2002 ISDA Master Agreement

Guide to Principal Changes

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Introduction

On 9 January, 2003, the International Swaps and Derivatives Association, Inc. ("ISDA") announced the publication of its **2002 ISDA Master Agreement** (the "2002 Agreement"). The 2002 Agreement is the result of a review of certain aspects of the 1992 ISDA Master Agreement (the "1992 Agreement") which began in 1999 in light of market difficulties experienced in the late 1990s and developments in market practice since publication of the 1992 Agreement.

Several working groups were formed by ISDA to prepare amendments to various sections of the 1992 Agreement. Initially it was proposed that such amendments be implemented by means of a **Protocol** (as the EMU Protocol had worked well in implementing amendments required by the introduction of European Monetary Union). However, it soon became evident that a Protocol approach would be unworkable given the nature and number of proposed amendments.

In late 2001, ISDA published a number of **standard form amendments** to the 1992 Agreement some or all of which parties could choose to incorporate into their 1992 Agreements on a bilateral basis. At about the same time ISDA decided to update the 1992 Agreement and to incorporate the standard form amendments in the **updated Agreement**. ISDA consulted with a number of market participants on successive drafts of the new master agreement, resulting in publication of the 2002 Agreement.

It remains to be seen to what extent, and when, the 2002 Agreement will be accepted as the new market standard agreement for documenting over-the-counter derivatives transactions. It is possible that the 2002 Agreement will be more readily accepted by derivatives dealers than "end users" as the principal changes to the 1992 Agreement have been put forward by the dealer community. Market participants will need to consider carefully the benefits of modifying their existing transactions to make them subject to the terms of the 2002 Agreement. Parties remain free to continue to use the 1992 Agreement. Similarly, parties wishing to incorporate only some but not all of the terms of the 2002 Agreement (e.g. the Close-out Amount provisions described below) may prefer to do this by way of an amending agreement to the 1992 Agreement.

It is expected that ISDA will publish later this year a "**User's Guide**" to the 2002 Agreement. It is understood that ISDA is also considering whether other ISDA standard documentation (e.g. its Credit Support documentation) will need to be amended to reflect the changes made to the 1992 Agreement.

The purpose of this memorandum is to highlight the **principal changes** made in the 2002 Agreement. The second part of this memorandum contains an outline of those changes. The third part contains a more detailed description of those changes.

It should be noted that the following description is not an exhaustive description of the changes made in the 2002 Agreement.

Outline of Principal Changes

The principal changes are as follows:

- Grace periods reduced for Failure to Pay or Deliver Events of Default, and new definition of Local Delivery Day introduced
- Events of Default expanded to include disclaimer or repudiation (in whole or in part) of the Master Agreement, any Confirmation or any Transaction
- New categories of transactions (e.g. credit derivatives and repos) included in definition of "Specified Transaction" for the purposes of Default under Specified Transaction Event of Default
- Bankruptcy Event of Default amended to restrict the circumstances in which a grace period will apply and to reduce the grace period where it does apply
- Illegality Termination Event amended and Force Majeure Event introduced as a new Termination Event
- Credit Event Upon Merger Termination Event expanded to include change of control and substantial change in capital structure as trigger events, although still subject to "material weakness in creditworthiness" requirement
- Market Quotation and Loss valuation measures replaced by Close-out Amount as a single valuation measure, and First Method for payment removed
- Set-off clause introduced to enable Non-defaulting Party or Non-affected Party to set-off any Early Termination Amount against amounts owing to or from Defaulting Party or Affected Party (whether or not arising under the ISDA Master Agreement)
- Interest and compensation provisions consolidated and developed to reflect different situations in which payment or delivery may not have been made (e.g. default, condition precedent not being satisfied, waiting period following Force Majeure Event or Illegality etc.)
- Absence of Litigation representation and warranty amended to apply only to Credit Support Providers and applicable Specified Entities instead of Affiliates
- Clarification of Section 10(a) (recourse against head/home office of a party) where obligations entered into through a branch office of that party
- Jurisdiction clause amended to reflect Article 17 Brussels and Lugano Conventions provisions relating to non-exclusive and exclusive jurisdiction of the English Courts
- Notice provisions amended to provide for use of e-mail for the purposes of giving notices (other than Section 5 or 6 notices)

Description of Principal Changes

GRACE PERIODS FOR FAILURE TO PAY OR DELIVER; LOCAL DELIVERY DAY

Section 5(a)(i) of the 1992 Agreement states that the grace period for failure to make payment or delivery is three Local Business Days following the giving of notice. Section 5(a)(i) of the 2002 Agreement reduces the grace period to one Local Business Day following the giving of notice in respect of failure to make payment and to one Local Delivery Day following the giving of notice in respect of failure to make delivery.

