Greece: the Months Ahead

SLAUGHTER AND MAY

April 2015
INTRODUCTION

The Greek Parliamentary elections of 25 January 2015 marked a watershed in Greek and potentially European politics with the victory of a left-wing and overtly anti-“bail-out” party. The Coalition of the Radical Left (“SYRIZA”) roundly defeated the pro-“bail-out” parties – New Democracy and the Pan-Hellenic Socialist Movement (“PASOK”) – falling just short of an absolute majority in the Greek Parliament. A governing coalition was quickly formed with the anti-“bail-out” right-wing Independent Greeks party which received the Defence Ministry. All other cabinet posts went to SYRIZA appointees.

A gulf quickly opened up between on the one hand SYRIZA’s rhetoric in opposition, and its programme for government, the economic realities Greece faced with a bail-out programme planned to expire on February 28th 2015, and the insistence of Greece’s lenders that it abide by prior commitments on the other hand. Demands that Greece’s debt be written off by up to one half were quickly rebuffed, and SYRIZA, despite having previously rejected the idea of a “bail-out”, was forced to seek an agreement on an extension to the existing programme of reforms. At the same time the idea of a third Greek programme, when the second programme expires in June 2015, has gained ground.

Initially negotiations between SYRIZA and its creditors appeared fraught, with public diplomacy replacing the private deal-making that characterises much of EU negotiations and the Euro Zone crisis in particular. However, there have been more recent signs that SYRIZA is learning the value of compromises in order to achieve implementation of part of its pre-election programme while achieving a long-term solution to Greece’s debt situation. A recent meeting between the Greek Prime Minister Alexis Tsipras and Germany’s Angela Merkel on 23 March seems to have dampened the verbal spats between Greece and Germany, and Greece has been afforded flexibility on the bail-out programme as to which reforms to enact provided that the overall effect on revenue and debt reduction is maintained.

Nonetheless, risks remain very much on the downside. Although it is objectively in Greece’s and the Euro Zone’s interests to reach a negotiated solution to this latest phase of the Greek crisis there is mounting opposition in some Euro Zone capitals against giving greater leeway to Greece while the Greek state is rapidly running out of money to meet domestic expenditure and impending debt servicing obligations. No new money has been promised to Greece until there has been a successful review of the current programme of reforms, while new reforms proposed by Greece have been slow in coming. There is therefore a real risk that Greece will face the choice in the weeks or months ahead of not meeting current government spending, or defaulting on debt repayments. In April approximately € 3.14 billion is due to be repaid which includes €458 million due to the International Monetary Fund (“IMF”). If Greece chooses to prioritise
domestic government expenditure then default is a real possibility with the potential to trigger cross-defaults on certain other obligations owed by Greece (such as under the Master Financial Assistance Facility Agreement with the European Financial Stability Facility (“EFSF”)). Default could, but need not, trigger Greek exit from the Euro Zone (“Grexit”).

At the same time, the Greek banking sector is under considerable pressure and is facing significant outflows while its continuing viability depends on forbearance by the ECB in terms of the Emergency Liquidity Assistance (“ELA”) provided by the Bank of Greece under ECB supervision. The Greek banking system is also dependent on the recognition of Pillar 2 and Pillar 3 bonds guaranteed by the Greek government. The chairman of the Eurogroup, Jeroen Dijsselbloem, has raised the prospect of capital controls being introduced in Greece. Meanwhile the ECB has recently been seen to put pressure on Greece. Greek government bonds ceased to be eligible as collateral with the ECB on 11 February 2015 while the ECB has capped the amount of Greek government treasury bills that can be purchased by Greek banks. Needless to say, Greek government bonds are ineligible for the ECB’s quantitative easing programme.

This briefing paper provides a brief summary of the main events since the elections on 25 January 2015 before discussing scenarios for the future development of the Greek crisis over the coming months. We do not attempt to assign probabilities to the outcomes discussed given that these are essentially political questions that will be taken at the highest level by Euro Zone governments and will be principally determined by non-legal and economic factors. Nonetheless we consider that all scenarios discussed in the briefing paper remain within the reasonable range of possible options.

