Termination and close-out netting under the 1992 and 2002 ISDA Master Agreements

New Zealand law opinion for the
International Swaps and
Derivatives Association, Inc.

15 November 2007

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1. INTRODUCTION

This opinion addresses the enforceability of the termination and close-out netting provisions in:

(a) the Multicurrency–Cross-Border Master Agreement (the **Cross Border Agreement**) and the Local Currency-Single Jurisdiction Master Agreement (the **Single Jurisdiction Agreement** and, together with the Cross Border Agreement, the **1992 Master Agreements**), published in 1992 by the International Swaps and Derivatives Association, Inc. (**ISDA**); and

(b) the 2002 Master Agreement (Multicurrency–Cross-Border) (the **2002 Master Agreement**) published by ISDA in January 2003.

Terms defined in the 1992 Master Agreements and the 2002 Master Agreement (together, the **Master Agreements**), and the 2001 Bridge and the 2002 Bridge (as defined below), have the same meaning where they are used in this opinion.

2. DOCUMENTS WE REVIEWED

For the purposes of this opinion, we were provided with the following documents:

(a) a copy of each Master Agreement;

(b) a marked version of the 2002 Master Agreement showing the changes made from the Cross Border Agreement;

(c) a list, labelled Appendix A and dated September 2007, describing the types of transactions that could be governed by the Master Agreements (the **Transaction List**);

(d) the 2001 ISDA Cross-Agreement Bridge (the **2001 Bridge**);

(e) a list, labelled Appendix D-2, of the master agreements that could be subject to the 2001 Bridge (the **Master Agreement List**);

(f) the 2002 ISDA Energy Agreement Bridge (the **2002 Bridge**); and

(g) a marked version of the 2002 Bridge showing the changes made from the 2001 Bridge.

3. ASSUMPTIONS

3.1 General assumptions

In this opinion, we assume that:

(a) two institutions, either:

(i) a corporation; or

(ii) a bank or other similar financial institution,

have entered into a Master Agreement;

(b) the parties have selected either English law or New York law to govern the Master Agreement;

(c) at least one of the institutions entering into the Master Agreement is incorporated in New Zealand and neither institution has specified that the provisions of Section 10(a) (Offices; Multibranch Parties) apply to it;

(d) the party incorporated in New Zealand (the **New Zealand Party**) is an ordinary company, insurance company or bank incorporated, or re-registered, under the Companies Act 1993 (the **Companies Act**)[1] (accordingly, in the context of the multibranch issues considered in this opinion, the New Zealand Branch is the New Zealand Party);

(e) the provisions of the Master Agreement that are crucial to the views expressed in this opinion (i.e., Section 5(a) (Events of Default) and Section 6 (Early Termination) (together with the related definitions)) have not been altered in any material respect;[2]

(f) on the basis of the terms and conditions of the Master Agreement and other relevant factors, and acting in a manner consistent with the intentions stated in the Master Agreement, the parties over time enter into a number of Transactions that are intended to be governed by the Master Agreement;

(g) the Transactions entered into include any or all of the transactions described in the Transaction List;

(h) some of the Transactions provide for an exchange of cash by both parties and others provide for the physical delivery of shares, bonds or commodities in exchange for cash;

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1 Accordingly, with the exception of insurance companies and banks, this opinion does not deal with bodies corporate, such as local authorities, producer boards or other statutory corporations, that are governed by special legislation or rules in addition to or other than the Companies Act. Also, this opinion does not deal with trusts. This opinion does, however, deal with partnerships to the extent that each partner is a company of the type described in section 3.1(d) above. This opinion also deals with partnerships to the extent that the partnership itself is made subject to statutory management or judicial management. This is possible in principle because New Zealand's statutory management legislation (which is outlined in section 6.3 below) can apply to a "body of persons, whether incorporated or not" and the judicial management legislation (which is outlined in section 6.6 below) can apply to "any person or association, corporate or unincorporate". Other than in these two instances, a partnership cannot be subject to the insolvency regimes outlined in section 6 below.

2 For this purpose, any selection contemplated by Sections 5(a) or 6 of a Master Agreement and made pursuant to the Schedule or in a Confirmation of a Transaction is not a material alteration.

(i) after entering into these Transactions and prior to their maturity, the New Zealand Party becomes the subject of a voluntary or involuntary case under the insolvency laws of New Zealand and, subsequent to the commencement of the insolvency, either the insolvent New Zealand Party or an insolvency official seeks to assume the Confirmations representing profitable Transactions for the insolvent New Zealand Party and reject the Confirmations representing unprofitable Transactions for the insolvent New Zealand Party;

(j) the parties have selected the Second Method, in the case of a 1992 Master Agreement;

(k) each party acts as principal and not otherwise when it enters into each Transaction;

(l) each party enters into each Transaction in the same capacity[3] and in the same right (i.e., there is mutuality between the parties for the purposes of insolvency set-off under New Zealand law);

(m) no party has assigned, declared any trust over or given any security interest over any of its rights under any Transaction or the Master Agreement, except in contravention of a prohibition in the Master Agreement;[4]

(n) each party has the capacity and the power to enter into and perform its obligations under the Master Agreement;

(o) the Master Agreement is in all respects enforceable in accordance with its terms under its governing law (i.e., English law or New York law);

(p) each Transaction is entered into for value on commercially reasonable terms and on an arm's length basis;

(q) no party is, or would be, seeking to conduct any relevant transaction or any associated activity under the Master Agreement in a manner or for a purpose not evident on the face of the document;

(r) the Master Agreement and each Transaction is entered into:

    (i) before a liquidator, statutory manager or administrator of the New Zealand Party is appointed; and

    (ii) at a time when the New Zealand Party is solvent and able to pay its debts as they become due;

(s) the Master Agreement is not part of a "multilateral netting agreement" as defined in section 310A of the Companies Act;[5] and

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3 Where a party is a life insurance company subject to the Life Insurance Act 1908, the effect of this assumption is that, for the purposes of section 15(1) of that Act, each Transaction must be entered into in connection with the life insurance business of that company. This is because section 15 ring-fences the life insurance business of that company from any other business it may carry on.

4 The reason for the proviso to this assumption is that New Zealand's netting legislation provides that any disposal of rights or any creation of a charge or other interest in respect of a qualifying netting agreement transaction that contravenes a prohibition in the netting agreement must be ignored in calculating the net settlement amount.

5 A "multilateral netting agreement" is defined in section 310A of the Companies Act as:

(t) the Master Agreement does not expressly exclude the application of sections 310A to 310O or sections 239AEI to 239AEP of the Companies Act.

3.2 Assumptions in relation to Multibranch Parties

For the purposes of our views on the specific issues relating to Multibranch Parties, we make the same assumptions as those set forth in section 3.1 above, with the following modifications:

(a) when addressing the issues set forth in sections 9.1 and 9.4 below, a bank incorporated in New Zealand (the **New Zealand Bank**) has entered into the Master Agreement on a multibranch basis by specifying that Section 10(a) (Offices; Multibranch Parties) applies to it. The New Zealand Bank has then entered into Transactions under the Master Agreement through its head office in New Zealand and also through one or more branches located in other countries that had been specified in the Schedule. After entering into these Transactions and prior to their maturity, the New Zealand Bank becomes the subject of a voluntary or involuntary proceeding under the insolvency laws of New Zealand; and

(b) when addressing the issues set forth in sections 9.2, 9.3 and 9.4 below, a bank (the **Foreign Bank**) organised and with its headquarters in a country other than New Zealand (the **Foreign Country**) has entered into the Master Agreement on a multibranch basis by specifying that Section 10(a) (Offices; Multibranch Parties) applies to it. The Foreign Bank has then entered into Transactions under the Master Agreement through the Foreign Bank and also through one or more branches located in other countries that had been specified in the Schedule, including in each case a branch of the Foreign Bank located in and subject to the laws of New Zealand (the **New Zealand Branch**). After entering into these Transactions and prior to their maturity, the Foreign Bank becomes the subject of a voluntary or involuntary proceeding under the insolvency laws of the Foreign Country.

4. SUMMARY OF CONCLUSIONS

On the basis of the assumptions contained in section 3 above and on the detailed discussion that follows in this opinion, the conclusions that we reach are summarised below. As we state in section 6.1 below, these conclusions are based solely on a consideration of New Zealand's liquidation, statutory management and administration regimes.

Enforceability of Automatic Early Termination (section 8.1)

The provisions in the Master Agreement automatically terminating all the Transactions upon the insolvency of the New Zealand Party are enforceable under New Zealand law.

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an agreement that provides for the settlement, between more than 2 persons, of payment obligations arising under transactions that are subject to the agreement, and that provides, in respect of transactions to which it relates, that debits and credits arising between the parties are to be brought into account so that amounts payable by or to each party are satisfied by -

(a) Payment by or on behalf of each party having a net debit to or on behalf of a clearing house (whether as agent or as principal) or a party having a net credit; and

(b) Receipt by or on behalf of each party having a net credit from or on behalf of a clearing house (whether as agent or as principal) or a party having a net debit:

Enforceability of optional termination (section 8.2)

The provisions in the Master Agreement permitting the non-defaulting party to terminate all Transactions upon the insolvency of the New Zealand Party are enforceable under New Zealand law.

Enforceability of close-out netting (section 8.3)

The provisions in the Master Agreement providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of the New Zealand Party are enforceable under New Zealand law.

Enforceability of the payment of the net termination amount in the Termination Currency (section 8.4)

In the liquidation of a New Zealand Party, any net termination amount payable by that party must be claimed in New Zealand dollars. Accordingly, appropriate currency conversions would be required to be made at the rate or rates prevailing on the date on which the liquidator of the New Zealand Party is appointed (the **Liquidation Date**).

In the administration of a New Zealand Party, any net termination amount payable by that party may be the subject of a (total or partial) release or a payment moratorium if that is the effect of the relevant deed of company arrangement approved by that party's creditors.

In the statutory management of a New Zealand Party, any net termination amount payable by that party may be paid in the Termination Currency. However, the statutory manager may suspend payment of that amount.

Foreign currency judgments (section 8.5)

A New Zealand court may give judgment in a foreign currency. Also, it is generally possible to enforce in New Zealand a judgment of a foreign court given in a foreign currency. However, in certain cases, the judgment debt may need to be converted into New Zealand currency.

Enforceability of the close-out netting provisions where the New Zealand Bank is a Multibranch Party (section 9.1)

There should be no change in our conclusions concerning the enforceability of close-out netting under the Master Agreement where the New Zealand Bank has entered into the Master Agreement on a multibranch basis and then conducted business in that fashion prior to its insolvency.

Separate insolvency proceeding in New Zealand in the insolvency of the Foreign Bank (section 9.2)

It is possible for there to be a separate proceeding in New Zealand with respect to the assets and liabilities of the New Zealand Branch upon or prior to the start of the insolvency proceeding for the Foreign Bank in the Foreign Country. If a liquidator of the New Zealand Branch were appointed in New Zealand, that liquidation should be ancillary to the principal liquidation in the Foreign Country. Local creditors of the New Zealand Branch may initiate a separate liquidation proceeding in New Zealand even if the relevant authorities in New Zealand do not do so.

Treatment of New Zealand assets and liabilities of the insolvent Foreign Bank in insolvency proceeding in New Zealand (section 9.3)

If there were a separate proceeding in New Zealand with respect to the assets and liabilities of the New Zealand Branch, the liquidator, statutory manager or administrator in New Zealand and the New Zealand courts should recognise the close-out netting provisions of the Master Agreement to the same extent described above.

Effect of actions taken by insolvency official or court in Non-Netting Jurisdiction (section 9.4)

There should be no change in our conclusions concerning the enforceability of multibranch netting where action is taken by an insolvency official or court in a Non-Netting Jurisdiction (as defined in section 9.4).

