts as discussed in Part II.

- Deadlines for the termination, presentation or payment of any securities and any relevant judicial deadlines are **suspended until the end of the bank holiday period**.
- A **new five member bank transactions approval committee** has been established by the General Accounting of the State in co-operation with the Ministry of Finance, the Bank of Greece, the Hellenic Bank Association, and the Hellenic Capital Market Commission to approve, on a case-by-case basis, any transactions deemed necessary to safeguard public or social interests including, for example, medical expenses of pharmaceutical imports.
- **Banks breaching the rules** face fines from the Bank of Greece of up to 10% of the amount of any transaction in breach of the control measures. Banks are also required to report any officers or employees undertaking any such transactions.

As a consequence of the capital restrictions, the Greek securities commission has resolved that the ATHEX regulated market, the alternative market of the Athens exchange (EN.A) and the secondary trading market for Greek government bonds (HDAT) (together, the "**Athens Exchanges**") will remain closed until and including Monday 6 July 2015.

The **Greek finance minister is also granted wide powers** to, among other things, introduce new capital control restrictions and/or extend (or shorten) the bank holiday period as he deems appropriate.

EU restrictions on capital controls

EU Member States are bound by the general prohibition on restrictions on the movement of payments and capital between EU Member States and between EU Member States and non-EU Member States set out in Article 63 of the Treaty on the Functioning of the European Union ("**TFEU**").

The TFEU provides for a number of exceptions from the requirement for the freedom of payment and capital movements. The most relevant of these for present purposes is the derogation contained in Article 65. This provides that the Article 63 prohibition is without prejudice to the right of a Member State to "*take measures which are justified on the grounds of public policy or public security*". These measures may not, however, constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments. In their current form, the Greek measures do not appear to be discriminatory, applying to all accounts held with the relevant credit institutions irrespective of the identity of the account holder.

The ECJ has previously sought to emphasise the limited scope of this derogation, providing that "*the general financial interests of a Member State… [and] … economic grounds can never serve as a justification*". Instead, there must be "*a genuine and sufficiently serious threat to a fundamental interest of society*" with the imposing state's measures being a necessary, and not overly-restrictive, response to this threat, whilst observing the principles of non-discrimination and proportionality throughout. However, despite these restrictive interpretations, the significant financial disruption and potential civil disorder resulting from the economic difficulties, and political challenges, facing Greece provide a strong case for arguing that temporary capital controls are justified under Article 65.

The European Commission issued a statement on 29 June 2015 which provided that "*In the current circumstances, the stability of the financial and banking system in Greece constitutes a matter of overriding public interest and public policy that would appear to justify the imposition of temporary restrictions on capital flows.*" The Commission further stated that "*While the imposed restrictive measures appear necessary and proportionate at this time, the free movement of capital will however need to be reinstated as soon as possible in the interest of the Greek economy, the Eurozone, and the European Union's single market as a whole.*" Whilst the Commission's views are instructive as to the EU's initial assessment of the Greek controls, it should be remembered that the ECJ, and not the Commission, is the arbiter of the scope of Article 65 and so the Commission's statement is by no means conclusive.

The legality of earlier Cypriot capital controls

A number of cases are pending before the ECJ which will ultimately determine the legality of the capital control measures introduced in Cyprus. In the meantime, the views of other EU institutions on their legality at the time of introduction is helpful when considering how those measures introduced in Greece might be judged.

"1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited."

Article 63 TFEU

"1. The provisions of Article 63 shall be without prejudice to the right of Member States:

…

(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security."

Article 65(1)(b) TFEU

Consistent with its approach to the Greek measures, the European Commission issued a statement on 28 March 2013 which considered the controls introduced by Cyprus, the previous day, to be justified by the overriding public policy of stabilising the Cypriot banking system and the financial markets, though the measures were expected to be short term temporary measures. In fact, the Cypriot controls which were originally introduced with a 7 day time limit were repeatedly extended and were only lifted completely in April 2015. As alluded to in the Commission's statement on Greece, the longer such measures remain in force, the more difficult it becomes to justify their continued application as truly "necessary" for the purposes of the Article 65 derogation.