THE ELECTIONS OF 25 JANUARY 2015

The elections of 25 January 2015 were triggered by the failure of the outgoing Parliament to elect a President of the Republic by the required 3/5 majority. SYRIZA and the Independent Greeks cooperated in order to ensure this outcome, although they had the support of some independent members of Parliament. Golden Dawn also voted against the election of a President. Where the Parliament fails to elect a president by the required majority the Greek Constitution requires early elections. Following the dissolution of Parliament on 31 December 2014 there followed a short election campaign marked by a sharp difference in strategy between the outgoing New Democracy-dominated government and opposition SYRIZA. Essentially, New Democracy focussed on Greek citizens’ fears for the future whereas SYRIZA promised hope and change in a country facing exceptionally high unemployment of 26% and a 25% loss in GDP since the 2009 financial crisis hit Greece. Ultimately it was SYRIZA’s message of hope that paid off at the polls with 149 seats in the 300 member chamber. Although the margin of victory of SYRIZA over New Democracy was only 8.5%, SYRIZA’s allocation of seats was boosted by the Greek electoral law that allocates a bonus of 50 seats to the party that wins the highest percentage of the votes.

SYRIZA’s manifesto was set out in a speech delivered by party leader Alexis Tsipras in Thessaloniki on 13 September 2014. The manifesto consisted of two parts: measures to be negotiated with Greece’s creditors, and measures that could be implemented unilaterally. The former included writing off the greater part of Greece’s nominal debt, a “growth clause” to apply to the remainder of the debt, a grace period on debt servicing, exemption of public investments from the Stability and Growth Pact and agreement on a “European New Deal”. The unilateral measures included steps to tackle what SYRIZA described as Greece’s humanitarian crisis, measures to restart the economy, a national plan to increase employment and institutional reforms. The unilateral
measures were broadly repeated in Tsipras’ speech on 8 February 2015 setting out the government’s programme in Parliament.

The day after the elections Alexis Tsipras was able to form a coalition with the Independent Greeks with a solid majority in Parliament. These are two very different parties with different ideological roots, but which have shared opposition to austerity policies imposed on Greece through the Memorandum of Understanding (the "Memorandum") agreed with the EU, ECB and IMF (the "Troika").

SYRIZA is a party with its origins on the far left of Greek politics that was founded in 2004 as a coalition of parties and groups and became a political party in 2012. In 2013 SYRIZA decided to dissolve the participating parties but factions remain. One of the most important is the Left Platform led by the minister of energy Panagiotis Lafazanis that holds 30% of the seats on the party central committee and remains a powerful force within SYRIZA on the left. There have already been tensions between Lafazanis and more pragmatic members of SYRIZA, notably on the question of privatisations, which Lafazanis has ruled out in the energy sector. Lafazanis has also criticised compromises made to seek to unlock bail-out moneys; insisting that SYRIZA should prioritise implementation of its manifesto commitments.

The Independent Greeks are a much smaller party with 4.75% of the votes and 20 members of Parliament. They were founded in 2012 on an anti-"bail-out" platform, and their members and voters mainly derive from right-wing New Democracy. Their policies include debt repudiation, German war reparations, opposition to multiculturalism, reduction in immigration and the development of a Christian Orthodox education system. It will be apparent that there is the potential for clashes between the Independent Greeks and SYRIZA on many issues.

**INITIAL STEPS**

The initial diplomatic steps taken by the new government were marked by public diplomacy that yielded little in terms of results. The economics minister Yanis Varoufakis toured Europe in an unsuccessful bid to build up support for SYRIZA’s economic platform. On 3 February Greece publicly abandoned its demand for a nominal debt cut, asking instead for growth bonds linked to Greece’s nominal economic growth, while the bonds held by the ECB would be converted into perpetual bonds.

On 5 February the government conceded that it would need a bridging loan to meet coming debt payments. This was the first recognition that Greece could not simply exit the bail-out due to expire on 28 February 2015 as SYRIZA had argued in its election campaign. The suggestion that Greece be granted a bridging loan was rebuffed at two Euro Zone summits on 11 and 16 February that collapsed in acrimony. Finally, Greece requested an extension of the Master Financial Assistance Facility Agreement with the EFSF which was agreed at a summit on 20 February 2015. Euro Zone finance ministers agreed to consider extending financial assistance to Greece for up to 4 months. This followed a request from the Greek authorities submitted on 19 February. The Greek government was required to present a first list of reform measures in line with existing agreements on 23 February. This was to be reviewed by the institutions to determine whether it was sufficiently comprehensive to be a valid starting point for successfully concluding the review of Greece’s current programme.

