

# The 1992 ISDA Master Agreement

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Section by section analysis of the 1992 ISDA Master Agreement

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Glossary of most terms in Section 14

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When I first came across an ISDA Master Agreement in 1990 (it was a 1987 style Agreement) I had three thoughts:

- **Where's my magnifying glass?**
- **Help!**
- **God so loved the world He didn't send a Committee.**

However, when I became more familiar with it, I found some similarities to provisions in loan agreements although the terminology differed. By and large, the main difference between ISDA documentation and loan agreements is the two-way application of many of the provisions in the Agreement.

## SECTION BY SECTION ANALYSIS OF THE 1992 ISDA MASTER AGREEMENT

The main interpretative document for the 1992 ISDA Master Agreement is the *User's Guide to the 1992 ISDA Master Agreements* (the *User's Guide*) published by ISDA in January 1993. This describes:

- **how the ISDA Master Agreement evolved;**
- **gives technical interpretations and reasoning for the provisions; and**
- **mentions areas where agreement was not reached by the Working Group.**

The *User's Guide* has a wealth of information but its language can at times be complex and, as it is likely that many of its users may not be legal or tax technicians nor speak English as their first language, I thought it might be useful to provide a section by section interpretation of the 1992 ISDA Master Agreement which is clear but not oversimplified.

# ISDA<sup>®</sup>

International Swap Dealers Association, Inc.

## MASTER AGREEMENT

dated as of .....

..... and .....

have entered and/or anticipate entering into one or more transactions (each a “Transaction”) that are or will be governed by this Master Agreement, which includes the schedule (the “Schedule”), and the documents and other confirming evidence (each a “Confirmation”) exchanged between the parties confirming those Transactions.

## Preamble

The ISDA Master Agreement starts by being expressed as “dated as of”. It is customary to date the Agreement and its Schedule as of the date of the first trade between the parties, even if the Agreement is not signed until some months later. This is based on US practice where the words “as of” mean “with effect from” a specified date. This is contrary to best English practice where it is normal to date an agreement on the day it is signed. Under English law you cannot create a contract retrospectively through backdating it. If you do, you run the high risk of it being considered a forgery. To avoid misleading any court, the preamble to the signing block on page 18 makes it clear that the “as of” date is merely the effective date. The signing block records the date upon which the Agreement is actually signed.

The two parties then enter their full legal names and can add details of the jurisdictions where they are incorporated. If cited, this would also be repeated on the first page of the Schedule. Then there is a statement that the parties have entered or propose to enter into Transactions under the Agreement which includes its Schedule (used to add to or amend the basic Agreement provisions and which is what negotiators negotiate) and any Confirmations exchanged between the parties. This is the basis for the parties’ contractual relationship and is important for the single agreement concept as we shall see shortly in Section 1(c). It is made clear that the Agreement can cover transactions entered into before it was executed.

Market practice is not to make changes directly on to the pre-printed Agreement text (although this was sometimes done in the early days of the market) but rather in the Schedule. This avoids the need to search the pre-printed text for changes when reviewing it at a later date.

Accordingly, the parties agree as follows:-

**1. Interpretation**

- (a) *Definitions.* The terms defined in Section 14 and in the Schedule will have the meanings therein specified for the purpose of this Master Agreement.
- (b) *Inconsistency.* In the event of any inconsistency between the provisions of the Schedule and the other provisions of this Master Agreement, the Schedule will prevail. In the event of any inconsistency between the provisions of any Confirmation and this Master Agreement (including the Schedule), such Confirmation will prevail for the purpose of the relevant Transaction.
- (c) *Single Agreement.* All Transactions are entered into in reliance on the fact that this Master Agreement and all Confirmations form a single agreement between the parties (collectively referred to as this “Agreement”), and the parties would not otherwise enter into any Transactions.

## **Section 1 – Interpretation**

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### **Section 1(a)**

Defined terms in Section 14 and the Schedule will have their relevant meanings for the purpose of the Agreement.

### **Section 1(b)**

Where there is any inconsistency between the Agreement text and the Schedule, the Schedule will prevail. Where there is a conflict between a Confirmation and the Agreement and its Schedule, the Confirmation will prevail in respect of the relevant Transaction. This gives the Confirmation supremacy in respect of individual deals.

### **Section 1(c)**

The single agreement concept is vitally important and is the basis of close-out netting. Section 1(c) states that all Transactions are entered into relying upon the fact that the Agreement and all Confirmations under it form a single agreement between the parties and they would not have entered into these Transactions otherwise. What this means is that in a close-out situation, the values of all Transactions between the parties are calculated and netted off against each other so as to produce a single figure payable one way or the other. In an insolvency situation, this prevents a liquidator cherrypicking, i.e. making payments on those Transactions which are profitable to his insolvent client and refusing to do so on other Transactions which are not profitable to them. A liquidator cannot do this if all the Transactions are collapsed into a single payment due to one party or the other. In other words there is only one cherry. The single agreement concept reinforces this position.

**2. Obligations**

(a) ***General Conditions.***

(i) Each party will make each payment or delivery specified in each Confirmation to be made by it, subject to the other provisions of this Agreement.

(ii) Payments under this Agreement will be made on the due date for value on that date in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement, in freely transferable funds and in the manner customary for payments in the required currency. Where settlement is by delivery (that is, other than by payment), such delivery will be made for receipt on the due date in the manner customary for the relevant obligation unless otherwise specified in the relevant Confirmation or elsewhere in this Agreement.

(iii) Each obligation of each party under Section 2(a)(i) is subject to (1) the condition precedent that no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing, (2) the condition precedent that no Early Termination Date in respect of the relevant Transaction has occurred or been effectively designated and (3) each other applicable condition precedent specified in this Agreement.

(b) ***Change of Account.*** Either party may change its account for receiving a payment or delivery by giving notice to the other party at least five Local Business Days prior to the scheduled date for the payment or delivery to which such change applies unless such other party gives timely notice of a reasonable objection to such change.



## Section 2 – Obligations

### Section 2(a)

- (a)(i) This is a simple statement that each party will make each payment or delivery required from it under the relevant Confirmation unless other terms of the Agreement (e.g. Early Termination provisions) intervene. The numerous references to “delivery” in the Agreement cover Transactions which are settled by physical delivery (i.e. delivery of a share or commodity instead of cash) which can also be covered by the Agreement. However, the Agreement itself cannot fully document physically settled Transactions, which is why Confirmations for them are very detailed.
- (a)(ii) This is a general statement to the effect that payments and deliveries will be made promptly, in freely transferable funds and in the customary manner in the place of settlement, unless otherwise agreed in a Confirmation or elsewhere in the Agreement.
- (a)(iii) This means that normal payments or deliveries under Section 2(a)(i) will stop if an Event of Default or Potential Event of Default (an event which could lead to an Event of Default if it develops) occurs to one of the parties or if an Early Termination Date (when close-out calculations are made) is designated whether for a Termination Event (see page 67 for an explanation of this latter term) or if any other condition precedent (e.g. the provision of credit support) in the Agreement is unfulfilled. Please note that under (1), the default could be outside the Agreement, e.g. non-payment of indebtedness under another agreement which might trigger the Cross Default clause in this Agreement.

Any payments withheld because of the events in section 2(a)(iii) will be treated as Unpaid Amounts under the Section 6 close-out calculations if Market Quotation is chosen as a payment measure (see commentary on Section 6, pages 77–9) or one of the components of Loss (if that is chosen as the payment measure).

### Section 2(b)

One party to the Agreement may give the other at least five Local Business Days’ notice of a change in its account for payments or deliveries. The *User’s Guide* clarifies that this notice period is to be calculated in the Local Business Days of the place where the new account is to be located. The other party may object to this (there is a reasonableness standard) by giving notice to the first party. It might do this if such a change of account is to an overseas Office of the first party and a withholding tax charge might arise. It might also object to an overseas transfer of account if there was a risk of exchange controls being imposed.

- (c) **Netting.** If on any date amounts would otherwise be payable:-
- (i) in the same currency; and
  - (ii) in respect of the same Transaction,

by each party to the other, then, on such date, each party's obligation to make payment of any such amount will be automatically satisfied and discharged and, if the aggregate amount that would otherwise have been payable by one party exceeds the aggregate amount that would otherwise have been payable by the other party, replaced by an obligation upon the party by whom the larger aggregate amount would have been payable to pay to the other party the excess of the larger aggregate amount over the smaller aggregate amount.

The parties may elect in respect of two or more Transactions that a net amount will be determined in respect of all amounts payable on the same date in the same currency in respect of such Transactions, regardless of whether such amounts are payable in respect of the same Transaction. The election may be made in the Schedule or a Confirmation by specifying that subparagraph (ii) above will not apply to the Transactions identified as being subject to the election, together with the starting date (in which case subparagraph (ii) above will not, or will cease to, apply to such Transactions from such date). This election may be made separately for different groups of Transactions and will apply separately to each pairing of Offices through which the parties make and receive payments or deliveries.

## Section 2(c)

Section 2(c) of the Agreement is about payment or settlement netting and aims to reduce settlement risk – sometimes called daylight risk.

Payments can be made net if they are in the same currency, for the same Transaction and payable on the same date. This means that both parties do not have to make payments to each other but the one who owes the most pays the difference between the two amounts to the other party. This avoids the inconvenience of each party making a gross payment to the other and also reduces settlement risk (i.e. that one party will fail to make its payment after the other party has done so).

The basic payment netting position is single Transaction netting, i.e. same Transaction, same currency and same value date. By making a choice in the Schedule that single Transaction netting will not apply, parties can net payments due under two or more Transactions in the same currency and on the same date both for the same and different products.

For multiple Transaction netting they can net different groups of Transactions (e.g. interest rate swaps only) and/or apply this separately to each pairing of their Offices. These arrangements can also be applied to deliveries. The provisions are very flexible, but you should only really agree to what you can actually do operationally or you could incur operational risk.

Figure 3.1 should help to illustrate this.



**FIG. 3.1**

Single Transaction payment netting:

- same Transaction
- same currency
- same value date

(d) ***Deduction or Withholding for Tax.***

(i) ***Gross-Up.*** All payments under this Agreement will be made without any deduction or withholding for or on account of any Tax unless such deduction or withholding is required by applicable law, as modified by the practice of any relevant governmental revenue authority, then in effect. If a party is so required to deduct or withhold, then that party (“X”) will:-

(1) promptly notify the other party (“Y”) of such requirement;

(2) pay to the relevant authorities the full amount required to be deducted or withheld (including the full amount required to be deducted or withheld from any additional amount paid by X to Y under this Section 2(d)) promptly upon the earlier of determining that such deduction or withholding is required or receiving notice that such amount has been assessed against Y;

(3) promptly forward to Y an official receipt (or a certified copy), or other documentation reasonably acceptable to Y, evidencing such payment to such authorities; and

(4) if such Tax is an Indemnifiable Tax, pay to Y, in addition to the payment to which Y is otherwise entitled under this Agreement, such additional amount as is necessary to ensure that the net amount actually received by Y (free and clear of Indemnifiable Taxes, whether assessed against X or Y) will equal the full amount Y would have received had no such deduction or withholding been required. However, X will not be required to pay any additional amount to Y to the extent that it would not be required to be paid but for:-

## Section 2(d)

(i)

This is a complex clause on withholding tax but it becomes clearer if you see X as the payer and Y as the payee or recipient. Please note that under ISDA, a withholding tax only applies in cross-border transactions.

The ISDA Master Agreement is an international agreement and where cross-border Transactions occur, tax authorities may impose taxes called withholding taxes on payments made under those Transactions. Where this happens and you were due to receive a payment as payee, you would receive less than you expected. Section 2(d) provides an indemnity that a payer has to increase his payment if a withholding tax is charged so that the payee receives what he expected to receive. Generally speaking, the burden of withholding taxes usually falls on the payer.

Withholding taxes can arise in three ways:

- **incorrect initial analysis that no withholding tax applied;**
- **a change in Tax Law or similar legal development;**
- **a change of facts relating to either the payer or payee which occurs after a Transaction is entered.**

This could arise through a change of status or business resulting in the party being no longer eligible for tax treaty benefits. If a withholding tax is levied because of a change of facts the responsible party will need to pay it or suffer it but will have no right to call a Tax Event Termination Event (see commentary on Section 5(b)(ii)).

Going through the various points, if a withholding tax is levied on a payer, it must:

- **promptly notify the payee of this;**
- **promptly pay the withholding tax calculated or assessed to the tax authorities;**
- **promptly send the payee satisfactory documentation evidencing the tax payment to the authorities; and**
- **pay the equivalent of the withholding tax together with the net payment to the payee so that it ends up with the amount it originally anticipated.**

(A) the failure by Y to comply with or perform any agreement contained in Section 4(a)(i), 4(a)(iii) or 4(d); or

(B) the failure of a representation made by Y pursuant to Section 3(f) to be accurate and true unless such failure would not have occurred but for (I) any action taken by a taxing authority, or brought in a court of competent jurisdiction, on or after the date on which a Transaction is entered into (regardless of whether such action is taken or brought with respect to a party to this Agreement) or (II) a Change in Tax Law.

Please note that an Indemnifiable Tax arises in a cross-border situation and is not a domestic income, capital or sales tax. It aims to indemnify a party adversely affected by it, usually a payee. It arises because the payer has decided to do business with a foreign payee.

However, (A) and (B) (in the text opposite) provide two exceptions to this.

The payee will not receive a payment grossed up for withholding tax where it has failed to provide any tax documentation necessary to the payer or a Payee Tax Representation it has made has become false, unless this has happened because of tax authority or court action or a Change in Tax Law.

Let's take an example to illustrate this. Suppose that a US payer has to pay a foreign payee US\$1,000,000 under the terms of a Confirmation. Assume further that the US levies withholding tax at 30% on this payment and under the terms of the Agreement the payer has to gross up the payment. The payer's total grossed up payment would be US\$1,428,571.

This is calculated as follows:

**Confirmation Payment/1-Withholding Tax rate = Grossed up payment**

**US\$1,000,000/0.70 (i.e. 100%-30%) = US\$1,428,571.**

The amount of the gross up payment as a percentage of the Confirmation payment is greater than the 30% withholding tax rate because it also applies to the additional gross up payment the payer is required to make. This is because the obligation to indemnify applies to gross payments.

Similar provisions are common in loan agreements where cross-border payments have to be made.

(ii) **Liability.** If:-

- (1) X is required by any applicable law, as modified by the practice of any relevant governmental revenue authority, to make any deduction or withholding in respect of which X would not be required to pay an additional amount to Y under Section 2(d)(i)(4);
- (2) X does not so deduct or withhold; and
- (3) a liability resulting from such Tax is assessed directly against X,

then, except to the extent Y has satisfied or then satisfies the liability resulting from such Tax, Y will promptly pay to X the amount of such liability (including any related liability for interest, but including any related liability for penalties only if Y has failed to comply with or perform any agreement contained in Section 4(a)(i), 4(a)(iii) or 4(d)).

(e) **Default Interest; Other Amounts.** Prior to the occurrence or effective designation of an Early Termination Date in respect of the relevant Transaction, a party that defaults in the performance of any payment obligation will, to the extent permitted by law and subject to Section 6(c), be required to pay interest (before as well as after judgment) on the overdue amount to the other party on demand in the same currency as such overdue amount, for the period from (and including) the original due date for payment to (but excluding) the date of actual payment, at the Default Rate. Such interest will be calculated on the basis of daily compounding and the actual number of days elapsed. If, prior to the occurrence or effective designation of an Early Termination Date in respect of the relevant Transaction, a party defaults in the performance of any obligation required to be settled by delivery, it will compensate the other party on demand if and to the extent provided for in the relevant Confirmation or elsewhere in this Agreement.