The reduced grace period reflects concerns expressed by some market participants who had found three Local Business Days after notice to be too long a period during the market turbulence in 1998. At the same time, it was felt that the obligations regarding timing of delivery of assets such as securities and commodities required more flexibility. Accordingly, a new defined term, "Local Delivery Day", has been introduced in Section 14. A Local Delivery Day is a day on which settlement systems necessary to accomplish the relevant delivery are generally open for business so that the delivery is capable of being accomplished in accordance with customary market practice. "Customary market practice" is intended to refer to generally recognised practice with regard to the delivery of securities or other relevant assets in a particular jurisdiction. Problems in a local settlement system on a particular day could result in that day not being a Local Delivery Day as either the settlement system would not be open for business or delivery could not be accomplished due to those problems. A Local Delivery Day may not be the same as a Local Business Day which, in this context, is, broadly, a day on which commercial banks are open for general business (including dealings in foreign exchange and foreign currency deposits) in the specified location.

DISCLAIMER OR REPUDIATION OF AGREEMENT, CONFIRMATION OR TRANSACTION

Section 5(a)(ii)(2) of the 2002 Agreement introduces a new Event of Default where a party (or a person appointed or empowered on its behalf) disaffirms, disclaims, repudiates or rejects, in whole or in part, or challenges the validity of, the 2002 Agreement, any Confirmation or any Transaction evidenced by such a Confirmation. Unlike the Breach of Agreement Event of Default in Section 5(a)(ii)(i) (which is subject to a 30 day grace period), this new Disclaimer/Repudiation Event of Default is not subject to any grace period. As Disclaimer/Repudiation is already an Event of Default under the Default under Specified Transaction provisions in Section 5(a)(v)(3) of the 1992 Agreement and the definition of "Specified Transaction" under the 1992 Agreement includes Transactions entered into under the Agreement, this is more a change of form rather than substance.

DEFAULT UNDER SPECIFIED TRANSACTION

Section 5(a)(v) of the 1992 Agreement provides for an Event of Default if one party (or its Credit Support Provider or an applicable Specified Entity) defaults under specified types of derivatives transactions entered into by such party (or its Credit Support Provider or applicable Specified Entity) and the other party (or its Credit Support Provider or an applicable Specified Entity). It is, in effect, a form of narrow cross-default: narrower than the normal cross-default provisions in that it does not cover transactions with third parties (other than Credit Support Providers and applicable Specified Entities) and is restricted to the specified categories of derivatives transactions falling within the definition of "Specified Transaction".

The corresponding provisions in the 2002 Agreement are broadened in two ways. First, the definition of "Specified Transaction" in Section 14 is expanded to include more recent financial products such as credit derivatives, weather index derivatives, repos, reverse repos, buy/sell backs, securities lending and forward purchase and sale agreements and other similar transactions which are not generally documented under ISDA Master Agreements but under other master documentation. The definition has also been expanded to clarify that transactions in new products of a similar type which are entered into as the market evolves over time will become "Specified Transactions" for these purposes. The amended definition of "Specified Transaction" in the 2002 Agreement makes clear, however, that it does not include any Transactions entered into under the Agreement. Secondly, Default under Specified Transaction has been broadened to cover not only a default under a Specified Transaction but also a default under any credit support arrangement relating to a Specified Transaction.

During the consultation process, several market participants expressed concerns that the addition of transactions such as repos and securities lending transactions to the definition of "Specified Transaction" could have the effect of making a failure to deliver securities that is not an event of default under the relevant repo or securities lending agreement into an Event of Default under the 2002 Agreement (noting that failures to deliver occur with some frequency in connection with repo and securities lending transactions due to administrative or settlement system problems rather than credit-related problems). In response to this concern, Section 5(a)(v) in the 2002 Agreement provides that Default under Specified Transaction will be triggered by a failure to deliver only if such failure results in a liquidation of, an acceleration of obligations under, or an early termination of, all transactions outstanding under the documentation applicable to that Specified Transaction. This means, therefore, that the "mini close-out" mechanics that apply on a default in making a delivery (which are applicable to a single transaction) found in certain repo and securities lending master agreements will not trigger the Default under Specified Transaction provisions of the 2002 Agreement unless and until there is a "full close-out" in respect of all transactions under the relevant master agreement.

