UNIVERSIDADE CATÓLICA PORTUGUESA
Faculdade de Direito // Católica Lisbon School of Business & Economics

EURO SECESSION AND BONDHOLDERS

IN WHICH CURRENCY WILL THEY GET PAID?

ISABEL CARNEIRO

MESTRADO EM DIREITO E GESTÃO
MASTER IN LAW AND BUSINESS

A dissertation submitted for the degree of Master of Law, under the orientation of
Francisco Barona, Master in Law

Lisboa, 27 March 2013

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Abstract

In the hypothetical scenario of secession from the Eurozone, this dissertation explores the legal implications of the new national monetary regime for investors in Euro-denominated debt securities.

Different withdrawal scenarios are considered in light of the European Union legal framework. Rome I and Brussels I Regulations are looked at from the perspective of the conflict of law solutions they offer regarding the effectiveness of choice of law and jurisdiction agreements when confronted with mandatory redenomination rules imposed by an exiting State. Furthermore, monetary law principles are presented as key tools for an assessment of the legal protection conferred to investors in Euro-denominated bonds, as regards their expectations to be paid in Euros, rather than in the new national currency.

This dissertation also includes a brief review of the monetary legal principle of nominalism from an economic theory perspective.

CONTENTS

Introduction

Even before the launch of the Eurozone on 1 January 1999 there was speculation around the possibility of its *break-up*[1].

Despite vehement refusal to acknowledge a potential failure of the single currency project by the high representatives of the European institutions and authorities[2], at least since the first bailout of Greece in 2010, the future of the Euro seems to be on the *razor's edge*. More recently, negotiations of a rescue package for Cyprus have once again put the Euro crisis in the spotlight.

In 2007, EICHENGREEN considered "unlikely that one or more members of the euro area will leave in the next ten years and that total disintegration of the euro is more unlikely". Through the economic turmoil experienced internationally since September 2008, and the ongoing sovereign debt crisis in the Eurozone, the arguments presented by the cited author for predicting a Eurozone *break-through* seem to remain valid. Actually, a Euro country considering the possibility of withdrawal from the EMU should not neglect "the technical difficulties of reintroducing a national currency" nor the economic indicators that despite the potential short-term economic advantages to be expected, there are likely "longer-term economic costs, and political costs of an even more serious nature"[3].

However, the financial markets in the Eurozone appear to be fragmented in the aftermath of the financial crises spurred by the Lehman Brothers bankruptcy, in September 2008, and there are recurrent concerns about the continuity of the less competitive countries in the common currency area.

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[1] See LASCELLES (1996); and SCOTT (1998).

[2] As highlighted by Mario Draghi in a recent speech: "[…] in the first half of last year [2012] fragmentation in the euro area had become so serious that some investors were questioning the future of our currency [and therefore] we acted to remove the unfounded fears about the future of the euro area that were undermining the stability of our currency". See Speech by Mario Draghi, President of the ECB, at the Katholische Akademie in Bayern (Feb, 2013) (http://www.ecb.int/press/key/date/2013/html/sp130227_2.en.html).

[3] © EICHENGREEN (2007) pp 1-2.

Thus, it seems appropriate, even if a sensitive matter, to analyse the hypothetical scenario of one country – say, Portugal – pulling out of the Eurozone. Being that the case, Portugal's monetary sovereignty would be restored, leading to the reintroduction of a national currency, with the option of its devaluation to the Euro, thereby enhancing the Portuguese competitiveness internationally. As a consequence, the Portuguese debt would be redenominated in the new currency at the initial conversion rate fixed by the Government. Furthermore, this process will likely coincide with monetary protective measures, including exchange and capital controls.

The redenomination of debt will extend to sovereign debt, as well as to Euro-denominated bonds and other debt securities issued by Portuguese corporate issuers.

Investors in these bonds will be looking to secure outstanding interest payments and capital redemption in Euros as a means to avoid the expected rapid depreciation of the new currency against the Euro. Conversely, admitting that most of the Portuguese corporate issuers' assets and revenue will have been converted into the highly depreciated domestic currency, issuers will find it extremely difficult, if not impossible, to fulfil their financial commitments in Euros.

Assuming the Eurozone will not break-up as a whole, and hence that the Euro will continue to exist, this dissertation explores the legal implications of a putative transition from the EU monetary system to a domestic monetary system for investors in Euro-denominated bonds issued by Portuguese companies.

This discussion is particularly relevant with regards to Euro-denominated bonds which have been submitted to a foreign governing law and jurisdiction, namely those of England, in light of the actual 'location' of the transaction, i.e. the place of payment of interest and capital under the bonds, register, settlement and admission to trading of the securities, the relevant supervisory authority, domicile of the investors, to name only a few (potentially relevant) connecting factors.

Different withdrawal scenarios are considered in light of the European Union legal framework. Rome I and Brussels I Regulations are looked at from the perspective of the conflict of law solutions they offer regarding the effectiveness of choice of law and

jurisdiction agreements when confronted with mandatory redenomination rules imposed by an exiting State. Furthermore, monetary law principles are presented as key tools for an assessment of the legal protection conferred to investors in Euro-denominated bonds, as regards their expectations to be paid in Euros, rather than in the new national currency.

This dissertation also includes a brief review of the monetary legal principle of nominalism from an economic theory perspective.

The topics discussed are selected and presented with the purpose of providing a legal background for the discussion of different problems that Portuguese issuers of Euro-denominated bonds and the respective investors may encounter in the future, if Portugal withdrew from the Eurozone.

1. Is withdrawal from the Eurozone possible under the EU Treaties?

The decision for Portugal to enter the Eurozone was a political decision, and, similarly, a decision from the Portuguese Government to drop-out of the Euro would be taken at a political level as well. The causes for such a decision are not relevant for this discussion.

This Chapter analyses the legal framework of a hypothetical withdrawal from the monetary union, with the purpose of providing sufficient background for the discussion of the impact of mandatory redenomination imposed by an exiting country on Euro-denominated bonds.

If Portugal left the Eurozone, this would give rise to practical difficulties around the performance of monetary obligations denominated in Euros with a relevant connection with the Portuguese territory, and specifically as regards the payment of principle and interest under the Euro-denominated Bonds. The expected difficulties will require a legal solution.

This Chapter explores three possible withdrawal scenarios: *(i)* voluntary withdrawal from the Economic and Monetary Union within the framework of the EU Treaties[4]; *(ii)* non-consensual unilateral withdrawal; and *(iii)* withdrawal negotiated at a political level and legitimated by a Treaty amendment.

The analysis carried out below is based on the assumption that a Member State's withdrawal from the Eurozone would be done at the initiative of that Member State. However, the contrary could also happen. The Eurozone might feel the urge to expel one of the Euro countries, *eg* "where the economy of the individual State has ceased to be comparable with that of the Eurozone as a whole, such that it threatens the effective conduct of monetary policy and the cohesion of monetary union itself"[5]. In the words of ATHANASSIOU, this scenario "would be legally next to impossible"[6].

[4] Unless stated otherwise, references to articles of the Treaties shall refer to their current versions.

[5] PROCTOR (2005), p 775. See further PROCTOR (2006), pp 934-937.

[6] ATHANASSIOU (2009), p 24; see further pp 31-39.

Only withdrawal by one or more Member States will be explored, and not the possibility of collapse of the Eurozone as a whole.

1.1 Withdrawal under the EU Treaties

The direct answer to the question of whether or not withdrawal from the Eurozone is possible under the EU Treaties is *no*, as the Treaties do not expressly contemplate the right of withdrawal from the EMU by one of its member States.

It is apparent from the Treaty of Maastricht of 1992, which laid down the foundations of the EMU, that the European Union aimed for the adoption of the single currency by all its Member States from the very beginning[7].

Since its outset, the implementation of the monetary union was seen as a one way road. Article 123(4) of the EC Treaty stressed the *irrevocability* of the transition from the former national currencies to the Euro. Furthermore, the *irreversibility* of the adoption of the single currency was declared by the Protocol (No 24) on the transition to the third stage of economic and monetary union (1992) annexed to the EC Treaty[8].

Withdrawal under the Treaty of Lisbon

The signing of the Treaty of Lisbon was the first formal and express recognition of the scenario of a possible secession of the European Union by the Member States (Article 50 of the TEU)[9].

The Member States sought to establish a voluntary right of withdrawal in identical terms in 2004 when they signed the Treaty establishing a Constitution for Europe (the

[7] See the first indent of Art B of the Treaty of Maastricht, which refers to the "establishment of economic and monetary union, ultimately including a single currency" as a main objective of the EU. See further Arts 3a(2) and 109j-l of the 1992 EC Treaty (92/C 224/01). For an analysis of the Treaty of Maastricht, see PITTA e CUNHA (1999), pp 34-45.

[8] Art 123(4) and the Protocol were repealed by the Treaty of Lisbon.

[9] Art 50(1) states as follows: "Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements".

"Constitution")[10]. Given that ratification of the Constitution was unsuccessful, negotiations followed for the adoption of an amending treaty instead, which was agreed and signed in Lisbon in December 2007.

Pursuant to the mentioned exit clause, the decision of the Member State is unilateral and unconditional, its effectiveness not being dependent on the consent from the other Member States or the verification of any requirements of EU law[11]. Member States are the "masters of the treaties" and their constitutional provisions constitute the only limitation to the exercise of the withdrawal right.[12].

However, does Article 50 allow a separate withdrawal from the EMU? The answer is *probably not*. Article 50 grants a discretionary power to the Member States to choose to be in or out of the EU as a whole, the so-called 'all-or-nothing approach'[13]. If a Member State decides to withdraw from the EU, it will necessarily drop-out of the EMU as well, since the latter is a mere subset of, and subject to, the former. The possibility to leave the EMU whilst remaining in the EU, in contrast, is neither expressly nor implicitly contemplated.

The a fortiori *argument*

On the face of the silence of the EU Treaty exit clause, under the general principle of law *a maiore ad minus*, or the *a fortiori* argument, the provision that allows the greater, i.e. the voluntary exit of a Member State from the EU, should also permit the smaller, i.e. that a Member State wishing to remain in the EU could simply drop out of the EMU.

[10] Constitution Art I-60. See, *eg*, GALVÃO TELES (2005), p 890.

[11] It is possible, although perhaps unlikely, that withdrawal becomes effective 2 years following due notification by the exiting Member State regardless of an agreement being achieved with the EU (TEU Art 50(3)).

[12] On the topic of State primacy, see FRIEL (2004), pp 422-428. For a succinct presentation on the Member States' approach over the years to the potential evolution of the EU from an economic to a federal union, see, *eg* PITTA e CUNHA (2011), pp 965-975.

[13] HOFMEISTER (2011), p 132.

However, a broad construction of Article 50, allowing a country to exit the EMU while remaining in the EU, does not seem to be correct in the light of an historical, teleological and systematic interpretation of this provision.

As mentioned, the establishment of the EMU is one of the main objectives of the EU[14]. This does not set out to be a mere programmatic guideline, rather they are mandatory and legally binding on the EU and on each Member State[15].