The IMF Articles of Agreement

The IMF Articles of Agreement apply to all IMF-member states (which include all members of the eurozone). The key provisions which may impact the legality of any capital controls are:

> **Article VI(3)** which provides that members may, at their discretion, impose certain controls on international capital flows (as distinct from current transactions);

> **Article VIII(2)(a)** which prohibits the imposition of restrictions on the making of payments or on transfers for current international transactions, unless among other things:

- the member has received IMF approval; or
- the IMF has declared the currency of that member to be scarce.

It could be argued that the Greek capital controls restrict both international capital flows and current international transactions (which are defined in the Articles to include among other things "*all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities*" and "*payments due as interest on loans and as net income from other investments*"); and

> **Article VIII(2)(b)** which provides for the unenforceability of certain 'exchange contracts'.

As discussed further below, the IMF has previously made formal statements on whether the capital controls imposed by certain countries comply with the Articles of Agreement. However, the IMF has not yet made any formal statement on the legality of the Greek capital controls. Indeed, no explicit formal approval has, as yet, been given to the Cypriot controls that were imposed in 2013 – see further under 'Exchange contracts', below.

"Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments..."

Article VI(3)

"Subject to the provisions of Article VII, Section 3(b) and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions"

Article VIII(2)(a)

Part II – The practical impact of the Greek measures

Enforceability issues

Conflicting laws

Where a contract is affected by the introduction of capital control measures, there can be a tension between the contractual obligation in one jurisdiction on a party to perform and a criminal or civil prohibition in another jurisdiction on that performance.

For example, a bank may be instructed by its client to transfer cash or assets where that client (or its cash or assets) is subject to capital controls restricting such a transfer. In these circumstances, the bank may find itself in a difficult position where, in seeking to comply with the capital controls in order to avoid potential civil or criminal liability in one jurisdiction, it declines to act on the instructions and, as a result, it is itself then subject to a claim for damages by its client in another jurisdiction which does not uphold the capital controls. Conversely, if the bank were to comply with the client's instructions, it may find itself the subject of civil or criminal liability.

It is therefore essential to be able to determine whether any particular contractual obligations will remain enforceable after the imposition of capital control measures. Whilst the Greek measures are limited in their scope and application at present, history demonstrates that controls typically increase in breadth following their introduction, following which the issues discussed below become more pertinent – for example, if the consequence for breach were to be extended to make it unlawful for individuals or entities to carry out the specified transactions. The controls currently sanction only the banks effecting the transactions and, as such, may not constitute an illegality for other market participants; instead, the doctrines of frustration, impossibility and force majeure may be more important – see further, below.

When will the courts uphold capital control measures?

A Greek court can be expected to apply the recently introduced Greek capital control legislation to litigation before it even where the underlying contract is governed by the law of another jurisdiction and would otherwise be enforceable under that governing law.

More complex questions arise where the court of another jurisdiction is asked to consider whether the capital controls imposed in Greece excuse performance of a contract. The conflict of laws rules which the courts of that other jurisdiction apply, together with the substantive law of the contract in dispute, will then be crucial in determining the extent to which the non-defaulting party will be able to seek redress for non-performance.

Under most EU Member States' laws, including English law, effect will be given to capital controls by determining a contract to be unenforceable by reason of those controls in three main scenarios, each of which is considered in more detail below:

> first, where the governing law of the contract is that of the imposing-state (i.e. it is a Greek law governed contract);

> second, where the place for performance of the contract is stipulated to be the imposing-state (meaning that the contract is required to be performed in Greece); and

> third, where a contract is determined to be an "exchange contract" which falls within Article VIII(2)(b) of the IMF Articles and is inconsistent with the capital control legislation.

Enforcing a Greek law contract outside Greece

The courts of another EU Member State asked to enforce a Greek law contract against a non-performing party would generally be bound under the Rome I Regulation (the "**Regulation**") or the Rome Convention (the "**Convention**") to apply the capital control legislation and refuse to enforce the contract where it breaches that legislation. Likewise, this will be the result in many other jurisdictions, including New York and Hong Kong.

