INSIDE STORY – JULY 2015 – GREECE

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?

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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?

We consider whether it is legally possible for Greece to temporarily cease to be a member of the Eurozone without a so-called "derogation", i.e. whether it is possible under law to change the status of Greece for the time being into being a member state whose currency is not the Euro like Poland, Sweden, the Czech Republic or Hungary, and what consequences such "Grexit" would have for existing trade contracts and loans with counterparties in Greece and the government bonds issued by the Hellenic Republic.

On 30 June 2015 the availability period for Greece to make further drawings under the EFSF Master Facility expired (the second rescue package). At the same time the Managing Director of the IMF notified the Executive Board that the Greek repayment due on 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 Master Facility and reserved EFSF's rights. The Board of Directors of the EFSF have not (yet) accelerated repayment of the entire EFSF Facility.

On 5 July 2015 the Greek Referendum on the proposed conditions for further drawings under the EFSF Facility resulted in a "no" vote. The second rescue package is no longer available to Greece after 1 July 2015 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.

Under the terms of the European Stability Mechanism (ESM) according to Article 136 (3) of the Treaty on the Functioning of the European Union (TFEU), a third rescue package could only be made for Greece if it is indispensable to safeguard the stability of the Eurozone as a whole and 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*.

In relation to a further debt restructuring, a major legal issue will be whether such debt restructuring would infringe Article 123 TFEU which prohibits a state financing through the European Central Bank (ECB) and the National Central Banks (NCBs). In that respect it needs to be noted that Advocate General Cruz Villalon stated in his opinion of 14 January 2015 in relation to the Outright Monetary Transaction (OMT) proceedings (which are not related to the crisis of Greece but which have wider implications on state financing in the Eurozone in general): "Moreover, the ECB has stated in its written observations that, in the context of a restructuring subject to 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.

Whether Greece could exit the Euro without exiting the EU is an open legal question. The views between lawyers range from a clear "no" to a clear "yes" and there are a number of techniques proposed by lawyers to legally achieve such an exit. One of the routes proposed would be to use the relevant Articles of the TFEU to change the status of Greece from a Member State to which no derogation within the meaning of Article 139 TFEU applies to a Member State to which, for the time being, a derogation pursuant to Article 139 TFEU does apply so that the currency of Greece would not be the Euro.

As for Greece exiting the Euro, such an 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.

A redenomination of Greek debt through European Union legislation rather than domestic Greek legislation was not in the focus of market participants in 2011/2012. If the political players in the discussions with Greece should come to the conclusion that it would be in the best interest of Greece and the Eurozone that Greece leaves the Euro, then they might conclude that Greece should not exit from the Euro unilaterally. Instead a structured exit of Greece from the Euro could be done on European Union level by giving a wide interpretation to those rules of the TFEU on which originally the accession of Greece to the Eurozone was based and proposing that TFEU allows a reversion of the accession of Greece by way of "*actus contrarius*" through the Council of the European Union adopting a decision and a

Council Regulation which states (i) that Greece is a Member State to which a derogation pursuant to Article 139 TFEU applies, (ii) Greece is allowed to introduce the New Currency and (iii) all outstanding debt of Greek debtors is redenominated after a certain time from Euro into the New Currency at the then prevailing established market rate.

Such a Council Regulation would be European Union law and would as such have priority over the domestic laws of the Member States of the European Union and in addition to such superiority in the hierarchy of rules it would be, if done in the form of a Regulation, directly applicable in all Member States of the EU.

Steps to temporary Grexit

The procedural steps which would 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.

If an exit of Greece from the Eurozone and a redenomination of Euro debt into New Currency debt would be effected by EU legislation, then the currency to be paid under trade contracts, loans, bonds, derivatives, and other instruments governed by a law of another Member State of the EU (for example governed by German, French, Italian, Spanish or English law) could be changed from Euro into New Currency because such EU legislation would be binding in all Member States of the EU and would need to be recognised and applied by all courts of the Member States.

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