The Treaties envisage the participation of all Member States in the EMU, with the exception of the UK and Denmark which have negotiated opt-out rights since the conception of the Eurozone. The other Member States that have not adopted the single currency yet, the so-called Member States with a derogation, are required under the Treaties to make progress towards the fulfilment of the necessary criteria for the accession to the third and final stage of the EMU, i.e. the transition from their national currencies to the Euro[16].

Furthermore, the Treaties give clear instructions to the competent EU institutions and authorities, including the ECB, to ascertain, on a regular basis, and make a decision on whether Member States with a derogation have achieved a state of compliance with the standards required for the adoption of the single currency[17]. If the conclusion is that they have satisfied the conditions necessary to join the Eurozone, the Council shall abrogate the derogation. This results in the concerned Member State automatically acceding to the EMU[18]. The opt-out States are subject to different rules and will only adopt the single currency on a voluntary basis.

Under the EU Treaties, the 'derogation' status is precarious as all of its holders are required to evolve to a complete monetary integration. Therefore, despite the right to voluntarily enter or exit the EU, from the moment a Member State chooses to be in the EU it will have to comply with the Treaties including complying with the obligation to

[14] TEU Art 3(4) and TFEU Art 119.

[15] HOFMEISTER (2011), p 129.

[16] TFEU Art 40(1).

[17] TFEU Art 140(1).

[18] TFEU Art 140(2).

participate in, or make its way to joining, the Eurozone. Failing to do this would place a Member State in breach of its Treaty obligations.

The risk of cherry-picking

The possibility of withdrawal from the EMU whilst remaining in the EU could result in different stages of integration for each Member State as it would open the gate for the so-called 'pick and choose' approach to Treaty obligations, which is in clear contradiction with the 'integrity' and 'sustainability' of the EU[19]. Selective withdrawal from different subsets of the EU by the Members States would also set off (lack of) transparency issues.

The evident counterargument is that it is against the goal of integration to let a Member State go against its will if the only reason for secession is the need to regain the control of monetary policy[20].

In conclusion, under the current framework of the Treaties, it looks as if the only way out for a country wishing to exit the Eurozone is to withdraw from the EU altogether, making use of the exit option granted by Article 50.

1.2 Withdrawal negotiated at a political level

Pulling out of the EMU would have implications not only for the exiting State, but also for the remaining Member States, including the opt-out States.

A Member State intending to pull out of the EMU may try to negotiate the withdrawal process with the other Member States at an institutional level.

While negotiating the withdrawal agreement, the exiting State would be aiming for recognition of an identical status under the Treaties as that conferred to the opt-out States, i.e. a sort of a 'retrospective opt-out'[21].

[19] ATHANASSIOU (2009), p 39-40.

[20] HOFMEISTER (2011), p 131.

The introduction of the necessary amendments to permit independent secession from the EMU will implicate a renegotiation of the Treaties, and the consent of all Member States. Again, this stems from the fundamental premise that the Member States are and shall remain 'the masters of the treaties'[22].

Such an amendment to the Treaties could follow the simplified revision procedure laid down by Article 48(6) of the EU Treaty. Accordingly, the exiting State would need to submit a proposal to the European Council, thereby requesting the revision of the Treaty provisions respecting the EMU[23]. The proposal shall be adopted upon unanimous decision by the European Council, after consulting the Parliament, the Commission, and the ECB. Any changes to the Treaties would only enter into force after approval by all Member States.

The withdrawal agreement would need to set the terms of the new status of the exiting State within the EU.

Note that the remaining Member States are not required under the Treaties to consent to a withdrawal from the EMU. Depending on the financial implications of such departure, negotiations of a price for the withdrawal agreement are likely to be commenced[24]. And as someone has observed, the critical point of the negotiations will probably be the agreement on the initial redenomination rates[25].

Reaching an agreement within the EU might not be an easy task considering the entrenched concept of irreversibility of the EMU project. This was highlighted by the former President of the ECB, Jean-Claude Trichet: "One cannot jump in and jump out of the euro area as one hops on and off from a bus. Participation in EMU commits the destiny of a country"[26].

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[21] *Idem*, p 130.

[22] PROCTOR (2005), p 774.

[23] TFEU Title VIII of the Part 3.

[24] PROCTOR (2005), p 775.

[25] GEORGIEV (2010).

[26] Interview with Jean-Claude Trichet, former President of the ECB, 9 April 2010 (http://www.ecb.int/press/key/date/2010/html/sp100409_1.en.html).

1.3 Non-consensual withdrawal

Given that voluntary withdrawal from the Eurozone is not possible within the Treaties framework, and assuming a putative scenario where a consensus is not reached regarding the amendment of the Treaties, hypothetically, a country under financial and economical distress may be compelled to make the drastic decision of pulling out of the EMU in breach of its Treaty obligations.

As a result, it would recuperate sovereign power over its monetary system. After the introduction of a new national currency, the exiting State would be able to devaluate it as a means to enhance international competitiveness of its economy. In doing so it should expect to achieve a reduction of the country's current account deficit[27].

However, the implications of a non-consensual withdrawal are very hard to anticipate.

[27] Please note that other factors may concur to such devaluation, including the lack of confidence of other countries and of the creditors regarding the new currency.

2. The law applicable to contractual obligations in the context of cross-border debt securities transactions

2.1 The conflict of laws and the freedom of choice

The conflict of laws, also referred to as international private law, is the branch of a national legal framework that deals with those situations that have a *foreign element*. A foreign element can be any point of contact with a different jurisdiction, either in terms of the parties' residence, the location of the object of the transaction or the place of performance of obligations[28].

The object of the conflict of laws is not domestic transactions, as there is no role for it to play without the confluence of at least two different jurisdictions. When applied to contract law, the conflict rules determine which national law shall govern the rights and obligations arising from international contracts, i.e. containing a foreign element.

The law applicable to contractual obligations in the context of cross-border transactions benefits from the long established and broadly accepted freedom of choice principle, recognised by modern legal systems[29], unlike proprietary rights, which are yet to gather consensus at international and European levels and have triggered competing conflict of law theories[30].

Two simple explanations may be at the origin of the early acceptance of the freedom of choice principle applied to contractual obligations. On the one hand, it has proven to be extremely difficult, if not impossible, to establish one objective criterion that fits all contracts in general or even specific criteria for different categories of contracts. On the other hand, the ability of the parties to pick out the law which better suits them and to

[28] DICEY (2006), Vol 1, p 3.

[29] LIMA PINHEIRO (2009), Vol 2, p 266; and FERRER CORREIA, in RBDC (1990), p 4.

[30] See BRIGGS, "Agreements on Jurisdiction and Choice of Law" (2008), p 400.

rely on that law to govern their legal affairs is a corollary of the party autonomy principle, a fundamental cornerstone of contract law[31].

Today it is generally accepted that the parties have the right to choose any law they deem most suitable to govern their contractual relationships despite the lack of objective connection between the chosen law and the facts of the contract. Moreover, the parties can agree on a foreign law to govern a contract of purely domestic nature. This has not always been the case though. In the not too distant past the legislature, judiciary and doctrine in civil law countries required the presence of a foreign element as a condition to the prerogative of the parties to choose a foreign law to govern their contracts[32]. Common law, however, has never imposed such a constraint to the exercise of autonomy by the parties[33].

In England, and in other common law countries, it eventually became common ground that the parties' choice shall not be overridden unless the parties did not enter into the agreement for *bona fide* reasons, the choice of law is illegal or on the grounds of public policy issues[34].

At EU level, the freedom of choice was consolidated as a principle of law following the implementation of the Rome Convention. It is now enforceable as a matter of EU law in accordance with the Rome I Regulation and applicable to contracts entered into force as from 17 December 2009.

Consensus has developed around the idea that *legal certainty* and *predictability* are the foundations and the ultimate mission of conflict of law principles, rules and techniques (the conflict of laws 'toolkit' as BRIGGS puts it[35])[36].

[31] See FERRER CORREIA, in RLJ (1990), p 291; and BRIGGS, "The Conflict of Laws" (2008), p 155.

[32] See FERRER CORREIA, in RLJ (1990), p 363; and DICEY (2006), Vol 2, pp 1560-1561.

[33] BRIGGS, "Agreements on Jurisdiction and Choice of Law" (2008), p 381.

[34] DICEY (2006), Vol 2, pp 1560-1561.

[35] BRIGGS, "The Conflict of Laws" (2008), Preface.

[36] See LIMA PINHEIRO (2009), Vol 2, p 266.

Confirming that idea, DICEY states that "the main justification for the conflict of laws is that it implements the reasonable and legitimate expectations of the parties to a transaction or an occurrence"[37].

2.2 The Rome I Regulation

EU Member States felt the need to replace the Rome Convention with the Rome I Regulation[38] in order to promote the internal market by improving "*predictability* of the outcome of litigation, *certainty* as to the law applicable and the free movement of judgments, for the conflict of law rules in the Member States to designate the same national law irrespective of the country of the court in which an action is brought"[39].

The material scope of Rome I is laid down by Article 1(1), its applicability being limited to those "situations involving a conflict of laws, to contractual obligations in civil and commercial matters"[40].

Rome I is in force both in Portugal and in the United Kingdom.

The UK was not convinced by the preliminary versions of the document. On that basis, it made use of its opt-out right, thus the reference in the final text of Rome I that "the United Kingdom is not taking part in the adoption of this Regulation and is not bound by it or subject to its application"[41].

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[37] DICEY (2006), Vol 1, p 4.

[38] Unless stated otherwise, mentions in this Chapter 2.2 to specific articles or recitals should be read as references to Rome I.

[39] Recital 6.

[40] Regarding the interpretation of 'contractual obligations' in the context of Rome I, it is useful to bear in mind that "the European Court has confirmed that the concept of 'matters relating to a contract' is to be regarded as an independent concept, and is not to be tested simply by reference to national law. [...] contractual obligation [is] by its nature one which is voluntarily assumed by agreement". DICEY (2006), Vol 2, p 1547.

[41] Recital 45.

In fact, the final text of Rome I did not introduce changes to the fundamental principles and structure of the Rome Convention, the Government having concluded that the UK should therefore opt in[42].

Freedom of choice applied to contractual aspects of securities

It is very uncommon that the parties to cross-border securities transactions do not expressly establish the respective governing law. Making use of the Latin expression, the parties choose the *lex causae* of their legal relationships. Thus, no account will be taken of the fall-back provisions of Rome I regarding the law applicable to contractual obligations, this discussion being exclusively focused on the freedom of choice principle and its limitations.

Under Rome I, the parties may choose the law applicable to their contractual rights and obligations, which shall be expressed in the contract or at least capable of being demonstrated[43]. The parties may pick out one law to rule their rights and obligations or as many as they wish to govern different parts of the contract. Further, there are no limitations in terms of the array of laws the parties are allowed to pick from: the parties may choose the law of whichever jurisdiction they like, whether or not such jurisdiction links back in any way to the contract, without any need to justify their choice. The only general limitation is that the choice should be made for *bona fide* reasons, whichever they may be, and not have a fraudulent purpose[44].