BANKRUPTCY

Under Section 5(a)(vii) of the 1992 Agreement, no grace period applies where a party (or its Credit Support Provider or applicable Specified Entity) commences formal bankruptcy or insolvency proceedings in respect of itself. However, where the proceedings are commenced by a third party, there is a 30 day grace period and no Event of Default is triggered if the proceedings are dismissed or discharged during that period.

During consultation on the 2002 Agreement some market participants expressed the view that insolvency proceedings commenced by any regulator or official with primary insolvency or regulatory jurisdiction over a party should be treated differently from proceedings commenced by other third parties on the basis that it is unlikely that such a regulator or official would commence proceedings in bad faith or without foundation. Further, based on their experience of market difficulties in the late 1990s, they considered that a grace period of 30 days was, in any event, too long.

Under Section 5(a)(vii)(4)(A) of the 2002 Agreement a grace period does not apply where the insolvency proceedings are instituted by a regulator, supervisor or any similar official with primary insolvency, rehabilitative or regulatory jurisdiction over the party (its Credit Support Provider or any applicable Specified Entity of such party) in the jurisdiction of its incorporation or organisation or the jurisdiction of its head or home office. Under Section 5(a)(vii)(4)(B), where the grace period continues to apply (i.e. proceedings commenced by "real" third parties), it is reduced from 30 to 15 days. The same reduction in grace period has been introduced, by Section 5(a)(vii)(7), in relation to execution, attachment or similar legal process commenced by secured creditors.

FORCE MAJEURE EVENT AND ILLEGALITY

The 1992 Agreement contains an Illegality Termination Event in Section 5(b)(i), but does not contain a "Force Majeure" or "Impossibility" Termination Event. Whilst the latter was discussed in the period leading up to publication of the 1992 Agreement, the ISDA User's Guide to the 1992 Agreement explains that there was insufficient consensus for its inclusion in the 1992 Agreement (although suggested language for an "Impossibility" provision was included in the User's Guide).

Subsequently, various definitions booklets (e.g. the 1998 FX and Currency Options Definitions published by ISDA, the Emerging Markets Traders' Association and The Foreign Exchange Committee) contained provisions that are intended to allow parties to deal with force majeure and impossibility in relation to specific transactions. In response to concerns expressed by its members, ISDA established a Force Majeure and Impossibility Working Group to consider whether it was appropriate to establish a standard set of provisions to address force majeure and impossibility issues at a master agreement level and to amend the existing illegality provisions. The Working Group decided that it was appropriate to do so.

The Illegality and Force Majeure Event provisions in the 2002 Agreement are complex. In summary, the 2002 Agreement amends the existing Illegality provisions, includes Force Majeure Event as a new Termination Event, and, in relation to both Illegality and Force Majeure Event, introduces the concept of a Waiting Period during which payment and delivery obligations are deferred and termination rights cannot be exercised. It also amends the close-out valuation provisions where Illegality or Force Majeure Event applies.

As under the 1992 Agreement, Illegality under the 2002 Agreement addresses circumstances that make it unlawful under applicable law to perform payment or delivery obligations. However, a number of specific changes and clarifications have been made in Section 5(b)(i). First, it is expressly stated that the Illegality provisions only apply after giving effect to any applicable provision, disruption fallback or remedy specified in, or pursuant to, the relevant Confirmation or elsewhere in "this Agreement" (which includes any such provisions in the ISDA Schedule and any relevant Definitions Booklets incorporated by reference into the Agreement). Secondly, in determining whether performance of an obligation has become unlawful "due to an event or circumstance … occurring after a Transaction is entered into", it provides that "any action taken by a party or, if applicable, any Credit Support Provider of such party" shall not constitute such an event or circumstance. Thirdly, the meaning of "applicable law" is clarified to include, without limitation, the laws of any country in which payment, delivery or compliance is required by either party or any Credit Support Provider (in order to give recognition to the fact that laws other than the governing law of the Agreement may also affect the parties' obligations).

The new Force Majeure Event in Section 5(b)(ii) of the 2002 Agreement relates to the occurrence of an event of force majeure or act of state which prevents or makes it impossible or impracticable for a party to make or receive a payment or delivery obligation in respect of a transaction or to comply with any other material provision. Any such force majeure or act of state must be beyond the control of the party or, if applicable, its Credit Support Provider and there is a further requirement that such party or Credit Support Provider could not, after using all reasonable efforts (which will not require such party or Credit Support Provider to incur a loss, other than immaterial, incidental expenses), overcome such prevention, impossibility or impracticability.