Courts of EU Member States have some discretion not to give effect to the Greek capital controls where they are considered to be incompatible with the public policy of the court. For example, an English court may decline to uphold the capital control legislation if it considers it to be oppressive or discriminatory. It is possible that a court may decline to apply the legislation where the measures are held to be unlawful under international treaty obligations (for example if a court of an EU Member State determines that the measures fall within the Article 63 TFEU prohibition discussed above). Similar discretions exist in New York and Hong Kong, although it remains unclear to what extent the courts of those jurisdictions might rely on such discretions in the context of, and in light of the legal issues surrounding, the use of capital controls as an economic management tool.

The relevance of the place of performance

Where the Regulation applies, a court that is asked to enforce the performance of a contract may decline to do so where the obligations under the contract are to be performed in Greece and the Greek capital controls make performance there unlawful. A court may choose to give effect to the Greek capital controls in such a scenario even if:

> the contract is governed by a law other than Greek law; and

> the party required to perform under the contract is neither a national of, nor resident in, Greece.

The position is less straightforward in relation to contracts entered into before 17 December 2009, where the Convention applies. Article 7(1) of the Convention permits the application of the mandatory rules of a third state where there is a "close connection" with that state. The UK, Germany, Ireland, Latvia, Luxembourg, Portugal and Slovenia have opted out of this provision. In litigation in those Member States, the existence of capital controls in the place of performance might not, of itself, discharge an obligation.

Courts of some non-EU Member States will apply their own conflict of laws rules. For example, Hong Kong has a similar approach to that taken under

Which law governs the relevant contract?

Courts of EU Member States will generally determine this in accordance with the rules set out in the Rome I Regulation (for contracts entered into on or after 17 December 2009) or under the Rome Convention (for contracts entered into before that date and after the Rome Convention came into force in the Member State whose courts are seized).

The exception is Denmark which opted out of the Rome I Regulation, so the rules of the Rome Convention are applied by its courts to all relevant contracts.

Under these instruments, effect is broadly given to the parties' express choice of law.

What if there is no express choice of law?

Whilst many contracts specify their governing law, this is not always the case.

If a choice cannot otherwise be inferred from the actions of the parties, the governing law will normally be the laws of the jurisdiction of the habitual residence of the party required to perform under the contract (which, for sales contracts, is the person selling the asset, rather than the person purchasing the asset).

This can, however, be overridden by other factors which suggest that a contract is manifestly more closely connected with a certain country (which then result in the laws of that country governing the contract instead) – for example, in some cases, the country in which the obligations under the contract are to be performed.

the Regulation and courts there may discharge an obligation on the basis of supervening illegality in the place of performance regardless of what the governing law of the contract provides.

Exchange contracts

Article VIII(2)(b) of the IMF Articles provides that certain "exchange contracts" are unenforceable. The effect of this prohibition is that a contracting party cannot ask a court in an IMF-member state to force its counterparty to perform or to order damages for breach of contract where that contract falls within Article VIII(2)(b). This Article therefore, in effect, provides the exchange control regulation with extra-territorial effect in other IMF-member states.

"Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member..."

Article VIII(2)(b)

The impact of Article VIII(2)(b) upon the enforceability of a contract will depend on what the relevant court determines constitutes an exchange contract.

Some jurisdictions, including England, the US and Belgium, have adopted a narrow construction of the term, interpreting it to mean only those contracts whose subject matter is the conversion of the currency of one state into the currency of another (for example, a currency swap or FX contract), or a contract which has the practical effect of so converting currencies. As such, for these jurisdictions, the current Greek controls do not comprise restrictions on exchange contracts which fall within the ambit of Article VIII(2)(b). Other jurisdictions, including France and Luxembourg, have adopted a broader construction, holding that an exchange contract exists when its subject-matter can affect in any manner the currency of a country and therefore its balance of payments and/or exchange resources.