Pursuant to Article 6(4)(d), the consensual terms and conditions of financial instruments, including bonds and other debt securities[45], are subject to the freedom of choice primary conflict under Rome I[46]. This ensures that the rights and obligations

[42] A formal decision of the EU Commission (2009/26/EC, 22 Dec 2008) was subsequently issued extending the entering into force of Rome I to the UK.

[43] Art 3, Recital 11.

[44] See LIMA PINHEIRO (2009), Vol 2, p 267; and FERRER CORREIA (2007), pp 421 sqq.

[45] Art 4 of the MiFID *ex vi* Recital 30.

[46] This stems from the need to avoid the applicability of different laws to each of the securities issued, depending on the residence of their respective holders, thereby securing uniformity of legal regime and fungibility of each series. See Recitals 26 and 28. The Rome Convention did not establish this exception (see Art 5). However, the definition of consumer contracts under the Rome Convention had a specific mention to supply of 'goods' and 'services'. Securities were not considered 'goods', and therefore the rules on consumer contracts were not applicable to them. See the Giuliano-Lagarde Report in this respect.

arising from an issue of debt securities, namely all aspects of the relationship established between the issuer and the investor[47], shall be governed by the law chosen by the parties at the time of issuance[48].

It has been argued that the exception introduced by Article 6(4)(d) was unnecessary because of Article 1(2)(d)[49]. This is not correct though as Articles 6(4)(d) and 1(2)(d) refer to two different realities: the former relates to an exception to the application of the stricter rules concerning consumer contracts, whereas the latter sets out an exclusion to the material scope of Rome I.

Furthermore, Article 1(2)(d) has a limited reach – it excludes from the scope of Rome I the obligations relating to, and arising out of, the negotiable character of the instruments, and not the negotiable instruments altogether[50]. It is worth noting the Giuliano-Lagarde Report on the Rome Convention affirmation that "neither the contracts pursuant to which such instruments are issued nor contracts for the purchase and sale of such instruments are excluded". This is also true for Rome I.

It is apparent from the text and structure of Rome I that negotiable instruments, including, among others, bonds and other debt securities, are within its scope of applicability, their terms and conditions being subject to the freedom of choice principle as a result of the exception laid down by Article 6(4)(d). Thus, falling within the scope of Rome I are those "legal questions concerning the nature, validity and content of the underlying rights represented by the instrument (*eg* the right to payment of principle and interest under the bond), and the obligations of the issuing party, as enforceable against that party by the original holder"[51].

On the differences between the Rome Convention and Rome I as regards financial instruments, see, "The Law of Cross-Border Securities Transactions" (1999), p 82; and ALFEREZ (2009), pp 85-91.

[47] Recital 26.

[48] Without prejudice to the right to subsequently agree on a different law (Art 3(2)).

[49] See ALFEREZ (2009), p 91.

[50] This exclusion is limited to "questions concerning the transfer of those rights to another person (the 'holder') by the 'negotiation' of the instrument so as to entitle the holder to enforce the original obligations to the issuing party". DICEY (2012), Vol 2, p 2099.

[51] DICEY (2012), Vol 2, p 2099.

As regards the currency in which the securities are denominated we should be able to affirm with a comforting degree of certainty that the freedom of choice principle endorsed by Rome I shall apply to its full extent[52].

The fundamental question is, however, whether the freedom of choice rule established by Rome I will suffice when it comes to securing the investors in Euro-denominated bonds with a connection with Portugal, *eg*, the issuer, from a mandatory redenomination of debt decreed by the Portuguese Government in case of secession from the Eurozone, even in those cases where the English law is expressed to govern the bonds[53]. This topic will be explored in Chapter 2.3.

Scope of the law applicable under Rome I

Article 12(1)(c) states that "within the limits of the powers conferred on the court by its procedural law, the consequences of a total or partial breach of obligations, including the assessment of damages in so far as it is governed by rules of law". This rule leaves it to the governing law of the contract to determine the consequences of a breach of obligations. This adds to the safeguard of the effectiveness of the governing law clause, especially where it is combined with a choice of jurisdiction clause. Article 12(1)(d) also supports the predominance of a foreign governing law concerning "the various ways of extinguishing obligations".

Article 12(2), however, favours the application of the laws of the country where performance takes place "in relation to the *manner of performance* and the steps to be taken in the event of defective performance"[54].

This provision might be relevant for an issue of bonds under which payments of interest and capital reimbursement are set to be made to accounts domiciled in Portugal. Thus, under Article 12(2), notwithstanding the *lex causae* being the English law, account shall

[52] Except in those cases covered by Art 3(3), *eg*, as a result of monetary protective measures.

[53] For an analysis of the concept of foreign bonds ('*obrigações estrangeiras*'), see PIRES (2001), pp 34-38.

[54] According to NUSSBAUM, the currency in which payment obligations under financial instruments shall be discharged are "merely a question of 'manner of payment'". NUSSBAUM (1950), pp 360 sqq. See further LIMA PINHEIRO (2009), Vol 2, p 324.

be taken of the Portuguese law as regards *the manner of performance* of payment obligations under the bonds.

2.3 Limitations to choice

The starting point of this discussion is the freedom of choice principle. This is the rule, in principle, and in most cases the judge will indeed give effect to the choice of the parties, as they are instructed to under the conflict of laws.

There are exceptions to this principle though which can significantly hamper the effectiveness of the *lex causae* defined by the parties. This Chapter 2.3 explores these limitations.

2.3.1 *Lex fori* and public policy

Lex fori

Courts may be directed by their domestic laws, i.e. the *lex fori*, to decide against the parties' express will, i.e. disrespecting the *lex causae*.

Let us focus on limitations introduced by the national law of the courts where a dispute resolution hearing related to the contract takes place.

It should be made clear that the law of the forum does not have the power to hinder the parties from making a free choice of governing law. Freedom of choice is a given. The *lex fori* limitation is a consequence of a 'dialogue' established between the legislature and the judiciary of the country with jurisdiction over any disputes relating to the contract[55].

Acting as the recipient of this dialogue, the judge will take account of the parties' choice, as per applicable conflict of law rules, but only to the extent it is allowed to do so by domestic law. Consequently, the result of a choice of law clause might not always

[55] See BRIGGS, "Agreements on Jurisdiction and Choice of Law", (2008), p 538.

live up to the parties' expectations either because the judge is not allowed to give effect to a particular rule of the law they picked or because the court is directed to apply a provision of the law of the forum which the parties would rather have avoided[56].

The limitations imposed by the *lex fori* and the parties' contractual choice, however, should not be regarded as incompatible or contradictory. Quoting BRIGGS to sum up this idea, the laws of the forum as they may be mandatorily applicable to the case are "located outside the universe of rules which are subject to the parties' contractual autonomy and its exercise, and choice of law has no relevance to them"[57].

Some certainty may be shed on this limitation through the choice of the competent forum. In so far as the parties are aware of the site of the lawsuit, should there be one in the future, then they will be in a position to predict the mandatory provisions of the forum that the judge may be directed to apply.

In some cases, the judge might be instructed to apply foreign provisions of law which are neither comprised in the governing law nor in the law of the forum[58]. This seems to be in contradiction with the idea upon choice of the forum the parties can assess the mandatory rules potentially applicable by the judge. This seems to open the gate to countless potential applicable laws, giving the parties the heavy onus, or even impossible task, of making the due diligence of all potential mandatory provision of law that may be applied. The burden imposed on the parties to make such an assessment, combined with the natural evolution of laws make it debatable to say that the parties can confidently choose the mandatory provisions of law by choosing the forum[59].

[56] On the relative effect of agreements on choice of law as a source of rights and obligations established between the parties regardless of its recognition by the courts, and which may give rise to civil remedies, see, BRIGGS, *op cit* (2008), pp 526 sqq.

[57] BRIGGS, *op cit* (2008), pp 381-383.

[58] On overriding mandatory rules of a legal system other than that of the *lex cause* or the *lex fori*, please refer to Chapter 2.3.2.

[59] Chapter 3.1 deals with the subject of choice of jurisdiction.

Public policy

Public policy has been described as the sum of 'fundamental principles of justice', 'prevalent conception of good morals' and 'deep-rooted tradition of the common weal'[60]. Through public policy we can generally understand the essence of a given legal system.

It is the duty of the judge to apply the public policy limitation in cases where the *lex causae* contradicts the *lex fori*. The judge must disregard specific provisions of the *lex causae* to protect a fundamental principle of the public policy of the forum which would otherwise be damaged. According to BAPTISTA MACHADO, a judge shall not apply a foreign law to the extent it sets rules which are 'essentially diverging' from the equivalent provisions of the national law which are inspired by the general welfare of the community and are, for that reason, absolutely imperative[61].

Under Rome I, rules of the *lex causae* which thwart the essential public policy of the forum may be refused applicability by the courts[62].

The prevalence of the public policy of the *lex fori* has a restrictive effect on the autonomy of the parties, and hence its exceptional nature. Invocation of the public policy exception should therefore be guided by the principle of the least possible harm to the *lex causae*[63].

The starting point of the public policy assessment is whether the performance of the contract violates a specific rule or principle of the *lex fori* so fundamental that it should be treated by the courts as a matter of public policy. Consequently, only if the performance of the contract in the particular case proves to be contrary to the public policy of the forum shall there be legal grounds for the exclusion of the governing law[64]. A mere abstract incompatibility is not enough. From a conflict of laws perspective, it is

[60] See DICEY (2006), Vol 2, pp 1626-1633.

[61] See BAPTISTA MACHADO (1999), p 261.

[62] Art 21. See Art 22 of the Portuguese Civil Code.

[63] See LIMA PINHEIRO (2009), Vol 1, p 596, on the so-called '*princípio do mínimo dano à lei estrangeira*'; and LIMA PINHEIRO (2012) Vol 3, pp 417-418.

[64] See BAPTISTA MACHADO (1999), pp 261-262.

not acceptable that the courts exclude the application of the expressed governing law on the basis that the performance of the contract would be illegal under the laws of the forum.

The scope of the public policy exception is dependent on the connecting elements with the forum. One situation may be manifestly contrary to the public policy if there is a close link to the country of the forum, whereas the opposite conclusion is possible in case of a faint connection[65].

Public policy is dynamic in the sense that it tends to change over time as a consequence of the evolution of general social or economic values[66]. Thus, the exact extension of the public policy of a legal system at a given point in time in the future is unpredictable. Furthermore, the relevant public policy which shall be taken account of by the judge is the one prevailing at the time of the concerned judicial proceeding[67].

The most typical principles integrating the public policy of a given legal system are human rights and other fundamental personality rights. However, provisions of law which pursue or protect economic values can also be recognised as part of the public policy of a State[68].

As a principle, monetary system rules, including exchange control provisions, integrate the essential public policy of a country.

2.3.2 Mandatory rules

Mandatory rules can be defined as those rules which cannot be derogated from by agreement of the parties. This is a general definition and encloses two types of mandatory rules: internal and external. The difference is that *internal mandatory rules* are binding within a certain legal system but can be excluded by the choice of a foreign

[65] See LIMA PINHEIRO (2009) Vol 1, p 594.

[66] See BELOHLÁVEK (2010), p 1488.