2001 Bridge and 2002 Bridge (sections 10 and 11)

The inclusion in a Master Agreement of the 2001 Bridge or the 2002 Bridge would not affect our opinion on the enforceability of close-out netting.

5. CONFLICT OF LAWS

5.1 Choice of law

A New Zealand court will give effect to the express choice of English law or New York law to govern the Master Agreement if that choice is made in good faith, is legal and there is no reason for avoiding the choice on the ground of public policy.[6] In general, each of these elements should be present where a New Zealand Party enters into the Master Agreement. Accordingly, except in unusual circumstances, the choice of law clause in the Master Agreement should be effective under New Zealand law.

5.2 Conflict of laws

Under New Zealand's conflict of laws rules, the following matters fall to be determined in accordance with the governing law of the Master Agreement (i.e., English law or New York law):

(a) the interpretation of the terms of the Master Agreement;

(b) the performance of the Master Agreement;

(c) the consequences of breach of the Master Agreement; and

(d) the discharge of the Master Agreement.[7]

On the assumption that the Master Agreement is in all respects enforceable in accordance with its terms under its governing law (i.e., English law or New York law), a New Zealand court will in general give effect to it except to the extent that it is inconsistent with New Zealand public policy. This inconsistency may arise, in the context of the issues we consider in this opinion, by reason of a provision of the Master Agreement contravening New Zealand public policy as expressed in the principles of New Zealand insolvency law.

Specific conflict of laws issues arise in the context of New Zealand's liquidation, administration and statutory management regimes. However, for the purposes of this

6 *Vita Food Products Incorporated v Unus Shipping Company Limited* [1939] AC 277 at 290 (PC).
7 Dicey & Morris, *The Conflict of Laws*, 14th ed. (2006), Rule 208.

opinion, we assume (as we believe would generally be the case) that a New Zealand court would apply the relevant rules to a New Zealand Party in liquidation, administration or statutory management, despite the foreign governing law of the Master Agreement.

6. NEW ZEALAND'S INSOLVENCY REGIMES

6.1 Introduction

There are six insolvency regimes in New Zealand that could apply to a New Zealand Party. These are:

(a) the liquidation regime set out in Part XVI of the Companies Act, which applies to companies incorporated in New Zealand and bodies corporate incorporated outside New Zealand (discussed in section 6.2 below);

(b) the administration regime set out in Part XVA of the Companies Act, which applies to companies incorporated in New Zealand and bodies corporate incorporated outside New Zealand (discussed in section 6.3 below);

(c) the statutory management regimes set out in the Corporations (Investigation and Management) Act 1989 (the **CIM Act**), which applies to corporations, whether incorporated in New Zealand or elsewhere, that have assets or conduct business in New Zealand,[8] and the Reserve Bank of New Zealand Act 1989 (the **Reserve Bank Act**), which applies to banks registered in New Zealand (discussed in section 6.4 below);

(d) the receivership regime set out in the Receiverships Act 1993 (the **Receiverships Act**) (discussed in section 6.5 below);

(e) the compromises regime set out in Parts XIV and XV of the Companies Act, which applies to compromises between companies incorporated in New Zealand, or overseas companies registered under the Companies Act, and their creditors (discussed in section 6.6 below); and

(f) the judicial management regime set out in the Life Insurance Act 1908 (the **Life Insurance Act**), which applies to "companies"[9] as defined in the Life Insurance Act (discussed in section 6.7 below).

These regimes are considered in the following paragraphs. The outline of these regimes is general and excludes the effect of New Zealand's netting legislation. That legislation is outlined in section 7 below.

Except for the discussion in sections 6.5, 6.6 and 6.7 below, the issues addressed in this opinion are considered solely in the context of the liquidation, administration and statutory management regimes. These are the regimes that, in our experience, are likely to be of greatest concern to a counterparty that deals with a New Zealand Party because they are the most frequently used regimes in the financial sector. These are also the regimes that have been amended by New Zealand's netting legislation (outlined in section 7 below). The netting legislation does not amend the other three regimes. We outline in sections 6.5, 6.6 and 6.7 below the circumstances in which close-out netting would be enforceable if the New Zealand Party were subject to any of the other three regimes.

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8 Section 2(4) of the CIM Act.

9 The term "company" is broadly defined in the Life Insurance Act. It means, broadly speaking, an entity that issues life insurance policies in New Zealand.

6.2 Liquidation regime

The liquidation regime in the Companies Act is, in broad terms, distributive in its intention rather than rehabilitative. The Companies Act contains a set of liquidation rules that is intended to realise the assets of the company, to distribute the proceeds to the company's creditors and shareholders and, ultimately, to dissolve the company.

This regime applies:

- to a company that is incorporated or re-registered under the Companies Act; or
- with certain modifications, and to the extent only that it has New Zealand assets, to a body corporate that is incorporated outside New Zealand.

A company is put into liquidation by the appointment of a liquidator. Pursuant to section 241(2) of the Companies Act, a liquidator may be appointed by:

- a special resolution of shareholders; or
- the board of the company on the occurrence of an event specified in the constitution; or
- the Court, on the application of the company, a director, a shareholder or other entitled person, a creditor (including any contingent or prospective creditor), the administrator (if the company is in administration), or the Registrar of Companies; or
- a resolution of creditors passed at the watershed meeting (which is a meeting held where a company is in administration).

6.3 Administration regime

Prior to the Companies Amendment Act 2006 coming into force on 1 November 2007, the only rehabilitative insolvency regime in New Zealand for viable companies was the compromises regime (see section 6.6 below). For a number of reasons (including, in particular, the need to obtain creditor consent), this had proved to be a difficult regime to apply in practice. Therefore, Parliament enacted an alternative regime to encourage business rehabilitation, based on the voluntary administration model adopted by Australia in 1992.

The administration of a company begins when an administrator is appointed by:

- board resolution; or
- a liquidator; or
- a secured creditor having a charge over all, or substantially all, of the company's property where that charge has become enforceable; or
- the High Court, on the application of a creditor, a liquidator or the Registrar of Companies.[10]

The appointment of an administrator has three main consequences. First, it vests control of the company's business in the administrator. Secondly, it triggers obligations on the

10 Section 239H(1) of the Companies Act.

administrator to hold various creditors' meetings to try to seek a consensus on the future of the company. Thirdly, it imposes a stay on certain creditor actions (similar to the moratorium imposed in a statutory management, as discussed in section 6.4 below). For example, while a company remains in administration, in the absence of administrator consent or a court order:

- a transaction or dealing that affects the company's property is void;
- a person may not enforce a charge over the company's property, except for:
  - a chargeholder having a charge over all, or substantially all, of the company's property who begins enforcing the charge no later than the 10th working day after the commencement of the administration; or
  - *any* chargeholder who begins enforcing its charge prior to the commencement of the administration;
- the owner or lessor of property occupied or used by the company may not repossess that property (unless repossession began prior to the commencement of the administration); and
- court proceedings or any enforcement process against the company or any of its property may not begin or continue.

Administration is intended to be a relatively short-term measure that (by and large) freezes the company's financial position while the administrator and the creditors negotiate the company's future. The administration of a company ends either when the negotiations have been successful (in which case, a "deed of company arrangement" is entered into)[11] or when the statutory timeframe expires without resolution. Other steps, such as the appointment of a liquidator, can also end an administration.

6.4 Statutory management regimes

Unlike New Zealand's liquidation regime, which is distributive in its intention, the statutory management regimes are more rehabilitative. In broad terms, making a party subject to statutory management in New Zealand creates a moratorium in relation to that party's affairs.[12] The effect of that moratorium is outlined below.

The two pieces of legislation governing statutory management in New Zealand are the CIM Act and the Reserve Bank Act. The CIM Act applies to any corporation, whether incorporated or not and whether incorporated or established in New Zealand or elsewhere. The Reserve Bank Act applies to banks registered in New Zealand. The two pieces of legislation are substantially the same. If a bank registered in New Zealand is made subject to statutory management, the Reserve Bank Act, rather than the CIM Act, applies. The significance of this is simply that the Reserve Bank of New Zealand (the **Reserve Bank**), New Zealand's central bank, is indirectly responsible for the supervision of the statutory management of banks registered in New Zealand.

A party is made subject to statutory management by way of a declaration to that effect in the form of an Order-in-Council signed by the Governor-General:

- (in the case of the CIM Act) on the advice of the Minister of Justice given in accordance with a recommendation of the Securities Commission; or

11 A deed of company arrangement must be approved by a majority in number representing 75% in value of creditors voting.

12 Section 42 of the CIM Act; section 122 of the Reserve Bank Act.

- (in the case of the Reserve Bank Act) on the advice of the Treasurer given in accordance with a recommendation of the Reserve Bank.

The statutory management moratorium provides that "no person shall",[13] among other things:

- take any action or other proceedings against the party made subject to statutory management; or
- apply or resolve to put that party into liquidation; or
- enforce any security interest it may have over that party's property (for example, margin); or
- exercise any right of set-off against that party.

In addition, the statutory manager is able, "notwithstanding the terms of any contract, [to] suspend in whole or in part, ...the payment of any debt, or the discharge of any obligation".[14] This suspension expressly does not "constitute a breach or repudiation" of the relevant contract, with the result that the non-defaulting party cannot cancel it for breach or repudiation.[15]

A statutory manager may also disclaim an unprofitable contract as if the statutory manager were a liquidator. In that event, the disclaimer provisions applicable to companies under section 269 of the Companies Act apply.[16]

6.5 Receivership regime

A receiver, manager or receiver and manager of a New Zealand company's affairs may be appointed either by the terms of a contract (typically, a contract granting a security interest) or by a court under the Receiverships Act. A receiver is generally appointed to manage all or substantially all of the company's affairs.

If a contract so provides, the appointment of a receiver may be an event giving rise to a right to terminate a contract.[17] In addition, receivership does not, under New Zealand law, prevent the operation of contractual rights of set-off. Therefore, the fact of a receivership should not prevent the operation of the termination and close-out netting provisions in the Master Agreement.

6.6 Compromises regime

The Companies Act contains a statutory procedure by which a company incorporated in New Zealand may enter into a compromise with its creditors. For this purpose, a "compromise" is defined in section 227 of the Companies Act to include:

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13 See the discussion in *In re Paramount Airways Ltd (in administration)* [1992] 3 WLR 690 (CA) where, in the context of the extra-territorial effect of English insolvency law (transactions at an under value), it was held that it was not possible, in the circumstances, to limit the meaning of the phrase "any person". That is, the relevant provision (which, "on its face, [was] of unlimited territorial scope": at 699) applied to a person not domiciled, resident or doing business in England.

14 Section 44(1) of the CIM Act; section 127(1) of the Reserve Bank Act.

15 Section 44(2) of the CIM Act; section 127(2) of the Reserve Bank Act.

16 Section 46(3) of the CIM Act; section 129(3) of the Reserve Bank Act.

17 The Master Agreement expressly gives the Non-defaulting Party the right to terminate on the appointment of a receiver in Section 5(a)(vii)(6) (bankruptcy).

a compromise -

(a) Cancelling all or part of a debt of the company; or

(b) Varying the rights of its creditors or the terms of a debt; or

(c) Relating to an alteration of a company's constitution that affects the likelihood of the company being able to pay a debt:

A compromise proposal may be initiated by the board of directors of the company, a receiver, a liquidator or, with the leave of the court, any creditor or shareholder of the company where any of those persons has reason to believe that the company is or will be unable to pay its debts.[18] Also, the court may, under section 236 of the Companies Act, on the application of the company or any shareholder or creditor of the company, order that a compromise is binding on the company and on such other persons as the court specifies.