If the relevant court is one which adopts a narrow construction of the term, it is therefore less likely to determine a contract to be unenforceable than a court which adopts a broader construction.

Exchange control regulations must also be consistent with the regime set out in the IMF Articles in order to fall within the scope of Article VIII(2)(b). The IMF will determine whether exchange control regulations which restrict international current transactions are consistent or not – effectively approving the extra-territorial effect of such exchange control regulations.

In the case of the Icelandic capital controls imposed in 2008, IMF approval was granted in respect of certain exchange restrictions on current international transactions, on the basis that they were imposed for balance of payment reasons and were non-discriminatory. Those measures therefore had extra-territorial effect in IMF member states.

IMF approval is not always given. The exchange controls introduced by Ukraine in 2008, which included a restriction on the early payment of loans denominated in foreign currencies, were not approved by the IMF on the grounds that the measures were discriminatory and so not consistent with the IMF Articles. Those measures therefore did not have extra-territorial effect and other IMF member states were not obliged to hold relevant exchange contracts to be unenforceable. Whilst the IMF has not made any formal statement explicitly approving the 2013 Cypriot controls, despite the Cypriot government formally requesting such approval in its April 2013 Memorandum of Economic and Financial Policies, the IMF – following the implementation of the controls earlier that same day – stated that Cyprus's bailout agreement had its "full support", thereby implicitly approving the measures imposed.

As mentioned above, the IMF has not yet made a statement with respect to the Greek capital controls, and so their views on the extent to which the Greek capital controls fall within the IMF regime is not yet confirmed. For the reasons discussed earlier, the Greek capital controls in their current form do not appear to have a discriminatory effect.

Even where an exchange contract is generally within the IMF regime, it is possible that a court may not be bound to hold an exchange contract to be unenforceable by reason of Article VIII(2)(b) where the exchange control legislation is contrary to the international public policy of the jurisdiction in which the court sits. This may be, for example, because of the discriminatory or abusive nature of the exchange controls. Alternatively, a court might decline to enforce the contract for public policy reasons because while the measures are IMF-compliant they breach another international treaty to which the state in which the court sits is a party. In the case of an EU Member State this could include a situation where the measures breach the Article 63 TFEU prohibition mentioned above, and are not within the scope of the Article 65 derogation.

Practical issues in relation to performance obligations

As discussed earlier, one of the features of the Greek capital controls is that – in contrast to many historic examples – they apply only to Greek banks rather than all individuals/entities seeking to carry out the prohibited transactions. As a consequence, whilst it may not be unlawful for those parties to carry out such transactions, it is practical considerations instead which may mean they will be unable to perform contractual obligations which are dependent upon their execution. Consequently, it is possible that 'illegality' provisions in contracts may not be triggered by the measures in their current form.

The effect of the measures on performance of contracts will depend on a number of factors, not least the identity and location of the parties, the types of contracts entered into and the form of documentation that they have agreed. For example, in the derivatives market, parties' relationships are likely to be governed by either a 1992 or a 2002 ISDA Master Agreement, both of which include an "Illegality" termination event, the trigger for which depends upon whether a payment from Greece is unlawful, rather than simply whether a particular method (for example, an electronic transfer) is unlawful.

The 2002 ISDA Master Agreement also includes a "Force Majeure" termination event, which is not present in the 1992 version. This applies if it becomes impracticable to perform, receive or comply with obligations under the agreement. As such, the argument for a Force Majeure having occurred appears stronger than that for an Illegality. Upon the occurrence of a Force Majeure, the 2002 agreement provides for the suspension of each party's payment and delivery obligations for up to eight business days (compared with three business days in the case of Illegality).

It is also worth noting that, in relation to underlying derivative transactions, parties will need to consider the interaction with the definitional booklets and collateral documentation incorporated into their agreements, for example the impact of the decree on valuation and payment mechanics. In relation to the credit derivatives market, whilst the capital controls themselves will not trigger payments under credit derivatives on standard terms, the practical consequences may ultimately lead to a “Failure to Pay” credit event. The market-wide determination of a credit event is likely to be determined by a committee comprising credit derivative market participants.