[67] This is what BAPTISTA MADADO calls the 'contemporaneity' ('*actualidade*') of the public policy. BAPTISTA MACHADO (1999), p 266.

[68] See LIMA PINHEIRO (2009), Vol 1, p 591; and BAPTISTA MACHADO (1999), p 261.

governing law, whereas the external ones, the so-called *overriding mandatory rules*[69], or foreign mandatory rules, are binding despite express choice of a foreign governing law[70].

Purely domestic contracts

The freedom of choice principle, as it is laid down by Article 3, is not limited in scope to cases effectively involving a conflict of laws. On this particular point, Rome I steps beyond its material scope, as it is set out in Article 1, to allow the parties to choose any governing law whether or not "all other elements relevant to the situation at the time of the choice are located in [another] country"[71].

When a transaction does not have an international side to it the parties can still pick a foreign governing law, but only for those rights and obligations that are purely consensual according to domestic law. Any other aspects ruled by imperative law of the country where the contract is located, referred to above as *internal mandatory rules*, will not be governed by such foreign law. In these cases the parties are not really choosing the law applicable to their contract, but just referring to a foreign law to govern the rights and obligations which are purely consensual from a domestic law perspective[72].

This rule seems to apply to those cases where, regarding an issue of bonds, the only connecting factor of the issue to a foreign jurisdiction are the clauses of governing law and choice of jurisdiction. In those cases, the choice of English law shall not exclude the application of the provisions of Portuguese law that cannot be derogated from by agreement of the parties. Depending on their exact terms, mandatory redenomination

[69] In the opinion of LIMA PINHEIRO, the correct designation of the so-called overriding mandatory rules ('*normas de aplicação imediata*' or '*normas de aplicação necessária*') is 'self-limiting provisions capable of mandatory applicability' ('*normas autolimitadas susceptíveis de aplicação necessária*'). LIMA PINHEIRO (2009)Vol 1, pp 243-254. See further MARQUES dos SANTOS (1991), Vol 2.

[70] See FERRER CORREIA (2007), pp 406 sqq; and PAUKNEROVÁ (2010).

[71] For a critical view of Art 3(3), see LIMA PINHEIRO (2009), Vol 2, pp 268-269.

[72] Art 3(3) reads as follows: "where a choice of law is made and all other elements relevant to the situation are located in a country other than the country whose law has been chosen, the choice of law should not prejudice the application of provisions of the law of that country which cannot be derogated from by agreement. This rule should apply whether or not the choice of law was accompanied by a choice of court or tribunal". See further Recital 15.

and exchange control rules are likely to be enforced by the judge regardless of the governing law of the bonds. At this point, however, it is only possible to speculate about the scope of such rules and their applicability to the particular circumstances of the case brought before the judge.

Overriding mandatory rules

Overriding mandatory rules are closely related to public policy. The aim of overriding mandatory rules, and of the public policy exception, is to protect the fundamental public interests of a certain community. Nevertheless, they constitute two different legal instruments. The line between them has been drawn as follows: "while public policy is a certain general value category, an overriding mandatory provision is a binding means of asserting a certain public interest"[73].

Overriding mandatory rules entails an exception to the conflict of law rules – they apply notwithstanding the provisions of law governing the materiality of a particular case. By definition, overriding mandatory rules belong to a legal system other than that of the *lex causae*. They can be rules of the forum and hence normally applicable to procedural matters, or some other law or laws other than the *lex causae* or the *lex fori*. Thus, a provision of law which falls outside of the legal system where the case is based by determination of the conflict of laws can have a significant impact on the ruling of that case.

Overriding mandatory rules shall not be blindly applied by the courts, rather account should be taken of the specific circumstances of the case. There is no abstract measurement stick for overriding mandatory rules.

Given their exceptional character, limitations introduced by overriding mandatory rules can only restrict full applicability of the governing law to that extent strictly necessary. Express choice of law shall not be voided altogether by virtue of an overriding mandatory rule. The governing law shall prevail in so far as it remains untouched by the specific scope of the relevant particular overriding mandatory provision.

[73] BELOHLÁVEK (2010), p 1488.

Similarly to the public policy exception, the intensity of the link that can established between the circumstances of the case and the foreign mandatory rule should be assessed by the judge for purposes of determining to which extent that rule applies and hence its potential to thwart the otherwise applicable law[74].

The idea of an overriding mandatory rule subverts everything that has been said so far about the principles of international private law. The normal mandate of the conflict of laws is to determine the law applicable to a particular situation in the name of legal certainty and predictability, and once that is settled the legal substance of the particular situation should be governed by that law. Despite the importance of legal certainty and predictability, they fade out where there is a potential interference from other laws.

It is important to consider what is the explanation for this exception to freedom of choice. In the words of DICEY, "one of the main reasons for the overriding character of such legislation is that otherwise the intention of the legislature to regulate certain contractual matters could be frustrated if it were open to the parties to choose some foreign law to govern their contract"[75].

Rome I rules regarding overriding mandatory provisions of law highlight how these exceptional rules constitute a significant limitation to party autonomy, overriding the effective applicability of the governing law chosen by the parties in the name of 'public interest'[76].

Article 9(1) starts off by laying down the following definition: "Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation". As further explained in Recital 37, overriding mandatory rules should not, however, be

[74] See BELOHLÁVEK (2010), p 1490.

[75] DICEY (2006), Vol 1, pp 24-29.

[76] Recital 37.

taken for a synonym of "'provisions which cannot be derogated from by agreement' and should be construed more restrictively"[77].

According to Article 9(2), Rome I sets out no restrictions to the application of overriding mandatory rules of the *lex fori*. In the words of BRIGGS, this rule "take[s] the form of mandatory laws directed at local judges, rather than direct constraints upon the freedom of the parties to exercise autonomy in choice of law"[78].

The exceptional rule laid down by Article 9(3) invests the courts of the forum with specific powers to give effect to overriding mandatory provisions of the law other than those of the forum, i.e. "of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful"[79]. Foreign provisions of law, however, cannot be completely foreign to the contract in the sense that there must be a link between the contract and the foreign legal system. The mandatory provisions that apply in such cases will be the overriding mandatory provisions of the country where the contract is bound to be performed, the so-called *lex loci solutionis*[80].

As a consequence of the provisions established by Articles 9(2) and 9(3), the parties should carefully review the mandatory provisions and public policy order of the chosen *lex fori*, and also conduct the same assessment in respect to the place where the contract is to be performed.

If the overriding mandatory provisions of the *lex fori* and of the *lex loci solutionis* are predictable at the time of the establishment of the contract, the parties agreeing on a specific jurisdiction should, or at least have the possibility to, be fully aware of them. However, the enactment of new overriding mandatory provisions of law imprints great

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[77] For a conceptual analysis of the difference between rules which cannot be derogated from by agreement of the parties (the so-called *internal public order*) and overriding mandatory rules (which integrate the so-called *international public order*), see, *eg* LIMA PINHEIRO (2009), Vol 1, p 588; and BAPTISTA MACHADO (1999), pp 253-257.

[78] BRIGGS, *op cit* (2008), p 425.

[79] Art 9(3) starts off by stating that "effect *may* be given…", suggesting that application of foreign mandatory rules is under the discretion of the judge and 'merely facultative'. BELOHLÁVEK (2010), p 1507;

[80] For a critical view of Art 9(3), see LIMA PINHEIRO (2009), Vol 2, p 326.

uncertainty about the future validity and enforceability of the contract[81]. However, it can be the case that such a variation in law has implicit a damage to the public policy order of the forum. This situation is likely to create a confrontation between the overriding mandatory provisions and public policy order.

Finance laws, including mandatory redenomination, respective conversion rates and monetary protective measures, such as exchange control rules and capital controls, are examples of overriding mandatory rules[82]. Consequently, when faced with monetary policy rules established by a foreign law, the judge will not have the power to ignore them if they were created "with the genuine object of protecting the State's economy", but only in those cases where the exchange control rules were laid down as "an instrument of oppression and discrimination"[83].

A turning point in the resolution of the redenomination issues could be the entering into a consensual protocol among the EU Member States, including the exiting State, under which all States commit to endorse any monetary restrictions as may be introduced by any State dropping out of the monetary union.

2.4 Portuguese law

Given that the Rome I Regulation constitutes the main source of conflict rules on contractual obligations in the Portuguese legal order, this Chapter on domestic rules concerning the law applicable to contractual aspects of securities will have a limited scope[84].

Article 40(1) of the Portuguese Securities Code ensures the freedom of choice principle applies generally to the terms and conditions of bonds and other debt securities, without

[81] On the dynamic character ('*variabilidade*') of overriding mandatory rules, see PISSARRA (2004), p 37.

[82] See, *eg* PROCTOR (2005), pp 416 sqq and 776 sqq; and BELOHLÁVEK (2010), pp 1464 sqq.

[83] DICEY (2006), Vol 2, p 1626-1633.

[84] On the hierarchical primacy of Rome I over domestic law, see TFEU Art 288 and Art 8(4) of the Constitution of the Portuguese Republic. Art 165(1)(o) of the Constitution needs to be interpreted in light of the hierarchy of laws.

prejudice to a few exceptions[85]. This rule stems from a similar provision contained in the Portuguese Civil Code (dating back to 1966)[86]. Pursuant to the universal principle of law that *lex specialis derrogat legi generali*, the general provision of the Civil Code and its restrictions are derogated from by the special set of rules applicable to securities. As mentioned, these internal provisions will only apply to those situations excluded from the scope of Rome I[87]. For this discussion, the Portuguese domestic order will be relevant if Portugal withdrew from the Euro area.

The parties involved in the issuance of bonds or other debt securities are statutorily required to expressly state the governing law on the register of the debt issue in order to give effect to the choice of law clause.

Without prejudice to the parties' freedom of choice, Article 3 includes a protective provision regarding overriding mandatory rules. Article 3 itself should be deemed as an overriding mandatory rule in the sense of Article 9(3) of Rome I[88].

Article 3 refers exclusively to any mandatory provisions of law ("*normas de aplicação imediata*") contained in the Portuguese Securities Code which shall prevail regardless of any other governing law. There is one condition, however, and this is that the situation, activity or act under consideration has a relevant connection with the Portuguese territory.

Confronted with increasingly globalised capital markets, the Portuguese legislator showed an eagerness to modernise the conflict of law regime applicable to securities transactions at the time of the adoption of the Portuguese Securities Code of 1999. On the face of such a phenomenon and the correlated rise in number of cross-border securities transactions with multiple connections with different jurisdictions, the conflict rules of 1999 intended to clearly delineate the scope of applicability of the Portuguese

[85] Unless stated otherwise, mentions in this Chapter 2.4 to specific articles or recitals should be read as references to the Portuguese Securities Code.

[86] The freedom of choice of law applicable to contractual obligations was first established in Portugal in 1888 by Art 4(1) of the Portuguese Commercial Code.

[87] For a comprehensive analysis of the conflict of law rules contained in the Portuguese Securities Code, please see, *eg* BRITO (2000), pp 50-73; LIMA PINHEIRO (Oct, 2009), pp 661-712; and LIMA PINHEIRO (2009), Vol 2, pp 334-356.