Except in the case of a compromise ordered by the court, notice of the proposed compromise must be given to each known "creditor" of the company as well as to the company itself. For this purpose, a counterparty to a Master Agreement is a "creditor", since "creditor" is defined expressly to include a person who, in a liquidation, is entitled to claim that a debt is owed to it.[19] The notice must state that a meeting of creditors is to be held. A compromise only becomes binding if a majority in number representing at least 75% in value of the creditors, or class of creditors, voting on the matter votes in favour of the compromise. A compromise is binding on the company and on all creditors to whom notice of the proposal is given.[20]

In theory, therefore, if the non-defaulting party receives notice of a compromise proposal, it can be bound by the terms of a compromise that eventuates even if it does not vote in favour of the compromise. However, as a practical matter, and although this is ultimately a matter of interpretation under English law or New York law, Section 5(a)(vii) (Bankruptcy) of the Master Agreement appears to enable the non-defaulting party to designate an Early Termination Date and to require payment of the net termination amount prior to the non-defaulting party becoming bound by the compromise.[21]

Notice of a compromise proposal may be an Event of Default under Section 5(a)(vii)(2) (becoming insolvent or being unable to pay debts as they become due) on the basis that the proponent of a compromise must have reason to believe that the company concerned is or will be unable to pay its debts. Alternatively, the notice may be an Event of Default under Section 5(a)(vii)(9) (taking action in furtherance of the specified bankruptcy events). In particular, the notice would likely be in furtherance of the Event of Default under Section 5(a)(vii)(3) (making a general assignment, arrangement or composition with or for the benefit of creditors).

Therefore, the fact of a compromise proposal should not prevent the operation of the termination and close-out netting provisions in the Master Agreement.

6.7 Judicial management regime

The judicial management regime set out in the Life Insurance Act is substantially similar to the statutory management regimes. A statutory moratorium is created in relation to the

18 Section 228(1) of the Companies Act.
19 Section 227 of the Companies Act.
20 Section 230 of the Companies Act.
21 Timing would be important in this regard. The non-defaulting party should ensure that both the Early Termination Date occurs and the net termination amount is paid to it prior to approval of the compromise.

affairs of a party made subject to judicial management. Broadly speaking, and with one important exception (discussed below), this moratorium prohibits the same actions being taken against the insolvent New Zealand Party or its assets as does the statutory management moratorium.

However, there is no prohibition on the exercise of rights of set-off against the party made subject to judicial management. In addition, a judicial manager, unlike a statutory manager, does not have the power to suspend the payment of a debt or the discharge of an obligation. Accordingly, the judicial management regime should not prevent the non-defaulting party exercising its rights under the termination and close-out netting provisions of the Master Agreement.

7. NEW ZEALAND'S NETTING LEGISLATION

On 26 April 1999, specific netting legislation came into force in New Zealand. The legislation is split into four statutes: the Companies Amendment Act 1999, the Corporations (Investigation and Management) Amendment Act 1999, the Reserve Bank of New Zealand Amendment Act 1999 and the Insolvency Amendment Act 1999. The first three of these four statutes, together with the Companies Amendment Act 2006,[22] (the **Netting Acts**) are relevant for the purposes of this opinion. The fourth statute deals with netting agreements entered into by individuals. It is, therefore, not relevant for the purposes of this opinion.

Each Netting Act amends its underlying principal Act to provide expressly for the enforceability of "netting agreements" in the context of the relevant insolvency regime.

"Netting agreements"

"Netting agreements" are of two types: "bilateral netting agreements" and "recognised multilateral netting agreements". Only the first type is relevant for the purposes of this opinion.

A "bilateral netting agreement" is defined in section 310A of the Companies Act as:

> an agreement that provides, in respect of transactions between 2 persons to which the agreement applies, -
>
> (a) That on the occurrence of an event specified in the agreement, all or any of those transactions must (or may, at the option of a party) be terminated and -
>
> (i) An account taken of all money due between the parties in respect of the terminated transactions; and
>
> (ii) All obligations in respect of that money satisfied by payment of the net amount due from or on behalf of the party having a net debit to or on behalf of the party having a net credit; or
>
> (b) That each transaction is to be debited or credited to an account with the effect that the rights and obligations of each party that existed in respect of the relevant account prior to the transaction are extinguished and replaced by rights and obligations in respect of the net debit due on the relevant account after taking into account that transaction; or

22 The Companies Amendment Act 2006 introduced the administration regime outlined in section 6.3 above. At the same time, that Act also adopted netting rules (consistent with those adopted in 1999) to apply to a company in administration.

(c) That amounts payable by each party to the other party are to be paid or satisfied by payment of the net amount of those obligations by the party having a net debit to the party having a net credit; -

but does not include any bilateral netting agreement that is part of a multilateral netting agreement.

In broad terms, a "bilateral netting agreement" is an agreement between two persons[23] that provides for any of three different types of netting: close-out netting, netting by novation or payments netting. In contrast to the equivalent legislation in a number of other jurisdictions, a "netting agreement" does not need to be entered into between particular types of counterparties or to relate to particular types of transactions in order to qualify for protection under the Netting Acts.

In principle, whether an agreement constitutes a "bilateral netting agreement" should, under New Zealand's conflict of laws rules, be determined by its governing law. We assume in this opinion that, under both English and New York law, the Master Agreement is a "bilateral netting agreement" in terms of section 310A of the Companies Act. It is also possible that a New Zealand court could conclude that the Netting Acts contain mandatory insolvency rules that should be interpreted in accordance with New Zealand law. In that regard, the Master Agreement is, as a matter of New Zealand law, a "bilateral netting agreement".

Consequences of an agreement being a "netting agreement"

The effect of the Netting Acts is that the contractual rights of netting or set-off contained in a "netting agreement" operate in accordance with their terms in the insolvency of a New Zealand Party. To this extent, those rights override the general insolvency rules that otherwise apply mandatorily in these circumstances.

8. CLOSE-OUT NETTING UNDER THE MASTER AGREEMENTS

8.1 *Assuming the parties have selected Automatic Early Termination upon certain insolvency events to apply to the insolvent New Zealand Party, are the provisions of the Master Agreement automatically terminating all the Transactions upon the insolvency of a counterparty enforceable under New Zealand law?*

Conflict of laws

If a contract governed by, and enforceable under, English law or New York law sets out a series of events (including breach), the occurrence of one of which results in automatic termination of that contract, then New Zealand law will give effect to that automatic termination unless it is inconsistent with New Zealand public policy (as expressed, for example, in the mandatory principles of New Zealand insolvency law) or its performance is

23 It is arguable that a "bilateral netting agreement" may have more than two parties provided that the netting arrangements embodied in the agreement only relate to transactions between two of the parties. For example, a third person may be a party to a "bilateral netting agreement" solely in the capacity of guarantor. This would not offend against the policy of the Netting Acts. However, the better view in these circumstances is that the tripartite agreement is not itself a "bilateral netting agreement" but has embedded in it a "bilateral netting agreement" consisting of the netting arrangement between the two relevant parties. This view is supported by the words at the end of the definition of "bilateral netting agreement" from which it may be inferred (albeit negatively) that a bilateral netting agreement may be contained in an agreement that itself has more than two parties. In any event, it is not necessary for us to consider this possibility in the context of this opinion as we have assumed that there are only two parties to the Master Agreement.

otherwise unlawful under New Zealand law. The issue therefore is whether Automatic Early Termination contravenes New Zealand public policy or is otherwise unlawful.

General principle

If a termination clause that takes effect on the giving of notice is effective (and we believe it is; see the discussion in section 8.2 below), then in principle the parties should equally be free to agree that no notice need be given, even though in the likely circumstances the automatic termination will occur before the non-defaulting party is actually aware of it. In this respect, an automatic termination clause is akin to an automatic crystallisation clause (by which a floating charge, upon the occurrence of certain events, is automatically converted into a fixed charge). It is accepted in New Zealand that an automatic crystallisation clause will be upheld by the courts.[24] That said, the effectiveness of automatic termination in the particular circumstances of the Master Agreement is untested in New Zealand.

(1) Liquidation

Section 6(a) of the Master Agreement provides for automatic termination upon the occurrence of certain insolvency events. In broad terms, all Transactions are automatically terminated:

(a) *upon the occurrence* of a range of insolvency events (such as dissolution or insolvency) (**immediate automatic termination**); and

(b) as of the time *immediately preceding*:

   (i) in the case of a 1992 Master Agreement, the institution of a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any insolvency law or other similar law affecting creditors' rights or the presentation of a petition against a party that either:

      (A) results in it being adjudged insolvent or being put into liquidation; or

      (B) is not dismissed, discharged, stayed or restrained within 30 days; or

   (ii) in the case of a 2002 Master Agreement:

      (A) the New Zealand Party, a regulator, supervisor or similar official with primary insolvency, rehabilitative or regulatory jurisdiction:

         (1) instituting a proceeding seeking a judgment of insolvency, bankruptcy or any other relief under any insolvency law; or

         (2) presenting a petition for liquidation; or

      (B) any other person:

         (1) instituting a proceeding seeking a judgment of insolvency, bankruptcy or any other relief under any insolvency law; or

24 *Re Manurewa Transport Ltd* [1971] NZLR 909 (SC); *Covacich v Riordan* [1994] 2 NZLR 502 at 507 (HC): "in principle there is nothing to prevent automatic crystallisation upon the occurrence of a triggering event of which potential creditors have no notice, and not even the practicable means of notice, so long as that intention is clearly spelled out in the debenture".

(2) presenting a petition for liquidation,

that either:

(3) results in the New Zealand Party being adjudged insolvent or being put into liquidation; or

(4) is not dismissed, discharged, stayed or restrained within 15 days,

(**retrospective automatic termination**).

Applicability of automatic termination in liquidation

Under New Zealand's conflict of laws rules, the issue whether the automatic termination wording is triggered by the liquidation of a New Zealand Party should be determined by English law or New York law.

However, if the matter falls to be determined by New Zealand law, as a matter of New Zealand law, the retrospective automatic termination wording covers the appointment of a liquidator by the court on the application of the persons specified in section 241(2)(c) of the Companies Act. It is unlikely, however, to cover the appointment of a liquidator by shareholders' special resolution,[25] by the board of directors on the occurrence of an event specified in the company's constitution,[26] or by a resolution of creditors passed at the watershed meeting.[27] These other methods of commencing liquidation are, however, covered by the immediate automatic termination wording.

Enforceability of automatic termination in liquidation

In our view, for the reasons given above under the heading "general principle", the automatic termination provisions of the Master Agreement are enforceable in the liquidation of a New Zealand Party. This view is supported by the amendments to the Companies Act made by the Companies Amendment Act 1999. While those amendments do not *expressly* confirm the enforceability of automatic termination clauses in "netting agreements", they do, in two provisions, lend support *implicitly* to the enforceability of those clauses.

(a) The first provision is the definition of "bilateral netting agreement" in section 310A of the Companies Act. "Bilateral netting agreement" is defined to include an agreement that provides:

> That on the occurrence of an event specified in the agreement, all or any of [the transactions to which the agreement applies] *must* (or may, at the option of a party) *be terminated*...(our emphasis)

Therefore, for the purposes of determining whether an agreement is a "bilateral netting agreement", either automatic or optional termination is acceptable. It would be an odd conclusion if, in the light of this provision, automatic termination clauses were invalidated elsewhere in the Companies Act.

(b) The second provision is section 310H of the Companies Act. Section 310H(a) provides that nothing in section 248(1)[28] affects:

25 This appointment is made under section 241(2)(a) of the Companies Act.
26 This appointment is made under section 241(2)(b) of the Companies Act.
27 This appointment is made under section 241(2)(d) of the Companies Act.
28 Section 248(1) is discussed in section 8.3 below.

