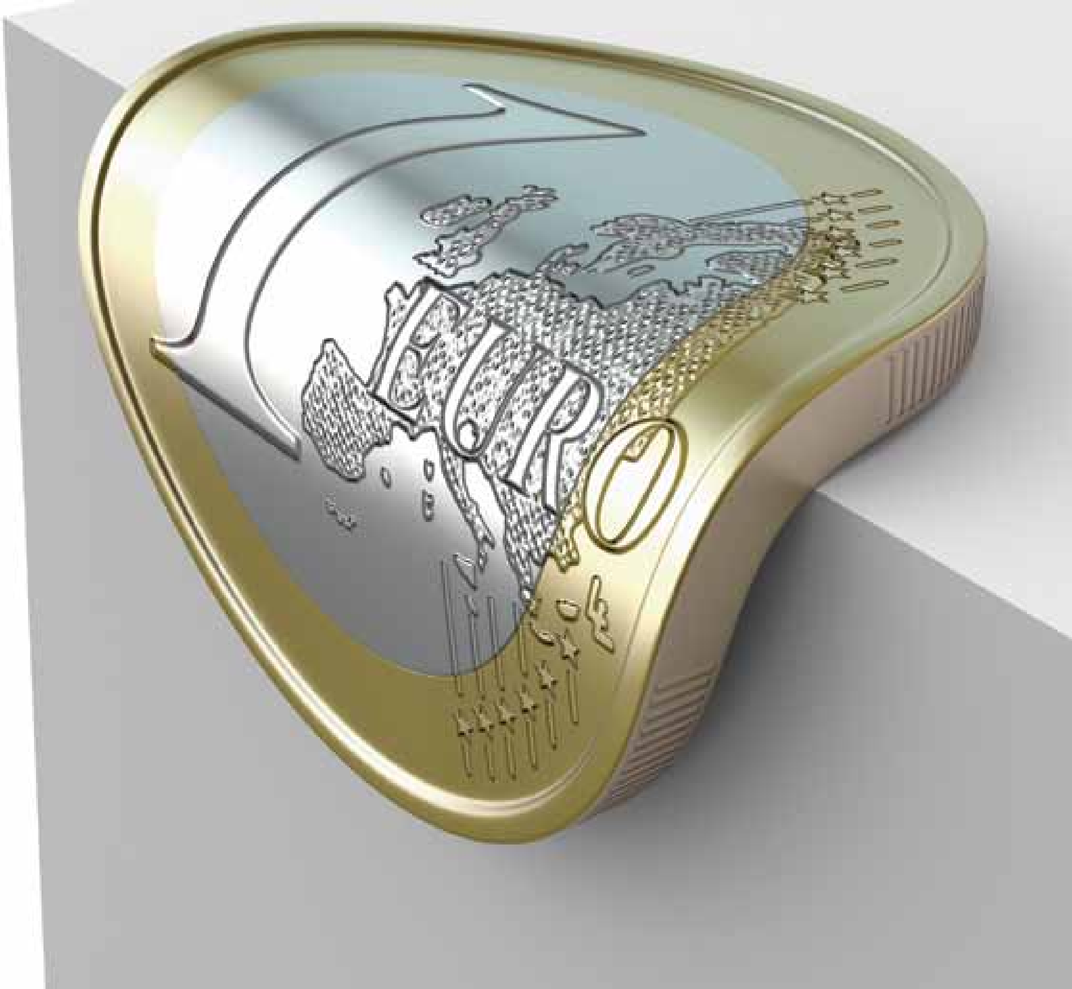
The Euro trade

Does your trade business deal with European vendors or manufacturers? Do you make or receive payments in Euros? With the currency's fate hanging in the balance, **Melissa Forbes**, an associate at the law firm Taylor Wessing, explains what steps you can take to protect your money.



As the Eurozone crisis continues to deepen, businesses should consider taking action to protect their trade activities from the potential fallout of a depreciating Euro. With Europe's rising sovereign debt levels and mounting concerns about the ability of European states to repay their debts, there is a risk that countries will begin to withdraw from the European Union and that certain member states will abandon the Euro and re-introduce their own local currencies. Therefore, it is important – especially if you have any commercial transactions in Europe – to act now by deploying contractual protection or otherwise using currency hedging.

CONTRACTUAL PROTECTION

Melissa Forbes, an Associate at Taylor Wessing, suggests that where a business receives payments in Euros it may wish to consider amending its contracts. This will ensure that the business is protected against any potential currency conversion loss, if one or more countries start to pull out of the European Monetary Union, or in the less likely event that a dispute arises between parties as to which currency shall apply in the event that the Euro no longer exists.

Likewise, it may be prudent to insert a similar provision in agreements where payments are made in Euros, for example to a supplier or a service provider, which shall apply if the Euro as a currency ceases to exist. Even if the default currency falls in value (which would benefit a business that is obliged to make payments to other parties in Euros), there is potential for uncertainty in case more than one European jurisdiction is connected to the contract. For example, a contract where products from a manufacturer in Germany are sold to a purchaser in France, in which case two European currencies will be connected with the contract.

(a) Payments received in Euros

For contracts where payments are to be received in Euros, you could nominate a currency that applies, in case the Euro ceases to exist, or if a country pulls out of the Euro, or a country introduces a second local currency. Ideally, you should choose a currency that is most likely to appreciate in value, or at least maintain its value over the term of the contract.

