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Due or Payable? Court of Appeal Clarifies ISDA Master Early Termination Provisions

The Court of Appeal has given renewed clarity on how to interpret the early termination provisions of section 6 of the 1992 ISDA Master Agreement.

It made clear that inadequate and/or late provision of details of how an early termination amount was calculated will not entitle the Defaulting Party to avoid liability to pay the amount notified under section 6(d). It gave guidance on key finance law concepts, and endorsed the policy of using liquidated damages to bring speed and certainty to a close-out under an ISDA Master Agreement.

The Disputed ISDA Master Agreement

In *Goldman Sachs International v Videocon Global Ltd*, Goldman and Videocon had entered into a 1992 ISDA Master Agreement, Schedule and Credit Support Annex in 2010. They entered into two currency swap trades in August and September 2011. Videocon failed to meet a US$840,000 margin call on 25 November 2011. Goldman served notice of early termination on 2 December 2011, designating that as the Early Termination Date. On 14 December 2011 Goldman served a statement purporting to comply with section 6(d)(i) of the ISDA Master Agreement, giving notice of the amount Goldman had determined to be payable to it (nearly US$4.1 million) and some details of how that loss had been calculated. When payment was not made, Goldman issued a claim in the Commercial Court in August 2012. It applied for summary judgment shortly afterwards.

Initially Videocon put up four hopeless defences and Goldman was duly awarded summary judgment on those points in September 2013. But before the summary judgment hearing Videocon raised another argument: that the statement of the early termination amount did not give "reasonable detail" of how that amount was calculated, as section 6(d)(i) required. The judge found that this allegation was well made, and that Goldman could not therefore have summary judgment for the amount claimed. Instead issues of quantum would have to go to trial.

Goldman responded by delivering a fresh section 6(d) statement on 9 March 2014 giving more detail on the calculation of loss. It amended its claim to rely on this second statement and applied afresh for summary judgment. Videocon amended its defence. It argued that the second statement did not comply with the requirement that it be served "as soon as reasonably practicable following… an Early Termination Date". It said the notice was therefore ineffective and did not render it liable to pay the early termination amount. In other words, Videocon argued that by failing to serve a compliant notice in time, Goldman had forfeited the right to use the liquidated damages mechanism in section 6 of the ISDA Master Agreement, and had to fall back on more difficult and uncertain common law unliquidated damages claims.

The Commercial Court in December 2014 rejected this argument and granted Goldman's second summary judgment application. Permission to appeal was later granted by the Court of Appeal, not because of any great prospects of success but because the issue was of wider significance to the financial markets.

The Court of Appeal Decision

The Court of Appeal gave an admirably clear dismissal of Videocon's appeal. The key points were:

- There is a clear distinction in the ISDA Master Agreement (like many finance contracts) between when a debt accrues (when it is "**due**") and when the obligation to pay it arises (when it is "**payable**"). This distinction was recognised in the *Lomas v JFB Firth Rixson* and *Pioneer Freight Co Ltd v TMT Asia Ltd* cases, which treated section 2(a)(iii) of the ISDA Master Agreement as suspending payment obligations rather than extinguishing the underlying debts.
- That distinction also operates in section 6 of the ISDA Master Agreement. Section 6 replaces the various payment obligations that apply pre-default with a single liquidated early termination amount. That amount accrues on the Early Termination Date. Loss is determined "*as of the relevant Early Termination Date*", and interest on the early termination amount accrues from the Early Termination Date. It would also be odd if the early termination amount did not accrue at the same time as the previous payment obligations are extinguished.
- Because the early termination amount becomes **due** on the Early Termination Date, it cannot be right that it is discharged by the subsequent failure to serve a compliant calculation statement.
- The obligation to **pay** the early termination amount arises on the day that the section 6(d) notice is "*effective*". Section 12 defines what an effective notice is – it relates to the method of delivery and the day on which it is deemed to take effect. Effectiveness is not affected by the quality of the calculation information given. If the information is not detailed enough the defaulting party may have a damages claim for breach of contract (if it can show a loss caused by that deficiency). But there is no basis for reading into section 6(d) or section 12 that a sufficiently detailed calculation is a condition precedent to the payment obligation.

This is a particularly robust decision. Goldman had conceded in the court below that the payment obligation did not arise until a compliant notice had been served. Its case was that the March 2014 notice was compliant and that triggered the payment obligation. The Court of Appeal said that was a bad concession: the early termination amount had been payable from the first notice despite its deficiencies.

Helpful Clarity

This decision is consistent with *ANZ Banking Group Ltd v Societe Generale* [1999] 2 All ER (Comm) 6252 and *Fondazione Enasarco v Lehman Brothers Finance SA* [2015] EWHC 1307 (Ch). In *ANZ* Mr Justice Aikens decided that the requirement for a section 6(d) statement to include the recipient's bank account details was not a precondition for a valid notice. And in *Fondazione Enasarco* Mr Justice David Richards held that although a section 6(d) statement was not served as soon as reasonably practicable, that breach of contract had no impact on the validity of the statement (albeit based on counsel's concession of the point). In this context the Court of Appeal's conclusion is not surprising. But it is helpful to have appellate level clarity on points that are often raised by defaulting parties to delay and complicate a derivative close-out.

Not everyone will agree with the semantics of Lady Justice Gloster's different meanings of "due" and "payable". But the distinction between the accrual of a debt and the obligation to make a payment is of wide application in finance agreements and provides a conceptual common thread between the section 2(a)(iii) decisions the court cited and the analysis of section 6. Lawyers analysing other debt and payment aspects of the ISDA Master Agreement in future should bear this framework in mind.

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