The terms "force majeure" and "act of state" are not defined in Section 14 of the 2002 Agreement. It was felt by the relevant Working Group that the question of whether or not an event constitutes a force majeure is a matter for judicial interpretation and that it would be unhelpful to specify the types of events that would fall within the meaning of that term. However, it is understood that the term is intended to cover events such as change in law, natural or man-made disaster, armed conflict, act of terrorism, riot, labour disputes and any other circumstances beyond the control of a party or its Credit Support Provider.

In the case of both Illegality and Force Majeure Event, the determination of whether or not it would be lawful, possible or practicable for a party or its Credit Support Provider to perform on a given day is made on the premise that performance of the relevant obligation is required on that day - i.e. the Illegality or Force Majeure Event occurs upon the occurrence of the relevant event, irrespective of whether payment or delivery is actually due on that day.

As with Illegality, Section 5(b)(ii) states that the Force Majeure Event provisions will only apply after giving effect to any applicable provision, disruption fallback or remedy specified in, or pursuant to, the relevant Confirmation or elsewhere in "this Agreement". Similarly, the Force Majeure Event provisions apply not only to the performance by the office through which a party makes and receives payments and deliveries with respect to a transaction, but also to the performance by a party or its Credit Support Provider under a Credit Support Document.

Both Illegality and Force Majeure Event are made subject to a "Waiting Period" - that is, an event that would otherwise constitute an Illegality or a Force Majeure Event will only become a Termination Event if the relevant Waiting Period has expired. The Waiting Period creates a "wait and see" period during which neither party is entitled to terminate transactions. During this period, all payment and delivery obligations under transactions affected by the Illegality or Force Majeure Event are deferred and do not become due until the Waiting Period has expired. The Waiting Period for Illegality is three Local Business Days following the occurrence of the relevant event, and the Waiting Period for Force Majeure Event is eight Local Business Days following the occurrence of the relevant event.

The inclusion of a Waiting Period reflected a concern to avoid transactions being terminated before there had been an appropriate passage of time to see whether the relevant difficulties could be resolved and to assess their impact on the transactions. The reason for having Waiting Periods of different duration reflects the thinking of the Force Majeure and Impossibility Working Group as to the different consequences that it considered likely to follow an Illegality and a Force Majeure Event. It was thought that the scope and extent of events falling within the definition of Illegality would be capable of being ascertained in a relatively short period of time, but that the effect of these events (such as a change in law) would be likely to be longer-lasting than for Force Majeure Events. Consequently, a Waiting Period of three Local Business Days was thought to be appropriate for these events. On the other hand, it was thought that the impact of the wide range of events that may constitute a Force Majeure Event may not be clear for a number of days after the event, but that the effect of such events may be short-lived, in which case a right of termination may be inappropriate. Consequently, it was thought that a longer Waiting Period of eight Local Business Days would be appropriate for Force Majeure Events.

A new Section 5(d) in the 2002 Agreement provides that, during the Waiting Period, the parties' payment and delivery obligations in relation to a transaction affected by Illegality or a Force Majeure Event will be deferred and will not be due until the first Local Business Day (or, in the case of a delivery, the first Local Delivery Day) following the end of the Waiting Period.

Unlike the position in relation to Illegality under Section 6(b)(ii) of the 1992 Agreement, there is no requirement under the 2002 Agreement for the parties to use reasonable efforts to transfer transactions affected by Illegality or Force Majeure Event to another office or affiliate as a condition to exercising termination rights. Once the Waiting Period expires and if the event is still continuing it will be a Termination Event entitling either party to terminate some or all affected transactions. The main reason for permitting "partial termination" was the view that the impact of an event on the economics of a transaction may be different from case to case; for example, transactions forming part of a structured financing (e.g. a swap transaction forming part of a repackaging or securitisation) may not be capable of being replaced at a commercially reasonable price and, therefore, the economic disadvantages of terminating such transactions may outweigh the potential benefits of termination. However, if a party elects to terminate only some of the affected transactions, the other party is given the right to elect to terminate (with effect from the same early termination date) some or all of the remaining affected transactions. It was considered that this approach would discourage a party from electing to terminate only those transactions that are in its favour since the other party could terminate the remaining transactions.

The close-out provisions relating to Illegality and Force Majeure Event provide for the Early Termination Amount relating to affected transactions to be calculated on the basis of mid-market values.

CREDIT EVENT UPON MERGER

Under Section 5(b)(iv) of the 1992 Agreement the "Credit Event Upon Merger" provision applies where a party (or its Credit Support Provider or applicable Specified Entity) consolidates with, merges with or into, or transfers all or substantially all of its assets to another entity and the creditworthiness of the surviving or transferee entity is materially weaker than that of the transferor immediately prior to such action. The occurrence of a Credit Event Upon Merger constitutes a Termination Event.