(ii)

Section 2(d)(ii) covers the situation where the payer makes a payment without withholding tax relying upon tax documentation received from the payee and is unaware of any breach of a Payee Tax Representation by the payee (which is not caused by a Change in Tax Law) and the payer's tax authority then requires him to pay withholding tax in respect of that previous payment. In these circumstances, the payee will indemnify the payer for that withholding tax, any interest on it or any other penalty for failing to provide the payer with necessary tax documentation so that, *inter alia*, the payer could avoid the withholding tax or pay it at a reduced rate.

### Section 2(e)

This means that late payments in the normal course will attract interest at the Default Rate (i.e. 1% over the payee's cost of funds) from, and including the date the payment was due to but excluding the date it was actually paid – the normal practice in the derivatives markets. If an Early Termination Date occurs (Section 6(c)), interest on overdue amounts will accrue as provided in Section 6(d)(ii).

During ISDA Working Group meetings there was no agreement on how to apply the concept of default interest to physically settled transactions. Section 2(e) provides that compensation for late delivery will be determined “as provided in the relevant Confirmation or elsewhere in this Agreement”.

However, this matter is extensively treated in Section 9(h) of the 2002 ISDA Master Agreement (see pages 256–67).

### 3. Representations

Each party represents to the other party (which representations will be deemed to be repeated by each party on each date on which a Transaction is entered into and, in the case of the representations in Section 3(f), at all times until the termination of this Agreement) that:-

(a) **Basic Representations.**

(i) **Status.** It is duly organised and validly existing under the laws of the jurisdiction of its organisation or incorporation and, if relevant under such laws, in good standing;

(ii) **Powers.** It has the power to execute this Agreement and any other documentation relating this Agreement to which it is a party, to deliver this Agreement and any other documentation relating to this Agreement that it is required by this Agreement to deliver and to perform its obligations under this Agreement and any obligations it has under any Credit Support Document to which it is a party and has taken all necessary action to authorise such execution, delivery and performance;

(iii) **No Violation or Conflict.** Such execution, delivery and performance do not violate or conflict with any law applicable to it, any provision of its constitutional documents, any order or judgment of any court or other agency of government applicable to it or any of its assets or any contractual restriction binding on or affecting it or any of its assets;

(iv) **Consents.** All governmental and other consents that are required to have been obtained by it with respect to this Agreement or any Credit Support Document to which it is a party have been obtained and are in full force and effect and all conditions of any such consents have been complied with; and

(v) **Obligations Binding.** Its obligations under this Agreement and any Credit Support Document to which it is a party constitute its legal, valid and binding obligations, enforceable in accordance with their respective terms (subject to applicable bankruptcy, reorganisation, insolvency, moratorium or similar laws affecting creditors' rights generally and subject, as to enforceability, to equitable principles of general application (regardless of whether enforcement is sought in a proceeding in equity or at law)).

## Section 3 – Representations

Each party represents various matters listed in this Section to the other. These representations are considered to be repeated each time a new Transaction is undertaken between the parties and the Payee Tax Representations in Section 3(f) are deemed made at all times until the termination of the Agreement. This is because payments need to be made periodically throughout the lives of the Transactions. Many of these representations are commonly seen in loan agreements.

Where parties are very active and enter into hundreds of deals over several years they should take care in agreeing representations which would require constant monitoring over the lives of deals so as to avoid a Misrepresentation Event of Default (under Section 5(a)(iv)) if a representation became untrue.

The basic representations in Section 3(a) are largely self explanatory and are:

- each party is properly organised and has a valid legal existence in its jurisdiction of incorporation;
- each party has the power and is authorised to execute, deliver and perform under the Agreement, related documentation and any Credit Support Document which it is providing itself (e.g an English law ISDA Credit Support Annex). A party's capacity and authority to enter into derivatives transactions are vital to the Agreement's effectiveness (as we shall see in Chapter 5 on legal issues);
- such actions do not conflict with a party's legal obligations, constitutional documents or any court or government agency order relating to its assets or any contractual restriction on them;
- each party has obtained any necessary government or other consents for the Agreement or any Credit Support Document and ensured that such consents are in full force and effect and fully complied with by the party concerned; and
- each party's obligations under the Agreement or any Credit Support Document constitute legal, valid and binding obligations enforceable against it subject to insolvency laws or general equitable legal principles. This is regardless of whether proceedings take place under common law or in equity. However, it is important that the Agreement or any Credit Support Document does not offend the public policy rules of any jurisdiction where you may seek to enforce it. Provided the Agreement is not, for instance, solely used for gambling purposes, this is not likely.

(b) ***Absence of Certain Events.*** No Event of Default or Potential Event of Default or, to its knowledge, Termination Event with respect to it has occurred and is continuing and no such event or circumstance would occur as a result of its entering into or performing its obligations under this Agreement or any Credit Support Document to which it is a party.

(c) ***Absence of Litigation.*** There is not pending or, to its knowledge, threatened against it or any of its Affiliates any action, suit or proceeding at law or in equity or before any court, tribunal, governmental body, agency or official or any arbitrator that is likely to affect the legality, validity or enforceability against it of this Agreement or any Credit Support Document to which it is a party or its ability to perform its obligations under this Agreement or such Credit Support Document.

(d) ***Accuracy of Specified Information.*** All applicable information that is furnished in writing by or on behalf of it to the other party and is identified for the purpose of this Section 3(d) in the Schedule is, as of the date of the information, true, accurate and complete in every material respect.

(e) ***Payer Tax Representation.*** Each representation specified in the Schedule as being made by it for the purpose of this Section 3(e) is accurate and true.

(f) ***Payee Tax Representations.*** Each representation specified in the Schedule as being made by it the purpose of this Section 3(f) is accurate and true.

### Section 3(b)

This is a useful representation made by each party that no actual or potential close-out event has occurred or persists and none would arise from entering into or performing its obligations under the Agreement or a Credit Support Document.

### Section 3(c)

Absence of Litigation deals with actual and threatened litigation against a party and its Affiliates (i.e. other group companies) which is likely to affect the legal enforceability of the Agreement or any Credit Support Document or a party's performance under them. Some market players seek to delete Affiliates by a Schedule amendment as, with a widely spread group like a major bank, it may not know of such litigation affecting its Affiliates in other parts of the world. Others seek to limit the clause to Specified Entities or Credit Support Providers. (These terms are explained in the commentary on Section 5.) In other cases parties amend the provision by stating that the litigation must have a material adverse effect on its ability to perform under the Agreement or upon the Agreement's enforceability.

Please note that Sections 3(a)(ii), (iv), (v) and 3(b) and (c) capture Credit Support Documents entered into by parties to the Agreement.

### Section 3(d)

Parties specify in Part 3(b) of the Schedule, the categories of information to which this representation applies. The test is rigorous – the information must be true, accurate and complete in every material respect. In Chapter 8, I discuss this representation in connection with audited accounts (see pages 487–8).

### Sections 3(e) and 3(f)

In Sections 3(e) and (f), the parties state that the Payer and Payee Tax Representations they have made are true and accurate. These representations are made in Parts 2(a) and (b) of the Schedule.

#### 4. **Agreements**

Each party agrees with the other that, so long as either party has or may have any obligation under this Agreement or under any Credit Support Document to which it is a party:-

(a) ***Furnish Specified Information.*** It will deliver to the other party or, in certain cases under subparagraph (iii) below, to such government or taxing authority as the other party reasonably directs:-

(i) any forms, documents or certificates relating to taxation specified in the Schedule or any Confirmation;

(ii) any other documents specified in the Schedule or any Confirmation; and

(iii) upon reasonable demand by such other party, any form or document that may be required or reasonably requested in writing in order to allow such other party or its Credit Support Provider to make a payment under this Agreement or any applicable Credit Support Document without any deduction or withholding for or on account of any Tax or with such deduction or withholding at a reduced rate (so long as the completion, execution or submission of such form or document would not materially prejudice the legal or commercial position of the party in receipt of such demand), with any such form or document to be accurate and completed in a manner reasonably satisfactory to such other party and to be executed and to be delivered with any reasonably required certification,

in each case by the date specified in the Schedule or such Confirmation or, if none is specified, as soon as reasonably practicable.

(b) ***Maintain Authorisations.*** It will use all reasonable efforts to maintain in full force and effect all consents of any governmental or other authority that are required to be obtained by it with respect to this Agreement or any Credit Support Document to which it is a party and will use all reasonable efforts to obtain any that may become necessary in the future.

(c) ***Comply with Laws.*** It will comply in all material respects with all applicable laws and orders to which it may be subject if failure so to comply would materially impair its ability to perform its obligations under this Agreement or any Credit Support Document to which it is a party.

## Section 4 – Agreements

Section 4 contains agreements of the parties which survive while they have any obligations under the Agreement or any Credit Support Document.

### Section 4(a)

Section 4(a) records the agreement of each party to supply certain specified information. In Section 4(a)(i), they must state in the Schedule or in a Confirmation any tax related forms, documents or certificates which are required to be delivered and the timescales for such delivery. Delivery will normally be to the other party but it can also be to a relevant government or tax authority.

Section 4(a)(ii) enables them to require delivery of financial statements, board resolutions, legal opinions, signatory lists and other appropriate documents for their contractual relationship. The actual documents and any Credit Support Documents are normally specified in Parts 3(b) and/or 4(f) of the Schedule but could also be referred to in a Confirmation.

Section 4(a)(iii) states that one party may be required to send the other party or a government or tax authority certain forms or documents so as to permit the other party or its Credit Support Provider (e.g. a guarantor) to make a payment under an Agreement or Credit Support Document without deduction or withholding for tax or, if necessary, at a lower rate. Under Section 4(a)(iii) of the Agreement, however, a party need not comply with this if doing so would “materially prejudice” its “legal or commercial position”. Where a timescale for compliance is not specified in the Schedule or a Confirmation, it must be done as soon as reasonably practicable.

### Section 4(b)

The obligation is self-explanatory. Sometimes these authorisations are referred to in Part 3(b) of the Schedule, e.g. licence renewals or exchange control permissions. A party must use all reasonable efforts to comply with this and any ongoing requirements in this respect.

### Section 4(c)

The obligation is self-explanatory. The test is if a party’s failure to comply with laws would *significantly* impair its ability to perform its obligations under the Agreement or any Credit Support Document. It must comply in all material respects which is a tougher standard than in Section 4(b).

(d) ***Tax Agreement.*** It will give notice of any failure of a representation made by it under Section 3(f) to be accurate and true promptly upon learning of such failure.

(e) ***Payment of Stamp Tax.*** Subject to Section 11, it will pay any Stamp Tax levied or imposed upon it or in respect of its execution or performance of this Agreement by a jurisdiction in which it is incorporated, organised, managed and controlled, or considered to have its seat, or in which a branch or office through which it is acting for the purpose of this Agreement is located (“Stamp Tax Jurisdiction”) and will indemnify the other party against any Stamp Tax levied or imposed upon the other party or in respect of the other party’s execution or performance of this Agreement by any such Stamp Tax Jurisdiction which is not also a Stamp Tax Jurisdiction with respect to the other party.



#### **Section 4(d)**

A party is obliged to give notice of any failure of a Payee Tax Representation made by it promptly upon becoming aware of it. Where such notice is not given and a payer has to pay a withholding tax, the payee will need to indemnify the payer for the tax, interest and any penalties thereon except where the failure of the Payee Tax Representation is due to a Change in Tax Law which is beyond the payee's control. An example of such a situation would be where a tax authority decided that the nature of a payee's business made it ineligible for tax treaty benefits.

#### **Section 4(e)**

Each party agrees to pay Stamp Taxes imposed on it by its home or branch jurisdiction and indemnify the other party against such Stamp Taxes if their jurisdiction is not the same. Section 4(e) is subordinate to the Section 11 remit that a Defaulting Party has, upon demand, to indemnify the Non-defaulting Party against certain Stamp Taxes. The indemnification only applies in a cross-border situation. The provision does not deal with Stamp Taxes levied in connection with Credit Support Documents.

## Section 5 — Events of Default and Termination Events

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### Introduction

Section 5 is very important and contains the Master Agreement's Events of Default and Termination Events. Events of Default are common in loan agreements – Termination Events far less so. Both Events of Default and Termination Events can be triggered by either party or by a condition or event involving a third party, e.g. a Specified Entity.

Section 5(a) covers Events of Default (where only one party is culpable) and there are eight of them. However, before looking at them I want to discuss Specified Entities and Credit Support Providers who feature a lot in this Section.

A Specified Entity is essentially another member or members in a party's group whom you want to join through the Schedule into certain Events of Default and Termination Events. The aim is to draw in those members of a party's group (such as its parent or asset rich fellow subsidiaries) whose relationship is so close to the contracting party that if an Event of Default happened to them it would be very likely to affect the contracting party too. The same reasoning applies to Credit Support Providers.

A Credit Support Provider is a third party providing security or a guarantee for a party's liabilities. It can also be one of the parties to the Agreement providing security for itself (e.g. a corporate providing an all moneys debenture). In the 1987 Agreement, the Credit Support Provider was usually nominated as a Specified Entity for those Events of Default and Termination Events which referred to Specified Entities. In the 1992 Agreement it is in a separate category and there is no need to do this.

The following Events of Default and Termination Events include any Credit Support Provider specified in respect of a party:

- **Credit Support Default;**
- **Misrepresentation;**
- **Default under Specified Transaction;**
- **Cross Default;**
- **Bankruptcy;**
- **Merger Without Assumption;**
- **Illegality;**
- **Credit Event Upon Merger.**

The Credit Support Provider is also mentioned in Section 4(a)(iii) in relation to providing tax forms.

The various Events of Default are now reviewed.

## 5. Events of Default and Termination Events

(a) *Events of Default.* The occurrence at any time with respect to a party or, if applicable, any Credit Support Provider of such party or any Specified Entity of such party of any of the following events constitutes an event of default (an “Event of Default”) with respect to such party:-

(i) *Failure to Pay or Deliver.* Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party;

(ii) *Breach of Agreement.* Failure by the party to comply with or perform any agreement or obligation (other than an obligation to make any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) or to give notice of a Termination Event or any agreement or obligation under Section 4(a)(i), 4(a)(iii) or 4(d)) to be complied with or performed by the party in accordance with this Agreement if such failure is not remedied on or before the thirtieth day after notice of such failure is given to the party;

### Section 5(a)(i)

Section 5(a)(i) covers a party's failure to make any payment or delivery when due under Section 2(a)(i) or 2(e) of the Agreement after a grace period of three Local Business Days following notice. The ISDA Master Agreement drafters chose this length of grace period because they believed it might take longer to terminate an Agreement than a loan agreement, for instance, where the failure to pay grace period is usually shorter. This thinking has changed as we shall see in Chapter 4.

### Section 5(a)(ii)

Section 5(a)(ii) covers a failure by either party to comply with any agreement or obligation under the Agreement by the expiry of a 30-day grace period following notice. The following are excluded from this provision:

- any obligations covered by the Failure to Pay or Deliver Event of Default (which has a shorter grace period of three Local Business Days);
- any failure to give notice of a Termination Event. The thinking here is that this failure should not be treated as an Event of Default when the subject of the notice could well be a less serious Termination Event;
- any failure to comply with certain tax related agreements or obligations contained in Section 4 of the Agreement (since denial of payment gross up is the penalty).