> The termination, in accordance with the netting agreement, of all or any transactions that are subject to the netting agreement by reason of the occurrence of an event specified in the netting agreement, being an event (including the appointment of a liquidator) occurring not later than the commencement of the liquidation;

This provision is silent whether the termination is optional or automatic. If automatic termination were prohibited, we would expect this provision expressly to acknowledge this. Instead, the focus is on the time at which the triggering event occurs (i.e., pre- or post-liquidation) rather than the means by which the triggering event terminates the underlying transactions. This is consistent with the policy of the Netting Acts.

(2) Administration

Applicability of automatic termination in administration

Under New Zealand's conflict of laws rules, the issue whether the automatic termination wording is triggered by the administration of a New Zealand Party should be determined by English law or New York law.

However, if the matter falls to be determined by New Zealand law, as a matter of New Zealand law, administration should constitute one of the Events of Default referred to in section 5(a)(vii)(6) of the Master Agreement ("seek or becomes subject to the appointment of an administrator ... for it or for all or substantially all its assets"). The appointment of an administrator of a New Zealand Party should, therefore, result in immediate automatic termination.

It is less clear whether administration also results in *retrospective* automatic termination under New Zealand law. However, the analysis is slightly different for the 1992 Master Agreements than for the 2002 Master Agreement.

(1) *1992 Master Agreements*

Administration neither results in a judgment of insolvency nor necessarily in a liquidation. Accordingly, the retrospective automatic termination provisions will only take effect if administration is, or is the result of, the institution of a proceeding[29] "seeking ... relief under any bankruptcy or insolvency law or any other similar law affecting creditors' rights" that is not dismissed within 30 days. As a matter of New Zealand law, administration clearly affects creditors' rights. However, whether the appointment of an administrator is the result of the "institution of a proceeding" depends on the manner of the administrator's appointment. For example, while an appointment by the court would likely be the result of the "institution of a proceeding" (and, therefore, result in retrospective automatic termination), an appointment by a secured creditor or the company's board would not be.

(2) *2002 Master Agreement*

It is unlikely that administration would fall within the wording of Section 5(a)(vii)(4)(A). This is because administration is not the result of a proceeding instituted by the New Zealand Party or "a regulator, supervisor or any similar official with primary insolvency, rehabilitative or regulatory jurisdiction over [it]" (with the possible exception of the Registrar of Companies).

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[29] In New Zealand, there is unlikely to be a significant distinction between the concepts of the institution of a proceeding and the presentation of a petition – both of which are referred to in Section 5(a)(vii)(4).

However, Section 5(a)(vii)(4)(B) could apply. The analysis in that case is the same as for the similarly-worded Section 5(a)(vii)(4) of the 1992 Master Agreements (discussed in (1) above).

Enforceability of automatic termination in administration

Automatic termination should be enforceable in the administration of a New Zealand Party for the same reasons that it should be enforceable in a liquidation. That is:

- the New Zealand courts accept the general principle of automatic termination;
- Part XVA of the Companies Act (administration) adopts the same definition of "netting agreement" used in Part XVI (liquidation), which contemplates both optional and automatic termination; and
- section 239AEN(a) of the Companies Act (administration) is drafted in the same way as section 310H(a) (liquidation), which, on its face, permits both optional and automatic termination to occur despite a potential impediment elsewhere in the legislation.

(3) Statutory management

Applicability of automatic termination in statutory management

Under New Zealand's conflict of laws rules, the issue whether the automatic termination wording is triggered by the statutory management of a New Zealand Party should be determined by English law or New York law.

However, if the matter falls to be determined by New Zealand law, as a matter of New Zealand law, statutory management should constitute one of the Events of Default referred to in Section 5(a)(vii)(6) of the Master Agreement ("seeks or becomes subject to the appointment of an administrator...receiver, trustee, custodian or other similar official for it or for all or substantially all its assets"). The appointment of a statutory manager of a New Zealand Party should, therefore, result in immediate automatic termination.

It is less clear whether statutory management also results in *retrospective* automatic termination under New Zealand law. However, the analysis is slightly different for the 1992 Master Agreements than for the 2002 Master Agreement.

(1) *1992 Master Agreements*

Statutory management neither results in a judgment of insolvency nor necessarily in a liquidation. Also, statutory management is instituted *against*, and not *by*, a person.[30] Accordingly, the retrospective automatic termination provisions will only take effect if statutory management is, or is the result of, the institution of a "proceeding seeking...relief under any bankruptcy or insolvency law or any other similar law affecting creditors' rights" that is not dismissed within 30 days. As a matter of New Zealand law, statutory management clearly affects creditors' rights. Also, under New Zealand law, it is arguable that the appointment of a statutory manager is the result of the "institution of a proceeding". On this basis, therefore, we believe that, if a New

30 It is possible that, say, the directors of an insolvent New Zealand Party could approach the Securities Commission or the Reserve Bank, as appropriate, and recommend that the party be put into statutory management. However, the New Zealand Party would have to rely on the Securities Commission or the Reserve Bank, in conjunction with the relevant Minister, to "institute" the statutory management "proceeding".

Zealand Party were made subject to statutory management, then retrospective automatic termination will apply even if, in the circumstances, 30 days must elapse before the "automatic" termination takes place. The position is not wholly clear or settled, however.

(2) *2002 Master Agreement*

It is likely that statutory management would fall within the wording of both Section 5(a)(vii)(4)(A) and (B).

In respect of Section 5(a)(vii)(4)(A), the retrospective automatic termination provisions will take effect if statutory management is:

- a "proceeding seeking...relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights"; and
- instituted by "a regulator, supervisor or any similar official with primary insolvency, rehabilitative or regulatory jurisdiction over [the New Zealand Party]".

In our view, retrospective automatic termination *would* apply in these circumstances as, under New Zealand law:

- statutory management clearly affects creditors' rights;
- the appointment of a statutory manager is likely to be the result of the institution of a "proceeding"; and
- statutory management is instituted by a "regulator, supervisor or ... similar official with primary insolvency ... jurisdiction" (being, in the case of a New Zealand Party that is a registered bank, the Reserve Bank and, in the case of any other New Zealand Party, the Securities Commission).

In respect of Section 5(a)(vii)(4)(B), the analysis is the same as for the similarly-worded Section 5(a)(vii)(4) of the 1992 Master Agreements (discussed in (1) above).

Enforceability of automatic termination in statutory management

Automatic termination should be enforceable in the statutory management of a New Zealand Party for the same reasons that it should be enforceable in a liquidation. That is:

- the New Zealand courts accept the general principle of automatic termination;
- section 42(7) of the CIM Act[31] adopts the definition of "netting agreement" used in the Companies Act (which contemplates both optional and automatic termination); and
- section 42(7)(b)(i) of the CIM Act[32] is drafted in the same way as section 310H(a) of the Companies Act (which, on its face, permits both optional and automatic termination to occur despite a potential impediment elsewhere in the legislation).

8.2 ***Assuming the parties have not selected Automatic Early Termination upon certain insolvency events to apply to the insolvent New Zealand Party, are the provisions of the Master Agreement permitting the non-defaulting party to***

31 The equivalent provision in the Reserve Bank Act is section 122(7).
32 The equivalent provision in the Reserve Bank Act is section 122(7)(b)(i).

terminate all the Transactions upon the insolvency of its counterparty enforceable under New Zealand law?

The discussion in section 8.1 above under the headings "Conflict of laws", "Applicability of automatic termination in a liquidation" and "Applicability of automatic termination in statutory management" is equally applicable to *optional* termination as it is to *automatic* termination. The remaining issue in respect of the question in this section 8.2, therefore, is whether optional termination is enforceable in the liquidation, administration or statutory management of a New Zealand Party.

(1) Liquidation

As a matter of general principle, if the Master Agreement were governed by New Zealand law, the non-defaulting party is able to give notice effectively terminating it on the occurrence of an Event of Default. There is authority that a termination clause such as Section 6(a) of the Master Agreement (which, among other things, permits the non-defaulting party to terminate all outstanding Transactions on the insolvency of its counterparty) that takes effect on insolvency is effective.[33]

Where the non-defaulting party purports to terminate (and, therefore, to set off) Transactions *after* the New Zealand Party is put into liquidation, this action is arguably contrary to the principle that insolvency set-off is a "mandatory and self-executing"[34] rule that operates automatically on the Liquidation Date (as defined in section 4). In other words, it is arguable that the optional termination (and set off) occurs too late because, as a matter of law, it has already taken place on the Liquidation Date. However, we believe the better view is that optional termination *would* be effective in these circumstances in the sense that the value attributed to the Transactions to be mandatorily set off on the Liquidation Date will be determined by reference to the (later) termination of those Transactions. Put another way, we do not believe that, for the purposes of insolvency set-off, those Transactions would be given their value as at the Liquidation Date. The scheme of the Netting Acts, which broadly favours giving effect to netting agreements in accordance with their terms, supports this view.

Accordingly, since New Zealand law would give effect to optional early termination, that early termination, when governed by English law or New York law, will be given effect to in New Zealand both prior to and upon liquidation.

The two provisions in the Companies Act that we refer to in section 8.1 above as supporting the enforceability of automatic termination also support the enforceability of optional termination.

(2) Administration

The administration regime generally prohibits a "transaction or dealing" by a company in administration that affects the company's property".[35] It is not clear whether this prohibition would apply to the purported termination of an existing contract. However, we believe the better view is that it would not.[36] That being the case, the administration of a New Zealand

33 See, for example, *Shipton, Anderson & Co. (1927), Ltd v Micks, Lambert & Co.* [1936] 2 All ER 1032 (CA).

34 *Stein v Blake* [1995] 2 All ER 961 at 969 (HL).

35 Section 239Z of the Companies Act.

36 Our reasons for this view are, first, that the purported termination is not "by [the] company in administration". It is by the non-defaulting party. Secondly, section 239Z(4)(a) suggests that the "transaction or dealing" must be something that the company can "enter into" – that is, a *new* contractual arrangement, as opposed to the mere exercise of rights under an *existing* contractual arrangement. Thirdly, the purported termination does not (arguably at least) affect the company's property, as that property (i.e., the contractual rights embodied in the relevant agreement) was, from

Party should not prevent the non-defaulting party from giving notice under Section 6(a) of the Master Agreement terminating all outstanding transactions under that agreement.

The two provisions in the Companies Act that we refer to in section 8.1 above as supporting the enforceability of automatic termination also support the enforceability of optional termination.

(3) Statutory management

The statutory management regimes do not prevent a party from terminating a contract (provided it does not also seek to do something that is subject to the statutory management moratorium). Accordingly, regardless of any conflict of laws issue, the onset of statutory management does not prevent the non-defaulting party from giving notice under Section 6(a) of the Master Agreement terminating all outstanding Transactions under that agreement.

The two provisions in the CIM Act (and their equivalent provisions in the Reserve Bank Act) that we refer to in section 8.1 above as supporting the enforceability of automatic termination also support the enforceability of optional termination.

8.3 *Are the provisions of the Master Agreement providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of a counterparty enforceable under New Zealand law?*

(1) Liquidation

General rules of liquidation

As a general rule, leaving aside the possible application of the Companies Amendment Act 1999 (which we consider below), if the close-out netting provisions in the Master Agreement are to be enforceable on and after the Liquidation Date, then, irrespective of the position under the governing law of that agreement:

- those provisions must not lead to a distribution of the assets of the New Zealand Party contrary to section 313(2) of the Companies Act (i.e., the ***pari passu* principle**);
- those provisions must not purport to operate contrary to the mandatory insolvency set-off rule laid down in section 310 of the Companies Act;
- those provisions must not allow the non-defaulting party to exercise any right contrary to section 248 of the Companies Act;
- the liquidator must not be able to "cherry pick" by disclaiming unprofitable Transactions under section 269 of the Companies Act; and
- those provisions must not provide for the valuation of certain claims contrary to section 309 of the Companies Act.