The extended bank holiday announced as part of the capital control measures may impact on the time when performance is required under a contract. This will depend upon the business day convention/definition adopted and may result in there being no performance required during the bank holiday period should a relevant ‘business day’ not occur as a result of the measures introduced. Some contracts may provide for performance to be deferred until the next occurring relevant business day, whilst problems may arise, for example, where a ‘modified following’ business day convention is adopted, given the timing of the decree towards the end of the month in particular.

Part III – The future for Greece and its banking sector

As noted above, the Greek government has called a bailout referendum for 5 July 2015 on measures previously proposed by its international creditors. Whilst there have been discussions in Greek legal circles as to the constitutional propriety of the referendum given its fiscal nature, the practical impact of this appears to be minimal. Regardless of any legal challenge likely being a lengthy process, the referendum’s practical effect seems limited to guiding the Greek government’s decisions going forwards, with the significant consequences which will arise from this irrespective of the outcome.

IMF repayment and the consequences of default

On 30 June 2015 the approx. €1.5bn aggregated payment is due to be paid by Greece to the IMF. If Greece were to default on this obligation or on a payment obligation owed to other financial creditors it may have consequences on other contracts to which Greece is a party. If such a contract were to contain a “cross default” clause, for example, non payment of financial indebtedness by Greece to the IMF or to other financial creditors might result in a default under that contract. A cross default clause would also typically be triggered if an event of default occurred under another financing contract and (if drafted as a cross acceleration) that financial indebtedness is accelerated following the event of default. Whether a particular clause is triggered will depend on its terms including how financial indebtedness is defined, whether it allows for a grace period applicable to that financial indebtedness to expire before the default arises and whether the amount of the financial indebtedness exceeds any threshold specified. By way of example, a cross default clause with a sovereign counterparty might provide that it is only triggered if the financial indebtedness is denominated in a currency other than the sovereign's domestic currency.

The facility between IMF and Greece is not publicly available and there is some uncertainty as to its terms. In particular, the precise nature of this facility, when amounts are due and payable and whether a grace period applies – if payment is not made on 30 June 2015, the IMF has stated that Greece will be in "arrears" rather than in default. The IMF facility appears to be denominated in euros although accounted for in the IMF accounts in SDRs. As a result of these uncertainties it may be difficult to rely on a non-payment to the IMF as triggering a cross default clause without further clarification of the position from the IMF or from Greece.

Greece is party to many different financing arrangements and the cross default position is complex, requiring an analysis of the terms of each of the relevant arrangements. However, by way of example, a payment default under the IMF facility would give the European Financial Stability Facility a right to trigger a default under the facilities it provides to Greece if there has been a declaration of default under the IMF facility or the IMF has notified the EFSF that the amounts are overdue. A payment default under the IMF facility would not, however, directly trigger an event of default under the Greek Government Bonds issued as part of the 2012 Sovereign Exchange Offer (the "**2012 Bonds**") because relevant indebtedness for the purpose of the cross default clause in the 2012 Bonds is limited to public bond issues and the IMF facility would not fall within the relevant definition.

In addition to the cross default position, a financing arrangement may contain other events of default which could be triggered, for example, if it could be shown that Greece is not able to pay its debts as they fall due or similar insolvency related provisions apply. If such an event of default were triggered this would in turn have cross default implications in other financing arrangements containing cross default clauses.

On 20 July 2015 a payment of €3.5bn falls due to the ECB and a further payment of €3.2bn falls due on 20 August 2015. In addition to cross default and event of default issues, a default on these payments would raise further questions about Greece's continued participation in the eurozone.

The potential introduction of IOUs

There has been speculation in recent weeks that the Greek government may in the future elect to make certain payments, including potentially payments to the public sector, in the form of an alternative parallel currency or as an IOU ("**IOUs**"). These IOUs may then be redeemed at some future date, for example against tax liabilities.

Other examples of IOUs

There are many other examples of governments having used IOUs during periods of financial stress, some of which may more closely represent separate domestic currencies than others.