[88] See LIMA PINHEIRO (2009), Vol 2, p 325.

securities law. Ultimately, the legislature's goal was to find a balance that would neither neglect the role of the Portuguese law nor overextend its applicability[89].

In the opinion of LIMA PINHEIRO the drafting of Article 3 is unfortunate and undesirable. The provision is not clear as to the limits or reach of the Portuguese securities law and it should have taken a step forward towards an enhanced legal certainty. The author argues that the legislature should have listed, or at least identified, categories of mandatory provisions of law[90].

The concept of "relevant connection with the Portuguese territory" is the key to understand the boundaries of the Portuguese jurisdiction in the applicability of its overriding mandatory rules to cross-border situations which are relevant from a securities law perspective.

As regards the issuer, does it qualify as a relevant connection with the Portuguese territory the fact that its legal or operational headquarters is situated in Portugal, or its main place of business, or its personal law is the Portuguese law? Looking at the wording of Article 3(1) and (2), the answer seems to be *negative*. Article 3(2) refers to "situations, activities and actions" that have a relevant connection with the Portuguese territory and Article(2) contains a non-comprehensive list of examples of situations that would be considered as upholding a relevant connection with the Portuguese territory. The focus is on the object of the transaction and the production or direction of its effects to the national territory, and not on its agents. The correct interpretation of this statute seems to be that the mere circumstance of the issuer of a securities transaction being a Portuguese entity should not constitute a relevant link for purposes of Article 3 and hence where no other connecting point with the national territory can be identified, it does not fulfil the provision's requirement[91].

A different view of the provision would have the perverse effect of extending the applicability of the Portuguese Securities Code beyond the law maker's intention. If the mandatory provisions of law of the Portuguese Securities Code were to be applied to

[89] Recital 6 of the Preamble of Decree-Law 486/99, of 13 Nov 1999.

[90] See LIMA PINHEIRO (Oct, 2009), pp 661-712.

[91] See DIAS (2001), pp 105-116.

every Portuguese issuer, they would be left with no freedom of choice of applicable law for the issuance of bonds and other debt securities. Moreover, such an interpretation of Article 3 would be incompatible with Rome I freedom of choice primary rule and hence cannot proceed.

3. Jurisdiction, recognition and enforcement of judgments following the Brussels I Regulation

With the Treaty of Amsterdam of 1997, for the first time the Member States gave a specific mandate to the EU for the adoption of measures on the subjects of recognition and enforcement of decisions and of the harmonisation of conflict of law rules at European level. This mandate was limited to measures necessary for the development of the internal market.

Ten years later, the Treaty of Lisbon established the grounds of the legislative competence of the EU institutions in the field of judicial cooperation between Member States in civil matters with a cross-border element. Under the TFEU, this competence is no longer limited in scope to those measures strictly necessary for the functioning of the internal market and the mutual recognition of judgments is established as the main aspect of judicial cooperation[92].

3.1 Jurisdiction agreements in the context of international debt securities transactions

The ability of the parties to define the court, or courts, which shall have jurisdiction over any disputes that may occur during the course of a certain legal relationship assumes an important role in the context of cross-border securities transactions.

As explained in Chapter 2.3.1, the laws of the forum can significantly limit the extent to which the law chosen by the parties to govern their rights and obligations will actually be applied by the judges in case of litigation.

Through the choice of the courts before which any disputes shall be brought, the parties are indirectly making an option as to the mandatory provisions of law and public policy principles of the forum that may impose restrictions to the full applicability of the *lex causae*.

[92] TFEU Art 81.

The prerogative to pick the forum is, therefore, a means to achieve a higher level of legal certainty and predictability in the context of international trade, and of cross-border bonds issues[93].

However, the effectiveness of exclusive jurisdiction agreements is currently weak, as explained in this Chapter 3.1.

Jurisdiction agreements under Brussels I

At present, the rules on jurisdiction agreements applicable in Portugal and in the UK are laid down by the Brussels I Regulation[94]. Although repealed by Regulation 1215/2012 (the "Recast Regulation"), Brussels I continues to apply to any judicial proceedings started before 10 January 2015, the date on which the Recast Regulation will start to be applied by the courts of the Member States bound by this regulation[95].

Brussels I recognises, and purports to give effect to, party autonomy in the field of jurisdiction[96]. Accordingly, the parties are free to choose the court, or courts, of a Member State which shall have *exclusive* jurisdiction over any disputes arising from a particular legal relationship, in so far as one of them is domiciled in a Member State[97].

As described by BRIGGS, "the general scheme is that an agreement on jurisdiction is binding and must be given effect by the court chosen (prorogation) and by all other courts which would have had, but by reason of the agreement do not have, jurisdiction (derogation)"[98].

[93] According to the Summary of the Impact Assessment accompanying the Commission Proposal for a recast of Brussels I (COM(2010) 748), "the overwhelming majority of EU business involved in cross-border trade makes use of choice of court agreements (almost 70% of all companies and 90% of large companies)".

[94] Unless stated otherwise, mentions in this Chapter 3 to specific articles or recitals should be read as references to Brussels I. Regarding the scope of application of Brussels I, see TEIXEIRA de SOUSA (2002), pp 675-691.

[95] All Member States, except for Denmark.

[96] See Art 23 (which is actually identical to its predecessor in the Brussels Convention), and Recital 14.

[97] The domicile requirement is dropped by the Recast Regulation.

[98] BRIGGS, *op cit* (2008), p 237.

There are exceptions to the choice of jurisdiction though. First, an agreement which is contrary to mandatory rules on jurisdiction agreements for insurance, consumer and employment contracts, or derogates the jurisdiction of a court with exclusive jurisdiction by virtue of Article 22[99] shall produce no legal effects[100].

Regarding this exception it is worth noting that Brussels I does not contain a similar provision to that of Rome I by which financial instruments are expressly excluded from the scope of applicability of consumer contract stricter rules on jurisdiction agreements[101]. Neither does the Recast Regulation[102]. Consequently, the correct interpretation of Brussels I seems to be that jurisdiction agreements regarding contractual rights and obligations established between the issuer and the investors shall be subject to the rules laid down for consumer contracts (Article 17), which aim for the protection of the consumers, and not to the general rule on jurisdiction agreements (Article 23)[103].

A choice of jurisdiction agreement in these cases would be rendered ineffective as regards the issuer's right to bring action against the investors in the English courts. Any judicial proceedings at the initiative of the issuer would have to be started in the courts of the defendant's domicile[104].

However, the jurisdiction agreement will be binding in the part which allows investors to bring action before the courts of England[105]. This prerogative granted to investors is not contrary to the restrictions laid down for consumer contracts and, to that extent, the jurisdiction agreement shall be effective.

The second exception to the free choice of jurisdiction is the defendant's consent after action is brought before a court other than that prorogated by agreement. In this case,

[99] Recast Art 24.

[100] Art 23(5), Recast Art 25(4).

[101] Art 15 sqq.

[102] Recast 17 sqq.

[103] See ALFEREZ (2009), p 89.

[104] Art 16(2) (Recast Art 18(2)) combined with Art 23(5) (Recast Art 25(4)).

[105] Art 17(2), Recast Art 19(2).

the jurisdiction agreement shall be disregarded if the defendant appears before the court seised and does not contest its jurisdiction[106].

Third, there is a limitation to the jurisdiction agreement implicit in the *lis pendens* rules, which will be separately addressed below.

Subject to these exceptions, as already mentioned, the jurisdiction agreement is binding and must be given effect by the prorogated, as well as by the derogated, courts. In that respect, no discretionary power is conferred upon the judges to respectively accept or decline a prorogation or derogation of jurisdiction.

Lis pendens *rules as an obstacle to the choice of jurisdiction*

Since Brussels I first came into effect in 2002, its rules on *lis pendens*[107] stand as a grave obstacle to the effectiveness of exclusive jurisdiction agreements.

The rationale behind a *lis pendens* rule is the prevention of parallel proceeding between the same parties and regarding the same cause and, more importantly, the risk of conflicting decisions by different judges before whom action might be brought. By avoiding the repetition of judicial proceedings, the *lis pendens* rules underpin the economy and efficiency of judicial procedure and hence the protection of the defendant[108].

In practice, however, the *lis pendens* regime under Brussels I has the perverse effect of giving room to an abusive use of the rules. The problem is that the court first seised shall have priority to accept or decline jurisdiction in relation to any other court, including the one prorogated by agreement. On that basis, a party with a tactical interest in bringing action before a different court than the one initially defined in the contract or with the intention of delaying the due course of the proceedings can achieve such purposes by acting quickly before the court that best suits that party's interests.

[106] Art 24, Recast Art 26.

[107] Art 27.

[108] Recital 15, Recast Recital 21. *Lis pendens* is defined under Art 497(1) of the Portuguese Civil Procedure Code as a repetition of a case which is already being heard before a different judge.

The defendant can contest the jurisdiction of the court seised but it is for the judge before whom the action was started to ascertain the validity of the jurisdiction agreement[109] and to accept or decline its own jurisdiction over the dispute[110].

If the court first seised accepts jurisdiction over the dispute, this will render the exclusive jurisdiction agreement ineffective.

Given the capability of the *lis pendens* rules to neutralise the theoretical legal force conferred upon exclusive jurisdiction agreements, it is clear that Brussels I failed its objective to provide legal support to party autonomy in the field of jurisdiction.

The European Court of Justice decision on the *Erich Gasser* case[111] has consolidated the interpretation of the overriding effect of *lis pendens* over exclusive jurisdiction agreements. This is an acceptable interpretation in light of the text of Brussels I, but it is not imperative from this interpretation that one should conclude this was the intention of the legislator.

For investors in the bond markets, the danger of this interpretation of the *lis pendens* rules is that proceedings may theoretically be initiated in the Portuguese courts, irrespective of a choice of jurisdiction of the English courts. If this happens, in light of what was said regarding mandatory rules in Chapter 2.3.2, the Portuguese courts will predictably apply the new monetary law enacted by the Portuguese Government regardless of the bonds being governed by English law.

The Portuguese court's decision will necessarily depend on the exact terms of the new monetary regime and the extent to which laws on redenomination should apply to

[109] On the topics of the definition of 'agreement' and its 'validity' under Art 23, see, *eg* BRIGGS, *op cit* (2008), pp 237-298; STEINLE (2010), pp 565-587; LIMA PINHEIRO (2012), Vol 3, pp 196-209; and FERNANDES (2008), pp 1174-1175. The Recast Regulation introduces an express conflict of law provision (Art 25(1) and (5)), which will likely put an end to discussions in literature around this topic. Under the new regime, the validity of jurisdictional agreements shall be assessed in accordance with the *lex fori* and independently from any considerations around the validity of the contract to which it applies.

[110] Jurisdiction agreements are not capable of being enforced, at least in so far as it is taken as given that the courts of a Member State shall not have the right to interfere with the jurisdiction of the courts another Member Sate. See BRIGGS, *op cit*.

[111] See C-116/02 *Erich Gasser GmbH v Misat srl* [2003] ECR I-14693.

specific obligations. In respect of the scope of such laws one can only speculate at this stage.