The list of reforms was accepted by the European Commission, although the IMF and the ECB expressed reservations. According to the ECB "the commitments outlined by the authorities differ from existing programme commitments in a number of areas. In such cases, we will have to assess during the review whether measures which are not accepted by the authorities are replaced with measures of equal or
better quality in terms of achieving the objectives of the programme" while the IMF observed "that there are neither clear commitments to design and implement the envisaged comprehensive pension and VAT policy reforms nor unequivocal undertakings to continue already-agreed policies for opening up closed sectors, for administrative reforms, for privatisation, and for labour market reforms".

The result was to extend Greece’s existing bail-out programme until 30 June 2015. However, no new money would be disbursed unless a review in April determined that Greece was on track to conclude the programme successfully. Subsequently, it was proposed that some funds might be released earlier if Greece were to come up with a credible reform programme. A Eurogroup meeting on 20 March 2015 proved inconclusive and reiterated the 20 February statement: "Within the framework of the Eurogroup agreement of 20 February 2015, the Greek authorities will have the ownership of the reforms and will present a full list of specific reforms in the next days".

Greece was subsequently tasked with delivering a list of reforms by 30 March 2015, which it did in part on 29 March but the list was deemed unsatisfactory. At the time of writing talks continue with the Troika (renamed the "Institutions"). Meanwhile government revenue figures for January 2015 were disappointing, with expectations that February would be similar. Greece has struggled to meet Government expenses requiring social security funds and regional administrations to pool resources so as to ensure that salaries and pensions were paid in March 2015. Hence, the Government’s wish to ensure the release of some of the bail-out funds as soon as possible. However, absent a credible reform programme, this currently looks unlikely, and Tsipras’ speech to Parliament on 30 March was long on rhetoric but showed little in the way of concrete reform measures.

A THIRD BAIL-OUT?

At the same time there has been rising speculation that Greece will need a third bail-out package after the existing second package expires on 30 June 2015. The possibility of a €50 billion package was raised by the Spanish economy minister Luis de Guindos on 2 and 3 March 2015 and was repeated by Commission Vice President Valdis Dombrovskis: Greece could need a third bail-out deal when its current program expires in June because markets may still not be prepared to lend to its government, even with a euro-area credit line. German Finance Minister Wolfgang Schäuble said in August 2013 that a new aid program would be needed to help Greece meet its debt obligations and estimates of the country’s needs have ranged from €12bn to €50bn1. On the other hand, a spokeswoman for Eurogroup chief Jeroen Dijsselbloem insisted that finance ministers were not discussing a third bailout and Commission President Jean Claude Juncker considers that it is premature to talk about a third programme. SYRIZA has stated that Greece does not require a third bail-out.

POSITION OF THE GREEK BANKING SECTOR

The Greek banking system is in many respects the Achilles heel of the Greek economy. While the banks are said to be well capitalized (following successive recapitalizations of the four systemic banks (Alpha Bank, Eurobank Ergasias, National Bank of Greece and Piraeus Bank)), they are currently significantly exposed to the Greek state with the result that a sovereign default by Greece would be likely to place the banking sector under considerable stress and possible insolvency. Moreover, the Greek banking sector is currently dependent on support through forbearance.

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Greek government bonds were withdrawn from eligibility as collateral for Eurosystem operations on 11 February 2015 which means that the Greek banking sector cannot access cash through pledging Greek government bonds with the ECB as collateral. More significantly the Greek banking sector is able to access funding from the emergency liquidity assistance programme (ELA). This is a facility operated by the Bank of Greece under which non-Eurosystem eligible assets may be pledged as collateral at the risk of the Bank of Greece. The amount of ELA is capped by the ECB, currently at €71 billion. The ECB could withdraw its permission for extension of the ELA at any time by a two thirds majority.

In addition there are the so-called Pillar 2 and Pillar 3 bonds guaranteed by the Greek state that were eligible until the end of February for Eurosystem operations. The decision to de-recognise Greek government bonds affected Pillar 2 and Pillar 3 bonds, which however remain eligible for ELA operations with the Bank of Greece. Finally, the ECB has permitted the Greek state to issue treasury bills, in respect of which the current purchasers are limited to Greek banks. The banks pledge the T-Bills under the ELA which amounts to an indirect means of financing the Greek state. The ECB has capped T-Bill issuance at €15 billion despite Greek requests to increase this to €25 billion.

