

Reflections on the *Metavante* decision and the ISDA Master Agreement: The British Virgin Islands perspective

On 15 September 2009¹ the judge responsible for the Lehman bankruptcy proceedings in the United States held that Metavante Corporation (“Metavante”) could not rely on Section 2(a)(iii) of the ISDA Master Agreement to suspend payments to Lehman Brothers Special Financing, Inc. (“LBSF”). Specifically, Judge Peck held that the safe harbour provisions in the US bankruptcy code protected a non-defaulting party’s contractual rights to liquidate, terminate or accelerate swaps and to net termination values but did not provide a basis to withhold performance under a swap if it did not terminate. The ruling in the Metavante case contrasts with that in a 2003 case heard in Australia relating to the Enron collapse² which upheld the right to suspend payments. Commentators are reasonably asking: if the US bankruptcy regime has taken one position and the Australian insolvency regime another, what will be the position taken in other jurisdictions?

This note considers the position in the British Virgin Islands (“BVI”) and confirms the historic view that a court in the BVI would uphold the contractual provisions of Sections 2(a)(iii) and 6(a) on the occurrence of a Section 5(a)(vii) bankruptcy event in respect of a BVI counterparty whether or not Automatic Early Termination has been selected.

It should perhaps be stressed that in both the Metavante case and the Enron case, the question was not over the validity of Section 2(a)(iii) as a contractual provision, but whether or not that provision was affected by national bankruptcy laws. In the Enron case Judge Austin held that Australia’s bankruptcy laws did not permit the court to deprive the counterparty of its contractual rights. The court specifically upheld the contractual right not to designate an Early Termination Date and the right under Section 2(a)(iii) to suspend performance indefinitely, and thereby effectively upheld the English common law position accepting the right to terminate a contract after the happening of a designated event by giving express notice. While a court in the BVI is not obliged to follow Australian judgments, a BVI court would, absent BVI case law or BVI statute that suggested otherwise, find judgements of courts in English common law jurisdictions persuasive. Furthermore, the reasoning in the Enron case accords with established BVI law: a liquidator under BVI law is in no stronger a position to force a counterparty to perform when an express contractual provision permits them to withhold performance.

Part XVII of the BVI Insolvency Act³ contains provisions based on the ISDA Model Netting Act which are designed to uphold the terms of financial contracts relating to termination through insolvency of a BVI counterparty. These protect “provisions

¹ re Lehman Brothers Holdings Inc., Case No. 08-13555 (JMP) (Bankr. SDNY Sept. 15, 2009)

² Enron Australia v. TXU Electricity [2003] NSWSC 1169

³ Insolvency Act, 2003, Part XVII (Netting and Financial Contracts)

relating to netting, the set off of money provided by way of security, the enforcement of a guarantee and the enforcement of a collateral arrangement and the set off of proceeds thereof, as contained within a netting agreement”⁴. While an ISDA Master Agreement will nearly always constitute a netting agreement for the purposes of these provisions, much like the US bankruptcy code safe harbour provisions it must be doubtful whether these provisions would protect a term such as Section 2(a)(iii) allowing a non-defaulting counterparty to withhold performance (if such a term would otherwise be unenforceable under BVI law).

Having said that, neither English common law nor BVI insolvency law appear to give a liquidator any grounds to attack the Sections 2(a)(iii) and 6(a). In particular there is no provision of BVI insolvency law that ought to allow a liquidator to compel a non-defaulting party to terminate (at least until the contractual right occurs as a result of a default in respect of that party as well) or would invalidate the right to withhold performance under Section 2(a)(iii). This is consistent with existing case law upholding the enforceability of “flawed asset” arrangements in the event of insolvency.

Both the *Metavante* and the *Enron* cases related to transactions where Automatic Early Termination was not selected. Were Automatic Early Termination to be selected, the Section 2(a)(iii) issues arising in the *Metavante* and *Enron* cases would not arise. Whether or not Automatic Early Termination has been selected, there is therefore no reason to change the historical view that Sections 2(a)(iii) and 6(a) will be enforceable in the BVI on the occurrence of a Section 5(a)(vii) bankruptcy event in respect of a BVI counterparty, and parties entering into swaps with BVI counterparties may feel reassured that BVI insolvency law will not interfere with the enforceability of those provisions.

FURTHER INFORMATION

For further information please contact Russell Willings (Russell.willings@harneys.com) or Colin Riegels (colin.riegels@harneys.com).

www.harneys.com

⁴ Insolvency Act, 2003, s.435