Assuming that redenomination is set to be mandatory for obligations impending on Portuguese debtors where payment is to be made in Portugal, it is probably safe to assume that a Portuguese judge would declare that the issuer shall be discharged of its obligations by payment of interest and principle under the bonds in the new domestic currency.

Reform of Brussels I

Following a legislative proposal from the Commission for a recast of Brussels I (the "Commission Proposal")[112], on 12 December 2012, the European Parliament and the Council adopted the Recast Regulation, which will apply from 10 January 2015.

The deficiencies of Brussels I regarding the (in)effectiveness of exclusive jurisdiction agreements are now addressed by the Recast Regulation. It is the legislator's express will that party autonomy should be strengthened through legal mechanisms which aim at enhancing the effectiveness of choice of court agreements.

Once the Recast Regulation is in effect, unconditional priority shall be granted to the court, or courts, chosen by the parties to assess its, or their, jurisdiction over the dispute. The courts of any Member State other than that chosen by the parties shall stay any proceedings until the court, or courts, designated in the agreement declare or decline jurisdiction under the agreement[113].

Having adopted, in this respect, the principles laid down by the Commission Proposal, the Recast Regulation stands as an acknowledgment of the improved solutions established in the Hague Convention on Choice of Court Agreements[114] regarding the priority that should be conferred upon the courts chosen by the parties. This might be

[112] COM(2010) 748.

[113] Recast Art 31(2) and (3) and Recital 22.

[114] Concluded on 30 June 2005.

the push that the EU needs to make a final decision on the ratification of this convention.

Definitely solved the problem of the ineffectiveness of jurisdiction agreements under Brussels I, bond investors can be assured that English courts will have exclusive jurisdiction over disputes arising in connection with the bonds.

However, whether or not the English courts will declare that the issuer's obligation to make payments of interest and principle under the bonds should be settled in Euros or in the new national currency is a different matter, which will be explored in Chapter 4.2.

3.2 Recognition and enforcement – the public policy exception

Brussels I establishes two different realities in terms of mutual judiciary cooperation between the Member States: the recognition of judgments and the enforcement of judgements.

A court of a Member State shall automatically recognise a decision taken by the courts of a different Member State. This means that recognition is not dependent on any previous checks or confirmation procedures[115].

On the other hand, enforcement is subject to an 'efficient' and 'rapid' previous procedure for the issue of a declaration of enforceability (*exequatur*) by the judge before which enforcement is sought[116].

Recognition or enforcement of a judgment given by the courts of a Member State may only be refused in limited exceptional cases by the judge before whom recognition or

[115] Art 33 and Recital 16, Recast Art 36 and Recital 26. This provision diverges from the Portuguese domestic law regarding recognition, which requires revision and confirmation of the foreign judgment ('*revisão e confirmação de sentença estrangeira*'). Arts 1094 sqq of the Portuguese Civil Procedure Code. See MOURA VICENTE (2002), p 371.

[116] Art 38 sqq and Recital 17. The Recast Regulation has abolished the *exequatur* accompanied by the establishment of certain safeguards. Recast Recital 26. With a critical view of this new regime, LIMA PINHEIRO (2012), Vol 3, p 437.

enforcement is sought[117]. Under no circumstances shall the substance of the judgment be reviewed in the context of its recognition or enforcement by the courts of another Member State[118].

Refusal of recognition or enforcement on the grounds of the judgment being manifestly contrary to the public policy in the Member State of the court addressed is particularly relevant for this discussion[119].

As explained in Chapter 2.3.1, the monetary regime of a State is commonly accepted as part of its fundamental public policy. In principle, the adoption of a new domestic currency followed by legal mandatory instructions for the conversion of debt into that new currency, as well as any protective measures, such as exchange control regulations, shall be deemed as essential for the functioning of the country's monetary regime and ultimately for the safeguard of its economy. Consequently, legislation of this kind will typically be considered within the scope of public policy.

On these grounds, recognition and/or enforcement in Portugal of a judgement by the English courts declaring that payments under bonds issued by a Portuguese company shall be made in Euros may be refused on the basis of the public policy exception laid down by Brussels I.

Attention should be paid to the fact that the court addressed is not allowed to raise of its own motion the argument of public policy for the refusal of recognition and/or enforcement of a judgment of another Member State. This procedure would have to be initiated by the persons against whom recognition and/or enforcement is sought, who would need to submit an application for refusal[120].

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[117] Arts 34, 35 and 45(1), Recast Arts 45 and 46. As LIMA PINHEIRO puts it, Brussels I establishes a legal presumption in favour ('*presunção legal favorável*') of mutual recognition and enforcement of judgments within the EU. See LIMA PINHEIRO (2012), Vol 3, p 409.

[118] Arts 36 and 45(2), Recast Art 52.

[119] Art 34(1), Recast Art 45(1)(a). The adverb 'manifestly' stresses the exceptional nature of public policy. Please note that it is the recognition and/or the enforcement that need to constitute a serious menace to public policy, and not the judgment itself. Consequently, whether or not recognition and/or enforcement shall be refused will be ascertained taking account of the public policy at the time recognition and/or enforcement are being sought. See LIMA PINHEIRO (2012), Vol 3, p 417 and pp 419-420.

[120] Arts 39 sqq (Recast Arts 45(4) and 47 sqq) and Recital 17. Given that the most likely scenario after a putative withdrawal from the Eurozone is a drastic depreciation of the new national currency in relation to

One final note on the potential scenario of Portugal exiting the EU altogether, and not only the Eurozone. In this case, the Brussels Regulation will no longer apply in Portugal[121] and hence the subject of recognition of foreign judgments (*confirmação de sentença estrangeira*) would have to be dealt with in the context of domestic law. Considering, however, that the Portuguese Civil Procedure Code also excludes recognition of a foreign judgment which is manifestly incompatible with the Portuguese public policy (*princípios da ordem pública internacional*), the practical result for any interested party would probably be the same[122].

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the Euro (predictably around 50%), issuers will have the right incentive to make such an application. See, *eg* LEÃO (2012), p 217.

[121] See TEU Art 50(3).

[122] See Art 1096(f), which provides that the Portuguese Courts shall not recognise a foreign judgment (*confirmação de sentença estrangeira*) which is manifestly incompatible with the Portuguese public policy (*princípios da ordem pública internacional*).

4. Foreign currency obligations and the conflict of laws

As noted by MANN, "wherever foreign currency comes into play, three legal systems may have to be considered: the law of the obligation or the proper law or the *lex causae*; the law of the currency, i.e. the law of the country whose currency is stipulated to be payable; and the *lex fori*"[123].

This Chapter intends to formulate the main principles of international private law regarding foreign currency monetary obligations[124]. In this respect, the rule proposed by DICEY reads as follows: "A debt expressed in the currency of any country involves an obligation to pay the nominal amount of the debt in whatever is legal tender at the time of payment according to the law of the country in whose currency the debt is expressed (*lex monetae*), irrespective of any fluctuations which may have occurred in the value of that currency […] between the time when the debt was incurred and the time of payment"[125].

This rule purports to explain two core principles of the legal regime of monetary obligations in those particular situations where there a conflict of laws element can be found. First, the well-established principle of nominalism and secondly the relevance of the law of the country in which currency the monetary obligations are bound to be performed as opposed to the law governing the contract from which such monetary obligations arise.

As regards the *lex monetae* of obligations expressed in Euros, with the adoption of the Euro, the Eurozone countries transferred their monetary sovereignty to the EU[126]. The Euro is a project of the EU. It was created and is ruled by EU law. Thus, the *lex monetae* of the Euro is the EU law.

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[123] MANN (2003), p 185.

[124] For a definition of money and for a general introduction to money obligations, see MANN (2003), pp 8 sqq; and pp 65 sqq.

[125] DICEY (2006), Vol 2, p 1975.

[126] TFEU Art 3(1)(c) states as follows: "The Union shall have exclusive competence [regarding the] monetary policy for the Member States whose currency is the euro". See, *eg* PITTA e CUNHA (1999), pp 54-58. On relative loss of sovereignty, PROCTOR (2012), pp 807-834.

The hypothetical secession of Portugal from the MEU creates a difficult problem for the legal theory. This scenario would certainly involve the creation of a new currency, and in all likelihood the mandatory redenomination of Portuguese debt. If we exclude the possibility of a Eurozone collapse and hence assume the continuation of the Euro as a currency in circulation in the European and international markets, this will give rise to a new problem.

It is not the symmetrical situation of the transition from national currencies to the Euro. In 1998/1999, redenomination of debt was determined by EU law and by decree of each of the Eurozone States. At the time, the States held control over their monetary systems, and the *lex monetae* of the old national currencies was the respective national law. The old currencies were gradually removed from circulation, while the Euro, the single currency, was introduced and eventually replaced them as the legal tender in the Eurozone. If not before, on 1 January 2002, all debt in the Eurozone was automatically redenominated in Euro, at the conversion rate fixed for each old currency[127].

Now that the return to national currency is being considered, the scenario is different. Unlike the transition to the Euro, the currency in which outstanding monetary obligations are denominated, i.e. the Euro, will not disappear. Furthermore, the *lex monetae* of such obligations is deemed to be the EU law, and perfectly detached from the multiple national laws of each of the Eurozone countries.

The traditional principles of nominalism and predominance of the *lex monetae* will have to be adapted to this new reality.

The aim of this Chapter is to provide the legal principles in which legal answers might reside.

[127] See PROCTOR (2005), pp 776 sqq.

4.1 The principle of nominalism

4.1.1 The fundamentals of the legal principle of nominalism

The principle of nominalism is generally accepted in countries that have developed modern legal systems and its fundamentals are simple. At the time they become due, monetary obligations shall be fulfilled by payment of their nominal value as expressed by the parties at the time the terms of the agreement where established or renegotiated, irrespective of any fluctuations in the value of the currency in which the obligations are denominated that may have occurred in the meantime[128].

In other words, "a mere change in the value of [money] however serious it may be, is irrelevant to the monetary rights and obligations of the parties"[129].

It should be noted that it follows from the principle of nominalism that monetary obligations are indestructible. In the words of MANN, this statement means that "neither circumstances peculiar to the debtor, such as his poverty, nor circumstance arising from developments in the monetary system, such as the emergence of a new currency or the elimination OF protective clauses or the introduction of exchange control, ever relieve the debtor of his duty to pay [his debts]"[130].

If a monetary system becomes extinct, still there will be no grounds to invoke the termination of a debt on the grounds of impossibility, as there will be no gap between the old and the new monetary system that shall succeed. This also stems from the principle of the continuity of contracts[131] The new monetary system shall establish the rules in accordance to which outstanding monetary obligations shall be discharged. Thus, the obligation shall be redenominated and the amount payable shall be calculated

[128] See NUSSBAUM (1950), pp 349 sqq.

[129] PROCTOR (2005), pp 331 sqq.

[130] MANN (2003), pp 65 sqq.

[131] See WAHLIG (2000), p 122.

in accordance with the conversion rate which shall be fixed having as a reference the previous currency, the so-called recurrent link[132].

