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Derivatives

The 1992 ISDA Master Agreement Says Notice Can Be Given Using an "Electronic Messaging System"; If You Think That Means "E-Mail," Think Again

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That was the conclusion of the High Court of England and Wales just last month in *Greenclose Limited v. National Westminster Bank PLC*, [2014] EWHC 1156 (Ch) (available on Westlaw at 2014 WL 1219575).

The English Court Litigation

In October 2006, U.K. hotel operator Greenclose entered into a £15,000,000 lending facility with Allied Irish Bank pursuant to which Greenclose was required to enter into an interest-rate hedging transaction as a condition to drawing on the facility. Greenclose entered into a five-year interest-rate collar governed by a 1992 ISDA Master Agreement. Under the terms of the transaction, the bank (to which National Westminster (NatWest) is the successor) had the right to extend the term of the collar for two additional years by giving notice to Greenclose before 11 a.m. on December 30, 2011.

In December 2011, the collar was in the money to NatWest, making it advantageous to exercise the extension right.[1] At 9:45 a.m. on December 30, 2011, NatWest sent an e-mail to Greenclose purporting to exercise the bank's extension right.

Greenclose disputed the validity of NatWest's purported notice on the grounds that e-mail was not a method of notice permitted by the parties' agreement. NatWest argued that the 1992 ISDA Master Agreement allowed for notice to be given using, among other things, an "electronic messaging system," and contended that e-mail constituted such a system. Litigation followed, and the case went to trial, with three days of hearings being conducted in March 2014.

The English Court's Decision

In an opinion by Mrs. Justice Andrews dated April 14, 2014, the court found for Greenclose, holding that NatWest's notice was invalid because it was not given using a contractually approved method. The key findings in the opinion were:

- The methods of notice specified in Section 12(a) of the 1992 ISDA Master Agreement are mandatory; no other methods are permitted absent express provision to the contrary in the Schedule or otherwise. (¶ 125.)
- Section 12(a)'s reference to an "electronic messaging system" does not mean e-mail. (¶ 129.) The court's conclusion focused on two facts. First, the parties had not included an e-mail address in the portion of Schedule to their ISDA Master Agreement setting forth notice addresses, fax numbers, and other details. (¶ 125 ("regardless of whether the phrase 'electronic messaging system' includes email, no email address was ever specified in the Schedule for the purposes of giving notice under this agreement. Thus the contracting parties did not intend notices to be served by email").) This omission was treated as an indication that the parties had not intended notice to be given by e-mail.

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Second, the court observed that e-mail was not in common usage in 1992, noting that the 2002 form of the ISDA Master Agreement expressly allows for e-mail notice, which indicated that it had not previously been permitted. (¶¶ 108, 129.)

- NatWest was required not merely to serve notice "on" Greenclose, but to give notice "to" Greenclose such that Greenclose actually had to have received notice before the deadline, not that it merely had arrived by then. (¶ 135.) Due to the closure of Greenclose's offices during the period when the notice was due, there was a substantial question whether Greenclose actually received NatWest's notice, and the *Greenclose* opinion contains a painstaking analysis of whether it did in light of conflicting evidence about the delivery of automated "out of office" replies. In the end, the *Greenclose* court's conclusion on this point arguably is dictum since the notice was held to be invalid in any event.

So What Is an "Electronic Messaging System"?

The most surprising finding is clearly the determination that e-mail is not an "electronic messaging system." The court indicated that such a system must have the following characteristics:

- It must be a recognized system expressly set up for the purpose of transmitting electronic messages. (*Greenclose*, at ¶ 131.) A computer does *not* constitute such a system, according to the *Greenclose* court, since it does more than just transmit messages.
- The system must provide for clear evidence of the fact, time, and date of receipt of messages. (Id. at ¶ 132.)

The *Greenclose* court pointed to SWIFT messaging as an example of something that qualifies as an "electronic messaging system." It remains unclear what other systems – for example, Bloomberg messaging or instant messaging – might also qualify.

Significance of Greenclose v. NatWest for Users of New York-Law ISDA Master Agreements