Each of these "rules" of the general liquidation is considered in the following paragraphs in the context of the close-out netting provisions in the Master Agreement. We conclude that

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the outset, subject to the right to terminate. In other words, the right to terminate has always been a feature of, and therefore has always qualified, the company's "property". In effect, this third point is a restatement of the "flawed asset" analysis.

those provisions operate in accordance with their terms in the liquidation of a New Zealand Party.

The pari passu principle

On and after the Liquidation Date, any agreement to which the company in liquidation is a party will not be enforceable to the extent that it offends against the *pari passu* principle laid down in section 313 of the Companies Act. Section 313 is in the following terms:

> (1) After paying preferential claims in accordance with section 312 of this Act, the liquidator must apply the assets of the company in satisfaction of all other claims.
>
> (2) The claims referred to in subsection (1) of this section rank equally among themselves and must be paid in full, unless the assets are insufficient to meet them, in which case payment shall abate rateably among all claims.

However, section 310B(1)(a) of the Companies Act (inserted by the Companies Amendment Act 1999) provides that:

> Despite anything in section 313, sections 310A to 310O apply -
>
> (a) To a netting agreement -
>
> (i) Made in or evidenced by writing; and
>
> (ii) In which the application of sections 310A to 310O has not been expressly excluded; and
>
> (iii) Whether made before or after the commencement of this section;

The intention of this provision is that nothing in section 313 prevents the operation of a netting agreement in accordance with sections 310A to 310O of the Companies Act.

Insolvency set-off

Prior to the Netting Acts coming into force, the main issue concerning the enforceability of close-out netting provisions in the liquidation of a New Zealand Party was whether those provisions purported to operate contrary to the mandatory insolvency set-off rule laid down in section 310 of the Companies Act. Now that the Netting Acts (specifically, sections 310A to 310O of the Companies Act) have come into force, this issue is more straightforward.

The sections referred to in the previous paragraph provide for two types of set-off rules. The first type of rules (contained in section 310) applies to all set-offs other than those effected under a "netting agreement". Section 310 has no application to the issues we consider in this opinion.[37] The second type of rules (contained in sections 310A to 310O) applies to set-offs effected under a "netting agreement". These "netting agreement" rules are discussed below.

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37 Section 310F(1) provides that:

> Section 310 does not apply to transactions that are subject to a netting agreement to which sections 310A to 310O apply.

However, section 310F(2) makes it clear that the net amount calculated as being payable under a netting agreement (which is referred to as the "netted balance") may, itself, be subject to section 310 set-off if there are other mutual dealings between the parties.

We have already concluded, in section 7 above, that, as a matter of New Zealand law, the Master Agreement is a "netting agreement" (i.e., a "bilateral netting agreement") under the Companies Act. Section 310C of the Companies Act provides that:

> If a company that is a party to a netting agreement is in liquidation, -
>
> (a) Any netted balance payable by or to the company must be calculated in accordance with the netting agreement; and
>
> (b) That netted balance constitutes the amount that may be claimed in the liquidation or is payable to the company, as the case may be, in respect of the transactions that are included in the calculation.

"Netted balance" is defined in section 310A to mean:

> any amount calculated under a netting agreement as the net debit payable by or on behalf of a party to the agreement to or on behalf of another party to the agreement in respect of all or any transactions to which the netting agreement applies:

The term "net debit" is not defined in the Companies Act. However, in our view, the "net debit", in the context of the Master Agreement, is the net termination amount payable by the out-of-the-money party under Section 6(e) of the Master Agreement.

Effect of the commencement of the liquidation

Section 248(1) of the Companies Act provides that:

> With effect from the commencement of the liquidation of a company, -
>
> ...
>
> (c) Unless the liquidator agrees or a Court orders otherwise, a person must *not* -
>
> (i) Commence or continue legal proceedings against the company or in relation to its property; or
>
> (ii) *Exercise* or enforce, or continue to exercise or enforce, a right or remedy over or against *property* of the company: (our emphasis)

"Property" is defined to include any amount payable or deliverable to the company in liquidation. It also includes a contractual right. Accordingly, prior to the Netting Acts coming into force, it was arguable that section 248(1)(c)(ii) prevented the exercise of a right of set-off under the Master Agreement where the New Zealand Party is in liquidation. However, section 310H(b) of the Companies Act (inserted by the Companies Amendment Act 1999) makes it clear that this is now not the case for a "netting agreement". Section 310H(b) provides that nothing in section 248(1) affects:

> The taking of an account, in accordance with the netting agreement, of all money due between the parties to the netting agreement in respect of transactions affected by the termination.

In our view, the close-out netting provisions in the Master Agreement involve "the taking of an account" for the purposes of section 310H(b). Section 248(1) will not, therefore, prevent the operation of those provisions.

Disclaimer of onerous or unprofitable Transactions

The liquidator of a New Zealand Party may disclaim onerous property by following the procedure laid down in section 269 of the Companies Act.

Prior to the Netting Acts coming into force, the risk that a liquidator may validly disclaim (i.e., "cherry pick") individual Transactions under the Master Agreement was, in our view, minimised by the "single agreement" provision in the Master Agreement. However, an amendment to section 269 inserted by the Companies Amendment Act 1999 now puts the issue beyond doubt. Section 269(2)(b) provides that the term "onerous property" does not include:

(i) A netting agreement to which sections 310A to 310O apply; or

(ii) Any contract of the company that constitutes a transaction under a netting agreement.

Accordingly, in the context of the Master Agreement, the liquidator of a New Zealand Party cannot disclaim individual Transactions or the master agreement itself.

Debts payable at least six months after the Liquidation Date

Section 309(1) of the Companies Act provides that:

> A claim in respect of a debt that, but for the liquidation, would not be payable until a date that is 6 months, or later than 6 months, after the date of commencement of the liquidation is to be treated, for the purposes of [Part XVI of the Companies Act (which deals with liquidation)], as a claim for the present value of the debt.

Section 309(2) prescribes, by reference to the Judicature Act 1908, the discount rate that must be used in determining the present value of the debt.[38] As section 309 is a mandatory insolvency rule, it will (subject to the exception noted below) prevail in the liquidation of a New Zealand company, regardless of any contractual provision that may provide otherwise.

Unlike in the case of sections 248, 269, 310 and 313, the Companies Amendment Act 1999 does not *expressly* override section 309 to the extent it may be applicable to "netting agreements". However, in our view, it does so *implicitly*. That is, section 310C(a) states that the "netted balance" must be calculated in accordance with the netting agreement.

(2) Administration

General rules of administration

If the close-out netting provisions in the Master Agreement are to be enforceable in the administration of a New Zealand Party, then, irrespective of the position under the governing law of that agreement:

- those provisions must not constitute a "transaction or dealing" by or on behalf of the New Zealand Party that affects its property,[39] which is prohibited by section 239Z(1) of the Companies Act; and
- those provisions must not constitute an "enforcement process in relation to the company's property", which is prohibited by section 239ABG of the Companies Act.

Each of these "rules" of administration is considered in the following paragraphs in the context of the close-out netting provisions in the Master Agreement. We conclude that those provisions operate in accordance with their terms in the administration of a New Zealand Party.

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38 By contrast, it appears that a future debt payable to the counterparty will not be discounted to compensate for early "payment" through the application of the insolvency set-off rules: *Ex parte Prescot* (1753) 1 Atk. 230.

39 As mentioned in section 8.3(1) above, "property" includes contractual rights.

Transaction or dealing affecting the company's property

In section 8.2(2) above, we conclude that section 239Z should not prevent the termination of Transactions under the Master Agreement. For the same reasons, we believe that this provision should not prevent the operation of the close-out netting provisions.

However, in any event, section 239AEN(b) provides that nothing in section 239Z affects:

> the taking of an account, in accordance with the netting agreement, of all money due between the parties to the netting agreement in respect of transactions affected by the termination.

In our view, the close-out netting provisions in the Master Agreement involve "the taking of an account" for the purposes of section 239AEN(b). Section 239Z will not, therefore, prevent the operation of those provisions.

Enforcement process in relation to the company's property

"Enforcement process" is defined in section 239C to mean, in relation to property:

> (a) execution against that property; or
>
> (b) any other enforcement process in relation to that property that involves a court or a sheriff.

In our view, the terms of this definition and the context in which the defined term is used in the Companies Act make it clear that an "enforcement process" must involve a formal court or arbitral procedure using the assistance of a third party to enforce a (most likely proprietary) claim against a company's property. It follows, therefore, that "self-help" remedies, such as the exercise of contractual rights of set-off or netting, should not constitute an "enforcement process".[40]

While the netting agreement provisions in Part XVA of the Companies Act do not expressly override section 239ABG, it is clear that the principal objective of those provisions (i.e., that netting agreements be enforceable in accordance with their terms) could not be met if section 239ABG applied in these circumstances and prevailed.

(3) Statutory management

General rules of statutory management

If the close-out netting provisions in the Master Agreement are to be enforceable on and after the date on which a statutory manager of a New Zealand Party is appointed, then, irrespective of the position under English law or New York law:

- those provisions must not contravene the statutory moratorium[41] including, in particular, the moratorium on exercising a right of set-off; and
- the statutory manager must not be able to "cherry pick" by disclaiming unprofitable Transactions[42] or by suspending payment of amounts owing by the New Zealand Party under individual Transactions.[43]

40 See *Re Paramount Airways Ltd* [1990] BCC 130 (ChD).
41 Section 42 of the CIM Act; section 122 of the Reserve Bank Act.
42 Section 46(3) of the CIM Act; section 129(3) of the Reserve Bank Act.
43 Section 44(1) of the CIM Act; section 127(1) of the Reserve Bank Act.

Each of these "rules" of statutory management is considered in the following paragraphs in the context of the close-out netting provisions in the Master Agreement. We conclude that those provisions operate in accordance with their terms in the statutory management of a New Zealand Party.

Statutory moratorium

Section 6.4 above outlines the moratorium provisions in the statutory management regimes. Prior to the Netting Acts coming into force, the most problematic of the moratorium provisions, in the context of the close-out netting provisions in the Master Agreement, was that preventing the exercise of a right of set-off.[44] However, in the case of a "netting agreement" to which the Companies Act applies, nothing in the set-off moratorium provision applies to any right of set-off provided for in the netting agreement.[45]

In addition, the statutory moratorium provisions are expressed not to limit or prevent:

> The taking of an account, in accordance with the netting agreement, of all money due between the parties to the netting agreement in respect of transactions affected by the [close-out] termination;[46]

Accordingly, the statutory moratorium provisions should not prevent the operation of the close-out netting provisions in the Master Agreement.

Statutory manager's power to suspend payments and disclaim onerous property

The statutory manager has two possible bases on which to "cherry pick" Transactions: a power to suspend the payment of money owing to any person and a power to disclaim onerous property. The scope of these two powers is described in section 6.4 above.

In the case of the power to suspend payment of money owing, the statutory management legislation provides that the provision containing this power does not authorise:

> the suspension by the statutory manager of the payment of any amount that would be included in the calculation of a netted balance in accordance with section 310C of the Companies Act 1993...However, [the empowering provision] applies to the payment of the netted balance.

In other words, the statutory manager may only suspend payment of the net termination amount calculated on close-out in accordance with the Master Agreement. The statutory manager may not suspend payment of the gross amounts under individual Transactions that collectively make up that net termination amount.

In the case of the power to disclaim onerous contracts, the same outcome results by virtue of the statutory management legislation adopting section 269 of the Companies Act (including the amendment to section 269 discussed in section 8.3 (1) above). That is, the restriction on the power of a liquidator to disclaim individual Transactions or the master agreement itself also applies to a statutory manager.

