

Statutory netting, contractual subordination and non-petition provisions under Jersey Law

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| Background

As financing transactions have become more sophisticated over the last decade, it has been common for parties to a transaction to agree in advance matters relating to:

1. The manner in which respective debts and credits between the parties will be calculated upon the happening of a defined event so that a single payment is to be made from one party to another ("netting"). In particular, netting provisions play a large part in the standard Master Agreements produced by the International Swap and Derivatives Association Inc. ("ISDA").
2. The order in which parties will have the priority in respect of claims against another person ("contractual subordination").
3. The circumstances under which one or more parties may take an action to have another person declared bankrupt ("non-petition"). The rating agencies often require debt issuing special purpose vehicles in capital markets transactions to have the protection of non-petition provisions as part of the 'bankruptcy remoteness' analysis.

The Bankruptcy (Netting, Contractual Subordination and Non-Petition Provisions) (Jersey) Law 2005 (the "Law") ensures certainty to parties entering into agreements involving netting, contractual subordination or non petition provisions.

This briefing note contains an overview of the provisions of the Law.

| Netting and set-off

Pursuant to Article 2 of the Law, notwithstanding any enactment of rule of law to the contrary,

any close-out netting provision or set-off provision in any agreement is enforceable in accordance with its terms. This will be the case regardless of the bankruptcy of a party to the agreement or of any other person or the lack of any mutuality of obligation between a party to the agreement and any other person. The Law provides that such provisions will be enforceable against any of the parties to the agreement, any guarantor or person providing security for a party to the agreement and any creditor of a party to the agreement.

The definition of an “agreement” is widely drafted to include any agreement between two or more parties, a series of inter-related agreements between two or more parties (whether pursuant to a master netting agreement or otherwise) or an agreement made between parties whether or not acting through multiple branches and whether operated through a clearing house system or otherwise.

The Law defines “netting” as the conversion, into one net claim or one net obligation, of all claims and obligations arising under the agreement to the effect that only a net claim can be demanded or a net obligation is owed.

A “close-out netting provision” means so much of an agreement as relates to:

1. there ceasing to be any time allowed for the performance of an obligation specified in the agreement on the occurrence of an event specified in the agreement, including its automatic termination (such as provided in the ISDA Master Agreement);
2. an obligation in an agreement to pay a specified amount but not immediately becoming an obligation to pay an amount determined pursuant to the agreement; or
3. any combination of the above, whether through the operation of netting or otherwise.

A “set-off provision” means so much of any agreement, other than a close-out netting provision, as relates to the netting of amounts due from one party to the agreement to any other party to it.

Contractual subordination

Pursuant to Article 2 of the Law, notwithstanding any enactment of rule of law to the contrary, any contractual subordination provision in any agreement is enforceable in accordance with its terms. As with close-out netting provisions and setoff provisions, this will be the case regardless of the bankruptcy of a party to the agreement.

The Law provides that such provisions will be enforceable against any of the parties to the agreement, any guarantor or person providing security for a party to the agreement and any creditor of a party to the agreement.

The Law defines “contractual subordination” as the subordination or deferral of all or any part

of a claim of one party to the agreement against a debtor of that party to the claim of any other creditor of that debtor.

Non-petition

Article 3 of the Law provides that any non-petition provision in an agreement is enforceable in accordance with its terms despite the bankruptcy of a party to the agreement or any other person or the lack of mutuality of obligation between the party to the agreement and any other person. Article 3 expressly states that the Royal Court is bound to refuse to grant any application which, if granted, would be inconsistent with the non-petition provision in any agreement.

Further provisions

Under Article 4 of the Law, any provision which relates to:

1. a system or mechanism to be used to convert a non-financial obligation to a monetary obligation of an equivalent value;
2. a system or mechanism to be used to value a non-financial obligation for netting purposes;
3. a rate of exchange or the method to be used to establish the rate of exchange to be applied for netting purposes when the sums to be netted are in different currencies;
4. the method to be used to establish the currency in which payment is to be effected; or
5. how certain transactions or other dealings or a type or class of transactions or dealings carried out pursuant to the agreement are to be treated as a single transaction or dealing for netting purposes,

shall be enforceable despite the bankruptcy of a party of the agreement or of any other person or the lack of mutuality or obligation between the party to the agreement and any other person.

Article 6 of the Law provides that close-out netting provisions, contractual subordination provisions, non-petition provisions and setoff provisions in any agreement shall also be valid and enforceable in Jersey where one of the parties to the agreement is a branch in Jersey of a body corporate established outside Jersey despite any other enactment or rule of law that may be applicable to such body corporate, including the law of the jurisdiction under which it is established.

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