It should be noted that in the above decisions the ECB has considerable discretion and the decision to limit ELA and T-Bill issuances have been seen as a means of putting additional economic pressure on Greece to reach an accommodation with its creditors.

The flight of deposits from Greek banks since the elections has also led to speculation that Greece may be forced to introduce capital controls. Such controls are permitted under EU law where necessary for “public policy or public security” and have previously been deployed in Iceland and Cyprus as part of addressing those countries’ financial crises.

### PROFILE OF DEBT REPAYMENTS

We here set out the most significant debt repayments over the period 1 April to 30 June 2015 (IMF repayments are denominated in special drawing rights so the market rate varies daily):

<table>
<thead>
<tr>
<th>Date</th>
<th>Type</th>
<th>Amount ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>9 April 2015</td>
<td>IMF</td>
<td>€458 million</td>
</tr>
<tr>
<td>14 April 2015</td>
<td>T-Bills</td>
<td>€1.428 billion</td>
</tr>
<tr>
<td>17 April 2015</td>
<td>T-Bills</td>
<td>€1.022 billion</td>
</tr>
<tr>
<td>20 April 2015</td>
<td>Bond (ECB*)</td>
<td>€80 million</td>
</tr>
<tr>
<td>1 May 2015</td>
<td>IMF</td>
<td>€200 million</td>
</tr>
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<td>8 May 2015</td>
<td>T-Bills</td>
<td>€1.428 billion</td>
</tr>
<tr>
<td>12 May 2015</td>
<td>IMF</td>
<td>€764 million</td>
</tr>
<tr>
<td>15 May 2015</td>
<td>T-Bills</td>
<td>€1.435 billion</td>
</tr>
<tr>
<td>24 May 2015</td>
<td>Bond</td>
<td>€22 million</td>
</tr>
<tr>
<td>5 June 2015</td>
<td>IMF</td>
<td>€306 million</td>
</tr>
<tr>
<td>12 June 2015</td>
<td>IMF</td>
<td>€344 million</td>
</tr>
<tr>
<td>16 June 2015</td>
<td>IMF</td>
<td>€573 million</td>
</tr>
<tr>
<td>19 June 2015</td>
<td>T-Bills</td>
<td>€1.643 billion</td>
</tr>
<tr>
<td></td>
<td>Bond (ECB*)</td>
<td>€85 million</td>
</tr>
</tbody>
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* Held by the ECB

We now consider possible scenarios for the near future.
SCENARIO 1: GREECE COMPLETES THE PROGRAMME

Under this scenario Greece is able to negotiate an agreement with its creditors that will unlock (part of) the €7.2 billion available under Greece’s second bail-out programme and related arrangements. According to the 20 February Eurogroup agreement this would require a positive assessment of the reform process being reached in April. Subsequently, there have been statements that funds could be released earlier if Greece were to present a credible programme for reforms, although it is unclear whether this would need to be enacted into law, or whether a commitment to pass the necessary legislation would suffice. It remains to be seen how this debate will pan out with agreement before Easter unlikely. Under the February 20 agreement Greece can choose the measures provided that overall they are fiscally neutral which provides some room for accommodating SYRIZA’s priorities.

Under such an agreed solution it would probably be necessary for some of the bail-out moneys to be released in order for Greece to remain current on its debt obligations in April and May 2015. Politically, Alexis Tsipras would need to carry his party with him in making the necessary compromises demanded by Greece’s lenders. The strength of the opposition offered by the Left Platform within SYRIZA remains to be seen, including whether they would press opposition to aspects of a negotiated solution to voting against the Government in Parliament, which could cause Tsipras to lose his Parliamentary majority, leading potentially to new elections. An alternative, if SYRIZA lost its majority, could be to reach out to other political parties, such as The River, although whether they would be willing to prop up a SYRIZA government may be questioned. In any case, Tsipras may be expected to implement elements of the Thessaloniki programme on which he was elected, including measures to ease the perceived humanitarian crisis as well as a gradual increase in the minimum wage.

Assuming Tsipras is able to satisfy Greece’s lenders and his domestic party constituency there remains the question of what Greece will do once the extension of the second bail-out programme expires in June 2015. Greece has substantial debt repayments in July and August, and it is by no means clear that it will be able to raise the necessary funds from the financial markets. This raises the spectre of a third bail-out already discussed by commentators and certain politicians. This has been publicly rejected by SYRIZA and would be toxic domestically as it would prevent the implementation of further aspects of SYRIZA’s manifesto. However, if Greece were forced to accept a third bail-out, its conditions would be key in ensuring acceptability to Greece’s creditors as well as maintaining the unity of the ruling party.