For example, in July 2009, and previously in 1992, the State of California issued ‘registered warrants’ or ‘scrip’ instead of cash in satisfaction of wage payments to state employees. The warrants were also issued to taxpayers receiving tax refunds. These warrants were issued to creditors for specific amounts and could be exchanged for dollars at a later date, but were not intended to circulate like currency.

Scrip was also issued in Argentina in 2001, and not only by the country’s government. Argentina’s various provinces issued scrip to pay salaries and pensions too. For example, in August 2001, the province of Buenos Aires issued $90m of one-year bonds, known as patacones, to employees as part of their pay. These one-year bonds were soon widely accepted in exchange for goods and services generally.

Greece itself previously issued IOUs in 2010 and 2011 in the form of so-called “pharma-bonds”. Having resolved to acquire the (approx. €5.6bn) debt of Greek state hospitals, the then Greek government passed legislation in 2010 enabling the state to settle invoices through the issuance of bonds that would be offered to the hospital suppliers. These zero-coupon bonds, which were denominated in the amount of each approved invoice, had a maturity of between one and four years, ranked *pari passu* with all other unsecured and unsubordinated Greek sovereign debt, were freely transferable and could be pledged for cash – suppliers could, and did, therefore trade the pharma-bonds, albeit at a heavy discount.

IOUs and the EU

It is not certain whether any introduction of IOUs in Greece would breach European law. If in practice they amount to a separate domestic currency or a form of legal tender, their introduction may breach certain provisions of European law which suggest that the eurozone member states are permitted to use only the euro as their currency. Examples include:

> Article 2 of Council Regulation 974/98 which provides that from the 1st January 1999 “*the currency of the participating Member States shall be the euro*”; and

> Article 10 of Council Regulation 974/98 which provides that “*banknotes denominated in euro shall be the only banknotes which have the status of legal tender in all these Member States*”.

Much will depend on the form any such instruments take if they are issued, and whether they have the status of legal tender in Greece. It may be some time after the instruments are issued before their acceptability for payment is established, which will be central to determining whether they constitute a currency and, therefore, their compliance with European law. IOUs in the form issued by Greece in 2010 and 2011 appear very unlikely to breach these provisions. Ultimately, however, whether or not any Greek IOUs amount to a separate currency, and whether such a separate currency would breach the terms of the applicable EU rules, is a question which would be decided by the European Court of Justice.

The future for Greek banks

A further consequence of the Greek debt crisis is uncertainty as to the future of the Greek banks. The availability of domestic deposits now stands at an eleven-year low. Non-performing loans continue to be a problem. Access to international capital markets has been cut off. Greek banks have therefore been forced to rely on eurosystem funding, but with access to the ECB's normal financing operations constrained, greater reliance has been placed on Greek Central Bank funding - Emergency Liquidity Assistance ("**ELA**").

In order to access ELA funding the Greek banks have been posting Greek T-Bills as collateral. For so long as the Greek banks agree to roll over T-Bills issued by the government, Greece appears solvent. However, the Governing Council of the ECB now reviews ELA operations at least weekly – indeed it has recently reviewed these operations on a daily basis – and, with a two-thirds majority, can require national central banks to restrict ELA availability. On the 28 June 2015 the ECB decided to maintain the ELA cap for Greek banks at €89bn, thereby restricting the amounts remaining available for the banks to access, resulting in the imposition of the capital controls discussed above. If the ECB considers that Greek banks are insolvent rather than just facing liquidity problems, the ECB would be required to stop the Greek Central Bank's continued provision of ELA in its entirety. If the Greek government defaults, the T-Bills that have been key to the banks accessing ELA funding will no longer be eligible collateral. With very limited access to other sources of funding, if ELA funding were to become unavailable, liquidity concerns would mount, increasing the likelihood of bank resolution or liquidation.

Greek bank resolution procedures

The decision making powers of the ECB under the Single Resolution Mechanism and its resolution toolkit will only apply to Eurozone states from 1 January 2016. Greece has not yet implemented the European Directive on Bank Recovery and Resolution (the "**BRRD**"), despite a requirement for Member States to do so by 1 January 2015. The extensive resolution powers, creditor safeguards and EU wide recognition benefits provided for under that legislation would not be available with respect to a Greek bank.