Since such events are subject to different treatment elsewhere, it was considered that *per se* they should not give rise to an Event of Default under Section 5(a)(ii). Examples of breaches of agreement could include failure to maintain authorisations as required in Section 4(b) or failure to provide accounting information or a legal opinion within an agreed deadline.

Some parties consider the 30-day grace period to be too long and seek to reduce it in the Schedule to 10–15 days.

(iii) ***Credit Support Default.***

(1) Failure by the party or any Credit Support Provider of such party to comply with or perform any agreement or obligation to be complied with or performed by it in accordance with any Credit Support Document if such failure is continuing after any applicable grace period has elapsed;

(2) the expiration or termination of such Credit Support Document or the failing or ceasing of such Credit Support Document to be in full force and effect for the purpose of this Agreement (in either case other than in accordance with its terms) prior to the satisfaction of all obligations of such party under each Transaction to which such Credit Support Document relates without the written consent of the other party; or

(3) the party or such Credit Support Provider disaffirms, disclaims, repudiates or rejects, in whole or in part, or challenges the validity of, such Credit Support Document;

(iv) ***Misrepresentation.*** A representation (other than a representation under Section 3(e) or (f)) made or repeated or deemed to have been made or repeated by the party or any Credit Support Provider of such party in this Agreement or any Credit Support Document proves to have been incorrect or misleading in any material respect when made or repeated or deemed to have been made or repeated;

### Section 5(a)(iii)

The Credit Support Provider first appears here in the Events of Default.

Section 5(a)(iii) first applies to a party if a Credit Support Document is provided by or on behalf of that party and is identified as such with its nature described in Part 4(f) of the Schedule or in the Credit Support Document itself. If the Credit Support Document is a third party guarantee, the name of the guarantor would be specified as a Credit Support Provider in Part 4(g) of the Schedule since this Event of Default also applies to a party's outside Credit Support Provider(s).

An English Law ISDA Credit Support Annex entered into by either party to the Agreement should not be specified in Part 4(f) and (g) of the Schedule because it is a title transfer document under which ownership of the collateral passes to the other party. However, the New York Law ISDA Credit Support Annex and the English Law ISDA Credit Support Deed are usually referred to as Credit Support Documents because they are by nature pledges or security interests. Normally Part 4(f) and (g) describe third party Credit Support Documents and Credit Support Providers.

This Event of Default is triggered if:

- a party or its Credit Support Provider(s) breaches a Credit Support Document and the breach persists beyond any agreed grace period; or
- the Credit Support Document becomes ineffective before discharge of all obligations under related Transactions without the other party's written consent; or
- a party or a Credit Support Provider repudiates or disowns its Credit Support Document.

### Section 5(a)(iv)

Section 5(a)(iv) applies to certain representation breaches (but excludes tax representations where gross up would be denied if misrepresentation occurred) made in the Agreement or in a Credit Support Document by a party or a Credit Support Provider which result in the representations made being materially misleading or incorrect. It is important to remember that most representations under the Agreement are deemed to be repeated with each new Transaction.

(v) ***Default under Specified Transaction.*** The party, any Credit Support Provider of such party or any applicable Specified Entity of such party (1) defaults under a Specified Transaction and, after giving effect to any applicable notice requirement or grace period, there occurs a liquidation of, an acceleration of obligations under, or an early termination of, that Specified Transaction, (2) defaults, after giving effect to any applicable notice requirement or grace period, in making any payment or delivery due on the last payment, delivery or exchange date of, or any payment on early termination of, a Specified Transaction (or such default continues for at least three Local Business Days if there is no applicable notice requirement or grace period) or (3) disaffirms, disclaims, repudiates or rejects, in whole or in part, a Specified Transaction (or such action is taken by any person or entity appointed or empowered to operate it or act on its behalf);



## Section 5(a)(v)

The term Specified Transaction is defined in Section 14 of the Agreement and is one or more of a wide range of OTC derivatives transactions between each party to the Agreement, a party and the other party's Credit Support Provider or Specified Entity or between their respective Specified Entities or Credit Support Providers, but which are not entered into under the Agreement nor governed by it. These might include transactions the parties have concluded under other agreements or under long form confirmations.

Figure 3.2 illustrates this.

Type of Transaction	Between whom
An OTC derivative transaction described in Section 14 but transacted outside the Agreement	(i) Each party to the Agreement; or (ii) One of the parties to the Agreement and the other party's Credit Support Provider or Specified Entity; or (iii) Each party's respective Specified Entities or Credit Support Providers.

**FIG. 3.2**

The categories of default in this sub-Section are:

- **acceleration or early termination of the Specified Transaction;**
- **payment or delivery default on the final Scheduled Payment Date or with any early termination settlement payment after the lapse of notice of a minimum three Local Business Day grace period;**
- **repudiation of a Specified Transaction by the party itself or third parties such as liquidators or regulators.**

This makes the provision similar to the Cross Default provision discussed below.

In the Schedule, the scope of this Event of Default may be widened or reduced by changing the definition of Specified Transaction to include other products, e.g. repos. Parties can also broaden the scope of the provision to include any third party contracting with one of the parties to this Agreement or their Specified Entities or Credit Support Providers. I will have more to say about this when we look at credit issues in the Schedule in Chapter 6.

**Please note there is no Threshold Amount with Default under Specified Transaction.**

This Event of Default is very important because it impacts the parties joined to this Agreement if a default occurs in transactions between them outside it. In other words, it has a direct impact on the credit risk of the respective parties to this Agreement on the basis that if they default outside the Agreement they will probably default within it too.

(vi) ***Cross Default.*** If “Cross Default” is specified in the Schedule as applying to the party, the occurrence or existence of (1) a default, event of default or other similar condition or event (however described) in respect of such party, any Credit Support Provider of such party or any applicable Specified Entity of such party under one or more agreements or instruments relating to Specified Indebtedness of any of them (individually or collectively) in an aggregate amount of not less than the applicable Threshold Amount (as specified in the Schedule) which has resulted in such Specified Indebtedness becoming, or becoming capable at such time of being declared, due and payable under such agreements or instruments, before it would otherwise have been due and payable or (2) a default by such party, such Credit Support Provider or such Specified Entity (individually or collectively) in making one or more payments on the due date thereof in an aggregate amount of not less than the applicable Threshold Amount under such agreements or instruments (after giving effect to any applicable notice requirement or grace period);

## Section 5(a)(vi)

Section 5(a)(vi) is very important. It also applies to Specified Entities and Credit Support Providers. This Event of Default is triggered by:

- a default or similar event under financial agreements or instruments that has resulted in indebtedness (above a Threshold Amount) becoming capable of being accelerated and terminated early by a Non-defaulting Party; or
- a failure to make any payments (above a Threshold Amount) on their due date under such agreements or instruments after notice or the expiry of a grace period.

A Threshold Amount is a monetary figure above which a Non-defaulting Party may exercise its rights following its counterparty's default elsewhere to terminate all Transactions under the Agreement. It is essentially the credit risk you are prepared to accept on your counterparty before you trigger your close-out rights under this Section 5(a)(vi). Specified Indebtedness essentially means "borrowed money" but it is possible in the Schedule to extend it to other types of indebtedness (e.g. lease purchase obligations, commercial paper, acceptances, factoring or derivative transactions with third parties), or alternatively to narrow it to exclude, for example, banking deposits. I will have more to say about this in Chapter 6, pages 386–7.

Section 5(a)(vi) only applies to a party if stated in Part 1(c) of the Schedule which is also an important reason to get an Agreement signed. If Cross Default applies, a Threshold Amount is nominated in Part 1(c) of the Schedule (either a fixed monetary sum or a small percentage of shareholders' equity are most common). Unless otherwise agreed, this Event of Default will automatically catch the Credit Support Provider of any party subject to Cross Default, but not any Specified Entity unless it is expressly nominated in Part 1(a) of the Schedule. If both Credit Support Providers and Specified Entities are included, it means that if a default occurred under any Specified Indebtedness owed by a contracting party, its Credit Support Provider(s) or Specified Entity(ies) elsewhere then the amounts of each of these defaults could be added together collectively to see if the relevant Threshold Amount under this Agreement had been breached. This applies to both parts of Section 5(a)(vi).

Note that unless the provision is amended in the Schedule, the Threshold Amounts of the two sub-clauses of Section 5(a)(vi) cannot be aggregated (see Chapter 8, page 547). Therefore, on an unamended basis, close-out can only be triggered by a breach of the Threshold Amount in an individual sub-clause i.e. Section 5(a)(vi) (1) or (2).

Sometimes there is a Schedule amendment which excludes Cross Default being triggered through operational or administrative error provided that the party concerned was solvent, had access to sufficient funds when such error occurred and paid up within an agreed grace period. An example of such wording may be found in Chapter 8, page 406.

This provision is very versatile and its scope can be expanded or contracted depending upon how Threshold Amount, Specified Entity, Specified Indebtedness and Credit Support Provider are defined.

(vii) **Bankruptcy.** The party, any Credit Support Provider of such party or any applicable Specified Entity of such party:-

(1) is dissolved (other than pursuant to a consolidation, amalgamation or merger); (2) becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due; (3) makes a general assignment, arrangement or composition with or for the benefit of its creditors; (4) institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights, or a petition is presented for its winding-up or liquidation, and, in the case of any such proceeding or petition instituted or presented against it, such proceeding or petition (A) results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for its winding-up or liquidation or (B) is not dismissed, discharged, stayed or restrained in each case within 30 days of the institution or presentation thereof; (5) has a resolution passed for its winding-up, official management or liquidation (other than pursuant to a consolidation, amalgamation or merger); (6) seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all its assets; (7) has a secured party take possession of all or substantially all its assets or has a distress, execution, attachment, sequestration or other legal process levied, enforced or sued on or against all or substantially all its assets and such secured party maintains possession, or any such process is not dismissed, discharged, stayed or restrained, in each case within 30 days thereafter; (8) causes or is subject to any event with respect to it which, under the applicable laws of any jurisdiction, has an analogous effect to any of the events specified in clauses (1) to (7) (inclusive); or (9) takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the foregoing acts; or

(viii) **Merger Without Assumption.** The party or any Credit Support Provider of such party consolidates or amalgamates with, or merges with or into, or transfers all or substantially all its assets to, another entity and, at the time of such consolidation, amalgamation, merger or transfer:-

(1) the resulting, surviving or transferee entity fails to assume all the obligations of such party or such Credit Support Provider under this Agreement or any Credit Support Document to which it or its predecessor was a party by operation of law or pursuant to an agreement reasonably satisfactory to the other party to this Agreement; or

(2) the benefits of any Credit Support Document fail to extend (without the consent of the other party) to the performance by such resulting, surviving or transferee entity of its obligations under this Agreement.

### Section 5(a)(vii)

Section 5(a)(vii) is very broad. Again, it applies to each party and its Credit Support Provider or a Specified Entity (specified in Part 1(a) of the Schedule). It can be triggered by many bankruptcy events or insolvency proceedings under New York or English law but recognises that market players will also be located in and organised under the laws of other countries.

**It is important to note that in an insolvency it is the laws of the insolvent party's jurisdiction of incorporation which prevail over the governing law of the Agreement.**

This Event of Default is drafted broadly enough to be triggered by proceedings or events under any insolvency laws likely to affect a particular party. Sometimes Schedule amendments are made to specify certain types of bankruptcy officials, e.g. an examiner in Irish Schedules. It is wise to check that an insolvency regime in an emerging market or exotic country is covered by the categories outlined in this provision. If not, an amendment will need to be made to it in the Schedule. Another Schedule amendment that may need to be made relates to partnerships which might be dissolved when a partner leaves but which are immediately reconstituted by the remaining partners.

### Section 5(a)(viii)

Merger Without Assumption applies to parties and their Credit Support Providers but not to their Specified Entities. It covers situations where a party or its Credit Support Provider amalgamates, merges or transfers all or most of its assets to another entity and such entity:

- fails to assume that party's obligations under the Agreement; or
- fails to assume that party's or the Credit Support Provider's obligations under a Credit Support Document.

In either case, the contractual position is weaker than originally envisaged and gives the non-merging party (who is also the Non-defaulting Party) the right to close out all Transactions under the Agreement.

Merger Without Assumption also arises where the benefits of a Credit Support Document fail to extend post-merger to the transferee's performance obligations under the Agreement (unless the other party consents).

Please note that just because a merger may involve companies in two different legal and tax jurisdictions, this is not relevant for this particular Event of Default but may possibly be for the Tax Event Upon Merger Termination Event (Section 5(b)(iii)) discussed below.

It is possible for a merger, consolidation or asset transfer to trigger Credit Event Upon Merger (see commentary on Section 5(b)(iv) at page 73) as well as Merger Without Assumption. Where this occurs, Section 5(b)(iv) indicates that it will be treated more severely as an Event of Default.

(b) **Termination Events.** The occurrence at any time with respect to a party or, if applicable, any Credit Support Provider of such party or any Specified Entity of such party of any event specified below constitutes an Illegality if the event is specified in (i) below, a Tax Event if the event is specified in (ii) below or a Tax Event upon Merger if the event is specified in (iii) below, and, if specified to be applicable, a Credit Event Upon Merger if the event is specified pursuant to (iv) below or an Additional Termination Event if the event is specified pursuant to (v) below:-

(i) **Illegality.** Due to the adoption of, or any change in, any applicable law after the date on which a Transaction is entered into, or due to the promulgation of, or any change in, the interpretation by any court, tribunal or regulatory authority with competent jurisdiction of any applicable law after such date, it becomes unlawful (other than as a result of a breach by the party of Section 4(b)) for such party (which will be the Affected Party):-

(1) to perform any absolute or contingent obligation to make a payment or delivery or to receive a payment or delivery in respect of such Transaction or to comply with any other material provision of this Agreement relating to such Transaction; or

(2) to perform, or for any Credit Support Provider of such party to perform, any contingent or other obligation which the party (or such Credit Support Provider) has under any Credit Support Document relating to such Transaction;

## Section 5(b) Termination Events

Termination Events allow a party to close out where the event substantially alters the Transaction economics or the risk profile of its counterparty. Sometimes no one party is sufficiently at fault but the effect of the Termination Event means it is not financially beneficial for the parties to continue the Transaction(s) concerned.

There are four Termination Events listed with the option of a fifth. Please note that with Termination Events, the party at fault is generally called the Affected Party. Under Section 5(b)(i)–(iii), if a Termination Event occurs and close-out follows through designating an Early Termination Date in a notice, only Transactions affected by the Termination Event (“Affected Transactions”) are closed out. Under Section 5(b)(iv) and usually under Section 5(b)(v), the Affected Transactions comprise all Transactions because the Termination Event taints the whole contractual relationship and all Transactions need to be terminated.

### Section 5(b)(i)

Section 5(b)(i) states that a Termination Event will arise if it becomes unlawful for a party to make or receive a payment or delivery or comply with any material provision of the Agreement or it becomes unlawful for a party or a Credit Support Provider to perform under a Credit Support Document. For the avoidance of doubt, the party impacted by the Illegality (i.e. the one faced with breaking the law in order to perform) will be the Affected Party.

Illegality excludes any breach by a party of the agreement in Section 4(b) to maintain authorisations necessary in connection with the Agreement or any Credit Support Document. Any such breach will be treated as a Breach of Agreement Event of Default and not as an Illegality.

As with the next two Termination Events an effort must be made to try to transfer the Affected Transactions to a third party or to a different Office of the party so as to avoid the Termination Event happening (please see commentary on Section 6(b)).