In practical terms, Scenario 1 will mean business as usual. Greece will remain current with its debt repayments, so there will be no event of default under its government bonds. The Greek banking system should continue to be assisted by the ECB in order to address deposit flight, although successful release of bail-out funds may reverse the post-election trend towards deposit flight and even lead to repatriation of deposits as occurred after the June 2012 elections. The main variables are: first, the willingness of Greece and its creditors to compromise on a mutually acceptable list of reforms that allows SYRIZA to implement elements of its platform, the cohesion of SYRIZA in the face of such compromises and the possible need for Greece to negotiate a third bail-out programme. Longer-term challenges include reducing Greece’s debt to GDP ratio either through debt forgiveness (as sought by SYRIZA) or through lengthening maturities and reducing interest rates so as to reduce the long-term burden to a level that Greece can bear and which allows a resumption of economic growth. Finally, Greece will need to ensure that its economy is in a position to benefit from any recovery in the Euro Zone economy, which is, after all, the objective of the structural reforms insisted on by the creditor nations.
SCENARIO 2: GREECE FAILS TO COMPLETE THE PROGRAMME IN APRIL 2015

Under Scenario 2 Greece fails to satisfy its creditors by April 2015 that the second bail-out programme is on track and the resulting €7.2 billion is not released. This could occur for a number of reasons, both internal and external. Internally, SYRIZA may be unable to come up with a credible package of reforms while satisfying the demands of internal party unity. In this case the need to preserve unity would trump the need to satisfy Greece’s external creditors. This is likely to depend on the strength of opposition of the Left Platform to privatisations, pension reform and changes to collective bargaining. Alternatively, Greece’s creditors could overplay their hand in demanding reforms that in the short term Greece is simply unable to deliver in the time available.

A risk with Scenario 2 is that Greece runs out of money. Greece’s debt repayments have been highlighted above, and while the T-Bills may be rolled over to the Greek banking sector there is no guarantee that Greece will find the funds necessary to meet repayments to the IMF and bond holders. Even if Greece were able to meet its funding needs in this way there remains the issue of a third bail-out. If Greece cannot fund itself from the capital markets then it is difficult to see how a third bail-out could be avoided. Yet if Greece and its creditors cannot agree the successful completion of its existing bail-out then negotiations for a third bail-out are likely to be fraught without any guarantee of success. The key indicators will be whether Greece meets its existing IMF and bond repayments.

A further risk is that a major Greek bank faces a liquidity crisis but Greece has insufficient funds available to it to resolve it, potentially triggering a domino effect.

SCENARIO 3: SOVEREIGN DEFAULT

Under Scenario 3 Greece defaults on some or all of its bonds. Default could come as early as 9 April 2015 when the IMF is due to be repaid €458 million. Default on the T-Bills seems less probable as Greece is likely to be able to prevail on the Greek systemic banks to continue to roll over repayments. Default would have potentially far reaching consequences for Greece as it may trigger a default under the Master Financial Assistance Facility Agreement entered into with the EFSF. Default could also trigger cross-default provisions in bonds issued prior to 2012. It should be stressed that default need not lead to Greek exit from the Euro Zone, although it would significantly increase the risk.

Under Scenario 3 the question will arise as to what the European institutions will do in the event of a default. Acceleration is a possibility, although in circumstances where Greece has defaulted there may not be much point in accelerating a loan unless it formed part of a multi-lateral agreement on a reduction of Greek debt through the Eurogroup. Distressed debt funds and hold-out creditors from Greece’s PSI in 2012 would have more of an incentive to accelerate bonds if the terms entitled them to do so (which will often be the case).

Default should therefore be seen as a starting point rather than an end of the analysis, although it would place the ball firmly in the court of Greece’s creditors as to what happened next. For example, default could be taken as a step to restructure officially held Greek debt on a sustainable basis in return for economically feasible reforms. In this case it need not have adverse effects beyond the need to satisfy bondholder claims where the default gave rise to an acceleration event (unless Greece wanted to follow Argentina’s (undesirable) example and simply not pay such creditors as a means of seeking to secure a further restructuring of privately held debt).
On the other hand, creditor nations could seek to use the default as a means of precipitating Grexit. It should be noted that there is no legally effective means of achieving this, and Greece cannot be expelled from the Euro Zone even should its partners wish it. Not even sovereign default confers this right. However, Greece’s partners could make life difficult for it within the Euro Zone. For example, the ECB could cut off all further financial assistance to the Greek banking sector, and cancel (by a two thirds majority) the availability of the ELA. In this case the Greek banking sector will come under intense pressure and may become insolvent. Capital controls would in any case be inevitable. In such circumstances, Greece’s European partners might decide that Grexit (possibly, on a temporary basis) was the necessary price to be exacted before they were willing to offer debt relief or further funding for Greece.