The calculation date for the conversion of the currency should be set at a time that is reasonably prior to the date on which the trigger is to occur (i.e. the date on which the Euro may cease to exist or the date on which a member country of the European Monetary Union may begin to recognise a second form of currency as the legal tender for such country). This is imperative as the Euro may decrease in value in the period immediately prior to the trigger date. Setting the calculation date reasonably prior to the trigger date may reduce the potentially adverse effects of a currency conversion.

(b) Payments made in Euros

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

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

ABOUT

Melissa Forbes is an associate in the corporate department of Taylor Wessing's Dubai office. She has worked as a legal consultant in Dubai since 2008 and, before that, worked for a number of years in London and Australia.

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

Melissa is qualified as a solicitor of both the Supreme Court of England and Wales and the Supreme Court of New South Wales in Australia.

Taylor Wessing is a leading International law firm, based primarily in the UK, Germany, France, the UAE and Belgium, with representative offices in Beijing and Shanghai. They also have well-established alliances with BSJP in Poland and RHT Law in Singapore. Taylor Wessing started in 1782 as a firm run by a sole practitioner, Thomas Smith. The first Taylor joined him as a partner in 1788. Its clients include leading financial institutions, major corporations, public sector bodies, as well as wealthy individuals and families.

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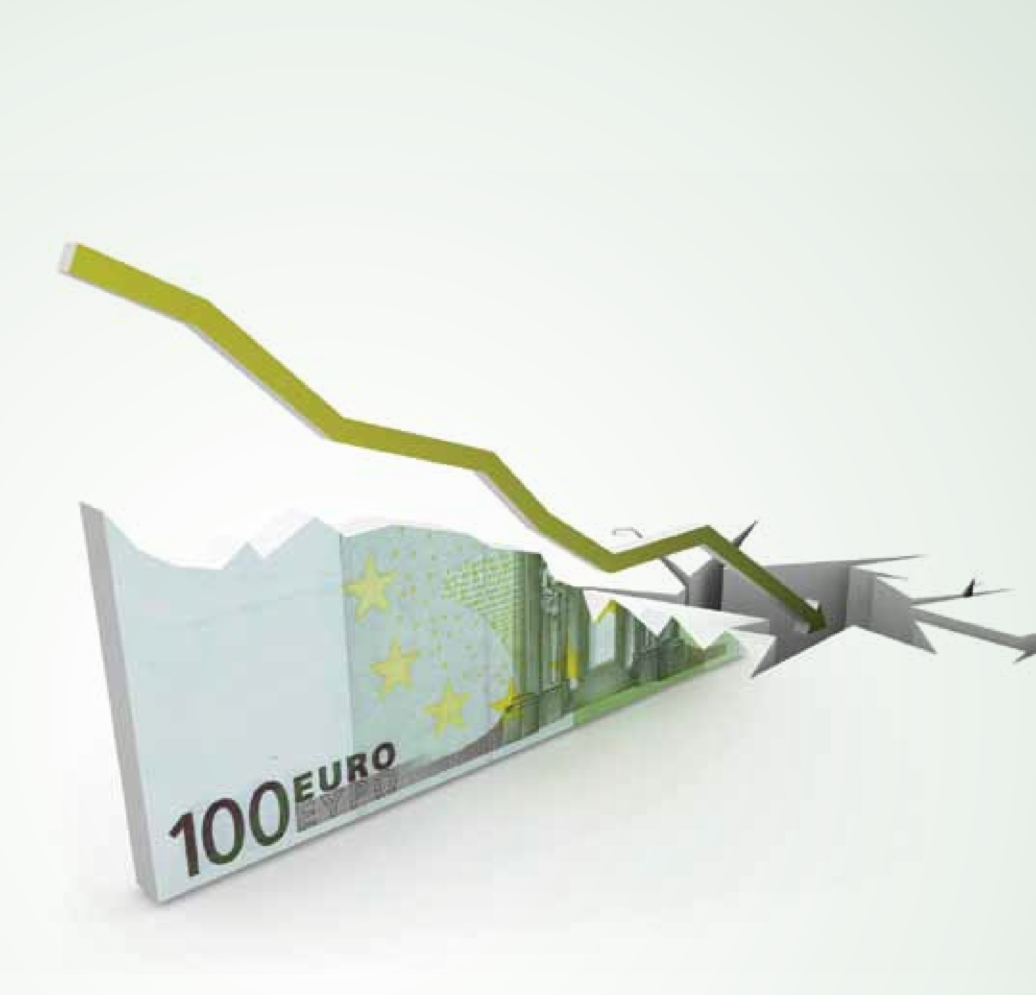

the period prior to the expiry of the Euro.

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

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USE OF DERIVATIVES

Regardless of whether the Euro fails or not, it is likely that if tensions in Europe keep mounting, the Euro will significantly fall in value.

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

A foreign exchange derivative instrument is an option in a contract, a sort of insurance, that allows a party to force its counterparty, the bank, to buy or sell a currency (in this case, the Euro versus the US dollar) for a particular price.

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

Let's say, for illustrative purposes, the level is USD 1.25: EUR 1 and the premium is 4.5%. If the value of the Euro drops to USD 1.10, at the end of that one year period, the company will be protected from the USD 0.15 currency conversion loss per Euro that it would have otherwise incurred had it not entered into the derivative agreement.

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

Thus, there are many alternative and cheap solutions available for businesses that seek to protect themselves against a deepening of the Eurozone crisis that would lead to a strong depreciation in the Euro. These solutions are different from what a business can use to manage a small decrease in Euro value. Given the uncertain times that companies in the trade business face with the Eurozone crisis, it is only prudent to employ a risk management policy that explores and implements practical solutions. ■