

EFMLG Symposium on Standard Market Documentation

Notice Provisions and Enforcement

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Topics

- Significance of notice provisions
- Form of notices
- Address to which notices delivered
- Methods of delivery of notices
- Business days and hours
- Summary of problems and suggestions
- Harmonisation?

Scope

- Agreements
 - ISDA Master Agreements (1992 and 2002), GMRA, GMSLA and European Master Agreement
 - Already broadly similar
 - Minor differences
 - GMRA requires English language, alternate certificate referred to below
 - GMSLA defines Close of Business
- Focus on ISDA Master Agreements; return to harmonisation at end

The Significance



- Formal notice provisions establish legal rights on enforcement; See Section 12 of ISDA Master Agreements
 - How do you give under long-form confirmation?
- If noncompliance, the notice may be invalid
 - May attempt to uphold validity through reliance on Mannai holding: if intent is clear and there are no timing ambiguities, an otherwise invalid notice will suffice
 - Counterargument is based on Peaceform holding: if critical date or dates are left uncertain, notice is invalid

- Commencement of the running of grace periods and hence the occurrence of an Event of Default
 - Sections 5(a)(i) and (ii)
 - Grace periods in Sections 5(a) (iii), (v), (vi) and (vii)(4)(B) do not require notice under the ISDA Master Agreements for commencement
 - An invalid notice would mean that the relevant grace period had not started
 - Ambiguity as to when the notice was effective
 - will mean ambiguity as to when grace period started and Event of Default occurs
 - if the breach is cured by the later resulting date, the ETD **cannot** be designated

- Designation of the Early Termination Date, which may fall on the effective date of the notice or within 20 days after effective date
 - Invalidity means that enforcement action cannot be taken; must give valid second notice
 - If invalidity is discovered late in the process, serious problem both legally and practically
 - Hedging positions closed out earlier on or about supposed ETD; exposed to rate changes

- Non-defaulting Party obligated on or as soon as reasonably practicable following the ETD to determine the close-out amount **and** provide a statement (notice) to the Defaulting Party with reasonable details
 - On effectiveness of notice
 - close-out amount is due (with interest from ETD) and
 - If owed by Non-Defaulting Party, interest starts accruing on the close-out amount the next day at the **Default Rate**
 - Invalidity of notice could put Non-defaulting Party in breach

- Other significant purposes
 - Notice of Termination Event promptly
 - Failure to give (or invalidity) may mean event treated as Event of Default rather than Illegality (Nuova Safim spa v Sakura)
 - Notify of change of address, change of account (or objection to it), withholding tax, failure of payee representation, inability to transfer after certain Termination Events and Process Agent failure
 - Demands and Events of Default under CSA
 - When does failure to Transfer become a Potential Event of Default? Is dispute timely? Demand for further assurances (NY law CSA)

Form

- No particular form required
 - **Minimum for enforcement**
 - refer to Master Agreement and Event of Default and
 - designate an ETD on or within 20 days after effectiveness of notice
 - Master Agreement does the rest
 - Other “boilerplate” helpful but not necessary
- What if, instead of designating an ETD, you say “We hereby terminate the Transactions under...”
 - Under Mannai, argue the intent is clear
 - Under Peaceform, counter argue that selection of actual date is critical and notice is invalid

Address

- Send to address or addresses specified in the Schedule; otherwise invalid
 - Or to other address specified in compliant notice by other party under the Agreement
 - Significance of record keeping and immediate access to this “minor bit of” information
 - Parties often require ETD notice to be given to second addressee (e.g., General Counsel)
 - Delays may result, and doubles the chance of invalidity

- What if address is old, no longer an address of Defaulting Party, but there has been no formal change? Will New York or English court treat that as valid?
 - Attempt also to give notice to Defaulting Party representatives you have been dealing with?
- If Defaulting Party is insolvent, is notice to insolvency representative required under **substantive** law for formal effectiveness? If so, is notice to address in Schedule still required?
- Presumably give notice to address formally required in agreement and, if an issue, formal communication of actual notice to required persons

Methods

- ISDA Master Agreements permit effective notice by
 - Writing, hand delivery
 - Telex (who has a telex? Not discussed further)
 - Fax (but 1992 not permit for Section 5 or 6 notice)
 - Certified or registered (air) mail, return receipt requested,
 - Electronic messaging (but not for Section 5 or 6)
 - Email (2002 only, but not for Section 5 or 6)
- Fax, electronic messaging or email **may** be relevant to Section 5 or 6 if through those means Defaulting Party had changed its notice particulars or either party had given notice of an Illegality or under a CSA

- Writing, by hand delivery, is effective when delivered
 - Safest, most secure, most sure means
 - At least if you are in same city, are indifferent to travel costs or can arrange a local representative to effect the delivery
 - What if the Defaulting Party refuses to accept delivery, or locks the doors?
 - Would a court take a more “flexible” view on compliance with formalities if Defaulting Party had taken steps to evade delivery?
 - Did notice specify today as ETD and you closed your hedge down today confident that delivery would be made?

