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Contractual risk during the Greek crisis: Do capital controls qualify as force majeure?

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Introduction

Sunday, 28 June 2015: A number of measures imposing a short-term bank holiday and capital controls are put into effect by the Greek legislator. The duration of these extraordinary measures was initially set to eight days. Three months later, the bank holiday has been terminated; nevertheless, capital controls, while partially relaxed, have become part and parcel of daily transactions in the debt-struck EU Member-State. With Greek banks bleeding cash and deposits draining from an overwhelming flee of assets over the months preceding capital controls' imposition, the legislator's primary concern has been the prevention of bank deposits' depletion and the domestic banking system's collapse.

In this context, the objective of capital controls has been the rigid limitation of domestic capital flow out of Greece. Transfer of funds to bank accounts held abroad is according to current legislation only possible on particular grounds and subject to approval by the Banking Transactions Approval Committee and the competent Special Subcommittee founded in each of the Greek banks. Practice has already demonstrated that such possibility, while theoretically in place, cannot meet the needs of business reality. With thousands of applications pending before the Committee or the aforementioned Sub-committees, performance of contractual obligations when the

latter concern payments to bank accounts held abroad is severely hindered resulting in uncertainty as to the future of the impacted contractual relationships.

The present note aims at providing an overview of the key legal issues arising out of the payment restrictions that have been imposed by virtue of capital controls legislation in Greece. To be more precise, following introductory clarifications as to the concept of force majeure in Greek civil law (I.) and the particular content of capital control measures currently in force (II.), we tackle the issues of legal qualification of the impediments caused by the mentioned capital controls with regard to the performance of contractual obligations (III.), and the consequences of these impediments (IV.). Having regard to the assumptions drawn from our analysis as regards existing contracts, we highlight a number of points to be taken into consideration by potential counterparties in future contracts (V.). We should stress from the outset that for our analysis we have assumed that Greek law is applicable to the relevant transaction.

I. Failure to perform due to force majeure

Under the relevant provisions of the Greek Civil Code, failure of a party to perform its contractual obligations is excused, i.e. such party is relieved

from liability, inter alia if said failure is not due to the party's fault, but can be attributed to events constituting force majeure. The concept of force majeure has been formulated through case law to encompass extreme events that could not have been contemplated and prevented by the debtor even by measures of extreme diligence.

The aforementioned definition applies when parties have not included a specific force majeure clause in their contract. Depending on the intent of the parties as to the extent of risk assumption that they wish to undertake, they may adopt a narrower or wider concept of force majeure formulating the wording of the relevant clause accordingly.

II. Capital control measures currently in force

For the purposes of this note we shall limit our analysis to the capital control measures pertaining to the limitation of effectuating payments from Greek bank accounts to bank accounts held abroad. According to the respective regulatory legal framework currently in force, transfer of funds to bank accounts held abroad is possible, albeit subject to strict conditions.

More specifically, following an application submitted by the interested party the requested transaction has to be approved by the competent Special Sub-committee of the respective Greek bank, which examines its necessity for the protection of public or social interest. Transactions relating to payment of medical expenses, tuition fees and living expenses of students studying abroad are recognized as serving the aforementioned interest. Additionally, the Special Sub-committee examines the applications of legal entities and entrepreneurs concerning the effectuation of payments on the basis of adequate documentation e.g. invoices, pro-forma invoices, bills of lading, within a daily limit of 100.000 € per client and within the limit that the Special Sub-committee announces for each bank.

As a guideline to the Sub-committees the legislator provides for three priority categories depending on the kind of goods and services imported to Greece, for which the respective payment to a bank account held abroad is requested. Medicinal

products, fuels and energy, food and perishable products, materials for the packaging of the mentioned products are for example designated as first priority.

Despite the existing afore-described legal framework, practical reasons, such as the massive amount of pending applications, have caused significant delays in the approval procedure, thus raising issues of frustration of contractual performance and of force majeure.

III. Legal qualification of impediments created due to the enacted capital control measures

Frustration is present if performance of the debtor's obligations has become impossible. Such impossibility has to be definitive, and is considered as such when according to common experience under the particular circumstances the critical impediment cannot be lifted within a time frame considered proper pursuant to the purpose of the contract. While capital controls imposing restrictions on bank transfers outside Greece can be considered an exceptional event that could not have been foreseen or prevented, it remains doubtful whether they could indeed qualify as circumstances leading to contractual frustration. Force majeure events render performance of obligations impossible, and force majeure clauses work as a mechanism of relief for the debtor. In the case of Greek capital controls however, assuming that the debtor does not hold a bank account with sufficient funds in a foreign bank, trans-border payments remain possible subject to the restrictions mentioned above. Only if approval of the transaction by the competent Sub-committee is denied or delayed to an extent that effectuation of the payment is rendered obsolete in view of the purpose of the particular contract, one can speak of force majeure and frustration of contractual performance. Last but not least, depending on whether the parties have included a material adverse change provision in the contract, imposition of capital controls may constitute a ground for termination of the contract.

IV. Legal consequences of the impediments on the affected parties' contractual relationship

Force majeure is considered a measure of relief for the debtor facing the relevant impediment in performing his obligations, allowing such debtor to evade liability for non-performance. In lieu of his primary obligation to perform the debtor bears the collateral obligation to inform the creditor of the event of impossibility as soon as he acquires knowledge thereof, otherwise he is liable to compensate the creditor for any prejudice caused by such omission. Additionally, the debtor can be requested to provide the creditor with the “surrogatum”, that is any benefit obtained by the debtor because of the impossibility, e.g. amount of insurance compensation. Notably, the “surrogatum” can be claimed only if the creditor’s counter-obligation has been performed pursuant to the contract. Otherwise, both parties are released from their contractual obligations.

V. Issues to be considered in future contracts

Evidently, the wording of the contractual provisions applicable in each particular case is of paramount importance. Depending on whether the parties have included a force majeure provision and their choice of a stricter or more lenient wording in that respect, impediments caused by capital controls imposition may qualify as force majeure, even if they merely render performance of an obligation more difficult than it would normally be, but not impossible. The parties’ intent is of particular significance for the interpretation of the respective clauses in case a dispute arises.

In view of the established factual precedent, potential counterparties should weigh the respective interests and attribute the commercial risk among them with precision by adopting force majeure clauses that are worded so as to reflect said risk attribution. Material adverse change clauses are equally important, as they may provide the parties with a legal basis for immediate termination of the contract in case of circumstances such as escalation of capital controls.

Conclusion

Not surprisingly, a “one-size-fits-all” answer to the question of legal qualification of capital control

measures limiting trans-border bank transfers cannot be provided. On the contrary, the answer depends heavily on the wording of any force majeure and material adverse change clauses in place as well as the ad hoc circumstances. On the face of it, absent any particular contractual provision providing otherwise, imposition of capital controls does not qualify as force majeure, given that the relevant legal framework principally allows the effectuation of trans-border payments subject to approval. It is nevertheless possible that the capital control measures’ practical application may give rise to force majeure circumstances, if it results in impracticability of the debtor’s contractual performance.