The most obvious disadvantage of the principle of nominalism is that the creditor will necessarily bear the risk of currency devaluation, which in particular geographies at certain periods of history can result in dramatic losses in real value. Of course the reverse of this is that the debtor shall bear the risk of currency appreciation, a much less common event though. Unfortunately, the alternatives are even less appealing and thus have been consistently precluded over time. In fact, as DICEY puts it, the principle of nominalism is "an indispensable foundation of modern economic life"[133].

Of course the parties may try to protect themselves from the undesirable effects of the principle of nominalism, i.e. the uncertainty of the value of money over time. For that purpose, to the extent admissible under the governing law of the monetary obligations assumed, the parties may agree on protective clauses, such as gold clauses, commodity clauses, index clauses or multiple currency clauses[134].

4.1.2 An economic perspective of nominalism

The principle of nominalism provides a limited, however useful and appropriate, legal answer to a basic contractual problem, which arises from the fluctuation of the value of money over time.

In short, the nominalistic principle states that an obligation to pay €10 shall be discharged by the payment to the creditor of that same amount of money at the time the obligation becomes due, regardless of any variations in the real value of €10, from when the debt was contracted up until the moment of its settlement.

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[132] For an extensive analysis of the indestructibleness of money debts and for an overview of the so-called Knapp's 'recurrent link' theory, see NUSSBAUM (1950), pp 131 sqq. In this respect, it seems worthwhile to quote NUSSBAUM (p 353): "Where a new currency is created a recasting rule for debts incurred in the old currency will […] ordinarily be provided by legislation. […] the state which has created a given currency must also have power from the international point of view to replace it by another, just as it may alter it: and this conclusion extends to the recasting rule, a necessary incident in the transition to the new currency, provided it is a *bona fide* rule not purporting to harm foreign creditors".

[133] DICEY (2006), Vol 2, pp 1978-1980

[134] See DICEY (2006), Vol 2, pp 1995-1997.

Variations in the real value of a currency affect the cost of goods, services, assets and its cash flows. The change in value of a currency can be illustrated by selecting a particular basket of goods that €10 can buy today and then calculating how much the same basket costs in 2, 10 or 50 years time. Assuming no fundamental changes to the demand and supply sides of the market, if the basket gets cheaper it is a result of deflation, whereas inflation would be associated with an increase in the (nominal) price of the goods.

Deflation is less frequent than inflation. Thus, the following reasoning and comments will refer to inflation only, without prejudice to drawing symmetric conclusions for deflation.

From an investor's perspective what is relevant is the *real* return of the investment. In the case of a bond, it will be represented by the sum of the proceedings from the coupons[135] plus the capital reimbursement, each payment adjusted according to the inflation verified since the inception of the obligation.

The value of money has a direct impact on the real value an investor will obtain from its investments. As changes to the rate of inflation are not predictable with accuracy, there is no certainty of the value of the currency in which the security is denominated and hence of the real value of the investment return. The investor necessarily faces this uncertainty when evaluating a prospective investment.

For an investor in the bond market, fluctuations in the value of money will have an impact on the real value of both interest payments and the capital reimbursed at maturity.

From the perspective of the economic theory, however, and to take account of inflation, the discussion might be entirely subsumed in the interest rate component and the key point is the distinction between the *real interest rate* and the *nominal interest rate* of the bond.[136]

[135] Zero coupon bonds, as their name implies, pay no interest. These bonds are placed with investors below their par value, the return resulting from the difference between price and nominal value.

[136] Note that, even in the secondary market, the value of the bond is factored in the implicit yield to maturity.

A fundamental reference in this matter is the renowned Fisher's theory of interest[137], cited prominently, for example, by MARK BLAUG[138]. Fisher's theory of interest was of the utmost relevance in the history of the economic theory, and the formula through which the real interest rate is still defined in the modern advanced economic theory is known as 'Fisher identity'[139]:

$$r \equiv i - \pi^e$$

where r stands for the real interest rate, i for the nominal interest rate, and π^e for the expected inflation.

As investors are confronted with the nominal interest rate at the time of making the investment decisions, for that purpose, the Fisher equation should be rewritten as follows:

$$i = r + \pi^e$$ [140]

The Fisher identity shows how an investor in bonds, in addition to the default risk factored in the nominal interest rate, i, takes account of the future inflation, π^e.

The investor makes a "rational guess" on the expected inflation, π^e, thus facing the risk of the variation between the expected inflation at the time of the investment decision and the real or effective inflation rate verified for each interest period.

The inflation enters in the equation as an *expected* value – arising from the uncertainty inherent to the future outcomes of economic variables and decisions. The investor's real rate of return stands as a pure economic problem It is not for the law to solve this problem, so that the investor can be reassured of the real return of its investment.

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[137] FISHER, "The Theory of Interest", first published in 1930 by The Macmillan Co.

[138] BLAUG (1985).

[139] See, *eg* ROMER (1996), p 392.

[140] For a brief summary on yield to maturity computation, see, *eg* DAMODARAN, (2002), p 888; and ROSS (2006), pp 198 sqq.

Moreover, to 'measure' inflation is a complex task, which reinforces the arguments in favour of keeping money fluctuations outside the scope of the legal theory of money. "Economists and analysts have expended considerable time and resources forecasting inflation, with mixed results"[141]. There are not only one, but multiple economic measures of inflation with different methods leading to different conclusions. Actually, there is always a margin of fluctuation in the calculation of indices. As a result, in organised markets, it is the best investor's criterion that prevails in estimating inflation. The consequence of this being that the investor is not confronted with uncertainty at a legal level, but with the normal uncertainty of economic activity and investment choice.

In the case of floating rate notes, where the coupon is indexed to a money market reference rate (*eg*, Euribor and Libor, among others), the expected inflation is assumed in the reference rate. Nonetheless, legal certainty remains unfettered. The reason for this is that the monetary correction factor, for example in the case of floating rate notes, is subsumed, even if imperfectly, in the contractual reference rate, for example the Euribor[142]. For these bonds, although the nominal obligation is not determined *ab initio*, it is determinable at the time of performance. In any case, this does not constitute derogation from the principle of nominalism, but an alternative contractual solution attempting to converge the effective return and the expected return, thereby mitigating the inflation risk.

From the rational investor's standpoint, the required interest rate (IRR, or yield to maturity in the particular context of bonds) for their investments will be determined as the sum of the following factors: risk-free interest rate (the opportunity cost), a spread which reflects the implicit risk of default and the expected inflation rate. In this regard, considering the increasing economic uncertainty inherent to extended investment horizons, including any variations in the risk-free interest rate, as a principle, investors will require higher yields for longer maturities.

In this context, the role of monetary law in general, and of the principle of nominalism in particular, is to determine what is determinable *ex ante*, i.e. that the issuer will be

[141] DAMODARAN, *op cit*, p 895.

[142] The Euribor is the benchmark rate at which Eurozone banks lend money to each other. It is calculated and published daily by the respective screen service provider. As such, although the applicable Euribor cannot be determined at inception, it is determinable at settlement.

discharged of its obligation by the payment of the nominal value of the bond at maturity. For the sake of legal certainty, "the extent of monetary obligations cannot be determined otherwise than by the adoption of nominalism"[143]. By doing so, this essential principle of monetary law is determining the content of a monetary obligation in so far as it is determinable at the time of the establishment of the obligation. Within the boundaries of what is possibly achievable by a formal rule of law, it purports to inject certainty into the financial transactions. It is not for the law to eliminate the risks of the economic activity, including the uncertainties concerning the evolution of prices.

As mentioned above, there is no standard economic measure of inflation gathering universal consensus in the academy[144]. If that was the case, then the parties could agree the real rate of return of the investment *ab initio*. It is precisely because of its aim to preserve the legal certainty to the maximum degree that it can possibly be preserved that the nominalism is a long established principle in the legal theory of money, and has managed to keep its relevance[145].

As a final note, it goes without saying that debtors and creditors seeking to exclude the effects of nominalism may agree on the issue of inflation-linked bonds, i.e. bonds where the principle and/or the interest rate(s) are indexed to inflation.

4.2 The *lex monetae*, the Euro and the redenomination of cross-border debt securities

The principle of nominalism when applied to foreign monetary obligations calls for the intervention of conflict of law rules.

Taking as a given that the nominalism is recognised as a principle by the *lex causae* and applied by the judges according to the *lex fori* (and that should indeed be the case in most countries with developed economies and modern laws), the nominalistic principle dictates that it shall be the law of the currency (the *lex monetae*) to determine what is 'legal tender' for purposes of the fulfilment of the foreign monetary obligation in

[143] MANN (2003), pp 86 sqq.

[144] DAMODARAN, *op cit*, p 895.

[145] For a historical overview of the evolution of the principle of nominalism, see MANN (2003), pp 86 sqq.

question and ultimately by which means the debtor can be discharged from its obligation[146].

In short, legal tender shall be the currency (or currencies) recognised by the applicable law, i.e. the *lex monetae*, and is the only one that can be offered as payment by a debtor and must be accepted by the creditor as valid fulfilment of a monetary obligation.

The primary reason behind the principle of the prevalence of the *lex monetae* in force at the time a debt is due derives from the fact that, in the words of DICEY, "it is a fundamental principle that monetary obligations cannot become impossible to perform by virtue of the currency in which the obligation is expressed ceasing to exist"[147].

In support of this principle, the conflict of laws dictates that the *lex monetae* shall have mandate to establish the terms of the succession of the ceasing currency and the new currency that shall replace it.

The currency in which a monetary obligation is expressed and the respective nominal value, which is defined with reference to the so-called units of account of the relevant currency, are defined by the *lex monetae*. This is a corollary of sovereign powers conferred upon the States over their own currency.

In the particular case of the Euro, however, monetary sovereignty lies with the EU.

No doubt that as a consequence of a pulling out of the Eurozone, Portugal would regain its monetary sovereignty. However, the former currency in which the monetary obligations were denominated, i.e. the Euro, does not disappear, and the *lex monetae* of the Euro is the EU law, as mentioned, and not the Portuguese law. Thus, the difficulties around the legal force and the consequences of a mandatory redenomination of debt ordered by Portugal if it withdrew from the EMU.

[146] In this respect, see further Art 558 of the Portuguese Civil Code. LIMA PINHEIRO (2009), Vol 2, pp 323-324.

[147] DICEY (2006), Vol 2, p 1981.

4.3 The impact of exchange controls on payments under debt securities

Exchange controls have been described as "a system of open restrictions on payments or transfers to or for the benefit of persons resident in another country, which is imposed to protect the financial resources of the country and which is thus primarily concerned with the outward movement of payments or transfers"[148].

4.3.1 International private law principles

In principle, foreign exchange control legislation implemented by the country of the *lex causae* will be recognised by the courts and applied in accordance with the ordinary principles of the conflict of laws. As a result, the judge hearing the case will only give effect to any contractual monetary obligations to the extent as the governing law may permit its performance under any foreign exchange control rules that may apply.

Under this principle of law, there seems to be no doubt that payments of interest and capital of a bond issue denominated in Euros and governed by Portuguese law shall be payable in the new currency if so dictated by Portuguese exchange control regulations, when and to which extent these may be implemented. If according to the governing law of the contract, Euro should no longer be legal tender for purposes of a specific monetary obligation, and judges, in or outside Portugal, will give effect to such restrictive legislation and decide according to the Portuguese exchange control regulations, i.e. that the debt shall be discharged in the national currency.