State funding could be an acute problem in a default situation. Greece is currently running a primary surplus so it should, in principle, be able to keep current with expenses other than interest payments. Moreover, as any Government could, Greece would have the ability to raise additional taxes (or clamp down on tax evasion) to cover current spending. However, eventually some negotiated solution would need to be reached with the IMF, particularly if Greece wished to rely on IMF funding in the future. Moreover, in any sovereign debt restructuring the IMF is a preferred creditor and will rank ahead of Greece’s other creditors, whether public (ECB, EFSF) or private. A prolonged period of default is likely adversely to affect the real economy pushing Greece back into recession and will delay needed foreign investment, particularly if Grexit is considered as a risk (as investors will delay investing until the situation is made clear).

In terms of contracts, sovereign default is unlikely in our view to have an effect unless the contract or the counterparty is very closely connected with the Government. Default is unlikely to give rise to frustration under English contract law as sovereign default is treated as an economic risk against which parties may protect themselves if so advised. Although much will turn on the precise drafting of each provision, we do not consider that it would be likely to trigger a “material adverse change” in respect of a borrower or a bidder in a loan agreement with a third party, or in a takeover offer, as again it is a commercial risk that does not directly affect the borrower.

Contracts often contain a force majeure clause excusing a party from performance where it is attributable to factors outside of its control. The intention is to achieve greater certainty than the common law of frustration. Moreover, unlike frustration, a force majeure clause does not bring an English contract to an end. The effect of any force majeure clause will depend on the construction of the relevant clause. However, an adverse change in economic conditions, such as a recession or depreciation of the euro, is unlikely to constitute force majeure. On the other hand, more severe dislocation, such as the closure of the domestic or international payments mechanism, or closure of the domestic banking system, making payments impossible, could constitute force majeure. If sovereign default were to lead to widespread strikes, a collapse in public order or martial law, then depending on the circumstances this could also amount to force majeure.

**SCENARIO 4: GREXIT**

Scenario 4 could come about through two different routes. First, it could be the consequence of sovereign default by Greece where Greece’s creditors make exit the price of an orderly restructuring of Greece’s outstanding debts. In this case exit would be external as it would depend essentially on factors affecting Greece and the wishes of its creditors rather than a conscious decision by the Greek Government. The second way in which Grexit could come about is by a decision by the Greek Government that a return to
the drachma would provide the economic flexibility to restore the competitiveness of Greece. Several prominent members of the Left Platform within SYRIZA, including the economist Costas Lapavitsas, have advocated a return to the drachma on such economic grounds. At present a deliberate decision seems unlikely as membership of the euro remains popular amongst Greeks despite the economic arguments in favour of devaluation (which in a currency union can come about only by leaving it).

The European Treaties do not make any express provision for Euro Zone Exit. However, that is different from containing a legal prohibition which the Treaties do not. In our view Article 352 of the Treaty on the Functioning of the European Union (“TFEU”) may provide an adequate legal basis for Greece to exit the euro on a temporary basis. Article 352 states:

"If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures".

There are four cumulative requirements before recourse may be made to Article 352. First, action by the EU must be necessary. Secondly, that action must be within the framework of the policies set out in the Treaties. Thirdly, it must be necessary to attain one of the objectives set out in the Treaties. Finally, the Treaties must not have provided the necessary powers.

In our view, these requirements may well be met. Action would be necessary to preserve monetary union through a temporary exit by Greece where it is unable to maintain the discipline of membership of the euro. Secondly, exit would be within the framework of the policy of monetary union set out in the Treaty on European Union as membership of the single currency falls squarely within the provisions on monetary union. Thirdly, it would be necessary to prevent damage to the euro as the single currency of the remaining member states. Finally, the Treaties have not provided the necessary powers. In respect of the first and third limb of the argument exit would promote the objective of the euro as the single currency of the European Union through safeguarding it as the single currency of the remaining member states and preventing damage to monetary union that would be caused by a non-consensual (or unilateral) exit. It is submitted that the other provisions governing the euro in the TFEU, the Treaty on European Union and the Treaty Establishing the European Community do not expressly or by necessary implication prevent exit. For further discussion of this point see chapter 5 of T Petch Legal Implications of the Euro Zone Crisis, Wolters Kluwer, 2014.