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44 Section 42(1)(h) of the CIM Act; section 122(1)(h) of the Reserve Bank Act.
45 Section 42(7)(a) of the CIM Act; section 122(7)(a) of the Reserve Bank Act.
46 Section 42(7)(b)(ii) of the CIM Act; section 122(7)(b)(ii) of the Reserve Bank Act.

8.4 *Assuming the parties have entered into either a Cross Border Agreement or a 2002 Master Agreement, the New Zealand Party is insolvent and the parties have selected a Termination Currency other than New Zealand dollars, is it possible to "prove" (that is, file) a claim in a New Zealand insolvency proceeding in a foreign currency?*

(1) Liquidation

The currency in which a claim is valued in a liquidation in New Zealand is New Zealand dollars. Section 306(2) of the Companies Act provides that:

> The amount of a claim based on a debt or liability denominated in a currency other than New Zealand currency must be converted into New Zealand currency at the rate of exchange on the date of commencement of the liquidation, or, if there is more than one rate of exchange on that date, at the average of those rates.

This is so even though the amount of the claim may have to be ascertained later. While this rule applies to a claim *against* the New Zealand Party in liquidation, it is not settled how a claim *by* the New Zealand Party *against* the counterparty should be valued. In principle, that claim should also be converted at the rate of exchange prevailing on the Liquidation Date.

Accordingly, while the Companies Amendment Act 1999 provisions give considerable freedom to parties to determine the method of calculation of the "netted balance" in their "bilateral netting agreement", the claim represented by that netted balance, once determined, becomes subject to the same rules that apply to all other claims. This includes the requirements of section 306(2).[47]

(2) Administration

In the administration of a company, creditors advise the administrator of their claim for the purpose of having that claim included in the deed of company arrangement to be adopted by the company and its creditors. The Companies (Voluntary Administration) Regulations 2007 set out the provisions that are deemed to be included in a deed of company arrangement if they are not expressly excluded. Paragraph 8(1) of Schedule 1 of those Regulations incorporates section 306 of the Companies Act (discussed in section 8.4(1) above). Accordingly, the analysis set out above in relation to liquidation applies equally to administration.

(3) Statutory management

A payment of the net termination amount by a New Zealand Party made subject to statutory management may be made in a termination currency other than New Zealand dollars. However, this is on the unlikely assumption that the statutory manager chooses to make the payment in the first place. As stated in sections 6.4 and 8.3 above, the statutory manager may suspend the payment of the net termination amount. Alternatively, the statutory manager may choose not to pay the net termination amount and rely on the statutory moratorium preventing the counterparty from bringing proceedings to recover that amount.

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47 In reaching this conclusion, we have read down a literal interpretation of section 310C(b) of the Companies Act. That provision states that the "netted balance constitutes the amount that may be claimed in the liquidation". For the reasons given in this section 8.4(1), it is the New Zealand dollar equivalent (calculated in accordance with section 306(2)) of the netted balance that may be claimed.

8.5 *Is it possible to obtain or execute a judgment in a foreign currency in New Zealand?*

Obtaining a foreign currency judgment in New Zealand

It is well established that a New Zealand court may give judgment in a foreign currency.[48] In the case of a liquidated debt (such as a net termination amount under a Master Agreement), it is generally sufficient that the debt was expressed in a foreign currency. In the case of damages for breach of contract, judgment can be awarded in a foreign currency if that was the currency in which the loss was effectively felt or borne by the entity suffering it, having regard to the currency in which that entity generally operates or with which it has the closest connection.[49]

Executing a foreign currency judgment of a foreign court in New Zealand

There are three means by which a foreign judgment may be enforced in New Zealand:

- by registering the judgment under the Reciprocal Enforcement of Judgments Act 1934 (the **REJ Act**);
- by an action on the judgment under common law; and
- by filing a memorial under section 56 of the Judicature Act 1908.

The REJ Act provides for the registration of judgments given by the courts of certain foreign countries (including the courts of England). The common law provides for the recognition of judgments to which the REJ Act does not apply (including judgments of the New York courts). The discussion below focuses solely on the significance of the relevant judgment of the foreign court being expressed in a foreign currency. We assume that the judgment otherwise qualifies for recognition in New Zealand (under the REJ Act or the common law, as the case may be).

REJ Act (English court judgments)

Section 4(3) of the REJ Act provides that, where the judgment to be registered is expressed in a foreign currency, the judgment creditor may choose to register that judgment in that foreign currency or convert that foreign currency amount to an equivalent New Zealand dollar amount.

If the judgment creditor wishes the judgment to be registered in the currency in which it is expressed, the judgment creditor must state this in the application for registration. If the judgment creditor is silent on this matter in the application, the judgment will be registered for an equivalent amount in New Zealand currency based on the rate of exchange prevailing on the day of the application for registration.

Section 4(2) provides that a registered judgment will, for the purposes of enforcement, be of the same force and effect as if the judgment had been a judgment originally given in the High Court on the date of registration.

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48 Dicey & Morris, *The Conflict of Laws*, 14th ed. (2006), Rule 242(1).

49 *Eleftherotria (Owners) v Owners of the Despina R* [1979] 1 All ER 421 (HL).

Common law (New York court judgments)

Where a foreign judgment has been entered in a foreign currency, a New Zealand court should enter judgment in New Zealand in that currency. There would need to be exceptional reasons for a court to decline to do so.[50]

However, where the judgment creditor comes to execute (or enforce) the judgment, the judgment debt generally needs to be converted into New Zealand currency. The relevant date for conversion is the date when the court authorises enforcement of the judgment.[51] Conversion may not be necessary where the judgment debtor owns assets denominated in the judgment currency (e.g., a foreign currency bank account with a New Zealand bank).

8.6 *Effect of inclusion of Force Majeure Event, Close-out Amount and set-off provision*

None of:

- the inclusion of the Force Majeure Event as a Termination Event in the 2002 Master Agreement; or
- the inclusion of Close-out Amount as the termination payment measure in the 2002 Master Agreement; or
- the inclusion of the set-off provision in Section 6(f) of the 2002 Master Agreement,

would affect the opinions we express above or below.

9. CLOSE-OUT NETTING FOR MULTIBRANCH PARTIES

9.1 *Would there be any change in the conclusions concerning the enforceability of close-out netting under the Master Agreement based upon the fact that the New Zealand Bank has entered into the Master Agreement on a multibranch basis and then conducted business in that fashion prior to its insolvency?*

Conflict of laws

The discussion below assumes that no law other than New Zealand law would affect our conclusions. If a foreign branch of the New Zealand Bank is itself the subject of a separate insolvency proceeding outside New Zealand, the laws of the relevant jurisdiction may, as a practical matter, affect this discussion.

(1) Liquidation

Under New Zealand law, a branch in a foreign jurisdiction of a company incorporated in New Zealand is not a separate legal entity. The branch is part of the company which, because it is incorporated in New Zealand, is domiciled in New Zealand.

In a New Zealand liquidation (whether of a company incorporated in New Zealand or of an overseas company), a New Zealand court will apply New Zealand law (including New

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50 Goddard and McQueen, *Private International Law in New Zealand* (2001), 65.

51 *Miliangos v George Frank (Textiles) Ltd* [1975] 3 All ER 801 (HL), *American Express Europe Ltd v Bishop* (1987) 1 PRNZ 635 and *Marinkovich v the proceeds of sale of the ship "Gold Coast"* (unreported, 17 March 1997, High Court, Whangarei M4/92 and M122/94).

Zealand's conflict of laws rules) in that liquidation (in particular, the relevant provisions of the Companies Act). This is an application of the conflict of laws principle that matters of procedure are determined by the law of the forum (in this case, New Zealand). Under New Zealand's conflict of laws rules, a liquidation of a New Zealand company in New Zealand:

- is a liquidation of the *company* and not merely of its New Zealand affairs.[52] In theory, the liquidation extends to *all* its assets and *all* its creditors without any distinction being made between its New Zealand assets and creditors, on the one hand, and its foreign assets and creditors, on the other hand. Accordingly, assets collected in by the liquidator may be applied in satisfaction of "foreign" as well as "New Zealand" liabilities; and

- has extra-territorial effect with the result that an insolvency proceeding of a New Zealand company outside New Zealand has only local operation. If there is a simultaneous insolvency proceeding abroad, a New Zealand court should seek to ensure that each creditor of equal priority benefits equally whether it is a claimant in New Zealand or in the foreign proceeding. This is an application of the so-called "hotchpot rule".

On this basis, therefore, the conclusions that we reach in section 8.3 above concerning the enforceability of the close-out netting provisions under the Master Agreement do not change if the New Zealand Bank enters into Master Agreements on a multibranch basis and conducts business in that fashion prior to its liquidation. That is, so far as New Zealand law is concerned, the same analysis applies where the New Zealand Bank is a Multibranch Party.

While the Companies Amendment Act 1999 does not *expressly* confirm the enforceability of multibranch netting, it does, in our view, *implicitly* support the general principles outlined above. Both in the definition of "netted balance" in section 310A and in section 310C(a), the Companies Act states that the netted balance must be calculated in accordance with the netting agreement. Accordingly, where the relevant netting agreement is a multibranch agreement, the netted balance must take into account Transactions booked through all branches.

(2) Administration

The conclusions that we reach in section 8.3 above concerning the enforceability of the close-out netting provisions under the Master Agreement do not change if the New Zealand Bank enters into Master Agreements on a multibranch basis and conducts business in that fashion prior to being put into administration.

The netting legislation provisions referred to in section 9.1(1) above apply equally to administration as to liquidation.

(3) Statutory management

The conclusions that we reach in section 8.3 above concerning the enforceability of the close-out netting provisions under the Master Agreement do not change if the New Zealand Bank enters into Master Agreements on a multibranch basis and conducts business in that fashion prior to being made subject to statutory management.

As in the context of liquidation, the netting legislation, in the context of statutory management, endorses by implication multibranch netting. The legislation provides that nothing in the statutory moratorium "applies to any right of set-off provided for in the netting

52 Dicey & Morris, *The Conflict of Laws*, 14th ed. (2006), para 30-078.

agreement".[53] This includes the multibranch set-off rights embodied in the close-out netting provisions in the Master Agreement.

9.2 ***Would there be a separate proceeding in New Zealand with respect to the assets and liabilities of the New Zealand Branch upon the start of the insolvency proceeding for the Foreign Bank in the Foreign Country? Or would the relevant authorities in New Zealand defer to the proceeding in the Foreign Country so that the assets and liabilities of the New Zealand Branch would be handled as part of the proceeding for the Foreign Bank in the Foreign Country? Could local creditors of the New Zealand Branch initiate a separate proceeding in New Zealand even if the relevant authorities in New Zealand did not do so?***

(1) Liquidation

Separate liquidation proceeding in New Zealand

The Companies Act expressly contemplates the possibility of a separate liquidation proceeding in New Zealand of the New Zealand Branch (whether upon or prior to the start of a foreign insolvency proceeding of the Foreign Bank). Section 342 of the Companies Act provides that an application may be made to a New Zealand court "for the liquidation of the assets in New Zealand of an overseas company" in accordance with the provisions set forth in the Companies Act for the liquidation of a New Zealand company. An "overseas company" for this purpose is "a body corporate that is incorporated outside New Zealand".[54] It does not matter whether the overseas company is registered as an overseas company in New Zealand, whether it has been dissolved or whether it has otherwise ceased to exist under the law of its domicile.

In order to appoint a liquidator of the New Zealand Branch, there must be assets of the New Zealand Branch to administer in New Zealand. The New Zealand liquidation accordingly applies only to the New Zealand assets of the New Zealand Branch. In order to appoint a liquidator, there must also be persons (e.g., creditors) subject to New Zealand jurisdiction who are concerned or interested in the proper distribution of the assets. What is comprised in those "assets" is considered in section 9.3 below.