- Certified or registered (air) mail, return receipt requested, effective when delivered or attempted to be delivered
 - Delays (three, five, ten days?) before get delivery details back from postal service
 - Lack of control over delivery process
 - How prove attempt at delivery?
 - Deciphering postal worker’s handwriting
 - Deciphering “signature” on a receipt
 - Has any financial institution ever sent registered mail, return receipt requested?

- Fax, effective on date received by a responsible official in legible form (1992 not permit for Section 5 or 6 notice)
 - Burden of proof of receipt on sender
 - Transmission report generated by sender's fax machine not sufficient
 - Legibility? How prove?
 - Who is a responsible official? Certainly not the fellow in the fax room
 - What if they turn off fax machine?
- Unsafe means of giving formal notice: do not know, when you send, if it is valid. Worst of all results

- Electronic messaging and (2002 only) email
 - Not permitted for Section 5 or 6 notices
 - Issues of interception and diversion if open system
 - Is email an electronic message? Probably not, but thoughts differ
- Differences between “delivered” and “received”
 - English case law under the Arbitration Act 1996 points to a notice served by e-mail being effective when it is delivered to the correct e-mail address, even though the e-mail is not accessed by the intended recipient
 - Reference to receipt in the same master agreement suggests more is required than with delivery
 - Receipt may well mean actual access by the intended recipient, and if so, would be fraught with problems and create anomalous results with notices via e-mail and via electronic messaging systems
- No logic to support different treatment between e-mail and electronic messaging

- UNCITRAL model law on e-commerce provides as suggested standard that a message is received when the message enters the system of the recipient, except where the sender sends to a different system to the designated one, in which case it is received when actually retrieved
- Problems of lack of certainty in present context would remain – sender has no knowledge of whether or not the notice has entered relevant system and read receipts or similar depend on protocols of recipient's systems

- Solution may lie in agreed principles relating to use of trusted third parties:
 - Both counterparties appoint a trusted third party (“TTP”) whose systems are set up to provide receipt confirmations to both sender and recipient
 - Electronic Notice of Termination Event or similar is sent to the intended recipient by e-mail or electronic message with a copy to the TTP
 - On receipt by TTP, the TTP automatically issues time and date stamped confirmations to sender and recipient, which constitutes sufficient proof of service at that date and time for close out, provided other rules, such as occurrence during normal business hours, are satisfied
- Normal issues remain around authenticity, integrity and reliability of electronic messages, but use of encryption may go a long way to resolve

Business Days/Hours

- Delivery, attempt or receipt: before the close of business on a Local Business Day
 - Otherwise, effective on **next** Local Business Day
 - Local Business Day: a day on which commercial banks are open for business (including dealings in FX and foreign currency deposits) in city specified in address in the schedule
 - Close of business? When the secretaries leave or get overtime? When bank retail branches close? When FX dealings stop? Do they ever?
 - Maybe OK for London, but Omaha, Nebraska?
 - What of attempted delivery before business hours, e.g., 5.00 a.m.?

- Nightmare scenario
 - Hand deliver notice designating today as ETD
 - Deliver at 4:01pm but the close of business is later determined to be 4:00pm
 - Notice will become effective tomorrow, but then the designated ETD is previous day
 - Notice is invalid
 - Did you shut your hedge down today?

- Multiple notice solution
 - Give notice by several methods to assure effectiveness
 - Make sure ETD is same in all and falls after the method with the latest possible ascertainable effective date
 - Problems: You are certain one failed but uncertain as to another (e.g. fax) or delay in confirming effectiveness of another (waiting for return receipt from postal service)

Problems/Suggestions

- Close of business
 - Clarification in agreement
 - GMSLA defines by reference to relevant bank, settlement system etc
 - Relevance to receipt of notice?
 - A line in the Schedule to agree?
 - What if change address? New agreement?
 - Simply agree a time, e.g., 4:00pm
 - A combination of those, as in the CSA for Notification Time? Also include **start** of business hours?

- Locked door, shut off fax
 - Alternative certificate of attempt to comply
 - GDSC proposal/GMRA provision
 - Try 2 methods, sign and date certificate reciting Event of Default, attempts at delivery
 - Problems:
 - How do you know fax wasn't received in legible form by responsible person (multiple notice problem)?
 - Moral hazard? Requirement for MD or equivalent to sign?
 - Notification on Non-defaulting Party website??
 - Privacy/confidentiality issues
 - Does everybody check that out?

Harmonisation

- Benefits
 - Convenience and speed: simpler and faster to send out one form rather than five
 - Avoid errors/mistakes because of fewer provisions to review
 - Reduce risk that one notice is invalid, others are valid and operative with consequent loss of opportunity for setoff

- Disadvantages
 - Unless Events of Default and other similar events are standardised, each situation must be looked at separately and in detail
 - Even then, enforcement mechanics differ, and will have different timing requirements
 - Technicalities of notice provisions should not be fiddled with to achieve broader desirable results that should be dealt with directly
 - Example: no payment by Non-defaulting Party until all agreements terminated and amounts due and payer determined
- Standard form of notice for all may not be practical

Terms to Harmonise Further



- Basic notice terms **can** be further modified on a harmonised basis
 - Business day and business hours
 - Methods
 - Exclude fax?
 - Alternate method when doors locked
 - Consistent effectiveness (when deemed delivered)
 - For all, but particularly important for email and electronic messaging