(ii) **Tax Event.** Due to (x) any action taken by a taxing authority, or brought in a court of competent jurisdiction, on or after the date on which a Transaction is entered into (regardless of whether such action is taken or brought with respect to a party to this Agreement) or (y) a Change in Tax Law, the party (which will be the Affected Party) will, or there is a substantial likelihood that it will, on the next succeeding Scheduled Payment Date (1) be required to pay to the other party an additional amount in respect of an Indemnifiable Tax under Section 2(d)(i)(4) (except in respect of interest under Section 2(e), 6(d)(ii) or 6(e)) or (2) receive a payment from which an amount is required to be deducted or withheld for or on account of a Tax (except in respect of interest under Section 6(d)(ii) or 6(e)) and no additional amount is required to be paid in respect of such Tax under Section 2(d)(i)(4) (other than by reason of Section 2(d)(i)(4)(A) or (B));



**Section 5(b)(ii)**

A Tax Event takes place when a Change in Tax Law occurs and results in a party becoming (or very likely to become) burdened by a withholding tax which leads to a payer being required to gross up or a payee receiving a lower payment net of withholding with no gross up. A termination right arises in such cases because neither party is regarded as sufficiently “at fault” for it to be burdened by an unexpected tax charge until the maturity of the Transaction. The party having to gross up or the party receiving less than it expected because the withholding tax is being levied is called the Affected Party and is entitled to call for close out of Affected Transactions.

A Tax Event does not occur if a withholding tax is levied on default interest under Section 2(e) or interest payments upon early termination under Section 6(d)(ii) or (e).

So, if any withholding tax arises because of a Change in Tax Law after the date the parties enter into a Transaction, the party impacted by the withholding tax has a right to terminate the Transaction(s) concerned under Sections 5(b)(ii) and 6(b) of the Agreement. The Section 6 procedure involves trying to transfer the Affected Transactions to a third party or to a different Office to avoid the Tax Event. The termination for the Affected Transactions is made on the basis that there is one Affected Party. This means the non-Affected Party makes the termination calculations.

However, if a change of facts occurs at the start or during the life of the Transaction, this will not give a right to trigger a Tax Event because the party concerned should have done its analysis properly in the first place and should not be able to close out as a result of its own actions if the change of facts happens later in the Transaction’s life.

(iii) ***Tax Event Upon Merger.*** The party (the “Burdened Party”) on the next succeeding Scheduled Payment Date will either (1) be required to pay an additional amount in respect of an Indemnifiable Tax under Section 2(d)(i)(4) (except in respect of interest under Section 2(e), 6(d)(ii) or 6(e)) or (2) receive a payment from which an amount has been deducted or withheld for or on account of any Indemnifiable Tax in respect of which the other party is not required to pay an additional amount (other than by reason of Section 2(d)(i)(4)(A) or (B)), in either case as a result of a party consolidating or amalgamating with, or merging with or into, or transferring all or substantially all its assets to, another entity (which will be the Affected Party) where such action does not constitute an event described in Section 5(a)(viii);

### Section 5(b)(iii)

Under Section 5(b)(iii), a Tax Event Upon Merger arises if a withholding tax is levied which results in a merging party having to gross up its payment or a non-merging party receiving any payment due to it net of withholding tax with no gross up. Such a party is called the Burdened Party. Such a transaction could result in the charging of withholding tax, for example, if the acquiror's jurisdiction of incorporation is different from that of the company being acquired. Again, only Affected Transactions are terminated because the trading relationship is fundamentally altered. Please note that the Affected Party is the one engaged in merging.

Certain exceptions apply to this. For instance, a Tax Event Upon Merger cannot occur because of interest payments due under Sections 2(e) or 6(b) or 6(d)(ii), nor will it apply if Transactions are impacted by the Merger Without Assumption Event of Default (Section 5(a)(viii)) because they can be terminated through an Event of Default which is more serious and will close out all Transactions under the Agreement.

If a Tax Event Upon Merger happens, only the Burdened Party can terminate the Affected Transactions and both it and the non-Affected Party must try to find a means to transfer them to a third party or another Office so that this Termination Event disappears. Again any termination payment to be made in respect of Affected Transactions is calculated on the basis of one Affected Party with the non-Affected Party making the termination calculations.

If a payee is not entitled to receive a gross up payment because it has given a false Payee Tax Representation or failed to deliver requested tax documentation, it will not be entitled to call a Tax Event Upon Merger. Please note that a Tax Event and a Tax Event Upon Merger will not apply if it is a Credit Support Provider that unexpectedly needs to gross up.

(iv) ***Credit Event Upon Merger***. If “Credit Event Upon Merger” is specified in the Schedule as applying to the party, such party (“X”), any Credit Support Provider of X or any applicable Specified Entity of X consolidates or amalgamates with, or merges with or into, or transfers all or substantially all its assets to, another entity and such action does not constitute an event described in Section 5(a)(viii) but the creditworthiness of the resulting, surviving or transferee entity is materially weaker than that of X, such Credit Support Provider or such Specified Entity, as the case may be, immediately prior to such action (and, in such event, X or its successor or transferee, as appropriate, will be the Affected Party); or

### Section 5(b)(iv)

The rationale for Credit Event Upon Merger is that a party may not have entered into an Agreement in the first place had it known that its counterparty would merge or be taken over and, as a result, become a much worse credit risk. However, parties do not usually invoke Credit Event Upon Merger as a knee jerk reaction but try to evaluate if the new counterparty will be able to perform its obligations under the Agreement or if, for example, credit support will need to be taken.

Section 5(b)(iv) of the Agreement only applies to a party if this is stated in Part 1(d) of the Schedule. It addresses the situation where your counterparty, its Credit Support Provider or any applicable Specified Entity (specified in Part 1(a) of the Schedule) is taken over by, or merges with, another entity and this results in a material reduction in their creditworthiness. A Termination Event will occur under this provision if the Transaction does not result in a Merger Without Assumption Event of Default (Section 5(a)(viii)). If this Termination Event occurs, the party who has entered into, or whose Credit Support Provider or Specified Entity has entered into, a merger or takeover transaction is the Affected Party and the other party is entitled to terminate all Transactions under the Agreement. The merger taints all Transactions, not just some of them.

Some market players amend this Termination Event to define “materially weaker” more objectively in terms of, for example, credit rating agency downgrades, a set minimum level of credit ratings or the loss by a merged party of its credit rating.

The basic Credit Event Upon Merger provision describes North American merger practice. In many European Schedules, the definition of Credit Event Upon Merger is expanded to include the purchase of voting shares giving the power to elect a majority of the board of directors of a party or its Credit Support Provider(s) or Specified Entity(ies). We shall review the standard amendment in the Schedule in Chapter 8, pages 448–9. This “European” language has now been adopted in the Credit Event Upon Merger provision in the main text of the 2002 Agreement.

The overriding point here is that the merged entity must be materially financially weaker post-merger.

(v) ***Additional Termination Event.*** If any “Additional Termination Event” is specified in the Schedule or any Confirmation as applying, the occurrence of such event (and, in such event, the Affected Party or Affected Parties shall be as specified for such Additional Termination Event in the Schedule or such Confirmation).

(c) ***Event of Default and Illegality.*** If an event or circumstance which would otherwise constitute or give rise to an Event of Default also constitutes an Illegality, it will be treated as an Illegality and will not constitute an Event of Default.

### Section 5(b)(v)

Section 5(b)(v) of the Agreement has been added so that parties may specify Additional Termination Events in Part 1(h) of the Schedule or any Confirmation and any Affected Party or Affected Parties for such Additional Termination Events.

It is assumed that where an Additional Termination Event arises, all Transactions will be Affected Transactions and the non-Affected Party will be entitled to terminate them. Many Additional Termination Events are credit related (e.g. rating agency downgrades of a party's outstanding long-term debt securities below a minimum rating or the cancellation of a rating by a credit ratings agency) and therefore impact the entire contractual relationship between the parties and not just a particular group of Transactions. A Change of Ownership clause and full prepayment of a loan linked to a swap are other common examples of an Additional Termination Event.

### Section 5(c)

Section 5(c) of the Agreement covers the position where an Event of Default can also be classified as an Illegality by providing that in those circumstances it will be treated as an Illegality. This is done to lessen the effect of the event by closing out only the Affected Transaction(s) rather than all Transactions. It protects a party unable to make a necessary payment because to do so would be unlawful but it does not defer the Scheduled Payment Date. Interest would accrue at the Default Rate from and including the Scheduled Payment Date to but excluding the date on which any early termination notice is given for the Illegality if the parties cannot transfer the deal under Section 6(b)(ii) to avoid the Illegality.





## Section 6 – Early Termination

Section 6 describes the detailed close-out netting mechanism where an Event of Default or Termination Event occurs.

Close-out netting is vital to the ISDA Master Agreement; so vital that ISDA has commissioned legal opinions from 39 countries to find out if they would recognise close-out netting if a Non-defaulting Party exercised its rights in a default or bankruptcy situation involving one of their nationals. The vast majority of jurisdictions do recognise the effectiveness of close-out netting. A list of these opinions is shown in Annex 4, pages 725–6. In order to minimise the capital allocated to derivatives' counterparty exposure, regulators require written, reasoned, independent legal opinions from major law firms for each jurisdiction where a bank is seeking to net its exposure in respect of Transactions under Agreements with various counterparties in that country. Regulators require these legal opinions to be updated at least once a year.

It is vital for a solvent party to have a clear and effective close-out mechanism so that it can replace the Terminated Transactions it had with an insolvent party as quickly as possible so as to maintain any underlying hedging transactions.

Before entering the tall grass and describing the Section 6 provisions in depth, I should first like to attempt a summary of them.

When an Event of Default occurs, only the Non-defaulting Party can choose an Early Termination Date and close out and net off all Transactions between the parties to reach a single figure payable one way or the other. This payment essentially represents damages for the curtailed Transactions. The Early Termination Date may be designated at any time that the Event of Default persists but it must be designated within 20 days of the termination notice.

Please note that once an Early Termination Date has been designated it can only be cancelled with the consent of both parties. Otherwise there is no turning back. Termination is not the sole remedy of an innocent party as Section 9(d) provides the possibility for other remedies to be pursued (see commentary on page 107).

With a Termination Event (except for Credit Event Upon Merger and probably Additional Termination Events), the parties have to find a way to keep the Affected Transaction alive possibly by transferring it to another office or group company. They have 20–30 days to do this but if they fail, the Affected Transaction or Transactions are closed out. This is done by using payment measures and methods which are chosen in the Schedule.

The payment measures are Market Quotation or Loss which each describe how termination payments are calculated. Market Quotation involves the Non-defaulting Party obtaining close-out quotations from four major dealers (called Reference Market-makers) for the replacement cost of the Terminated

Transactions (i.e. how much it would theoretically cost to step into the Non-defaulting Party's shoes). Under this measure the highest and lowest quotations are disregarded and the arithmetic mean of the two remaining quotations is taken to which are added any net Unpaid Amounts to produce the net termination payment (see commentary on Section 6(e)).

But how does a Reference Market-maker make his calculation?

If, for example, the overall position was profitable for the Non-defaulting Party (i.e. he was "in the money") the quotation would represent how much the Reference Market-maker would have to be paid to take over the Defaulting Party's future payment obligations. The Reference Market-maker would calculate the net present value of these and add a margin to compensate it for theoretically assuming them. He does not really assume them because he is just providing a quotation.

If the overall position was unprofitable (i.e. "out of the money") for the Non-defaulting Party, the Reference Market-maker's quotation would represent what he would potentially need to pay to take over the Defaulting Party's rights to receive future payments. This time the Reference Market-maker would deduct its compensatory margin.

Loss can be used as a fallback measure to Market Quotation where the Non-defaulting Party believes that using Market Quotation may not produce a commercially reasonable result perhaps because there are grounds for believing Market Quotations could be distorted (e.g. many traders requesting termination figures in a major close-out situation – Barings in 1995). In these circumstances dealers are also wary about disclosing the terms for a Defaulting Party whom the other dealer may also have as a counterparty and so may prefer the greater privacy of Loss.

Loss can also be used where a market is thin or not liquid or because that is the norm for that market (e.g. the FX market). It may also be preferable for Transactions settling by physical delivery.

Under Loss, the Non-defaulting Party makes its own good faith calculations as to what its losses and costs are (i.e. if it is "in the money") and the level of its gains if it is "out of the money". The losses and costs are expressed as positive numbers and the gains as negative numbers.

If the Non-defaulting Party is "in the money", its position is impaired because it will not receive any future payments from the Defaulting Party. If it is "out of the money" it will gain because it will not need to make future payments to the Defaulting Party. The Non-defaulting Party can include hedging transaction unwind or breakage costs and funding costs in its calculation of Loss. Section 11 expenses (e.g. legal fees and stamp duties) are excluded.

Loss can include obtaining market quotations (see the last sentence of the Section 14 definition of Loss) which indicates that it is a broader measure than Market Quotation.

Calculations have to be made on the Early Termination Date or on the earliest date as soon as reasonably practicable thereafter. Concerns of some commentators in 1992 that this could lay parties open to attack from liquidators if calculations were not made on the Early Termination Date itself and markets moved quickly thereafter in their favour, have not materialised.

Parties normally adopt one payment measure to apply to all Transactions documented under the Agreement but I have seen Loss stated as applying to foreign exchange and currency option Transactions (the norm in those markets) and Market Quotation as applying to all other products under the same Agreement.

The payment methods are the First Method or the Second Method. The choice is made in Part 1(f) of the Schedule. Where no choice is made, the fall-back is the Second Method. The Non-defaulting Party makes the calculations and the payments due are netted off to produce a single figure payable one way or the other.

Under the First Method, if the single net payment is due to the Defaulting Party he does not get it. The Non-defaulting Party keeps it as a windfall. Under the Second Method, the Defaulting Party would receive the payment.

The First Method is often referred to as “limited two-way payments” or a “walk away clause” because the Non-defaulting Party can walk away from its obligations. This represents a punishment for the Defaulting Party. The First Method was the basic approach under the 1987 Agreement.

The Financial Services Authority and other regulators prohibit the use of the First Method where banks are seeking to have derivatives contracts reported on a net basis for capital adequacy and large exposure purposes relating to counterparty risk. Here, the Second Method must be used. In addition, limited two-way payments were not widely accepted outside the swaps market and in several jurisdictions it was doubtful whether they could be enforced especially where caps or options were concerned and the Defaulting Party had fulfilled its obligations by paying the agreed premium.

There is more about the calculation of termination payments in the commentary on Section 6(e), pages 92–9.

Thoroughly confused? Hopefully, Figures 3.3 and 3.4 will help.

Figure 3.3 shows who has the right to terminate under the Section 5 events. Figure 3.4 illustrates the effect of termination on the Transactions involved.

I would also like to discuss Automatic Early Termination.

Under Section 6(a), the Non-defaulting Party has the right to designate an Early Termination Date (for close-out purposes) for all outstanding Transactions upon an Event of Default arising and continuing. Section 6(a) also allows parties to choose in Part 1(e) of the Schedule that “Automatic Early Termination” will apply to a party if certain bankruptcy or insolvency

**FIG. 3.3**

Early termination: who can terminate

Reason	Who may terminate
<b>Events of Default</b> <ul style="list-style-type: none"> <li>• Bankruptcy</li> <li>• Other</li> </ul>	<ul style="list-style-type: none"> <li>• Non-defaulting Party or Automatic*</li> <li>• Non-defaulting Party</li> </ul>
<b>Termination Event</b> <ul style="list-style-type: none"> <li>• Illegality</li> <li>• Tax Event</li> <li>• Tax Event Upon Merger</li> <li>• Credit Event Upon Merger</li> <li>• Additional Termination Event</li> </ul>	<ul style="list-style-type: none"> <li>• either party</li> <li>• Affected Party</li> <li>• Burdened Party</li> <li>• non-Affected Party</li> <li>• non-Affected Party or either party (if there are two Affected Parties)</li> </ul>

\* only applies if selected in Schedule

**FIG. 3.4**

Early termination: effect of termination

Event of Default	• all Transactions terminated
Credit Event Upon Merger	• all Transactions terminated
Additional Termination Event	• all Transactions terminated (presumably)
Other Termination Events	• only Affected Transactions terminated

events occur. If parties fail to make a selection in Part 1(e), Automatic Early Termination will not apply. If Automatic Early Termination applies and certain Section 5(a)(vii) insolvency events occur, an Early Termination Date will arise automatically for all outstanding Transactions.