Subject to certain minor differences, the consequences of the appointment of a liquidator of the New Zealand Branch are the same as they are for a New Zealand company. The liquidator of the New Zealand Branch has the same powers and duties as the liquidator of a New Zealand company. While this is correct in principle, in practice the extra-territorial reach of a New Zealand liquidator's powers and duties in these circumstances is uncertain. The Companies Act provides no guidance on this issue. Since the authorities suggest that little, if any, extra-territorial effect should be given to foreign company liquidations,[55] in principle a New Zealand court should take the same view of a liquidation ordered by it in New Zealand.

If the New Zealand Branch is the subject of a liquidation proceeding in New Zealand, this does not prevent a creditor in relation to the (New Zealand) assets of which the liquidator is appointed:

- from bringing proceedings outside New Zealand against the Foreign Bank in relation to a debt not claimed in the liquidation in New Zealand; or

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53 Section 42(7)(a) of the CIM Act; section 122(7)(a) of the Reserve Bank Act.
54 Section 2(1) of the Companies Act.
55 *New Zealand Loan & Mercantile Agency Co. v Morrison* [1898] AC 349 (PC); but see *The Bank of Otago (Limited) v The Commercial Bank of New Zealand (Limited)* (1864) Macassey's Rep 233 (SC) and *Re Oriental Inland Steam Co.* (1874) 9 Ch App 557 (CA).

- from bringing an action in New Zealand in relation to the balance of a debt remaining unpaid after completion of the liquidation.[56]

New Zealand proceeding should be ancillary to the principal insolvency proceeding

The grounds on which a New Zealand court may appoint a liquidator of the New Zealand Branch are discretionary: e.g., if it is satisfied that, among other things, the Foreign Bank is "unable to pay its debts" or that it is "just and equitable that the...[Foreign Bank] be put into liquidation".[57] A New Zealand court will not automatically appoint a liquidator even if it is satisfied that one of the grounds for the appointment of a liquidator exists under New Zealand law. In principle, a New Zealand court will not assume jurisdiction over matters that naturally and properly lie within the competence of the courts of another country.[58] Even where there are both assets of the New Zealand Branch in New Zealand and creditors in New Zealand interested in the proper distribution of its assets, the exercise of the jurisdiction by a New Zealand court remains discretionary.[59] In effect, therefore, there must be some commercial subject matter in respect of which a liquidator can be appointed in New Zealand.

If the Foreign Bank is also the subject of a liquidation proceeding in the jurisdiction of its incorporation, a New Zealand court would, in our view, not lightly appoint a liquidator in New Zealand of the New Zealand Branch. That said, there is no settled New Zealand authority on the grounds upon which the New Zealand court would exercise its discretion to appoint a liquidator of the New Zealand Branch.[60] The grounds might, for example, include whether the courts of the jurisdiction of incorporation discriminate against New Zealand creditors lodging claims from outside that jurisdiction or whether it is evident that New Zealand creditors will be materially disadvantaged if the New Zealand court does not exercise its discretion.[61]

If, however, the New Zealand court does exercise its discretion to appoint a liquidator of the New Zealand Branch, then in principle the liquidation proceeding in the Foreign Country should (on the basis of the doctrine of the convenient or appropriate forum, but in the absence of fraud or New Zealand public policy considerations compelling otherwise) be regarded as the principal liquidation. Accordingly, the liquidation in New Zealand of the New Zealand Branch, while conducted in accordance with New Zealand law (including New Zealand's conflict of laws rules), should be regarded as *ancillary* to the principal liquidation.[62] It is not clear under New Zealand law precisely what the relationship is between the ancillary New Zealand liquidation and the principal foreign liquidation.[63] In principle, however, the New

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56 Clause 2 of Schedule 9 of the Companies Act.

57 Section 241(4) of the Companies Act.

58 *Banque des Marchands de Moscou (Koupetschesky) v Kindersley* [1951] Ch 112 (CA).

59 *Banque des Marchands de Moscou (Koupetschesky) v Kindersley* [1951] Ch 112 (CA); *In re Azoff-Don Commercial Bank* [1954] Ch 315 at 331-332 (HC).

60 See *In re the Westland Gold-Mining Syndicate Limited* [1916] NZLR 169 (SC).

61 *Gavigan v Australasian Memory Pty Ltd (in liquidation)* (1997) 8 NZCLC 261,449 (HC) states (at 261,452) that:

> This Court has a wide discretion in determining whether or not to make an order under s342 and should not be slow to do so if it is not satisfied that the laws of the country of incorporation adequately protect New Zealand creditors in respect of New Zealand assets.

62 See *Re Bank of Credit and Commerce International S.A. (No. 11)* [1997] 1 BCLC 80 (Chancery Division (Companies Court)) for an examination of the relevant authorities.

63 For example, the (ancillary) New Zealand liquidator might take the view that the New Zealand assets should either be administered wholly in accordance with New Zealand law (including New Zealand's conflict of laws rules) or be handed over to the (principal) foreign liquidator on an undertaking from the latter that those assets will be dealt with according to the (New Zealand) law of the ancillary liquidation. In either case, the New Zealand liquidator would be bound to carry out the New Zealand liquidation in accordance with New Zealand law. This was the view in *Gavigan v Australasian Memory Pty Ltd (in liquidation)* (cited above):

Zealand court should take care to ensure that there is no conflict between its jurisdiction and that of the relevant foreign jurisdiction.[64]

If a New Zealand court exercises its discretion *not* to appoint a liquidator of the New Zealand Branch, then the foreign liquidator's authority to collect in the New Zealand assets of the New Zealand Branch should in principle be recognised in New Zealand.[65] The counterparty would accordingly have to prove its claims under the Master Agreement in the Foreign Country.

Who may initiate the separate liquidation proceeding in New Zealand?

A liquidator of the New Zealand Branch may be appointed by a New Zealand court upon the application of the same persons who are entitled under the Companies Act to apply to have a New Zealand company put into liquidation (e.g., a creditor[66] or the Registrar of Companies in New Zealand).[67]

(2) Administration

Section 239H of the Companies Act sets out the circumstances where an administrator may be appointed to "a company". "Company" is defined in section 239C to include an overseas company. It is, therefore, possible for an overseas company (or at least its New Zealand assets) to be put into administration in New Zealand.

Very broadly, we expect that the cross-border insolvency principles we outline in section 9.2(1) above in the context of liquidation would apply equally in the context of administration. However, given that the administration regime has only been introduced very recently, there is no case law supporting this view.

(3) Statutory management

It is also possible that the New Zealand Branch may be made subject to statutory management in New Zealand because the CIM Act applies to the New Zealand assets of any corporation, whether incorporated in New Zealand *or elsewhere*.[68] If the Foreign Bank is also a registered bank in New Zealand, then the New Zealand Branch could be made subject to statutory management under the Reserve Bank Act. Although there is no authority on the extra-territorial effect of New Zealand's statutory management regimes, in our view they would apply only to the New Zealand assets of the New Zealand Branch.

> While the liquidator would be required to work concurrently and in an ancillary fashion with the Australian liquidator, he would have his obligations at law spelt out by this Court and New Zealand law and would not be required to take instructions or directions from the Australian liquidators if they were in conflict with the rights under New Zealand law of New Zealand creditors in respect of New Zealand assets. (at 261,453-4)

64 *Felixstowe Dock and Railway Co. v United States Lines Inc.* [1988] 2 All ER 77 (Queen's Bench Division (Commercial Court)).

65 Dicey & Morris, *The Conflict of Laws*, 14th ed. (2006), Rule 166. The liquidation of a foreign company in the jurisdiction of its incorporation will generally be recognised in New Zealand unless the foreign proceedings are not final, are in breach of natural justice or are contrary to public policy, subject always to any positive law in New Zealand: *Turners and Growers Exporters Ltd v The ship "Cornelis Verolme"* [1997] 2 NZLR 110 (HC).

66 A "creditor" for this purpose is a "person who, in a liquidation, would be entitled to claim in accordance with section 303 of...[the Companies] Act that a debt is owing to that person by [the Foreign Bank]": section 240(1) of the Companies Act.

67 Section 241(2)(c) of the Companies Act.

68 Section 2(1) of the CIM Act.

We are not aware of any New Zealand branch of a foreign entity having been made subject to statutory management in New Zealand. We think the issue unlikely to arise in practice, except perhaps in the context of a request from the relevant authorities of the jurisdiction of domicile of the relevant entity. In theory, however, it is possible. On this basis, therefore, the analysis in section 8 above relating to the statutory management of the New Zealand Party should be equally applicable to the statutory management of the New Zealand Branch.

(4) Insolvency (Cross-Border) Act

The Insolvency (Cross-Border) Act 2006 (the **ICBA**) was enacted to implement the Model Law on Cross-Border Insolvency (the **Model Law**) adopted by the United Nations Commission on International Trade Law (**UNCITRAL**) in 1997. However, the ICBA is not yet in force and is not expected to come into force until Australia also adopts the Model Law. In this regard, the Cross-Border Insolvency Bill 2007 was introduced into the Australian Federal Parliament on 20 September 2007. It is not clear when that Bill will be passed.

Nevertheless, given that the ICBA has been enacted, we briefly outline below the provisions that would be relevant in the context of the questions raised in this section 9.

Schedule 1 of the ICBA sets out the rules that apply in cross-border insolvency proceedings. However, in the context of the issues considered in this opinion, there are two important exceptions to the application of these rules:

- first, these rules do *not* apply in the statutory management of a registered bank (although they *do* apply in the statutory management of any other "corporation");[69] and
- secondly, these rules do not prevent a New Zealand court from refusing to take any action that would be manifestly contrary to the public policy of New Zealand.[70] While we are not aware of any case law directly on point, it is possible that some of the principles enshrined in New Zealand's corporate insolvency law (such as the right of set-off) could be regarded as part of public policy.[71]

Chapter II of Schedule 1 of the ICBA provides generally that a "foreign representative" (that is, the administrator in foreign insolvency proceedings) is entitled to apply to a New Zealand court to commence insolvency proceedings in New Zealand. Also, foreign creditors have the same right to commence, and participate in, insolvency proceedings in New Zealand as local creditors.

Chapter III of Schedule 1 of the ICBA governs the recognition in New Zealand of foreign insolvency proceedings. In particular, Chapter III provides a mechanism for the foreign representative to apply to the High Court to have a foreign insolvency proceeding recognised in New Zealand. That proceeding may be recognised as either a foreign *main* proceeding (if it takes place in the State where the debtor has the centre of its main interests) or as a foreign *non-main* proceeding (if the debtor has an "establishment" in the foreign State).

If a foreign insolvency proceeding is recognised as a foreign main proceeding:

- commencement or continuation of individual actions or proceedings concerning the debtor's assets, rights, obligations, or liabilities is stayed;

69 Article 1(2).

70 Article 6(1). See Dicey & Morris, *The Conflict of Laws*, 14th ed. (2006), Rule 210 for a general discussion of public policy.

71 See, more generally, the discussion of the public policy exception in International Insolvency Institute, *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment* (1999), para.s 86-89.

- execution against the debtor's assets is stayed; and
- the right to transfer, encumber, or otherwise dispose of any assets of the debtor is suspended.

If a foreign insolvency proceeding is recognised (whether as a foreign main proceeding or a foreign non-main proceeding), a court may entrust distribution of all the debtor's New Zealand assets to the foreign representative if the interests of local creditors are adequately protected.

Chapter V of Schedule 1 governs concurrent insolvency proceedings. Article 28 provides that, once a foreign main proceeding is recognised, a New Zealand insolvency proceeding may only be commenced if the debtor has assets in New Zealand. Article 29, in effect, provides for local proceedings to prevail over foreign proceedings.