Following the 2010-2012 banking crisis, however, Greece does have a bank resolution regime similar to BRRD and transfers to bridge banks are theoretically possible to enable a good bank/bad bank split should that be desired. A limited form of bail-in is also possible and would need to be exercised if funding from the Hellenic Financial Stability Fund were needed to capitalise the bridge bank. However, it is unclear whether this Fund is sufficiently financed to provide the support required in the circumstances contemplated.

Any required resolution of Greek banks would be complicated by the fact that the financial health of all Greek banks has been impacted heavily by the nation's financial situation of recent years. Whilst the terms of any resolution procedures would become clearer over time, it is clear that the Hellenic

Deposit and Investment Guarantee Fund provides for customer deposits to be legally protected up to €100,000 in accordance with the EU's Deposit Guarantee Schemes Directive. However, it should be noted that this scheme is only funded domestically in Greece (and not on an EU-wide basis) and it has been reported that the scheme does not appear to be fully funded.

The potential for a eurozone exit

If the Greek government were to default on its debts to international creditors, or to issue IOUs, this would not automatically mean that Greece has to leave the eurozone.

It has been the stated intention of both the Greek government and its creditors throughout the course of recent negotiations that Greece remains in the eurozone. However, the failure to reach agreement over the route ahead has led to speculation that Greece may be required to exit the eurozone in order to effect a currency devaluation and, possibly, commence its own quantitative easing programme. Indeed, numerous European leaders and politicians are reported to have said that the 5 July referendum amounts to a referendum on not only Greece's continued membership of the eurozone, but potentially also its membership of the EU.

Absent a treaty change, there is currently no treaty provision providing for either the expulsion of a non-compliant Member State from the eurozone or a voluntary unilateral eurozone exit by a Member State. The lack of a pre-existing legal framework for an exit from the eurozone does not, however, make it impossible. There are three theoretical exit routes:

> **voluntary withdrawal from the EU:** Article 50 of the Treaty on European Union provides for a voluntary right of secession from the EU. Greece could voluntarily withdraw from the EU and also exit the eurozone. However, this is not a speedy process. Whilst it is theoretically possible for Greece to leave the EU (and the eurozone) and then reapply for admission to the EU – either seeking an opt-out from monetary union or relying on the fact that it is unlikely to satisfy the criteria for admission to the eurozone – the financial and legal uncertainty that would arise in the considerable time period required to effect withdrawal and readmission means this is not generally regarded as a practical option.

> **unanimous consent to a eurozone exit**: if Greece wishes to exit the eurozone but remain in the EU, it could seek the consent of the other 27 EU Member States for a eurozone exit. Again, this would be a time consuming, lengthy process that would require treaty amendments.

> **unlawful unilateral exit from the eurozone**: it would be possible for Greece to unilaterally exit the eurozone and introduce a new national currency without withdrawing from the EU. Taking such action without the consent of the other 27 EU Member States would place Greece in breach of its obligations under the EU treaties.

If a eurozone exit were to occur, the likely sequence of events that would unfold is difficult to predict with certainty. However, it is likely that as part of the process the Greek government would need to pass legislation establishing (i) its exit from the eurozone, (ii) a new national currency, (iii) the fixed exchange rate for the automatic conversion of all existing euro payment obligations between the euro and the new currency, and (iv) the automatic redenomination of euro deposits, contracts and obligations into the new currency. For more information on the legal issues arising from a Member State exit from the eurozone, refer to our earlier Eurozone Bulletin: Updating Contingency Plans.

Whilst this Bulletin reflects the views of Linklaters LLP as at the date of publication, we are grateful for the assistance provided on matters of Greek law by Christina Papanikolopoulou at Kyriakides Georgopoulos Law Firm, Athens.

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For further information please contact your regular Linklaters contact or click here for a list of Linklaters lawyers who will be able to help.

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