BETTER SAFE THAN SORRY

As the Eurozone crisis continues to deepen, businesses should consider taking action to protect their position from the potential effects of the continuing drop in the value of the Euro and the possibility that one or more countries may drop out of the European Monetary Union, says Melissa Forbes, Associate, Taylor Wessing.

With sovereign debt levels continuing to rise and concerns abounding about the ability of the European states to repay their debts, there is a risk that countries will begin to withdraw from the European Union and that certain member states will abandon the Euro and re-introduce their own local currencies.

Where a business receives payments in Euros it may wish to consider amending its contracts to ensure that it is protected against any potential currency conversion in the less likely event that a dispute arises between the parties as to which currency shall apply instead.

It may also be prudent to consider inserting a similar provision in agreements where payments are made in Euros; for example to a supplier or a service provider, which shall apply where the Euro as a currency ceases to exist. Even if the default currency falls in value (which would benefit a company's position where it is obliged to make payments to other parties in Euros), there is the potential for uncertainty where there is more than one European jurisdiction that is connected to the contract.

For example, there may be a contract for the sale of products from the manufacturer in Germany to a purchaser in France and therefore, two European currencies that have a connection with the contract.

Payments received in Euros

For contracts where payments are to be received in Euros, you could nominate a currency to apply if the Euro no longer exists, or if a particular country pulls out of the Euro, or introduces a second local currency. Ideally, you would choose a currency that is most likely to increase, or at least maintain its value over the term of the contract as the currency that the Euro is to convert to.

The calculation date for the conversion of the currency may be set at a time that is reasonably, prior to the date, on which the trigger is to occur (i.e. the date on which the Euro may cease to exist, or the date upon which a member country of the European Monetary Union may begin to recognise a second form of currency as the legal tender for such country). The reason for this suggestion is that the Euro may decrease in value in the period immediately prior to the trigger date. By setting the calculation date reasonably prior to the trigger date it may reduce the risk of a potentially adverse effect of the currency conversion.

Where payments are to be made in Euros, the provision would ideally be drafted so that it is only to be exercised if the Euro disappears completely, rather than a particular country dropping out of the European Monetary Union or adopts a dual currency system.

Payments made in Euros

Where payments are to be made in Euros, the provision would ideally be drafted so that it is only to be exercised if the Euro disappears completely, rather than a particular country dropping out of the European Monetary Union or adopts a dual currency system. This would allow your business to benefit from the currency drop that is likely to ensue where countries drop out or adopt a dual currency system.

Similarly, the conversion would ideally occur based on the prices at the time of expiry of the Euro rather than a certain period beforehand in order to allow your business to benefit from the currency drop that is likely to ensue in the period prior to the expiry of the Euro.

However, you need to consider the contract as a whole in order to ensure that your position is adequately protected under the contract. For example, the governing law and jurisdiction would need to be reviewed in order to ensure that the contract is subject to a legal system that is likely to enforce such a provision. There may also be a material adverse change provision or a force majeure provision in the agreement. If so, it would also be prudent to ensure that such provision is not drafted so broadly that it is triggered by the break-up of the Euro, a change of currency, or a drastic drop in currency value where payments are to be received in Euros.

Protection against a drop in the value of the Euro by use of derivatives

Regardless of whether the Euro breaks up or not, it is likely that if the tensions keep mounting in Europe, it will result in a significant fall in the value of the Euro.


Melissa Forbes

Mehdi Al Amine, Director, deNovo Corporate Advisors, suggests that foreign exchange derivatives could be used as a solution to protect businesses against the effect of a potential drop in the value of the Euro.

A foreign exchange derivative instrument such as the *Option* is a contract and an insurance, which allows a party to force its counterparty, the bank, to buy or sell a currency (in this case, the Euro versus the US Dollar) for a particular price.

For example, a company is expecting to receive a payment in Euros in one year and, at the time of entering into the agreement, the exchange rate of USD to Euros is USD 1.2750 to EUR 1. As Al Amine explains, the company could pay a percentage of the notional amount as a premium in order to buy the protection and, if the Euro falls, will force the bank in one year to buy the Euros for a pre-agreed level.

If the value of the Euro drops to USD 1.10, at the end of that one year period, the company will be protected from the USD 0.15 currency conversion loss per Euro that it would have otherwise incurred if it had not entered into the derivative agreement.

The cost of hedging the currency varies, depending on the exercise level of the option and other variable factors, but would usually be between 1-5% of the amount to be hedged.

Al Amine advises that "alternative and cheaper solutions are available where the business seeks only to protect itself against a strong depreciation in the Euro, which would correspond to a deepening of the Eurozone crisis, as opposed to a slight and manageable decrease in its value."

A business that employs a prudent risk management policy will want to explore these solutions, given the uncertain times that we face in the Eurozone. ■

About

Melissa Forbes is an Associate in the corporate department of Taylor Wessing. Melissa has advised on a number of cross-border and domestic corporate transactions including mergers and acquisitions, corporate re-organisations, private equity investments, joint ventures and divestitures. She has also advised on a variety of commercial matters relating to issues such as corporate governance, regulatory compliance, management incentive schemes, shareholder disputes, agency and brokerage agreements, licensing, company formations and de-registrations, as well as various commercial and property related disputes.

Melissa is qualified as a solicitor of both the Supreme Court of England and Wales and the Supreme Court of New South Wales in Australia. She can be contacted at *m.forbes@taylorwessing.com.*