The fact that the *Greenclose* decision comes from an English court applying English law does not make it irrelevant to users of ISDA Master Agreements governed by New York law, which normally provide for litigation to be brought in New York courts. A New York court may turn to English (or other foreign) law to interpret a New York-law ISDA Master Agreement for a number of reasons. First, the language of many provisions of English-law and New York-law versions of the ISDA Master Agreement is similar or even identical, and both litigants and courts can be expected to cite English-law precedents interpreting similar or identical language where no New York-law authority is available. See, e.g., *In re Millennium Global Emerging Credit Master Fund Ltd.*,458 B.R. 63, 74 (Bankr. S.D.N.Y. 2011)(citing English case law interpreting provisions of UNCITRAL Model Law on Cross-Border Insolvency in construing similar language in U.S. Bankruptcy Code Chapter 15); *CSX Corp. v. The Children's Investment Fund Management (UK) LLP*, 08-2899-CV, Brief of Amici Curiae International Swaps and Derivatives Association, Inc. and Securities Industry and Financial Markets Association at 20 (2d Cir. July 18, 2008) (citing cases from New Zealand and Canada addressing issue of first impression before Court of Appeals). Moreover, a number of the non-judicial authorities cited by the *Greenclose* court treat identical language the same under both New York and English law, including on the notice issues that were before the court in *Greenclose*. See, e.g.,User's Guide to the 1992 ISDA Master Agreements at 33.

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That said, U.S. courts will not necessarily follow the lead of the English courts. See, e.g., *Lehman Brothers Special Financing, Inc. v. BNY Corporate Trustee Services Ltd.*, 422 B.R. 407, 417 (Bankr. S.D.N.Y. 2010) ("In applying the Bankruptcy Code to these facts, this Court recognizes that it is interpreting applicable law in a manner that will yield an outcome directly at odds with the judgment of the English Courts").[2]

How to Provide for E-mail Notice

A number of factors point toward the importance of e-mail as an available form of notice under the ISDA Master Agreement. E-mail communication has become far more commonplace, reliable, convenient and cost-efficient than any of the other notice methods allowed in the 1992 form of ISDA Master Agreement, some of which have fallen out of use entirely. (When was the last time you sent a telex, a SWIFT message, or even a fax?) Derivatives counterparties also are more geographically dispersed than ever, which can make methods such as hand delivery or certified/registered mail (or even air mail) impracticable, unreliable, or simply too slow.

Nevertheless, for a variety of understandable reasons, derivatives users continue to use the 1992 ISDA Master Agreement form, which does not expressly permit e-mail notice, rather than the more recent 2002 form, which does. If you use a 1992 form, and you absolutely must be able to give notice by e-mail, you may want to consider either amending the Schedule to your 1992 form or switching to the 2002 form. But amending your documents presents the risk of starting an unwanted conversation with your counterparty about other amendments to your documents.

An easier way around the problem would be to provide for e-mail notice – *and* include the relevant e-mail addresses – in individual trade confirmations. This is expressly permitted by Section 1(b) of the ISDA Master Agreement, which states that "In the event of any inconsistency between the provisions of any Confirmation and this Master Agreement (including the Schedule), such Confirmation will prevail for the purpose of the relevant Transaction." This will, of course, apply only to those transactions for which the confirmation allows e-mail notice.

How to Avoid Difficulty in Giving Notice Under the 1992 ISDA Master Agreement

In addition to making sure you have available the forms of notice that you need, it is critical to take care in giving notices that are to have legal significance. The key areas in which NatWest's attempted notice seems to have fallen short were:

- failing to consult the ISDA Master Agreement to determine what form of notice was necessary (*Greenclose*, ¶ 44 ("Mr Tew had not checked the terms of the ISDA Master Agreement or the Schedule. Indeed, he never checked it. Mr Tew always intended to give notice by fax; he decided to do so for no other reason than that it was a standard method of communication with the Bank's customer base));
- using only one method of notice, which turned out not to be a contractually permitted method and which did not provide a clear indication whether it had actually been received; and
- leaving little or no time to spare if the method NatWest chose to use did not work, particularly given that the notice deadline fell in the middle of the holiday season, when Greenclose's offices turned out to be closed.

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Thus, if a party has to give notice under an ISDA Master Agreement (or, indeed, any agreement), it is advisable to use as many contractually permissible methods as possible, to give notice as far as possible in advance of any contractual deadline, and to document thoroughly the counterparty's actual receipt of any notice. It also is recommended that notice addresses be verified regularly and updated as necessary.[3]

To view a copy of the *Greenclose* decision, click here.

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[1] According to the opinion, the cost to Greenclose of continuing the collar was approximately £57,000 per quarter as of the end of 2011. (¶ 40.)

[2] The cross-pollination can be expected to go in both directions: the *Greenclose* court cited a decision of Judge Duffy in the Southern District of New York interpreting the 1987 form of ISDA Master Agreement, which did not permit notices to be served by fax. See *First National Bank of Chicago v. Ackerley Communications Inc.*, No. 94 Civ. 7539 (KTD), 2001 WL 15693 (S.D.N.Y. Jan. 8, 2001), cited in *Greenclose* at ¶ 115.

[3] It is not necessary to amend the Schedule to update notice details. Section 12(b) of the 1992 ISDA Master Agreement states that "Either party may by notice to the other change the address, telex or facsimile number or electronic messaging system details at which notices or other communications are to be given to it."