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In Practice

Author Paul Carroll and Clive Wells

ISDA hedges its bets over Brexit

The International Swaps and Derivatives Association (ISDA) has published Irish law and French law editions of the ISDA Master Agreement in an attempt to provide flexibility in the documentation of hedging agreements in a post-Brexit environment. This In Practice article examines the reasons behind this development, the pros and cons for practitioners of migrating to these new documents, market reaction to the introduction of these documents and whether use of these forms of agreements are likely to become commonplace over the coming years.

On 28 June 2018, ISDA published Irish law and French law governed editions of their industry standard 2002 ISDA Master Agreements. The development and publication of these agreements is motivated by the uncertainty created by the upcoming withdrawal of the UK from the European Union on 29 March 2019.

HISTORY OF ISDA

Since 1985, ISDA has helped to create a globally accepted infrastructure within which derivatives transactions are negotiated and documented. Since its inception, ISDA has acted as an industry association, an effective lobbyist and, most importantly, has created and championed a standard set of derivatives contracts: the ISDA Master Agreements.

The ISDA Master Agreement is widely accepted as the standard bearer for the negotiation and documentation of hedging, derivative and swap transactions. The English law version of the 2002 ISDA Master Agreement is commonly used to govern hedging transactions entered into in connection with English law debt financings. Practitioners' familiarity with and confidence in the standard form documents have contributed to more efficient, certain and cost-effective derivative transaction negotiations.

BACKGROUND

Following the UK's decision in mid-2016 to leave the European Union, legal and finance professionals began assessing the practical implications of documenting finance transactions in light of Brexit. One particular theme which has repeatedly arisen relates to that of governing law and jurisdiction and how contracts (and judgments relating thereto) will be enforced and recognised across the European Union after March 2019. This question is equally relevant in the case of the ISDA Master Agreements.

The primary concern relates to the enforcement, in the EU, of judgments rendered by English courts and, conversely, the enforcement of judgments rendered by EU member states in the English courts post-Brexit. This uncertainty has been heightened by failure of the negotiating parties to agree the terms

of departure and how enforcement and recognition will operate post-Brexit.

In the absence of agreement on the issue, English law would become a third-country law, and therefore decisions of the English courts would no longer be automatically recognised and enforced across the EU (and European Economic Area) pursuant to Regulation 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. This may be of particular concern to counterparties operating in remaining EU member states and entering into derivative contracts which, in the past, would traditionally have been governed by English law.

PROCESS

In early 2018, ISDA announced that, in response to certain concerns expressed by its members relating to (among other things) automatic recognition of judgments and protections under certain EU national insolvency laws, it was working on the drafting of French law and Irish law governed Master Agreements. This would add to the suite of Master Agreements which then included English, Japanese and New York law editions. The logic for choosing both Irish law and French law versions was to represent common law and civil law legal systems.

Over the following months, ISDA worked with its members, stakeholders and local advisers to analyse and create the new Master Agreements. The publication of both sets of documents was announced on 28 June 2018.

CONSEQUENCES

In creating the new documents, ISDA have endeavoured to keep the documentation as close as possible to the current English law documents. The difference between the previously existing English law Master Agreement and the new Irish law Master Agreement is an updated s 13 (*Governing Law and Jurisdiction*). The differences in the French law Master Agreement are also limited but include new arbitration provisions and condition precedent language as well as equivalent governing law and jurisdiction changes. These changes are set out in Box 1 overleaf.

Updated Irish law and French law netting opinions from local law firms were issued alongside the new Master Agreements and it is expected that updated collateral agreements and credit support documentation will follow.

MARKET REACTION

Stakeholders in Ireland and France have welcomed the publication of these documents. Predictably, local law firms have taken the opportunity to promote the entry into derivatives contracts in their jurisdiction and the legal certainty which accompany such a decision.

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BOX 1: KEY CHANGES IN THE FRENCH-LAW MASTER AGREEMENT

- **Section 2(a)(iii): Flawed assets arrangement:** Civil law does not have an equivalent version to the “flawed asset arrangement”, but the new French Master Agreement provides for the suspension of performance and a conditional element.
- **Section 2(c): Payment netting:** An amendment has been made to prevent payment netting being classified as a novation.
- **Section 3: Binding obligations representation:** The caveat that references to equitable principles of general application has been removed, given they are not applicable under civil law.
- **Section 9(f): No waiver of rights:** A five-year contractual limitation period has been included.
- **Section 13(a): Governing law:** French law is the governing law of the Agreement.
- **Section 13(b): Jurisdiction:** Disputes are to be submitted to the Paris Commercial Courts and the Paris Court of Appeals jurisdiction.
- Parties can choose whether the jurisdiction is to be exclusive or non-exclusive.

The response from regular users of the English law Master Agreement has been relatively muted so far. The addition of additional choices for counterparties entering into derivative transactions has been welcomed as a method of dealing with the possibility of market and legal uncertainty. However there have been few indications as to whether regular users of the English law governed ISDA Master Agreement intend to begin using an alternative.