Automatic Early Termination was the norm for Bankruptcy Events of Default under the 1987 Agreement. It means that with the happening of certain bankruptcy events (e.g. the presentation of a winding-up order), an Early Termination Date is automatically and immediately designated without notice to the Defaulting Party. Quite possibly, the Non-defaulting Party may be unaware of the bankruptcy event and when he finds out, markets may have moved significantly since the deemed Early Termination Date. This could result in hedging transactions having to be replaced at higher cost in the market.

In general, lawyers consider that the drawbacks of Automatic Early Termination outweigh its benefits. However, it is helpful to apply it to counterparties subject to certain insolvency regimes, e.g. Germany, Japan, Belgium, Denmark and Switzerland. It is not necessary in the UK or the USA. This subject is discussed further in Chapters 5 and 8.

To mitigate its effects, you sometimes see clauses in the Schedule (see Chapter 8, pages 451–3) which indemnify the Non-defaulting Party against movements in prices and rates from the Automatic Early Termination date until the Non-defaulting Party becomes aware of the insolvency event. Note that Automatic Early Termination only applies to certain Bankruptcy events and not to other types of Events of Default.

Some market players have been concerned that Automatic Early Termination might not be enforceable because it might cut across automatic stay bankruptcy proceedings. In many jurisdictions this issue has been addressed in Automatic Early Termination's favour but this point should always be checked if it is important for Automatic Early Termination to be fully effective.

The individual sub-Sections of Section 6 are now reviewed.

## 6. Early Termination

(a) ***Right to Terminate Following Event of Default.*** If at any time an Event of Default with respect to a party (the “Defaulting Party”) has occurred and is then continuing, the other party (the “Non-defaulting Party”) may, by not more than 20 days notice to the Defaulting Party specifying the relevant Event of Default, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all outstanding Transactions. If, however, “Automatic Early Termination” is specified in the Schedule as applying to a party, then an Early Termination Date in respect of all outstanding Transactions will occur immediately upon the occurrence with respect to such party of an Event of Default specified in Section 5(a)(vii)(1), (3), (5), (6) or, to the extent analogous thereto, (8), and as of the time immediately preceding the institution of the relevant proceeding or the presentation of the relevant petition upon the occurrence with respect to such party of an Event of Default specified in Section 5(a)(vii)(4) or, to the extent analogous thereto, (8).

## Section 6

### Section 6(a)

Where an Event of Default occurs and is continuing, the Non-defaulting Party has the option (but not the obligation) to terminate all outstanding Transactions under the Agreement by giving the Defaulting Party not more than 20 days' notice of its intention to close out all Transactions on a certain date called the Early Termination Date. The notice must describe the Event of Default and the Early Termination Date is normally much sooner than 20 days after the notice is given.

With certain insolvency events (as described in Section 5(a)(vii)) termination may be automatic rather than by notice. These insolvency events are:

- **dissolution (except in the case of a merger, amalgamation or consolidation); or**
- **a general arrangement, assignment or composition with creditors; or**
- **a winding-up resolution is passed (except again in the case of a merger, amalgamation or consolidation); or**
- **the appointment of an administrator or similar insolvency official over all or most of a party's assets.**

In these four cases termination takes place immediately after they happen. However, with the insolvency Event of Default in Section 5(a)(vii)(4) (which is the starting of proceedings or the filing of a winding-up order which either results in a bankruptcy adjudication or is not dismissed within 30 days), the close out is deemed to occur immediately before the proceedings start or the order is presented. The problem here is that the Non-defaulting Party may not be aware of the insolvency event and by the time it is the markets may have moved strongly against it. Chapter 8 examines possible indemnifying amendments designed to protect the Non-defaulting Party in these circumstances (see pages 451–3).

If an Event of Default impacting a party is cured before a termination notice is given, the Non-defaulting Party loses its right to give such a notice because Section 6(d)(i) requires that the Event of Default is “continuing”. However, once the notice is given, the Defaulting Party cannot then cure the Event of Default. As soon as the Non-defaulting Party gives notice it must have certainty and be free to enter into replacement Transactions to cover the open position that will arise on the Early Termination Date or unwind existing hedging Transactions without concern that a late performance by the Defaulting Party of its obligations will mean the Non-defaulting Party will have to reverse its actions, possibly at a loss. It is important for the parties to set sensible cure periods for Events of Default if the ones in the Agreement are not suitable for their particular circumstances.

(b) ***Right to Terminate Following Termination Event.***

(i) ***Notice.*** If a Termination Event occurs, an Affected Party will, promptly upon becoming aware of it, notify the other party, specifying the nature of that Termination Event and each Affected Transaction and will also give such other information about that Termination Event as the other party may reasonably require.

(ii) ***Transfer to Avoid Termination Event.*** If either an Illegality under Section 5(b)(i)(1) or a Tax Event occurs and there is only one Affected Party, or if a Tax Event Upon Merger occurs and the Burdened Party is the Affected Party, the Affected Party will, as a condition to its right to designate an Early Termination Date under Section 6(b)(iv), use all reasonable efforts (which will not require such party to incur a loss, excluding immaterial, incidental expenses) to transfer within 20 days after it gives notice under Section 6(b)(i) all its rights and obligations under this Agreement in respect of the Affected Transactions to another of its Offices or Affiliates so that such Termination Event ceases to exist.

If the Affected Party is not able to make such a transfer it will give notice to the other party to that effect within such 20 day period, whereupon the other party may effect such a transfer within 30 days after notice is given under Section 6(b)(i).

Any such transfer by a party under this Section 6(b)(ii) will be subject to and conditional upon the prior written consent of the other party, which consent will not be withheld if such other party's policies in effect at such time would permit it to enter into transactions with the transferee on the terms proposed.



## Section 6(b)

Generally speaking, except for Credit Event Upon Merger and some Additional Termination Events, a non-Affected Party will only have the option to terminate individual Transactions affected by some specified event rather than *all* Transactions as under an Event of Default.

The process is as follows:

### *Notice*

Under Section 6(b)(i), if a Termination Event occurs, an Affected Party must promptly inform and provide reasonable information to the other party of the particular Termination Event and each Affected Transaction.

### *Transfer to avoid Termination Event*

However, there is a duty by both parties to try to mitigate a Termination Event on the principle that it is better to continue a Transaction if possible. With Tax Event Upon Merger this duty arises for the Burdened Party where it is also engaging in the merger.

Consequently Section 6(b)(ii) of the Agreement requires an Affected Party impacted by one or more Termination Events first to use all reasonable efforts to transfer all Affected Transactions to another of its Offices or Affiliates (i.e. other group companies) to avoid the Termination Event concerned. The Affected Party is given a period of up to 20 days after notice to do this.

Where the Affected Party cannot make such a transfer, it must within the 20-day notice period notify the non-Affected Party who can try to do so within 30 days from the original notice date. So if the Affected Party tries to transfer and fails on the twentieth day and then notifies the non-Affected Party, the non-Affected Party only has ten days in which to make a transfer.

The prior written consent of the other party is necessary to make this transfer but must not be unreasonably withheld, especially if the non-Affected Party's policies would, in the normal course, allow it to enter into Transactions with the proposed transferee Office or Affiliate of the Affected Party.

(iii) **Two Affected Parties.** If an Illegality under Section 5(b)(i)(1) or a Tax Event occurs and there are two Affected Parties, each party will use all reasonable efforts to reach agreement within 30 days after notice thereof is given under Section 6(b)(i) on action to avoid that Termination Event.

(iv) **Right to Terminate.** If:-

(1) a transfer under Section 6(b)(ii) or an agreement under Section 6(b)(iii), as the case may be, has not been effected with respect to all Affected Transactions within 30 days after an Affected Party gives notice under Section 6(b)(i); or

(2) an Illegality under Section 5(b)(i)(2), a Credit Event Upon Merger or an Additional Termination Event occurs, or a Tax Event Upon Merger occurs and the Burdened Party is not the Affected Party,

either party in the case of an Illegality, the Burdened Party in the case of a Tax Event Upon Merger, any Affected Party in the case of a Tax Event or an Additional Termination Event if there is more than one Affected Party, or the party which is not the Affected Party in the case of a Credit Event Upon Merger or an Additional Termination Event if there is only one Affected Party may, by not more than 20 days' notice to the other party and provided that the relevant Termination Event is then continuing, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all Affected Transactions.

*Two Affected Parties*

Where an Illegality under Section 5(b)(i)(1) or Tax Event under Section 5(b)(ii) has occurred and there are two Affected Parties, they must both use all reasonable efforts to agree on action to avoid the relevant Termination Event within 30 days following notice.

*Right to Terminate*

If the parties are unable to agree to transfer or otherwise avoid the relevant Termination Event, an Early Termination Date may be designated in accordance with Section 6(b)(iv) of the Agreement.

Where a transfer fails to be made by either party in the 30-day period following the original notice in respect of a Termination Event, the Affected Party may choose an Early Termination Date (not earlier than the date the original notice became effective) in respect of all Affected Transactions. With Tax Event Upon Merger the Burdened Party has this right provided that it is not engaging in the merger.

(c) *Effect of Designation.*

(i) If notice designating an Early Termination Date is given under Section 6(a) or (b), the Early Termination Date will occur on the date so designated, whether or not the relevant Event of Default or Termination Event is then continuing.

(ii) Upon the occurrence or effective designation of an Early Termination Date, no further payments or deliveries under Section 2(a)(i) or 2(e) in respect of the Terminated Transactions will be required to be made, but without prejudice to the other provisions of this Agreement. The amount if any, payable in respect of an Early Termination Date shall be determined pursuant to Section 6(e).

### Section 6(c)

Where an Early Termination Date notice is given for an Event of Default or Termination Event, the Early Termination Date will occur on the chosen date whether or not the Event of Default or Termination Event is then continuing.

When an Early Termination Date happens or is chosen, neither party is required to make normal payments or deliveries under Sections 2(a)(i) or 2(e) of the Agreement for Transactions to be terminated. The Agreement itself is not terminated by the giving of an early termination notice; only the parties' obligations to make payments or deliveries terminate. Several provisions (e.g. obligation to gross up payments (Section 2(d)(i)), obligation to make settlement payments under Section 6(e); currency conversion obligations (Section 8); and obligation to pay enforcement expenses (Section 11)) all survive because of Section 9(c) – Survival of Obligations. Payments or deliveries that would have been due on dates after the termination notice takes effect but on or before the Early Termination Date (as well as any obligations that did not become payable or deliverable because of the failure to satisfy all conditions precedent) are included in the definition of Unpaid Amounts (if Market Quotation applies) or Loss (if it applies), as the case may be, and are therefore included in the close-out calculation.

(d) **Calculations.**

(i) **Statement.** On or as soon as reasonably practicable following the occurrence of an Early Termination Date, each party will make the calculations on its part, if any, contemplated by Section 6(e) and will provide to the other party a statement (1) showing, in reasonable detail, such calculations (including all relevant quotations and specifying any amount payable under Section 6(e)) and (2) giving details of the relevant account to which any amount payable to it is to be paid. In the absence of written confirmation from the source of a quotation obtained in determining a Market Quotation, the records of the party obtaining such quotation will be conclusive evidence of the existence and accuracy of such quotation.

(ii) **Payment Date.** An amount calculated as being due in respect of any Early Termination Date under Section 6(e) will be payable on the day that notice of the amount payable is effective (in the case of an Early Termination Date which is designated or occurs as a result of an Event of Default) and on the day which is two Local Business Days after the day on which notice of the amount payable is effective (in the case of an Early Termination Date which is designated as a result of a Termination Event). Such amount will be paid together with (to the extent permitted under applicable law) interest thereon (before as well as after judgment) in the Termination Currency, from (and including) the relevant Early Termination Date to (but excluding) the date such amount is paid, at the Applicable Rate. Such interest will be calculated on the basis of daily compounding and the actual number of days elapsed.

## Section 6(d)

On, or shortly after, an Early Termination Date, each party, where practicable, is to provide the other with a statement of early termination payment calculations in reasonable detail and advise the account to which any termination payment is to be made. The records of the Non-defaulting Party or both parties where no party is at fault shall be conclusive evidence of Market Quotations received from dealers who do not confirm them in writing.

Early termination payments for Events of Default are payable on the day that the Early Termination Date notice becomes effective. Early termination payments for Termination Events are payable two Local Business Days after the day that the Early Termination Date notice becomes effective. The amount concerned will be paid with accrued interest and in the Termination Currency agreed in Part 1(g) of the Schedule (otherwise the fallback is US\$). In calculating net termination payments, the relevant payment measure (i.e. Market Quotation or Loss) and any Unpaid Amounts are converted into a Termination Currency Equivalent by obtaining a market foreign exchange rate from an FX dealer chosen by the Non-defaulting Party.

With Events of Default, interest is payable on an early termination payment from and including the relevant Early Termination Date to but excluding the day on which it is actually paid. A Defaulting Party will pay interest at the Default Rate (i.e. 1% over the payee's cost of funds).

A Non-defaulting Party will pay interest at the Non-default Rate (i.e. the Non-defaulting Party's cost of funds) from and including the Early Termination Date to, but excluding the date (i.e. two Local Business Days following the date) the termination notice is effective. If it fails to pay on time it will be charged at the Default Rate.

With Termination Events (and one Affected Party) the Affected Party will pay interest at the Default Rate from and including the Early Termination Date to but excluding the date (i.e. two Local Business Days following the date) the termination notice is effective.

With Termination Events (and two Affected Parties) interest is paid at the Termination Rate (i.e. the arithmetic mean of each party's cost of funds). Where payment is late interest is charged at the Default Rate. The same rates apply to interest on Unpaid Amounts. However, the interest period is from and including the date such payments are required to be paid to, but excluding the Early Termination Date.

(e) **Payments on Early Termination.** If an Early Termination Date occurs, the following provisions shall apply based on the parties' election in the Schedule of a payment measure, either "Market Quotation" or "Loss", and a payment method, either the "First Method" or the "Second Method". If the parties fail to designate a payment measure or payment method in the Schedule, it will be deemed that "Market Quotation" or the "Second Method", as the case may be, shall apply. The amount, if any, payable in respect of an Early Termination Date and determined pursuant to this Section will be subject to any Set-off.

(i) **Events of Default.** If the Early Termination Date results from an Event of Default:-

(1) **First Method and Market Quotation.** If the First Method and Market Quotation apply, the Defaulting Party will pay to the Non-defaulting Party the excess, if a positive number, of (A) the sum of the Settlement Amount (determined by the Non-defaulting Party) in respect of the Terminated Transactions and the Termination Currency Equivalent of the Unpaid Amounts owing to the Non-defaulting Party over (B) the Termination Currency Equivalent of the Unpaid Amounts owing to the Defaulting Party.

(2) **First Method and Loss.** If the First Method and Loss apply, the Defaulting Party will pay to the Non-defaulting Party, if a positive number, the Non-defaulting Party's Loss in respect of this Agreement.

(3) **Second Method and Market Quotations.** If the Second Method and Market Quotation apply, an amount will be payable equal to (A) the sum of the Settlement Amount (determined by the Non-defaulting Party) in respect of the Terminated Transactions and the Termination Currency Equivalent of the Unpaid Amounts owing to the Non-defaulting Party less (B) the Termination Currency Equivalent of the Unpaid Amounts owing to the Defaulting Party. If that amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if it is a negative number, the Non-defaulting Party will pay the absolute value of that amount to the Defaulting Party.

(4) **Second Method and Loss.** If the Second Method and Loss apply, an amount will be payable equal to the Non-defaulting Party's Loss in respect of this Agreement. If that amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if it is a negative number, the Non-defaulting Party will pay the absolute value of that amount to the Defaulting Party.



## Section 6(e)

Section 6(e) provides four ways for the calculation of payments on early termination arising from an Event of Default :

- **First Method and Market Quotation**
- **First Method and Loss**
- **Second Method and Market Quotation**
- **Second Method and Loss.**

Under the Agreement an early termination payment consists of the following three components:

- payments for the future replacement value of the Terminated Transactions (included in the definition of “Market Quotation”);
- contractual payment or delivery obligations (i.e. amounts due under Section 2(a)(i)) which were due before the Early Termination Date but not paid (“Unpaid Amounts”); and
- payments or deliveries which would have been due before the Early Termination Date if all pre-conditions (such as no Event of Default having taken place) had been satisfied or if the Early Termination Date had not been designated. These are amounts due under Section 2(a)(iii) and are also called “Unpaid Amounts”).

These amounts are covered in the definition of “Loss”. Unpaid Amounts are computed separately under the Agreement when calculating termination payments under Market Quotation. With Loss, Unpaid Amounts are part of the Loss calculation (unless Loss is used as a fallback to Market Quotation). Depending on whether Market Quotation or Loss, the First Method or the Second Method, an Event of Default or Termination Event applies (and, if a Termination Event occurs, whether one or two Affected Parties are involved), calculations of early termination payments are made as follows:

### *(e)(i) Payments arising from an Event of Default*

*First Method and Market Quotation* First the positive and negative values of all Transactions are calculated and added together. The resulting net figure is then added to the Unpaid Amounts due to the Non-defaulting Party. From it are subtracted the Unpaid Amounts due to the Defaulting Party.

If the resultant net amount is a positive number, it is paid by the Defaulting Party to the Non-defaulting Party. Where the net amount is a negative figure the Non-defaulting Party makes no payment to the Defaulting Party. This is known as “limited two-way payments”. The Non-defaulting Party makes the necessary calculations in this case.

*First Method and Loss* If Loss is used and the amount of a Non-defaulting Party's Loss is a positive number, the Defaulting Party pays that sum to the Non-defaulting Party but if it is a negative number, no payment is made. The Non-defaulting Party again makes the necessary calculations.

*Second Method and Market Quotation* Where the net amount is a positive number, it is paid by the Defaulting Party to the Non-defaulting Party. Where it is a negative number, it is paid by the Non-defaulting Party to the Defaulting Party. This is known as "full two-way payments" and is favoured by regulators. The Non-defaulting Party still makes the necessary calculations.

*Second Method and Loss* If the amount of a Non-defaulting Party's Loss is a positive number, the Defaulting Party pays that sum to the Non-defaulting Party but if it is a negative number, the Non-defaulting Party pays the absolute value of that amount to the Defaulting Party. The Non-defaulting Party makes the calculations.

An easy way to remember who gets what (particularly under the Second Method) is to view the positive and negative amounts from the Non-defaulting Party's viewpoint. If the close-out amount is positive, the Non-defaulting Party receives it and could be said to view the situation positively. If the close-out amount is negative, the Non-defaulting Party has to pay it over and so views the situation negatively.

Figure 3.5 illustrates the above payments.

**FIG. 3.5**

Payments arising from an Event of Default

Process for Market Quotation:

1. Calculate and add together the positive and negative values of all Transactions.
2. Add Unpaid Amounts due to the Non-defaulting Party.
3. Subtract Unpaid Amounts due to the Defaulting Party.

Method and Measure	Positive net figure	Action	Negative net figure	Action
First Method and Market Quotation	Yes	Defaulting Party pays Non-defaulting Party	Yes	Non-defaulting Party does not pay Defaulting Party
First Method and Loss	Yes	Defaulting Party pays Non-defaulting Party	Yes	Non-defaulting Party does not pay Defaulting Party
Second Method and Market Quotation	Yes	Defaulting Party pays Non-defaulting Party	Yes	Non-defaulting Party pays Defaulting Party
Second Method and Loss	Yes	Defaulting Party pays Non-defaulting Party	Yes	Non-defaulting Party pays Defaulting Party

1. Note that whichever payment method is chosen, the Defaulting Party will always pay the Non-Defaulting Party where it is "out of the money".
2. Note that, as defined, Loss includes Unpaid Amounts and is a single figure for all Terminated Transactions. When used as a fallback to Market Quotation, Loss excludes Unpaid Amounts.

(ii) **Termination Events.** If the Early Termination Date results from a Termination Event:-

(1) **One Affected Party.** If there is one Affected Party, the amount payable will be determined in accordance with Section 6(e)(i)(3), if Market Quotation applies, or Section 6(e)(i)(4), if Loss applies, except that, in either case, references to the Defaulting Party and to the Non-defaulting Party will be deemed to be references to the Affected Party and the party which is not the Affected Party, respectively, and, if Loss applies and fewer than all the Transactions are being terminated, Loss shall be calculated in respect of all Terminated Transactions.

(2) **Two Affected Parties.** If there are two Affected Parties:-

(A) if Market Quotation applies, each party will determine a Settlement Amount in respect of the Terminated Transactions, and an amount will be payable equal to (i) the sum of (a) one-half of the difference between the Settlement Amount of the party with the higher Settlement Amount ("X") and the Settlement Amount of the party with the lower Settlement Amount ("Y") and (b) the Termination Currency Equivalent of the Unpaid Amounts owing to X less (ii) the Termination Currency Equivalent of the Unpaid Amounts owing to Y; and

(B) if Loss applies, each party will determine its Loss in respect of this Agreement (or, if fewer than all the Transactions are being terminated, in respect of all Terminated Transactions) and an amount will be payable equal to one-half of the difference between the Loss of the party with the higher Loss ("X") and the Loss of the party with the lower Loss ("Y").

If the amount payable is a positive number, Y will pay it to X; if it is a negative number, X will pay the absolute value of that amount to Y.

**(e)(ii) Close out arising from a Termination Event**

If close out arises from a Termination Event, the net payment figure is calculated as follows:

*Market Quotation (One Affected Party)* Where the net amount is a positive number it is paid by the Affected Party to the non-Affected Party. Where it is a negative number it is paid by the non-Affected Party to the Affected Party. The non-Affected Party makes the calculations.

*Loss (One Affected Party)* If the amount of a non-Affected Party's Loss is a positive number, the Affected Party pays that sum to the non-Affected Party, but if it is a negative number, the non-Affected Party pays the absolute value of that amount to the Affected Party. The non-Affected Party again makes the calculations.

*Market Quotation (Two Affected Parties)* Each Affected Party solicits Market Quotations from Reference Market-makers for all Transactions to be terminated and adds the resultant positive and negative figures together so that two close-out amounts are calculated.

They then split the difference between the higher and lower close-out amounts. This amount is then added to the Unpaid Amounts payable to the party with the higher close-out amount and Unpaid Amounts due to the other party are then subtracted. If the net amount is a positive number, the party with the lower net amount pays that amount to the other party. If the net amount is negative, the party with the higher net amount pays the absolute value of that amount to the other party.

This is referred to as a "mid market" calculation and, as there are two Affected Parties, it will result in a smaller net sum payable.

*Loss (Two Affected Parties)* Each party calculates its own Loss and splits the difference equally between them. If the amount is positive, the party which calculated the lower Loss will pay the amount to the other party. If it is negative, the party with the higher Loss will pay it to the other party.

The First and Second Method are not used in the termination of Transactions following a Termination Event because they are only used where *all* Transactions are closed out under an Event of Default.

(iii) ***Adjustment for Bankruptcy.*** In circumstances where an Early Termination Date occurs because “Automatic Early Termination” applies in respect of a party, the amount determined under this Section 6(e) will be subject to such adjustments as are appropriate and permitted by law to reflect any payments or deliveries made by one party to the other under this Agreement (and retained by such other party) during the period from the relevant Early Termination Date to the date for payment determined under Section 6(d)(ii).

(iv) ***Pre-Estimate.*** The parties agree that if Market Quotation applies an amount recoverable under this Section 6(e) is a reasonable pre-estimate of loss and not a penalty. Such amount is payable for the loss of bargain and the loss of protection against future risks and except as otherwise provided in this Agreement neither party will be entitled to recover any additional damages as a consequence of such losses.

*(iii) Adjustment for Bankruptcy*

Section 6(e)(iii) deals with the situation where the close-out amount will be adjusted where an Early Termination Date is deemed to have occurred because Automatic Early Termination applies. It is designed to protect a Non-defaulting Party who has made payments to an insolvent counterparty and was unaware that Automatic Early Termination had occurred. In such circumstances appropriate adjustments can be made to the close-out amount payable.

*(iv) Pre-estimate*

This clause states that an amount recovered through an early termination payment (calculated using the Market Quotation measure) reflects a loss of bargain and loss of protection against future risks and is not a penalty. Parties cannot claim additional damages because of such losses. Hence consequential loss claims are prohibited.

**7. Transfer**

Subject to Section 6(b)(ii), neither this Agreement nor any interest or obligation in or under this Agreement may be transferred (whether by way of security or otherwise) by either party without the prior written consent of the other party, except that:-

- (a) a party may make such a transfer of this Agreement pursuant to a consolidation or amalgamation with, or merger with or into, or transfer of all or substantially all its assets to, another entity (but without prejudice to any other right or remedy under this Agreement); and
- (b) a party may make such a transfer of all or any part of its interest in any amount payable to it from a Defaulting Party under Section 6(e).

Any purported transfer that is not in compliance with this Section will be void.



## Section 7

Section 7 forbids either party to transfer the Agreement or any rights and obligations under it without prior written consent. However, there are three exceptions:

- if the purpose of a transfer is to avoid an Illegality, Tax Event or Tax Event Upon Merger as per Section 6(b)(ii), consent may not be withheld if a party's current policies would permit it to deal with the proposed transferee on the proposed Transaction terms;
- where a transfer of an Agreement arises from a merger or amalgamation type event involving the transfer of all or most of a party's assets to another entity. The words in brackets indicate that other restrictions in the Agreement relating to mergers and similar transactions are in no way prejudiced by this exception, e.g. the Merger Without Assumption Event of Default which will not be extinguished because of Section 7(a);
- if a Non-defaulting Party transfers its interest in any close-out amount payable to it from a Defaulting Party under Section 6(e).

Section 7 also makes clear that granting a security interest in respect of an Agreement constitutes a transfer and is prohibited to ensure that mutuality between the parties is present for the purposes of close-out netting. Any transfers not complying with the Section's terms will be void. It is becoming more common to see amendments to this transfer provision in the Schedule. These vary from general phrasing that consent to a transfer shall not be unreasonably withheld to blanket advance approvals of transfers to unspecified Affiliates upon an agreed notice period. The pros and cons of these amendments are examined in Chapters 6 and 8.

## 8. Contractual Currency

(a) *Payment in the Contractual Currency.* Each payment under this Agreement will be made in the relevant currency specified in this Agreement for that payment (the “Contractual Currency”). To the extent permitted by applicable law, any obligation to make payments under this Agreement in the Contractual Currency will not be discharged or satisfied by any tender in any currency other than the Contractual Currency, except to the extent such tender results in the actual receipt by the party to which payment is owed, acting in a reasonable manner and in good faith in converting the currency so tendered into this Contractual Currency, of the full amount in the Contractual Currency of all amounts payable in respect of this Agreement. If for any reason the amount in the Contractual Currency so received falls short of the amount in the Contractual Currency payable in respect of this Agreement, the party required to make the payment will, to the extent permitted by applicable law, immediately pay such additional amount in the Contractual Currency as may be necessary to compensate for the shortfall. If for any reason the amount in the Contractual Currency so received exceeds the amount in the Contractual Currency payable in respect of this Agreement, the party receiving the payment will refund promptly the amount of such excess.

(b) *Judgments.* To the extent permitted by applicable law, if any judgment or order expressed in a currency other than the Contractual Currency is rendered (i) for the payment of any amount owing in respect of this Agreement, (ii) for the payment of any amount relating to any early termination in respect of this Agreement or (iii) in respect of a judgment or order of another court for the payment of any amount described in (i) or (ii) above, the party seeking recovery, after recovery in full of the aggregate amount to which such party is entitled pursuant to the judgment or order, will be entitled to receive immediately from the other party the amount of any shortfall of the Contractual Currency received by such party as a consequence of sums paid in such other currency and will refund promptly to the other party any excess of the Contractual Currency received by such party as a consequence of sums paid in such other currency if such shortfall or such excess arises or results from any variation between the rate of exchange at which the Contractual Currency is converted into the currency of the judgment or order for the purposes of such judgment or order and the rate of exchange at which such party is able, acting in a reasonable manner and in good faith in converting the currency received into the Contractual Currency, to purchase the Contractual Currency with the amount of the currency of the judgment or order actually received by such party. The term “rate of exchange” includes, without limitation, any premiums and costs of exchange payable in connection with the purchase of or conversion into the Contractual Currency.

## **Section 8**

The Contractual Currency and judgment currency provisions here protect a party against foreign exchange losses.

### **Section 8(a)**

Section 8(a) provides that all payments made in the normal course of business (i.e. where no Event of Default or Termination Event has intervened) must be made in the contractual currency agreed by the parties (normally in a Confirmation). Where payments are made in another currency it must be converted into the Contractual Currency and any conversion shortfalls or surpluses must be paid to the party owed them.

### **Section 8(b)**

The same principle applies where this happens to payments under the Agreement due after legal proceedings where a recovering party has the right to convert an alternative currency into the Contractual Currency. Premia and exchange costs incurred in the conversion process are also payable to the recovering party. This is an example of a judgment currency clause and it is necessary because courts in some jurisdictions will only make awards in their local currency which may well be different from the Contractual Currency.

(c) ***Separate Indemnities.*** To the extent permitted by applicable law, these indemnities constitute separate and independent obligations from the other obligations in this Agreement, will be enforceable as separate and independent causes of action, will apply notwithstanding any indulgence granted by the party to which any payment is owed and will not be affected by judgment being obtained or claim or proof being made for any other sums payable in respect of this Agreement.

(d) ***Evidence of Loss.*** For the purpose of this Section 8, it will be sufficient for a party to demonstrate that it would have suffered a loss had an actual exchange or purchase been made.

### **Section 8(c)**

This is rather technical. The provisions in Section 8(a) and (b) are described as separate and independent indemnities which are separately enforceable to avoid the risk that a court might combine a claim based on either indemnity with other claims being pursued for other sums under the Agreement. The indemnities will remain separate notwithstanding any indulgence or concessions granted by a creditor to his debtor or any judgment made or other claim being pursued for other sums payable under the Agreement.

### **Section 8(d)**

Section 8(d) states that it will be enough for a party to show that it would have suffered a loss had an actual exchange or purchase of currency been made.

## 9. Miscellaneous

(a) **Entire Agreement.** This Agreement constitutes the entire agreement and understanding of the parties with respect to its subject matter and supersedes all oral communication and prior writings with respect thereto.

(b) **Amendments.** No amendment, modification or waiver in respect of this Agreement will be effective unless in writing (including a writing evidenced by a facsimile transmission) and executed by each of the parties or confirmed by an exchange of telexes or electronic messages on an electronic messaging system.

(c) **Survival of Obligations.** Without prejudice to Sections 2(a)(iii) and 6(c)(ii), the obligations of the parties under this Agreement will survive the termination of any Transaction.

(d) **Remedies Cumulative.** Except as provided in this Agreement, the rights, powers, remedies and privileges provided in this Agreement are cumulative and not exclusive of any rights, powers, remedies and privileges provided by law.

(e) **Counterparts and Confirmations.**

(i) This Agreement (and each amendment, modification and waiver in respect of it) may be executed and delivered in counterparts (including by facsimile transmission), each of which will be deemed an original.

(ii) The parties intend that they are legally bound by the terms of each Transaction from the moment they agree to those terms (whether orally or otherwise). A Confirmation shall be entered into as soon as practicable and may be executed and delivered in counterparts (including by facsimile transmission) or be created by an exchange of telexes or by an exchange of electronic messages on an electronic messaging system, which in each case will be sufficient for all purposes to evidence a binding supplement to this Agreement. The parties will specify therein or through another effective means that any such counterpart, telex or electronic message constitutes a Confirmation.

(f) **No Waiver of Rights.** A failure or delay in exercising any right, power or privilege in respect of this Agreement will not be presumed to operate as a waiver, and a single or partial exercise of any right, power or privilege will not be presumed to preclude any subsequent or further exercise, of that right, power or privilege or the exercise of any other right, power or privilege.

(g) **Headings.** The headings used in this Agreement are for convenience of reference only and are not to affect the construction of or to be taken into consideration in interpreting this Agreement.

## **Section 9**

### **Section 9(a)**

The ISDA Master Agreement is stated as forming the entire agreement between the parties and supersedes all previous oral and written communications.

### **Section 9(b)**

Amendments (communicated by a variety of traditional means) are only effective if in writing and executed by both parties. Alternatively this can take place through the exchange of telexes or electronic messages. This does not include e-mails.

### **Section 9(c)**

This provision is self-explanatory, but note that Transactions subject to early termination are excluded from it. Section 2(a)(iii) and Section 6(c)(ii) respectively introduce conditions precedent and the replacement of normal payment and delivery obligations by a close-out regime. These provisions therefore limit survival of obligations which is why the Agreement wording was drafted this way.

### **Section 9(d)**

It should be remembered that termination is not the sole remedy of a Non-defaulting Party. It also has the options of leaving the Agreement in place or seeking specific performance of its counterparty's obligations where monetary compensation is not sufficient, e.g. where physical delivery of a share or commodity is required.

### **Section 9(e)**

Parties may execute and deliver in counterparts an Agreement, amendment, modification and waiver and transmit the same by fax. Each document will be regarded as an original.

Parties are legally bound by the terms of each Transaction from the moment they agree to them (orally or otherwise). A Confirmation should follow as soon as possible and may be executed in counterparts using traditional or electronic means of communication but not e-mail.

### **Section 9(f)**

Variations of this standard provision are also commonly seen in loan agreements. No precedent is set if a full or partial waiver is exercised in respect of any right, power or privilege under the Agreement.

### **Section 9(g)**

Headings in the Agreement are for convenience only and do not affect its interpretation.

**10. Offices; Multibranch Parties**

(a) If Section 10(a) is specified in the Schedule as applying, each party that enters into a Transaction through an Office other than its head or home office represents to the other party that, notwithstanding the place of booking office or jurisdiction of incorporation or organisation of such party, the obligations of such party are the same as if it had entered into the Transaction through its head or home office. This representation will be deemed to be repeated by such party on each date on which a Transaction is entered into.

(b) Neither party may change the Office through which it makes and receives payments or deliveries for the purpose of a Transaction without the prior written consent of the other party.

(c) If a party is specified as a Multibranch Party in the Schedule, such Multibranch Party may make and receive payments or deliveries under any Transaction through any Office listed in the Schedule, and the Office through which it makes and receives payments or deliveries with respect to a Transaction will be specified in the relevant Confirmation.



## Section 10

### Section 10(a)

Parties must choose in Part 4(c) of the Schedule if they want Section 10(a) to apply. Section 10(a) stipulates that both parties may have recourse to each other's Head Office regardless of the credit or political risk of branches through which they are transacting should a default occur under the Agreement.

Parties to an Agreement may regard Transactions entered into through their branches as equivalent to Transactions entered into through their Head Offices. This represents an implied payment or performance guarantee to their counterparty.

This representation, if stipulated in Part 4(c) of the Schedule as applying, relates to all parties and not only Multibranch Parties. The representation is also repeated by a party on each date on which a Transaction is undertaken. The giving of this representation was automatic in the 1987 Agreement but now parties can choose if it will apply. If a Multibranch Party does not want this provision to apply, then it is seeking to shift the political risk of dealing with its overseas branch on to its counterparty. It is therefore vital where this is agreed that the branch is located in a jurisdiction favourable to close-out netting.

Some banks believe their counterparties should bear this risk in the same way they would have to accept it if they dealt with a local bank in the same country.

### Section 10(b)

Section 10(b) prevents a party from changing the Office through which it makes and receives payments or deliveries without the other party's written consent beforehand in order to avoid, *inter alia*, possible unfavourable tax consequences for the other party. Booking offices may also be relevant for the payment netting provisions in Section 2(c). Although not stated here, Section 6(b)(ii) probably overrides this as a party cannot unreasonably refuse consent to a transfer to avoid a Section 5(b)(i)–(iii) Termination Event.

### Section 10(c)

If a party wants to make and receive payments under different Transactions through different Offices, it should be nominated in Part 4(d) of the Schedule as a Multibranch Party and the addresses of all such Offices should be listed in Part 4(a) of the Schedule. The relevant Office for each Transaction should also be stated in the Confirmation.

### **11. Expenses**

A Defaulting Party will, on demand, indemnify and hold harmless the other party for and against all reasonable out-of-pocket expenses, including legal fees and Stamp Tax, incurred by such other party by reason of the enforcement and protection of its rights under this Agreement or any Credit Support Document to which the Defaulting Party is a party or by reason of the early termination of any Transaction, including, but not limited to, costs of collection.

## Section 11

The expenses referred to in this Section are different to those incurred on early termination in Section 6(e)(iv).

This Section requires a Defaulting Party to pay certain reasonable out-of-pocket expenses (including legal fees and stamp duties) incurred by the Non-defaulting Party when enforcing and protecting its rights under an Agreement or any Credit Support Document given by the Defaulting Party. However, the Section does not specifically provide for the payment of expenses arising from the enforcement and protection of rights under any third party Credit Support Document and it is therefore necessary to check that such a Credit Support Document contains an acceptable indemnity for expenses.

Note that the Section 6(e)(iv) prohibition on recovering consequential losses is not intended to prevent recovery of the expenses specified in Section 11.

However, Section 11 legal fees and out-of-pocket expenses are excluded in the definition of Loss in Section 14.

## 12. Notices

(a) **Effectiveness.** Any notice or other communication in respect of this Agreement may be given in any manner set forth below (except that a notice or other communication under Section 5 or 6 may not be given by facsimile transmission or electronic messaging system) to the address or number or in accordance with the electronic messaging system details provided (see the Schedule) and will be deemed effective as indicated:-

(i) if in writing and delivered in person or by courier, on the date it is delivered;

(ii) if sent by telex, on the date the recipient's answerback is received;

(iii) if sent by facsimile transmission, on the date that transmission is received by a responsible employee of the recipient in legible form (it being agreed that the burden of proving receipt will be on the sender and will not be met by a transmission report generated by the sender's facsimile machine);

(iv) if sent by certified or registered mail (airmail, if overseas) or the equivalent (return receipt requested), on the date that mail is delivered or its delivery is attempted; or

(v) if sent by electronic messaging system, on the date that electronic message is received,

unless the date of that delivery (or attempted delivery) or that receipt, as applicable, is not a Local Business Day or that communication is delivered (or attempted) or received, as applicable, after the close of business on a Local Business Day, in which case that communication shall be deemed given and effective on the first following day that is a Local Business Day.

(b) **Change of Addresses.** Either party may by notice to the other change the address, telex or facsimile number or electronic messaging system details at which notices or other communications are to be given to it.

## **Section 12**

Section 12 states the means by which any notice or communication in connection with an Agreement may be made, including by fax or electronic messaging systems which does not include e-mail. Notices relating to Section 5 or 6 may not be given by fax or electronic messaging system because an original signature is necessary for them.

### **Section 12(a)**

Section 12(a) defines when receipt is considered to take place with the recipient. As regards a fax (Section 12(a)(iii)), its receipt is only effective on the date a responsible employee receives the fax in legible form. The sender has to prove receipt and a transmission report from a fax machine is not good enough for this purpose. There is no definition of who is a responsible employee and any doubts about this could affect the timing of receipt of the notice. A permitted electronic message is effective on receipt. If the date of delivery or receipt is not a Local Business Day or takes place after close of business on a Local Business Day, then it will only become effective on the next following Local Business Day.

### **Section 12(b)**

Changes to relevant addresses, numbers or electronic messaging details specified in Part 4(a) of the Schedule to the Agreement may be made by either party notifying the other in any of the prescribed forms under sub-section (a) above.

**13. Governing Law and Jurisdiction**

(a) **Governing Law.** This Agreement will be governed by and construed in accordance with the law specified in the Schedule.

(b) **Jurisdiction.** With respect to any suit, action or proceedings relating to this Agreement (“Proceedings”), each party irrevocably:-

(i) submits to the jurisdiction of the English courts, if this Agreement is expressed to be governed by English law, or to the non-exclusive jurisdiction of the courts of the State of New York and the United States District Court located in the Borough of Manhattan in New York City, if this Agreement is expressed to be governed by the laws of the State of New York; and

(ii) waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings, that such court does not have any jurisdiction over such party.

Nothing in this Agreement precludes either party from bringing Proceedings in any other jurisdiction (outside, if this Agreement is expressed to be governed by English law, the Contracting States, as defined in Section 1(3) of the Civil Jurisdiction and Judgments Act 1982 or any modification, extension or re-enactment thereof for the time being in force) nor will the bringing of Proceedings in any one or more jurisdictions preclude the bringing of Proceedings in any other jurisdiction.

## Section 13

### Section 13(a)

Parties to the Agreement choose its governing law in Part 4(h) of the Schedule. The Agreement offers a choice between English law and the laws of the State of New York because it was composed with the requirements of the common law codes of those jurisdictions in mind. Where it is proposed that the governing law is to be other than English law or the laws of the State of New York, this should be the subject of specific legal advice. There are no real exceptions to this because it is vital to ensure that the Agreement (and particularly its close-out netting provisions) are effective under any law other than English or New York law. It is conceivable that two parties might enter into a Local Currency Master Agreement where they are both located in the same jurisdiction and only entering Transactions in their own local currency but this is a comparatively rare occurrence.

### Section 13(b)

Section 13(b) provides that the parties submit to the jurisdiction of the English courts if English law is chosen and to the jurisdiction of the courts of the State of New York and the US District Court located in the Borough of Manhattan in New York if New York law is selected. Waivers of objection to venue, inconvenient forum and objection to questioning the court's jurisdiction are also included. The submission to the jurisdiction of the New York courts is non-exclusive which means that actions may be commenced in other courts. The submission to the jurisdiction of the English courts is exclusive as far as courts of the Contracting States of the European Union are concerned and non-exclusive for other courts. This complies with the provisions of the English Civil Jurisdiction and Judgments Act 1982.

(c) ***Service of Process.*** Each party irrevocably appoints the Process Agent (if any) specified opposite its name in the Schedule to receive, for it and on its behalf, service of process in any Proceedings. If for any reason any party's Process Agent is unable to act as such, such party will promptly notify the other party and within 30 days appoint a substitute process agent acceptable to the other party. The parties irrevocably consent to service of process given in the manner provided for notices in Section 12. Nothing in this Agreement will affect the right of either party to serve process in any other manner permitted by law.

(d) ***Waiver of Immunities.*** Each party irrevocably waives, to the fullest extent permitted by applicable law, with respect to itself and its revenues and assets (irrespective of their use or intended use), all immunity on the grounds of sovereignty or other similar grounds from (i) suit, (ii) jurisdiction of any court, (iii) relief by way of injunction, order for specific performance or for recovery of property, (iv) attachment of its assets (whether before or after judgment) and (v) execution or enforcement of any judgment to which it or its revenues or assets might otherwise be entitled in any Proceedings in the courts of any jurisdiction and irrevocably agrees, to the extent permitted by applicable law, that it will not claim any such immunity in any Proceedings.



### **Section 13(c)**

Process Agents for the receipt of writs or other legal documents, where applicable, are to be specified in Part 4(b) of the Schedule. They are necessary where a Defaulting Party cannot easily be served with the necessary legal papers required to commence legal proceedings in the jurisdiction whose laws govern the Agreement.

Section 13(c) states that each party also consents to service of process in the manner provided for notices in Section 12. However, certain means of providing notice in Section 12 may not be practical for serving process (e.g. telex or electronic messaging systems) and may not be a valid means of serving process in certain countries despite the parties' consent in Section 13(c). Section 13(c) also provides that where a party's Process Agent is unable to act, such party will promptly notify its counterparty and, by mutual agreement, appoint a substitute Process Agent within 30 days. Service of notice by a Process Agent can be very important where failure to serve process in a jurisdiction could result in a foreign judgment not being enforceable in that country.

### **Section 13(d)**

Section 13(d) provides for a waiver of immunities from prosecution by the parties to the greatest extent permitted by applicable law. This provision is also common in loan agreements.

#### 14. Definitions

As used in this Agreement:-

“*Additional Termination Event*” has the meaning specified in Section 5(b).

“*Affected Party*” has the meaning specified in Section 5(b).

“*Affected Transactions*” means (a) with respect to any Termination Event consisting of an Illegality, Tax Event or Tax Event Upon Merger, all Transactions affected by the occurrence of such Termination Event and (b) with respect to any other Termination Event, all Transactions.

“*Affiliate*” means, subject to the Schedule, in relation to any person, any entity controlled, directly or indirectly, by the person, any entity that controls, directly or indirectly, the person or any entity directly or indirectly under common control with the person. For this purpose, “control” of any entity or person means ownership of a majority of the voting power of the entity or person.

“*Applicable Rate*” means:-

- (a) in respect of obligations payable or deliverable (or which would have been but for Section 2(a)(iii)) by a Defaulting Party, the Default Rate;
- (b) in respect of an obligation to pay an amount under Section 6(e) of either party from and after the date, (determined in accordance with Section 6(d)(ii)) on which that amount is payable, the Default Rate;
- (c) in respect of all other obligations payable or deliverable (or which would have been but for Section 2(a)(iii)) by a Non-defaulting Party, the Non-default Rate; and
- (d) in all other cases, the Termination Rate.

“*Burdened Party*” has the meaning specified in Section 5(b).

“*Change in Tax Law*” means the enactment, promulgation, execution or ratification of, or any change in or amendment to, any tax law (or in the application or official interpretation of any law) that occurs on or after the date on which the relevant Transaction is entered into.

“*consent*” includes a consent, approval, action, authorisation, exemption, notice, filing, registration or exchange control consent.

“*Credit Event Upon Merger*” has the meaning specified in Section 5(b).

“*Credit Support Document*” means any agreement or instrument that is specified as such in this Agreement.

## Section 14 – Definitions

All significant terms in the Agreement are defined, sometimes exhaustively, in Section 14. No doubt with the disapproval of lawyers, but with a big “government health warning” I set out below a simple glossary of most of these Definitions except where they are self-evident.

### GLOSSARY OF MOST TERMS IN SECTION 14

Additional Termination Event	An extra Termination Event chosen by the parties, e.g. a change of control event or a credit ratings downgrade event.
Affected Party	The party at fault under a Termination Event.
Affected Transactions	The relevant Transactions affected by a Termination Event.
Affiliate	Essentially any other company or entity in a party’s group.
Applicable Rate	The relevant interest rate in a series of penalty rates for late payment or delivery.
Burdened Party	The party afflicted or at fault (if it is the merging party) in the Tax Event Upon Merger Termination Event as the case may be.
Credit Event Upon Merger	A deterioration in the creditworthiness of a party to the Agreement following a merger type event.
Credit Support Document	A document securing a party’s obligations under the Agreement provided either by the party itself or a third party (e.g. a guarantor).

“**Credit Support Provider**” has the meaning specified in the Schedule.

“**Default Rate**” means a rate per annum equal to the cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount plus 1% per annum.

“**Defaulting Party**” has the meaning specified in Section 6(a).

“**Early Termination Date**” means the date determined in accordance with Section 6(a) or 6(b)(iv).

“**Event of Default**” has the meaning specified in Section 5(a) and, if applicable, in the Schedule.

“**Illegality**” has the meaning specified in Section 5(b).

“**Indemnifiable Tax**” means any Tax other than a Tax that would not be imposed in respect of a payment under this Agreement but for a present or former connection between the jurisdiction of the government or taxation authority imposing such Tax and the recipient of such payment or a person related to such recipient (including, without limitation, a connection arising from such recipient or related person being or having been a citizen or resident of such jurisdiction, or being or having been organised, present or engaged in a trade or business in such jurisdiction, or having or having had a permanent establishment or fixed place of business in such jurisdiction, but excluding a connection arising solely from such recipient or related person having executed, delivered, performed its obligations or received a payment under, or enforced, this Agreement or a Credit Support Document).

“**law**” includes any treaty, law, rule or regulation (as modified, in the case of tax matters, by the practice of any relevant governmental revenue authority) and “**lawful**” and “**unlawful**” will be construed accordingly.

“**Local Business Day**” means, subject to the Schedule, a day on which commercial banks are open for business (including dealings in foreign exchange and foreign currency deposits) (a) in relation to any obligation under Section 2(a)(i), in the place(s) specified in the relevant Confirmation or, if not so specified, as otherwise agreed by the parties in writing or determined pursuant to provisions contained, or incorporated by reference, in this Agreement, (b) in relation to any other payment, in the place where the relevant account is located and, if different, in the principal financial centre, if any, of the currency of such payment, (c) in relation to any notice or other communication, including notice contemplated under Section 5(a)(i), in the city specified in the address for notice provided by the recipient and, in the case of a notice contemplated by Section 2(b), in the place where the relevant new account is to be located and (d) in relation to Section 5(a)(v)(2), in the relevant locations for performance with respect to such Specified Transaction.

Credit Support Provider	The party providing security under a Credit Support Document.
Default Rate	1% over the payee's cost of funds.
Defaulting Party	The party at fault under an Event of Default.
Early Termination Date	The date upon which close-out occurs.
Event of Default	One or more events in Section 5(a) of the Agreement which can trigger close-out of all Transactions with a Defaulting Party under the Agreement.
Illegality	Under Section 5(b)(i) an event which prevents lawful payment or performance under the Agreement or a Credit Support Document.
Indemnifiable Tax	Essentially a cross-border tax against which a party to the Agreement is entitled to be indemnified by the other party. It excludes domestic income, sales and capital taxes.
Local Business Day	A normal business day in the location required for the performance of various obligations under the Agreement.

“*Loss*” means, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, the Termination Currency Equivalent of an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, including any loss of bargain, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made, except, so as to avoid duplication, if Section 6(e)(i)(1) or (3) or 6(e)(ii)(2)(A) applies. Loss does not include a party’s legal fees and out-of-pocket expenses referred to under Section 11. A party will determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.

Loss	A party's good faith determination of its losses and costs (except legal fees and Section 11 expenses) minus its gains in respect of Terminated Transactions.
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*“Market Quotation”* means, with respect to one or more Terminated Transactions and a party making the determination, an amount determined on the basis of quotations from Reference Market-makers. Each quotation will be for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as a positive number) in consideration of an agreement between such party (taking into account any existing Credit Support Document with respect to the obligations of such party) and the quoting Reference Market-maker to enter into a transaction (the “Replacement Transaction”) that would have the effect of preserving for such party the economic equivalent of any payment or delivery (whether the underlying obligation was absolute or contingent and assuming the satisfaction of each applicable condition precedent) by the parties under Section 2(a)(i) in respect of such Terminated Transaction or group of Terminated Transactions that would, but for the occurrence of the relevant Early Termination Date, have been required after that date. For this purpose, Unpaid Amounts in respect of the Terminated Transaction or group of Terminated Transactions are to be excluded but, without limitation, any payment or delivery that would, but for the relevant Early Termination Date, have been required (assuming satisfaction of each applicable condition precedent) after that Early Termination Date is to be included. The Replacement Transaction would be subject to such documentation as such party and the Reference Market-maker may, in good faith, agree. The party making the determination (or its agent) will request each Reference Market-maker to provide its quotation to the extent reasonably practicable as of the same day and time (without regard to different time zones) on or as soon as reasonably practicable after the relevant Early Termination Date. The day and time as of which those quotations are to be obtained will be selected in good faith by the party obliged to make a determination under Section 6(e), and, if each party is so obliged, consultation with the other. If more than three quotations are provided, the Market Quotation will be the arithmetic mean of the quotations, without regard to the quotations having the highest and lowest values. If exactly three such quotations are provided, the Market Quotation will be the quotation remaining after disregarding the highest and lowest quotations. For this purpose, if more than one quotation has the same highest value or lowest value, then one of such quotations shall be disregarded. If fewer than three quotations are provided, it will be deemed that the Market Quotation in respect of such Terminated Transaction or group of Terminated Transactions cannot be determined.



Market Quotation	Replacement value of Terminated Transactions calculated by reference to quotations from Reference Market-makers. Fallback is Loss.
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“**Non-default Rate**” means a rate per annum equal to the cost (without proof or evidence of any actual cost) to the Non-defaulting Party (as certified by it) if it were to fund the relevant amount.

“**Non-defaulting Party**” has the meaning specified in Section 6(a).

“**Office**” means a branch or office of a party, which may be such party’s head or home office.

“**Potential Event of Default**” means any event which, with the giving of notice or the lapse of time or both, would constitute an Event of Default.

“**Reference Market-makers**” means four leading dealers in the relevant market selected by the party determining a Market Quotation in good faith (a) from among dealers of the highest credit standing which satisfy all the criteria that such party applies generally at the time in deciding whether to offer or to make an extension of credit and (b) to the extent practicable, from among such dealers having an office in the same city.

“**Relevant Jurisdiction**” means, with respect to a party, the jurisdictions (a) in which the party is incorporated, organised, managed and controlled or considered to have its seat, (b) where an Office through which the party is acting for purposes of this Agreement is located, (c) in which the party executes this Agreement and (d) in relation to any payment, from or through which such payment is made.

“**Scheduled Payment Date**” means a date on which a payment or delivery is to be made under Section 2(a)(i) with respect to a Transaction.

“**Set-off**” means set-off, offset, combination of accounts, right of retention or withholding or similar right or requirement to which the payer of an amount under Section 6 is entitled or subject (whether arising under this Agreement, another contract, applicable law or otherwise) that is exercised by, or imposed on, such payer.

Non-default Rate	The Non-defaulting Party's cost of funding.
Non-defaulting Party	The party not at fault in an Event of Default.
Office	A branch or office of a party including its head or home office.
Potential Event of Default	An event which would become an Event of Default if not cured within a grace period or if a default notice was issued in relation to it.
Reference Market-makers	Four leading dealers in the relevant market satisfactory to the party seeking the Market Quotations.
Scheduled Payment Date	The date on which a normal payment or delivery under a Transaction is due.
Set-Off	The right to net other amounts owing by the two parties to the Agreement to each other after calculation of the close-out amount on the Early Termination Date.

“**Settlement Amount**” means, with respect to a party and any Early Termination Date, the sum of:-

- (a) the Termination Currency Equivalent of the Market Quotations (whether positive or negative) for each Terminated Transaction or group of Terminated Transactions for which a Market Quotation is determined; and
- (b) such party’s Loss (whether positive or negative and without reference to any Unpaid Amounts) for each Terminated Transaction or group of Terminated Transactions for which a Market Quotation cannot be determined or would not (in the reasonable belief of the party making the determination) produce a commercially reasonable result.

“**Specified Entity**” has the meaning specified in the Schedule.

“**Specified Indebtedness**” means, subject to the Schedule, any obligation (whether present or future, contingent or otherwise, as principal or surety or otherwise) in respect of borrowed money.

“**Specified Transaction**” means, subject to the Schedule, (a) any transaction (including an agreement with respect thereto) now existing or hereafter entered into between one party to this Agreement (or any Credit Support Provider of such party or any applicable Specified Entity of such party) and the other party to this Agreement (or any Credit Support Provider of such other party or any applicable Specified Entity of such other party) which is a rate swap transaction, basis swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap, equity or equity index option, bond option, interest rate option, foreign exchange transaction, cap transaction, floor transaction, collar transaction, currency swap transaction, cross-currency rate swap transaction, currency option or any other similar transaction (including any option with respect to any of these transactions), (b) any combination of these transactions and (c) any other transaction identified as a Specified Transaction in this Agreement or the relevant confirmation.

“**Stamp Tax**” means any stamp, registration, documentation or similar tax.

“**Tax**” means any present or future tax, levy, impost, duty, charge, assessment or fee of any nature (including interest, penalties and additions thereto) that is imposed by any government or other taxing authority in respect of any payment under this Agreement other than a stamp, registration, documentation or similar tax.

“**Tax Event**” has the meaning specified in Section 5(b).

Settlement Amount	The Non-defaulting Party's or the non-Affected Party's determination of the close-out amount taking into account Market Quotation and Unpaid Amounts or Loss. The net sum to be paid over on the Early Termination Date.
Specified Entity	An entity a party wants to join to certain Section 5 events named in Part 1(a) of the Schedule.
Specified Indebtedness	Borrowed money.
Specified Transaction	One of a list of OTC derivatives Transactions between the two parties to the Agreement or their Specified Entities or Credit Support Providers but which are outside of the Agreement.
Tax Event	The Termination Event in Section 5(b)(ii) which can conditionally trigger termination of Affected Transactions due to adverse changes in tax law or their implementation by tax authorities or courts.

“**Tax Event Upon Merger**” has the meaning specified in Section 5(b).

“**Terminated Transactions**” means with respect to any Early Termination Date (a) if resulting from a Termination Event, all Affected Transactions and (b) if resulting from an Event of Default, all Transactions (in either case) in effect immediately before the effectiveness of the notice designating that Early Termination Date (or, if “Automatic Early Termination” applies, immediately before that Early Termination Date).

“**Termination Currency**” has the meaning specified in the Schedule.

“**Termination Currency Equivalent**” means, in respect of any amount denominated in the Termination Currency, such Termination Currency amount and, in respect of any amount denominated in a currency other than the Termination Currency (the “Other Currency”), the amount in the Termination Currency determined by the party making the relevant determination as being required to purchase such amount of such Other Currency as at the relevant Early Termination Date, or, if the relevant Market Quotation or Loss (as the case may be), is determined as of a later date, that later date, with the Termination Currency at the rate equal to the spot exchange rate of the foreign exchange agent (selected as provided below) for the purchase of such Other Currency with the Termination Currency at or about 11:00 a.m. (in the city in which such foreign exchange agent is located) on such date as would be customary for the determination of such a rate for the purchase of such Other Currency for value on the relevant Early Termination Date or that later date. The foreign exchange agent will, if only one party is obliged to make a determination under Section 6(e), be selected in good faith by that party and otherwise will be agreed by the parties.

“**Termination Event**” means an Illegality, a Tax Event or a Tax Event Upon Merger or, if specified to be applicable, a Credit Event Upon Merger or an Additional Termination Event.

“**Termination Rate**” means a rate per annum equal to the arithmetic mean of the cost (without proof or evidence of any actual cost) to each party (as certified by such party) if it were to fund or of funding such amounts.

Tax Event Upon Merger	The Termination Event in Section 5(b)(iii) which conditionally can trigger termination of Affected Transactions due to adverse changes in tax law or their implementation by tax authorities and which affect one party to the Agreement where its counterparty has merged with a third party.
Terminated Transactions	Transactions terminated or to be terminated on the Early Termination Date.
Termination Currency	The currency (selected in Part 1(g) of the Schedule) into which all Transactions are converted when calculating a final close-out amount on the Early Termination Date.
Termination Currency Equivalent	The equivalent value of the Terminated Transactions in the Termination Currency chosen in Part 1(g) of the Schedule.
Termination Event	The events in Section 5(b) which can trigger close-out.
Termination Rate	In a no fault termination, the arithmetic mean of the funding costs of both parties.

“*Unpaid Amounts*” owing to any party means, with respect to an Early Termination Date, the aggregate of (a) in respect of all Terminated Transactions, the amounts that became payable (or that would have become payable but for Section 2(a)(iii)) to such party under Section 2(a)(i) on or prior to such Early Termination Date and which remain unpaid as at such Early Termination Date and (b) in respect of each Terminated Transaction, for each obligation under Section 2(a)(i) which was (or would have been but for Section 2(a)(iii)) required to be settled by delivery to such party on or prior to such Early Termination Date and which has not been so settled as at such Early Termination Date, an amount equal to the fair market value of that which was (or would have been) required to be delivered as of the originally scheduled date for delivery, in each case together with (to the extent permitted under applicable law) interest, in the currency of such amounts, from (and including) the date such amounts or obligations were or would have been required to have been paid or performed to (but excluding) such Early Termination Date, at the Applicable Rate. Such amounts of interest will be calculated on the basis of daily compounding and the actual number of days elapsed. The fair market value of any obligation referred to in clause (b) above shall be reasonably determined by the party obliged to make the determination under Section 6(e) or, if each party is so obliged, it shall be the average of the Termination Currency Equivalents of the fair market values reasonably determined by both parties.



Unpaid Amounts	Payments or deliveries due to a party on a Scheduled Payment Date which remain unpaid due to an Early Termination Date occurring, plus interest. Unpaid Amounts are used in close-out calculations.
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IN WITNESS WHEREOF the parties have executed this document on the respective dates specified below with effect from the date specified on the first page of this document.

By:..... By:.....

(Name of Party)

(Name of Party)

Name:

Name:

Title:

Title:

Date:

Date:

## Signature Block

The name of each party and the names and titles of signatories must be filled in on the signature page along with the dates of signing by each signatory. The main text of the Master Agreement must be signed. A Schedule can, but need not, be signed.

The pre-printed text of the Master Agreement ends on page 18. A Schedule is always attached and begins on page 19.

The Schedule is where provisions in the ISDA Master Agreement are amended or added through negotiation. We shall examine the Schedule in Chapter 8.

