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European Law and the Euro

The recent discussions over the high cost of borrowing for certain members of the Eurozone has prompted speculation that one or more of them may seek to leave the Eurozone and adopt another currency.

This article looks at whether it is legally possible under EU law for a member of the Eurozone to withdraw from the single currency and if such a withdrawal were to occur, raises some additional questions about the extent to which such a state would have a free hand in imposing rules and regulations such as capital controls to protect the value of its new currency.

This article focuses on Greece, since it has so far probably been subject to more speculative interest than any of the other members of the Eurozone. However many of the conclusions and observations would apply also to other Eurozone members.

The scenario is examined under the applicable provisions of the:

(1) European Union treaties, which create various obligations of the Member States to each other and establish the authority of the various EU institutions;

(2) the Articles of Agreement of the International Monetary Fund, which set forth the obligations of the individual Member States as members of the IMF and the authority of the Fund;

(3) bilateral investment treaties (BITs) to which individual Member States are a party, and which create protections for (and which are also enforceable by) foreign investors;

(4) the World Trade Organisation (WTO) General Agreement on Trade in Services (GATS), which disciplines the use by the EU and its Member States of regulatory measures that disadvantage foreign financial service suppliers.

Legal reality of an attempt by Greece to leave the euro

There is no provision in EU law for withdrawal from the euro. Adoption of the single currency is an activity integral to the EU's economic policy, not just a choice by those Member States to adopt the euro. Unless, like the United Kingdom and Denmark, they have negotiated express opt-out agreements.[1] Countries which joined the EU more recently but which are not (yet) members of the Eurozone have the status under the Treaty on the Functioning of the

[1] Protocol No 15 (United Kingdom); and Protocol No 16 (Denmark).

European Union (TFEU) of 'Member States with a derogation'.[2] Being a Member State with a derogation is considered a transitional stage pending a decision by the Eurozone members that those countries have fulfilled the criteria for membership.

Article 50 of the Treaty on the European Union (TEU) provides a legal mechanism for withdrawal from the EU, and as a consequence, the euro. More specifically, it provides that Greece may seek to negotiate the terms of its EU withdrawal with other Member States. It further provides that, if agreement is reached, withdrawal takes effect as of the date specified in the agreement. If no agreement is reached, withdrawal takes effect two years after Greece notified its intention to withdraw. It is significant that although the Article 50 procedure would involve negotiation between Greece and the Council, the right to withdraw is effectively unilateral.[3] Greece's complete withdrawal from the EU could not be blocked by other Member States, nor are there any withdrawal conditions that apply unless Greece consents to them. The sole leverage afforded to the Council under the TEU is to force Greece to wait for two years before withdrawal.[4]

Were Greece to withdraw from the EU this would be highly problematic. There would be widespread economic and administrative upheaval across Europe. It is likely therefore that the EU Member States would wish to keep Greece in the EU at least, if not in the euro, perhaps by negotiating a derogation similar to that of the UK's or Denmark's allowing Greece to opt-out of the euro in isolation from the rest of its obligations arising from its membership of the EU. The terms of such negotiation would be informed by political decisions as much as the terms of current legislation.

If negotiations were unsuccessful, Greece were forced to leave the EU as well as the Eurozone and the Eurozone were to disintegrate (as a result of other countries leaving the euro as well) the remaining Member States might be expected to seek an accord, if at all possible, to allow the EU to remain intact in the event of the failure of the euro. Such an accord would require a legal mechanism to manage the dissolution of the euro, the European System of Central Banks, and the European Central Bank, without disturbing the rest of the "European Project" wherever possible.

Interestingly, nothing prevents Greece from leaving the EU and continuing to use the euro as its currency, just as Panama uses U.S. dollars as its currency. Rather, leaving the EU means most immediately, that Greece would no longer be bound by the EU Treaties and European Central Bank (ECB) requirements.

Post-withdrawal from the euro – governing legislation

If Greece withdrew from the euro but remained within the EU and imposed restrictions on the free movement of capital to and from another Member State, the European Commission or another EU Member State would, if the current laws are not changed, have the power to challenge the measure in the European Court of Justice. Individual EU nationals could also potentially challenge Member State measures through national courts and seek injunctive relief, although this has been difficult to obtain in practice.

If Greece were to leave the EU, such challenges would no longer be available. There are however certain other institutions that could exercise control over Greece's economic activities and these are discussed below.

Greece is separately bound as a member of the International Monetary Fund. Although the IMF Articles of Agreement generally permit a member to impose capital controls, these must be limited so that they do not restrict cross-border payments for current transactions and commitments. If Greece seeks to leave the EU, it would be likely to rely heavily

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[2] Article 139(1) of the TFEU.

[3] Article 50(1) provides that "Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements." See Pheobus Anthanassiou, "Withdrawal and Expulsion from the EU and EMU: Some Reflections" European Central Bank, Legal Working Paper Series, No 10, December 2009, at 24.

[4] Further, some commentators hold the view that a right to withdraw existed (and may continue to exist) independently of the procedure set out in Article 50 such that a Member State could withdraw without waiting for two years. That view, however, is based on principles of constitutional and public international law which are not considered in this article.

on the financial support of the IMF and would thus be even more susceptible to pressure from the IMF leadership. The IMF has the power to vote to expel Greece if it is not in compliance with its obligations, supplying a significant incentive for Greece to comply with IMF regulations, at least.

The IMF prohibits "restrictions on the making of payments and transfers for current international transactions" without the approval of the IMF. Thus if having left the EU Greece imposes capital controls without the permission of the IMF, the IMF would consider whether such controls restrict payments and transfers for current international transactions. If the controls do result in such restrictions, and those restrictions persist, Greece could lose the privileges of IMF membership and ultimately its membership in the IMF, which would prove to be a significant disincentive for a Greece without the support of the EU. If, on the other hand, the controls do not result in restrictions which are prohibited by the IMF then Greece would not be subject to such disciplinary measures.

Each of the EU Member States, as well as the EU itself, is also a Member of the World Trade Organisation and is bound by the obligations under the GATS to provide market access to, and not to discriminate against, foreign service suppliers. Thus, if Greece were to leave the euro, the WTO obligations would serve as a source of discipline on capital restrictions even if the EU and Eurozone broke apart (although some of these measures might fit under the GATS "prudential" exception). In contrast to the EU or the IMF, in which the institutions have the authority to enforce treaty obligations, only WTO Member *governments* may seek enforcement of a treaty violation.

Individual EU Member States, including Greece, also have in place bilateral investment treaties (BITs) that protect the rights of foreign investors from government measures that restrict capital movements or discriminate in favour of home country or third-country nationals. Each BIT is somewhat different but generally individual states have BITs that allow foreign investors the right to bring claims for money damages in international arbitration.

BIT remedies could provide substantial leverage for foreign investors as Greece considers the full cost of imposing capital restrictions or discriminatory measures, but could also help companies protect the value of their investments in Europe after such measures are imposed. If Greece were to impose capital controls (e.g. impose limits on the movement of foreign currency out of the country), it may be in breach of a number of BIT protections. For example Greece may be in breach of the free transfers provision, because such a measure may prevent an investor from repatriating profits from, or the proceeds of a sale related to, an investment. Greece may also be in breach of its most-favoured-nation treatment obligations if such restrictions affected only foreign investors and not domestic investors or only certain foreign investors. Greece might also be in breach of its obligations to provide fair and equitable treatment to foreign investors and to provide a stable and predictable environment to the extent that Greece promised investors that it provided a stable environment in which to invest and a foreign investor invested on the basis of such promises.

However, depending on the reasons for imposing such controls, Greece may also be able to invoke the necessity and/or public order defences. In order for Greece to successfully raise such a defence it would have to prove that imposing capital controls was the only way for Greece to safeguard an "essential interest" against "grave and imminent peril" and that such measure "[d]oes not seriously impair an essential interest of the state or states towards which the obligation exists, or of the international community as a whole."[5] Although the fact that a similar defence raised by Argentina has been rejected by most tribunals (or only partially accepted) may provide some comfort.

There are numerous other potential reactions to the situation in the Eurozone, such as:

(i) the euro and the EU remain intact but members of the Eurozone (collectively or individually) take certain measures individually to restrict capital movement in and out of their countries, block access to their capital markets, and/or impose terms and conditions on access to capital that discriminate against foreign nationals;

[5] See International Law Commission's Articles on Responsibility for Internationally Wrongful Act, Article 25(1) ("ILC's Articles on State Responsibility").

(ii) the euro and the EU remain intact but the EU takes measures as a whole, through EU legislation or ECB regulation, that implements capital controls, restrictions on access to capital markets, or discriminatory terms and conditions; and

(iii) the EU and the Eurozone break up because certain Eurozone members leave and create their own common currency.

Finally, it is possible that the EU Member States collectively will seek to interpret the EU treaties in creative ways to address the challenges to the Eurozone; for example by recourse to the "flexibility clause" in the TFEU, or some form of simplified or 'after-the-fact' amendment procedure.

If you would like to talk to us about any of these situations and what they might mean for you, please contact the following Sidley lawyer.

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