ISDA COMMENTARY

Commentary from ISDA around the publication of these alternative documents has been relatively guarded and diplomatic, so far. It is not committing to or encouraging the use of one jurisdiction over another and is most likely also waiting to consider the details of the UK’s withdrawal regime. ISDA’s General Counsel, Katherine Tew Darras, stated that:

“An English law Master Agreement won’t become any less valid in the EU post-Brexit, irrespective of the outcome of the Brexit negotiations. There will be good reasons for EU/EEA counterparties to continue using the English law Master Agreement, and there will be good reasons for them to start using the French and Irish law versions. This is all about providing choice to the market and allowing counterparties to choose the option that best suits their needs.”

Essentially, ISDA is attempting to futureproof their arrangements and provide useful alternatives for their members in order to confidently document the terms of their derivative transactions in future, as they have facilitated over the past few decades.

FUTURE

The prospective uptake of usage of the Irish law and French law Master Agreement will depend on a number of factors. Most importantly, the future prevalence of these documents will depend on the outcome of the EU-UK withdrawal negotiations, and how the recognition and enforcement of judgments of the English courts are treated following the UK’s withdrawal from the EU. If a deal is reached which substantially replicates the current system enjoyed by EU member states, then it is likely that the uptake of the new documents will be limited, save for particular instances where use of a particular version is sensible for other reasons – for example, the documentation of a hedging transaction between a French hedging provider and a French counterparty.

Where a deal is not reached to facilitate easy recognition and enforcement of judgments in a similar manner to the current system, or the agreement for the introduction of such a system is delayed, then we may see greater take-up of these Irish law and French law documents. Industry groups and regular users of the English law documentation will likely also form a view as to the risks of continuing to use the English law documentation, which documentation and legal system they will be familiar with versus adapting to a new jurisdiction with which they may not be familiar.

IRELAND OR FRANCE

As previously mentioned, the stated rationale for the introduction of both Irish law and French law was to represent both common law and civil law system alternative options. From a business perspective, both countries have welcomed the publication of these documents and, along with it, the possibility of increased transaction volume in derivative contracts (and potentially related transactions) being negotiated and documented (and, in some cases, later adjudicated upon) in their jurisdictions.

If it comes to pass that hedging providers and counterparties do, post-Brexit, seek to document their derivative transactions under an alternative governing law to English law, it is difficult to predict whether Irish law or French law would become the preferred option.

Decisions of the courts of England are commonly used as a persuasive authority in Irish courts, particularly in considering new issues not previously adjudicated upon. Where the parties’ concern is to preserve the type of system they have been used to over the years under English law, but to retain the advantages of EU member state recognition, then Ireland would seem like the obvious choice. However, as the overwhelming majority of EU member states operate under a civil law system, contracting parties operating in these jurisdictions may take a longer-term view that the adoption of documentation of a civil law jurisdiction, which was not previously available, would be a better fit for their business needs going forward. The decision will also likely depend on whether the hedging provider is located in London, or in another member state.

Biog box

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CONCLUSION

It remains highly likely that the majority of hedge providers and those who regularly document derivative contracts in Europe using the ISDA Master Agreement will continue to do so under the English law governed document.

While certain transactions may lend themselves to the use of the new documentation (for example, the documentation of a swap transaction between a Paris-based financial institution and a French corporate) it would appear unlikely that hedging providers in the London market will migrate to regular use of these documents, particularly taking into account other differences in the respective legal systems outside of the walls of the derivative contract (for example, French debtor protections).

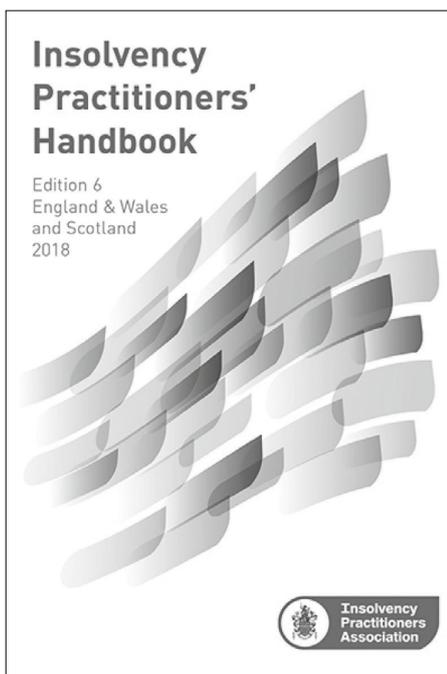
While Irish law may appear to lend itself more easily as a substitute for English law in such circumstances, where an

underlying transaction is being documented by way of English law contracts it is unlikely that there will be appetite to document the hedging or derivative element of such transaction under a different governing law. However, as with many Brexit-related issues, only time (and the exact outcome of the Brexit negotiations) will tell. ■

Further Reading:

- ▶ Post Brexit: the factors increasing the pressure to refer matters to EU law (2018) 3 JIBFL 135.
- ▶ Recognition of civil and commercial judgments if the UK reaches “exit day” without a new arrangement in place (2017) 10 JIBFL 646.
- ▶ LexisPSL Banking and Finance blog: The ISDA master agreement and the new European governing law and jurisdiction options.

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