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EUROZONE CRISIS - EXPECT THE UNEXPECTED

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The Eurozone debt crisis has caused the (re)insurance market to consider carefully the consequences of the exit of a Eurozone state from the Euro and a re-denomination into a replacement local currency.

Any withdrawing state would be likely to enact new laws making compulsory the re-denomination of contractual payment obligations governed by local law into a new replacement local currency, as well as requiring payments into that state to be in the new local currency. The governing law and jurisdiction which applies to such contracts will be crucial in determining the impact upon (re)insurance contracts of such re-denomination provisions.

(Re)insurance contracts governed by express local law and jurisdiction clauses will have to comply with any local laws on re-denomination into any new currency, which will be difficult to avoid as they are likely to trump any currency conversion or re-denomination clauses providing for other harder currencies (e.g. Euro, GB Pounds, US Dollar). However, even where (re)insurance contracts incorporate express English choice of law and jurisdiction clauses, issues may nonetheless arise because of two conflict of laws principles.

Firstly, there is the internationally recognised principle of *lex monetae*, by which the choice in a contract of a particular currency is taken to imply a choice of the law of the country of that currency to determine, where necessary, what that currency is or may re-denominate into. In the current context of the risk of re-denomination into a replacement local currency (e.g. Euros back to Spanish Pesetas), issues may arise as to whether an English court, in applying this principle, should regard the choice of the Euro in a contract as a choice of the law of a particular Member State or a choice of the law of the Eurozone as a whole. To avoid such difficulties, currency fluctuation or conversion clauses, which provide either that the contract will be in Euros only or will be converted into other harder currencies such US Dollars or GB Pounds on any re-denomination, should be incorporated into policies. Such clauses should

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also address what rate of exchange will apply.

Secondly, there is the principle known as *lex loci solutionis*, whereby under Rome I Regulation, art 9(3), English courts may also give effect to the overriding mandatory rules of the law of the place of performance of a contract (i.e. the *"lex loci solutionis"*). In doing so, courts have the discretion to render performance unlawful if payment of a claim under a contract in, for example, Euros is unlawful in the country in which payment must be made. Possible solutions here include incorporating clauses which require payment to be made to a party (e.g. a broker) outside of the country of the Member State which is at risk of currency re-denomination. It would be sensible to incorporate such clauses before any re-denomination takes place.

The prospect of re-denomination presents various uncertainties, and parties to potentially impacted contracts may wish to act now to mitigate any future impact. With a view to avoiding exposures, parties should consider revising their contracts as above so as to avoid those EU states which are perceived as higher risk. In the case of existing contracts, this may be achievable by endorsement. In the case of new contracts, by express provision. Where necessary, standard market clauses can be modified for these purposes. They should also consider including contract continuity clauses, which maintain the validity of the contracts in the event of a Eurozone re-denomination.

Whilst re-denomination could impact contractual obligations, it will also of course affect counter-party and investment risks. In that context, parties to (re)insurance undertakings must consider minimising their exposure through careful negotiation of their future and existing contracts, with a particular focus on governing law, jurisdiction, currency conversion, validity and place of performance provisions.

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