In principle, the same is true for those cases where exchange control rules are put in place by the country where payments are set to be performed, regardless of the governing law of the contract from which those monetary obligations arise. Consequently, if payment in the currency established by the parties in the contract is or becomes illegal according to the legislation applicable in the country where performance takes place, commonly referred to as the 'place of payment', then the court will give effect to this legislation and hence determine that payment shall not be made in any such banned currency.

[148] PROCTOR (2005), pp 331 sqq.

In addition, the doctrine seems to concur that the place of payment should be the relevant connecting factor to foreign exchange control legislation and no other. Nationality, the country of residence or the place of business should not be considered as sufficient link to foreign exchange rules with the power to excuse performance under the contract.

On the face of the above, let us consider the following example: an issue of Euro-denominated bonds by a Portuguese issuer, which is governed by English law, was underwritten by mainstream international banks, the syndicate perhaps including one or two Portuguese banks, the bonds were deposited with Euroclear/Clearstream and admitted to trading in the London Stock Exchange, payments of interest and capital on maturity are set to be made to an account of the syndicate leader opened with an English bank and domiciled in London. In this example there is only one, or maybe two points of contact with the Portuguese jurisdiction: the issuer is Portuguese in accordance with Portuguese law and one or more underwriters might have their headquarters or carry out business in Portugal. If, in a potential scenario where Portugal drops out of the Eurozone, the Portuguese Government implements exchange control regulations, according to the conflict of law principles mentioned previously, notwithstanding the said connecting elements, the terms of the bond issue, including the original currency in which payments have to be made, shall be safeguarded from foreign exchange controls intrusion, and the Portuguese regulations shall not constitute defence on a dispute resolution on the contract or contracts relating to the Euro-denominated bonds.

4.3.2 Rome I and Brussels I

The Rome I Regulation provisions that are particularly relevant in the field of foreign exchange control regulations are contained in Article 9 concerning overriding mandatory rules of law and in Article 21 on the public policy exception of the forum.

Regarding the Brussels I Regulation, the fundamental rule for purposes of this discussion is that relating to the public policy exception in the context of recognition and enforcement of judgments[149].

[149] Art 34(1), Recast Art 45(1)(a).

Following a hypothetical withdrawal from the EMU, Portugal will likely implement measures which envisage the protection of the new monetary system. These will typically include exchange controls. Under such exchange controls, as a rule, payments in any currency other than the new national currency, including in Euro, will be restricted.

It has been argued that genuine exchange controls "are intended for the protection of a country and its economy as a whole"[150], especially in those cases of national distress. Thus, restrictive monetary policy measures, including exchange controls, should, in principle, qualify as overriding mandatory provisions. This understanding is in line with the definition of overriding mandatory rules under Article 9(1) of Rome I[151].

Furthermore, such monetary protective rules which will likely be implemented by Portugal following a putative withdrawal from the EMU will also integrate the Portuguese fundamental public policy[152].

If the Portuguese courts have jurisdiction where the *lex causae* is a foreign law (a very unlikely hypothesis), a judge in Portugal will be required to take account of such exchange controls on the grounds that they are subsumable under mandatory rules and public policy of the forum[153]. Similar deference would be required in the context of recognition and/or enforcement in Portugal of a judgement by the courts of another Member State in light of the public policy exception[154]. Accordingly, the Portuguese court before which action is brought should decide that payments under the bonds shall be discharged in the new national currency, regardless of the law governing the concerned monetary obligations. Similarly, recognition and/or enforcement in Portugal of a judicial decision by a court of another Member State determining payment in Euros shall be refused as manifestly contrary to the public policy of Portugal[155].

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[150] PROCTOR (2005), pp 416-417. See further MICHAEL MANN (1956), pp 286-301.

[151] Refer to Chapter 2.3.2 regarding the concept of overriding mandatory rules.

[152] Refer to Chapter 2.3.1 regarding the concept of public policy.

[153] In accordance with Arts 9(2) and 21 of Rome I.

[154] In accordance with Art 34(1) of Brussels I, Recast Art 45(1)(a).

[155] On a different front, please note that where enforcement of monetary obligations is being sought in Portugal, conversion into the new national currency is 'usually inevitable", "since compulsory liquidation of the debtor's property at public sale will yield local currency". NUSSBAUM (1950), pp 370 sqq.

Notwithstanding the above, considering a different scenario where jurisdiction belongs to the courts of another Member State, *eg* the English courts, effect may still be given to Portuguese exchange controls in so far as the settlement of any monetary obligations is set to occur in Portugal. Under Article 9(3) of Rome I, which recognises the *lex loci solutionis*, the judges of another Member State shall only attend to rules so fundamental that would "render the performance of the contract unlawful". This requirement, however, does not seem to stand as an obstacle against effectiveness of Portuguese exchange rules being granted by the courts of another Member State, since exchange control rules determine the illegality of payments in any currency other than that defined by the Government as legal tender.

In the scenario proposed in the previous paragraph, there is a chance of a conflict between the Portuguese exchange rules which are granted an overriding mandatory status under Rome I, and the fundamental public policy of the courts of the Member State where proceedings are being heard, *eg* the English courts. If the Portuguese exchange controls are deemed as manifestly contrary to the English public policy, then it is arguable that the English courts may refuse the application of such exchange controls, namely on the grounds that they have been established or are being used "for the purpose of oppression or discrimination"[156]. This possibility, however, is very unlikely in practice in light of the International Monetary Fund Agreement, as explained in the next Chapter.

4.3.3 The International Monetary Fund Agreement

Article VIII(2)(b) of the IMF Agreement, also known as the Bretton Woods Agreement, mandates that the courts of IMF member States shall recognise exchange control rules imposed by other IMF members in so far as these rules are consistent with the IMF Agreement. Consequently, any obligations expressed in the currency of a member country which has implemented exchange control rules that introduce any restrictions to payments in the contractual currency shall not be enforced by the judges of other IMF countries.

[156] See DICEY (2006), Vol 2, pp 2006-2007; and PROCTOR (2005), pp 331 sqq.

This provision can lead to the application of the laws of a country which is connected with the transaction on one single aspect – the currency in which monetary obligations are denominated (the *lex monetae*). The IMF rule does not call for any additional link with the country implementing exchange control rules – it applies simply as a matter of the currency which the parties have chosen to pay their debts or other monetary obligations, irrespective of where they are or where the performance of the contract is intended to occur. This is made very clear by IMF Decision No 446-4 by expressing IMF views that any contracts in conflict with exchange control rules of a member State "will be treated as unenforceable notwithstanding that under the private international law of the forum, the law under which the foreign exchange control regulations are maintained or imposed is not the law which governs the exchange contract or its performance".

As per the said decision, IMF's official interpretation of Article VIII(2(b) also makes the point that "the member country before which the proceedings are brought will not, on the ground that they are contrary to the public policy (*ordre public*) of the forum, refuse recognition of the exchange control regulations of the other member which are maintained or imposed consistently with the Fund Agreement".

The above is an official interpretation of an international agreement and as such it is not binding on the judges to whom it is addressed. Needless to say that this interpretation, although not legally binding, will influence the judiciary. As a result, DICEY speculates, it seems very unlikely that a judge in England, as or in any other member of the IMF, would disregard IMF instructions by not giving effect to another member's exchange control rules based on arguments of offence to the public order of the forum, even if the exchange controls in question have been or are being "administered in a discriminatory or oppressive manner"[157].

The IMF Agreement is applicable in the Portuguese legal order and is capable of being invoked before a judge hearing a dispute arising in connection with an international contract[158].

[157] See DICEY (2006), Vol 2, pp 2010-2013.

[158] Decree-Law 43 338, of 28 November 1960. See PIRES (2001), p 268.

Article VIII(2)(b) also foresees the possibility of the establishment of an agreement or terms of cooperation and mutual recognition of foreign exchange control measures implemented, or to be implemented, by either member to the extent that such initiatives are in compliance with the IMF Agreement.

Finally, the IMF Agreement is particularly relevant for this discussion in the hypothetical scenarios of Portugal withdrawing from the EU altogether pursuant to the right conferred to the Member States in Article 50 of the EU Treaty, or of a non-consensual unilateral withdrawal from the Eurozone. In such cases, the EU law will no longer bind Portugal. However, and assuming that Portugal does not resign as a member of the IMF, the IMF Agreement will still apply and the Portuguese exchange controls would have to be recognised by other IMF Members, including the English courts.

Conclusion

In light of the considered legal framework, and assuming a hypothetical scenario of Eurozone secession, it seems there is a high probability that Euro-denominated bonds, even though governed by English law, will be redenominated in the new national currency. This probability is stronger when the transaction consists of a purely or mainly domestic issue and does not hold relevant foreign elements. A fundamental aspect for consideration is whether payments under the bonds are set to be made in Portugal, since in that case mandatory redenomination and exchange controls should be given effect by foreign courts.

Nevertheless, the resolution of the problems enunciated depends on unpredictable variables. First, it is dependent on the exact terms according to which transition from the Euro to the national currency is effected, including as regards the subjective and objective scope of mandatory redenomination and the implementation process of exchange controls. Second, judges will need to ascertain the relevance of each internal or foreign connecting factor, which vary significantly by issuance, in light of the conflict of law rules and principles. And finally, the decision as to whether monetary obligations shall be discharged in Euros or in the new national currency will ultimately be subject to the judges' interpretation of the *lex monetae* of the concerned Euro-denominated bonds.

Since the beginning of the Eurozone crisis, the capital markets entail an additional risk associated with the bonds issued by the Eurozone peripheral countries. This risk is commonly referred to as the 'redenomination risk' and it is affecting not only sovereign issues, but also securities issued by private sector companies in these countries.

The redenomination risk also affects the yield to maturity of Euro-denominated bonds expressed to be governed by English law and submitted to the jurisdiction of the courts of England. This fact might be seen as an evidence of markets anticipating, i.e. putting some probability on, a mandatory redenomination of even these specific bonds in case of an Euro exit event.

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APPENDICE

Abbreviations

Brussels Convention	1968 Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters
Brussels I Regulation *or* Brussels I	Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters,
EC Treaty	Treaty establishing the European Community
ECB	European Central Bank
EMU	Economic and Monetary Union
EU	European Union
EU Treaties	Include the TEU and the TFEU
EU Treaty or TEU	Treaty on European Union
Giuliano-Lagarde Report	Report on the Rome Convention on the law applicable to contractual obligations by Mario Giuliano, Professor, University of Milan, and Paul Lagarde, Professor, University of Paris I, of 31 October 1980 (Official Journal C 282).
IMF	International Monetary Fund
IMF Decision No. 446-4	IMF Decision No. 446-4 of 10 June 1949 regarding Unenforceability of Exchange Contracts

MiFID	Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments
Regulation 1215/3012/EU *or* Recast Regulation	Regulation 1215/3012/EU on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters of 12 December 2012 (the "Recast")
Rome Convention	1980 Rome Convention on the law applicable to contractual obligations
Rome I Regulation *or* Rome I	Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom