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Briefing note March 2016

Payments due following swap close-out

The English Court of Appeal has decided that the provision of reasonable details showing the calculation of the sum due on the early termination of transactions subject to the ISDA Master Agreement is not a pre-requisite to the sum becoming payable. All that is required is the correct figure. Similarly, the right to payment does not depend upon those details being provided within a reasonable time.

When a non-defaulting party to the ISDA Master Agreement designates an Early Termination Date following an Event of Default, section 6(d)(i) requires it to calculate the sum due as soon as reasonably practicable. Within that same timeframe, the non-defaulting party must then send the defaulting party a statement showing those calculations in reasonable detail, accompanied by information about the account to which payment should be made. The payment becomes due on the day on which "notice of the amount payable" is effective (section 6(d)(ii)).

In *Videocon Global Ltd v Goldman Sachs International* [2016] EWCA Civ 130, the Court of Appeal considered whether the defaulting party's obligation to pay the sum due on early termination was conditional on the notice both setting out reasonable details of the calculation and being served as soon as reasonably practicable after the Early Termination Date. The Court decided that neither was a condition of payment. The sum in question became payable as soon as notice of its amount was given. Reasonable details of the calculation could follow later – indeed, much later.

Videocon concerned a currency swap subject to the 1992 ISDA Master Agreement. C terminated the swap in late 2011 following D's failure to meet a margin call. C then served notice of the amount due under section 6(d)(i). D failed to pay the sum set out in C's notice. When C sought judgment for that sum, D claimed that the notice was ineffective because it did not provide reasonable details of C's calculation of the sum due. The judge concluded that C had validly terminated the swap, but also that C had not provided proper details of its calculation. The judge therefore refused to enter judgment for C in the sum set out in the notice ([2013] EWHC 2843 (Comm)).

By this time, well over two years had passed since the Early Termination Date. To correct the position, C served a new notice, setting out the same sum and providing all the detail that D could possibly have wanted. C returned to court, again seeking judgment for the sum due.

This time round, D claimed that C's new notice was also invalid because it had not been served as soon as reasonably practicable after the Early Termination Date. C had, through its delay, lost its right to calculate the sum due under the terms of the Master Agreement (though D acknowledged that C could claim damages at common law for D's breach of contract).

Key issues

- Notice under sections 6(d)(i) and (ii) can be separate, though rarely will be
- Delay or lack of details may be a breach but does not invalidate the payment notice
- Technical challenges to a notice may be harder to bring

The judge disagreed with D ([2014] EWHC 4267 (Comm)). He considered that the requirement to serve the notice as soon as reasonably practicable was not a condition precedent to the sum due on termination becoming payable. C might have been in breach of contract by serving the notice late, but the notice was still valid. C was entitled to be paid, and judgment was given in its favour.

D went to the Court of Appeal. It argued that the two requirements for a notice under section 6(d)(i) – that it be served as soon as reasonably practicable and that it contain reasonable details of the calculation – were indistinguishable. If a notice that did not contain reasonable details was invalid, a notice served late was also invalid.

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The Court of Appeal followed – to a degree – D's reasoning, but reached the opposite conclusion. The two requirements were indistinguishable, but this meant that neither was a condition precedent to the sum due on early termination becoming payable, not that both were.

The Court distinguished between a sum becoming due and its becoming payable. The debt arising on early termination following an Event of Default became due on the Early Termination Date. It was determined as of that Date, and interest ran from that Date. But it did not become payable until "notice of the amount payable is effective", in accordance with section 6(d)(ii). Contrary to both parties' contentions, the Court of Appeal considered that this notice was not necessarily the notice required by section 6(d)(i) setting out the reasonable details of the non-defaulting party's calculation (though it could be) but was simply a notice stating the sum due. As long as this section 6(d)(ii) notice is effective in accordance with section 12, the sum was payable regardless of whether a valid notice had been served under section 6(d)(i).

As a result, C's first notice in late 2011 was effective to oblige D to pay even though the notice did not contain reasonable details of how C had calculated the sum due. The initial decision in *Videocon* was not technically under appeal, but the Court of Appeal clearly considered it to be wrong. Even if that was not so, the second notice was also effective, despite being served well over two years after the Early Termination Date.

Conclusion

The full implications of the Court of Appeal's decision in *Videocon* may take time to work out, but a number of tentative initial conclusions can be offered, including the following.

First, the case considered ISDA's 1992 Master Agreement (second method, loss), but the Court of Appeal's reasoning is equally applicable to ISDA's 2002 Master Agreement.

Secondly, the Court of Appeal decided that the non-defaulting party only had to give notice of the sum due on early termination, not details of its calculation, for the sum to become payable. In *Videocon*, C claimed the same sum in both its initial and subsequent notices. If its second notice had claimed a different sum, then the first would not have set out the amount payable as required by section 6(d)(ii) and, therefore, would not have caused that sum to become payable. *Videocon* does not affect the need to get the calculation right first time.

Thirdly, interest accrues on the sum due as a result of early termination from the Early Termination Date regardless of when notice is given.

Fourthly, as long as the correct sum due on early termination is notified to the defaulting party, that party is obliged to pay the sum. But a non-defaulting party's failure to provide as soon as reasonably practicable proper details of the sum due will place the non-defaulting in breach of contract. In most cases, the defaulting party will not be able to prove that it has suffered any loss as a result of this failure, but there could be rare cases in which the defaulting party may be able to recoup a loss (eg where the interest rate claimed by the non-defaulting party is particularly high, effectively reducing the non-defaulting party's claim).

Fifthly, in order to calculate the sum properly due on early termination, the non-defaulting party must have to hand details of its calculation. There is nothing to be gained for the non-defaulting party in holding back those details – if challenged, the non-defaulting party will have to justify its calculation. Good practice therefore remains to provide details of the calculation as soon as they are available, which points to serving a single notice under sections 6(d)(i) and (ii), not separate notices. All that *Videocon* may really do is to prevent a defaulting party from relying on technical points as an excuse for non-payment, particularly from producing those points at the last minute before a hearing. In *Videocon*, the defaulting party was able to put off judgment being entered against it for well over a year. That will not be possible again.

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