Euro Zone exit could also be implemented through the simplified treaty revision procedure as it only affects Part Three of the TFEU: Article 48(6). While such treaty amendment would need to be ratified by the member states (unlike a regulation under Article 352 TFEU) there seems to be no legal obstacle to giving it retrospective effect from the date decided to give effect to Grexit.

Grexit would require a degree of advance planning. In order to be implemented in an orderly fashion it would need to be agreed in secret, and implemented over a "bank holiday" during which banks would be closed and the amounts that individuals could withdraw would be strictly limited. If not already in place, capital controls would be required. Bank accounts and other obligations would then be redenominated into new drachmae, presumably at a one-to-one exchange rate. The new drachma could be introduced electronically quite quickly, although past precedent suggests the printing of new banknotes and the minting of coins could take up to six months. In this case euro notes and coins may continue to circulate at the market rate of exchange, while publicly held euro notes could
be overprinted to provide banknotes in drachmae as occurred when Czechoslovakia split.

The practical effect of exit will depend on the scope of the redenomination law. We expect that this is likely to be limited to rights and obligations closely connected to Greece (e.g. wages, wholly domestic payments, bank accounts maintained with branches in Greece, debts payable to public authorities in Greece, etc.). Seeking to expand the scope of the redenomination law beyond this would run into difficulties as applying the law on an extraterritorial basis may break EU law and would be likely not to be given effect to by non-Greek courts.

In terms of recognition, Greek courts should recognise and give effect to the Greek redenomination law as a mandatory law of the forum. Other courts are likely to do so if the asset or liability, or contract, is governed by Greek law, or if the lex monetae is Greek law. Detailed legal advice will be required in such circumstances.

Practically, the new drachma would be likely to fall in value against the euro. Devaluation is likely to be a primary motivation for any Grexit chosen by Greece as it would immediately reduce domestic costs denominated in euro, and provided that inflation can be controlled, will result in a one-off gain in competitiveness.

WIDER IMPLICATIONS OF GREXIT

If Grexit did happen it would demonstrate that, like previous monetary unions, Economic and Monetary Union (“EMU”) was not permanent and that membership was not a one way street. In the light of history this should not come as a great surprise as all nineteenth century monetary unions that lacked political and economic union ultimately failed due to incompatibilities in the economic policies pursued by member states. Likewise, the post-war Bretton Woods system, the Snake and the Exchange Rate Mechanism of the European Monetary System failed to prevent changes in parity as a result of divergent economic policies pursued by the contracting states. Grexit would therefore demonstrate that EMU was a particularly sticky and inflexible fixed exchange rate regime. However, it is unlikely to lead to a queue of other countries heading to the exit. The reasons are the costs of Euro Zone exit compared with the benefits of exchange rate devaluation. Despite five years of recession Greece remains uncompetitive compared with other southern European countries, still less Turkey and Middle Eastern competitors in key sectors (e.g. tourism). Nonetheless, the fact of a Greek exit may be expected to have a moderate effect on the spread over the risk-free rate payable by other heavily indebted sovereigns as in extremis exit would have been shown to be a viable option. It would also be seen as a setback to European integration, as a key policy objective will have been shown to be reversible.
Our Sovereign Debt and Euro Zone group includes lawyers with sovereign debt, restructuring, financing, financial regulation and litigation expertise. We have provided advice to a range of public and private sector clients around the world on sovereign debt, restructuring and Euro Zone-related issues. Our disclosable experience includes advising HM Treasury on the Government support given to the UK banking and finance industry, the Irish Government on the reorganisation and recapitalisation of certain Irish banks and on legislation relating to the Irish banking crisis, the Portuguese Ministry of Finance in connection with the recapitalisation of certain systemically important banks, and the Central Bank of Cyprus on the emergency resolution of the Cypriot banking sector. In addition, we have been advising clients on the possible implications of the current Euro Zone crisis, including considering the impact of a break up of the euro or a withdrawal from the euro by one or more Euro Zone member states.
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