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Euro crisis: Effects of a possible currency conversion on companies

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Euro crisis planning - how does it impact your business?

With their resolutions to monitor the individual member states more intensely and to intensify economic cooperation in the Euro zone, the EU government has laid a cornerstone for the stabilization of the European currency system. However, there is a long way to go until these resolutions are implemented. First, they need to be ratified by the 17 Euro member states in order to become binding. Until then it cannot be ruled out that a state will leave or have to leave the European Monetary Union (EMU) and as a consequence re-introduce its national currency. This exit scenario could entail far-reaching consequences for entrepreneurial activity in or with the exiting state. For this reason, companies should take the possible consequences of the state's exit from the EMU into account within the framework of risk management.

From a legal standpoint the following aspects could be relevant:

Risks for contracts in force

A currency conversion may trigger contractually agreed mechanisms for termination or adaptation of the contract. Such trigger events, such as material adverse change clauses, force majeure clauses or events of default, are commonly found in agreements used between professional parties and specifically in financing agreements with banks. It is thus expedient to carefully examine these contracts with regard to such clauses and to make any amendments if necessary.

There is a significant risk when receivables are paid in Euros. Should a state exit the EMU it is likely that it will issue orders for the satisfaction of all payment liabilities established according to the state's laws, in the new currency at a fixed exchange rate. In the case of contracts within an international context, the question then arises as to which currency the payments are to be made in. A significant exchange rate risk is incurred by companies due to this legal uncertainty as it can be anticipated that a new currency will be traded on the free market at a lower rate than the exchange rate fixed by the government of the relevant state. For this reason, existing payment agreements and price clauses should be thoroughly reviewed.

Existing contracts may need to be revised in order to exclude potential exchange rate risks. The laws governing the contract will play an important part in this context.

Where a contract stipulates the use of a specific referential interest rate (e.g. EURIBOR or EONIA), the question as to whether this provision is still meaningful arises in the case of a currency conversion. Alternative agreements could already possibly be concluded in advance.

Items to be considered in connection with the conclusion of new contracts

Even though the exit scenario has been considered to be rather unlikely, the risks associated with a state's exit from the EMU should be taken into consideration and the changed risk situation should be taken into account when negotiating new contracts and, where possible, amending existing contracts.

► Dependency on a single contractual partner

In general, it is advisable to avoid being dependent on a single contractual partner, especially when such partner is established in a country that is most likely to exit the Eurozone. If a company depends on a single contractual partner, it may mitigate risks by reducing such dependency or by having a substitute contractual partner available and on stand-by in another jurisdiction.

► Terms of the contract

Terms and conditions that are considered standard in contracts require greater consideration in the future. This concerns particular terms regarding the place of performance and manner of payment, the currency in which the purchase price is to be paid, rights of set-off, exceptional rights of termination (in particular in the case of a currency conversion and in the case of an increase of the loan interest) and choice of forum clauses. Further, parties may choose not to have as governing law, the laws of a country that is most likely to exit the Eurozone.

► Liquidity and insolvency

As part of the currency conversion process, bank accounts in the exiting state could be temporarily frozen by the authorities in order to stabilize the state's banking system. This may result in liquidity shortages for a contractual partner established in such state, which may ultimately lead to such contractual partner becoming insolvent. The risk of an ensuing payment default can be limited by requesting such counterparty to provide sufficient security, such as creating security rights on assets, parent guarantees, letters of credit, retentions of title, etc. Payment deadlines for customers in states that are most likely to exit the Eurozone should be kept as short as possible and the management of the accounts receivable may be intensified. In addition, it is recommended to ask customers to make advance payments and to avoid that they fulfill their payment obligations in installments.

► Temporary government regulations

When developing their liquidity plans, companies should take the risk of a temporary government regulation of cash flow (capital and currency controls) into account. Maintenance of bank accounts in states within and outside of the EMU that are regarded as secure should also be considered.

Specifics in the case of company purchases

In the case of M&A-transactions, the changed risk situation should be taken into account during the due diligence stage of the transaction. It is expedient to thoroughly examine which risks could result from the business activity of the target company in the respective states. In addition, a currency conversion could have an effect on the value of the target company if it has significant financial assets or considerable business activity in or with the exiting state.

Given that these risks can also materialize in the period between the conclusion of the share purchase agreement and the closing of the transaction, the purchaser should secure himself through the conclusion of material adverse change clauses which specifically take the depicted scenarios into account. In this context "subject-to-finance" clauses are of special relevance and the question as to what efforts need to be made and what conditions need to be accepted in order to receive loan financing need to be discussed.

Restrictions of the free movement of goods and capital

Should a state exit the EMU, it cannot be ruled out that the respective state will continue to take further-reaching protective measures to protect the national economy. This could result in far-reaching restrictions of free movement of goods and capital. There is a threat of impairment of delivery of goods and services to companies in the exiting states. Contractual provisions such as exceptional rights of termination should also be concluded for such cases.

Miscellaneous

If a currency conversion occurs, companies will face a range of additional challenges. The conversion of their IT-systems to the new currency or the adaptation of employment contracts with their employees are just two examples. Business as usual is not an option.

We are pleased to offer you support by providing legal professionals who work together in multidisciplinary teams with Ernst & Young service lines to determine potential risks and to develop and implement approaches and recommendations to help you manage these potential risks.

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