While we must wait to see how the broad principles in the ICBA are applied in practice, we do not expect that the application of those principles will produce a different outcome to that outlined in this section 9. This is consistent with the intention behind the Model Law, which is to achieve harmonisation of *procedural*, but not *substantive*, domestic insolvency laws.

9.3 ***If there would be a separate proceeding in New Zealand with respect to the assets and liabilities of the New Zealand Branch, would the receiver or liquidator in New Zealand and the New Zealand courts, on the facts set out, include the Foreign Bank's position under a Master Agreement, in whole or in part, among the assets of the New Zealand Branch and, if so, would the receiver or liquidator and the New Zealand courts recognise the close-out netting provisions of a Master Agreement in accordance with their terms? The most significant concern would arise if a New Zealand receiver, liquidator or court considering a single Master Agreement would require a counterparty of the New Zealand Branch to pay the mark-to-market value of Transactions entered into with the New Zealand Branch to the liquidator or receiver of the New Zealand Branch while at the same time forcing the counterparty to claim in the proceeding in the Foreign Country for its net value from other Transactions with the Foreign Bank under the same Master Agreement. In considering this issue, we assume that close-out netting under all the relevant Master Agreements would be enforced in accordance with its terms in the proceeding for the Foreign Bank in the Foreign Country.***

(1) Liquidation

On the stated assumption that close-out netting under each relevant Master Agreement would be enforced in accordance with its terms in the insolvency proceeding for the Foreign Bank in the Foreign Country, then the liquidator of the New Zealand Branch should, in our view, recognise the close-out netting provisions of the Master Agreement in the same way in which the liquidator would recognise those provisions if a New Zealand Party were in liquidation.

If an application were made in New Zealand for the liquidation of the New Zealand Branch, and a liquidator were appointed in New Zealand, then the liquidator is bound to apply New Zealand law (including, in particular, the Companies Amendment Act 1999 provisions). For the reasons given in section 9.1 above, we believe that the New Zealand courts should recognise the *global* net termination amount (i.e., the net termination amount taking into account Transactions with *all* branches) as being the netted balance payable by or to the New Zealand Branch. Therefore, the liquidator of the New Zealand Branch should not be able to require the counterparty to pay the *local* net termination amount (i.e., the net termination amount taking into account Transactions with the New Zealand Branch *only*) and force the counterparty to claim in the proceeding in the Foreign Country for the net value from other Transactions with the Foreign Bank.[72]

(2) Administration and statutory management

Likewise, in the administration or statutory management of the New Zealand Branch, we believe that the New Zealand courts would recognise the *global* net termination amount as being the netted balance payable by or to the New Zealand Branch.

9.4 ***Would the conclusions to the issues in sections 9.1, 9.2 and 9.3 remain the same, notwithstanding possible actions that could be taken by an insolvency official or court in another jurisdiction where close-out netting may be unenforceable (the Non-Netting Jurisdiction). Such actions taken by an insolvency official of a Non-Netting Jurisdiction include the following scenarios:***

(1) In the case of an insolvency proceeding for a New Zealand Bank, the New Zealand Bank, acting as a multibranch party, has booked Transactions through its home office and one or more branches located in Non-Netting Jurisdictions (the Non-Netting Branches).

(2) In the case of an insolvency proceeding for a New Zealand Branch of the Foreign Bank, the Foreign Bank acting as a multibranch party, has booked Transactions through

(i) its home office;

(ii) its New Zealand Branch; and

(iii) one or more Non-Netting Branches in other jurisdictions.

That is, where New Zealand courts have jurisdiction over the assets of a New Zealand Bank or a New Zealand Branch, would a multibranch master agreement be treated as a single, unified agreement by a New Zealand receiver under New Zealand law regardless of the treatment of the agreement or transactions under the agreement by an insolvency official in a Non-Netting Jurisdiction?

On the basis of the analysis in sections 9.1, 9.2 and 9.3 above, the conclusions that we reach remain the same notwithstanding action taken by an insolvency official or court in a Non-Netting Jurisdiction.

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72 This principle was accepted in *Gavigan v Australasian Memory Pty Ltd (in liquidation)* (cited above) (at 261,452):

> This protection [i.e., the court's power to appoint a liquidator of the New Zealand branch] should not extend to endeavouring to preserve New Zealand assets for New Zealand creditors as the normal *pari passu* rule relating to distribution to unsecured creditors should apply universally and not on a regional basis.

10. 2001 BRIDGE

In expressing our opinions in this section 10 and in section 11 below, we assume that each of the 2001 Bridge and the 2002 Bridge has been suitably modified, where relevant, for inclusion in the Schedule to the 2002 Master Agreement. For example, paragraph 1(e) of the 2001 Bridge and paragraph 1(f) of the 2002 Bridge contemplate the relevant payment measure being Market Quotation or Loss (terms used in the 1992 Master Agreements, but not in the 2002 Master Agreement).

On that basis, neither:

- the inclusion in the Master Agreement of the 2001 Bridge; nor
- the inclusion under the 2001 Bridge of any of the master agreements set out in the Master Agreement List,

would affect the opinions we express above.

11. 2002 BRIDGE

In order for the Master Agreement to constitute a "bilateral netting agreement" under section 310A of the Companies Act, each Event of Default, Termination Event or Bridging Event must be "an event specified in the [Master] agreement". In this regard, the 2002 Bridge adopts a different approach to the 2001 Bridge. It provides that a Bridging Event can occur not only following the occurrence of an Event of Default (under the Master Agreement), but also following the occurrence of an event of default under a Bridged Agreement. Therefore, to the extent of the Bridged Agreement events of default, the Master Agreement will not specify all events of default (other than through cross reference).

We do not believe this would jeopardise the Master Agreement's qualification as a "bilateral netting agreement". In our view, it should be sufficient for the purposes of the definition of that term to cross refer to events of default in another agreement, without having to repeat those events of default in the Master Agreement.

On that basis, the inclusion in the Master Agreement of the Bridge would not affect the opinions we express above.

12. DEVELOPMENTS PENDING

There are no developments pending as a result of which the current regulatory or legal environment in New Zealand may be expected to change in the foreseeable future with respect to the opinions we express above.

This opinion is provided solely for the benefit of ISDA and its members.

Yours faithfully

Bell Gully

APPENDIX A
SEPTEMBER 2007

CERTAIN TRANSACTIONS UNDER THE ISDA MASTER AGREEMENTS

Basis Swap. A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

Bond Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

Bullion Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of Bullion in exchange for the strike price or may be cash settled based on the difference between the market price of Bullion on the exercise date and the strike price.

Bullion Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the COMEX Division of the New York Mercantile Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

Bullion Trade. A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a "spot" or two-day basis or on a specified future date. A Bullion Trade may be settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price.

For purposes of Bullion Trades, Bullion Options and Bullion Swaps, "Bullion" means gold, silver, platinum or palladium and "Ounce" means, in the case of gold, a fine troy ounce (or in the case of reference prices not expressed in Ounces, the relevant Units of silver, platinum or palladium).

Buy/Sell-Back Transaction. A transaction in which one party purchases a security (in consideration for a cash payment) and agrees to sell back that security (or in some cases an equivalent security) to the other party (in consideration for the original cash payment plus a premium).

Cap Transaction. A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap).

Collar Transaction. A collar is a combination of a cap and a floor where one party is the floating rate, floating index or floating commodity price payer on the cap and the other party is the floating rate, floating index or floating commodity price payer on the floor.

Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. The payment calculation is based on the quantity of the commodity and is settled based, among other things, on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g., West Texas Intermediate Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

Contingent Credit Default Swap. A Credit Default Swap Transaction in which the credit protection seller pays an amount determined by reference to the value of a hypothetical swap transaction.

Credit Default Swap Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to enter into a Credit Default Swap.

Credit Default Swap. A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a “Reference Obligation”) issued, guaranteed or otherwise entered into by a third party (the “Reference Entity”) upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. A Credit Default Swap may also be physically settled by payment of a specified fixed amount by one party against delivery of specified obligations (“Deliverable Obligations”) by the other party. A Credit Default Swap may also refer to a “basket” (typically ten or less) or a “portfolio” (eleven or more) of Reference Entities or may be an index transaction consisting of a series of component Credit Default Swaps.

Credit Derivative Transaction on Asset-Backed Securities. A Credit Default Swap for which the Reference Obligation is a cash or synthetic asset-backed security. Such a transaction may, but need not necessarily, include “pay as you go” settlements, meaning that the credit protection seller makes payments relating to interest shortfalls, principal shortfalls and write-downs arising on the Reference Obligation and the credit protection buyer makes additional fixed payments of reimbursements of such shortfalls or write-downs.

Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument.

Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and or final exchanges of amounts corresponding to the notional amounts.

Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

Currency Swap. A transaction in which one party pays fixed periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

Economic Statistic Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency by reference to interest rates or other factors and the other party pays or may pay an amount or periodic amounts of a currency based on a specified rate or index pertaining to statistical data on economic conditions, which may include economic growth, retail sales, inflation, consumer prices, consumer sentiment, unemployment and housing.

Emissions Allowance Transaction. A transaction in which one party agrees to buy from or sell to the other party a specified quantity of emissions allowances or reductions at a specified price for settlement either on a "spot" basis or on a specified future date. An Emissions Allowance Transaction may also constitute a swap of emissions allowances or reductions or an option whereby one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which the specified quantity of emissions allowances or reductions exceeds or is less than a specified strike. An Emissions Allowance Transaction may be physically settled by delivery of emissions allowances or reductions in exchange for a specified price, differing vintage years or differing emissions products or may be cash settled based on the difference between the market price of emissions allowances or reductions on the settlement date and the specified price.

Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity of shares of an issuer to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

<u>Equity Index Option</u>. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

<u>Equity Option</u>. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) shares of an issuer or a basket of shares of several issuers at a specified strike price. The share option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

<u>Equity Swap</u>. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor's 500 Index.

<u>Floor Transaction</u>. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor).

<u>Foreign Exchange Transaction</u>. A transaction providing for the purchase of one currency with another currency providing for settlement either on a "spot" or two-day basis or a specified future date.

<u>Forward Rate Transaction</u>. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

<u>Freight Transaction</u>. A transaction in which one party pays an amount or periodic amounts of a given currency based on a fixed price and the other party pays an amount or periodic amounts of the same currency based on the price of chartering a ship to transport wet or dry freight from one port to another; all calculations are based either on a notional quantity of freight or, in the case of time charter transactions, on a notional number of days.

<u>Interest Rate Option</u>. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

<u>Interest Rate Swap</u>. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency

based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a commodity, such as coal, electricity or gas, at a fixed or floating price for actual delivery on one or more dates.

Property Index Derivative Transaction. A transaction, often structured in the form of a forward, option or total return swap, between two parties in which the underlying value of the transaction is based on a rate or index based on residential or commercial property prices for a specified local, regional or national area.

Repurchase Transaction. A transaction in which one party agrees to sell securities to the other party and such party has the right to repurchase those securities (or in some cases equivalent securities) from such other party at a future date.

Securities Lending Transaction. A transaction in which one party transfers securities to a party acting as the borrower in exchange for a payment or a series of payments from the borrower and the borrower's obligation to replace the securities at a defined date with identical securities.

Swap Deliverable Contingent Credit Default Swap. A Contingent Credit Default Swap under which one of the Deliverable Obligations is a claim against the Reference Entity under an ISDA Master Agreement with respect to which an Early Termination Date (as defined therein) has occurred.

Swap Option. A transaction in which one party grants to the other party the right (in consideration for a premium payment), but not the obligation, to enter into a swap with certain specified terms. In some cases the swap option may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity"), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation.

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.