Under Section 5(b)(v) of the 2002 Agreement the Credit Event Upon Merger provisions have been expanded to include two events additional to those referred to above. These additional events are: change of control transactions and substantial changes in capital structure which, in each case, result in the creditworthiness of a party (or its Credit Support Provider or applicable Specified Entity) being materially weaker than it was immediately prior to the transaction in question. The language of the "substantial changes in capital structure" event (each of the three events is now called a "Designated Event") is particularly broad in that it refers to any substantial change in capital structure by means of the issuance, incurrence or guarantee of debt or the issuance of preferred stock or other securities convertible into or exchangeable for debt or preferred stock. Corporate users are likely to have some concerns regarding the breadth of the new "Designated Events". Under a further change, it is now expressly provided that parties must take into account any applicable Credit Support Documents in determining whether or not the creditworthiness of any successor, surviving or transferee entity is "materially weaker".

CLOSE-OUT AMOUNT (AND REPLACEMENT OF MARKET QUOTATION AND LOSS)

Under the 1992 Agreement, if transactions are terminated following an Event of Default or a Termination Event, an early termination amount is calculated in accordance with whichever of the Market Quotation or Loss measure is selected by the parties in their ISDA Schedule.

These valuation measures had been under review following the market difficulties in the late 1990s and also in light of the increased number of complex, structured transactions involving derivatives since the 1992 Agreement was published.

Whilst Market Quotation had worked well, particularly for non-complex transactions in stable markets where price quotations are readily available, some market participants had experienced difficulties in obtaining appropriate price quotations in turbulent markets (particularly for complex, structured transactions). On the other hand, whilst the Loss measure had provided greater flexibility in valuing complex, structured transactions, concern had been expressed that too much discretion was left in the hands of the determining party. In addition, the market had witnessed the development of sophisticated internal valuation systems which, it was suggested, provided a more appropriate methodology for valuing transactions (particularly the complex transactions). Finally, certain decisions made by the English courts during this period created some uncertainty as to the construction of these provisions.

After extensive consultation on this subject a consensus developed that a single valuation measure be adopted to replace Market Quotation and Loss. In the 2002 Agreement, that single valuation measure is known as the "Close-out Amount". Market Quotation and Loss have been removed from the 2002 Agreement. The First Method of payment has also been removed as it has very rarely been selected by parties in their ISDA Schedules (largely owing to the unfavourable regulatory capital treatment that applies to regulated financial institutions if the First Method is selected).

Close-out Amount means, with respect to each terminated transaction or each group of terminated transactions, the amount of the losses or costs that a Determining Party would incur (or the amount of the gains that a Determining Party would receive) in replacing or providing (for the Determining Party) the economic equivalent of (a) the material terms of the terminated transaction (or group of terminated transactions), including payments and deliveries contemplated under such transaction(s) and (b) the option rights of the parties in respect of the terminated transaction (or group of terminated transactions). Unlike the definition of Market Quotation in the 1992 Agreement (which refers to "the economic equivalent of any payment or delivery"), the definition of Close-out Amount refers to "the economic equivalent of the material terms of the terminated transactions" (including the contemplated payments and deliveries) thus recognising that the value of a transaction does not depend simply on the future payments and deliveries provided for by it.

The lengthy definition of Close-out Amount in Section 14 of the 2002 Agreement covers, broadly speaking, two areas: first, the procedures to be followed in determining the Close-out Amount and, secondly, the type of information that can be taken into account in determining the Close-out Amount.

The basic procedural principle is that, in determining a Close-out Amount, the Determining Party (or its agent) must "act in good faith and use commercially reasonable procedures in order to produce a commercially reasonable result". The other procedural principles are as follows. First, the Determining Party may determine a Close-out Amount for any individual terminated transaction or any group of terminated transactions but, in the aggregate, for not less than all terminated transactions. Secondly, each Close-out Amount is to be determined as of the relevant Early Termination Date or, if that would not be commercially reasonable, as of such date or dates following the Early Termination Date as would be commercially reasonable. This flexibility was considered to be important, particularly in valuing large portfolios or in illiquid markets.

The definition then goes on to provide a detailed but non-exhaustive list of relevant information that a Determining Party may (but is not obliged to) take into account in determining a Close-out Amount. This includes (i) quotations (either firm or indicative) for replacement transactions supplied by one or more third parties that may take into account the creditworthiness of the Determining Party at the time the quotation is provided (there was no express reference to creditworthiness in the 1992 Agreement) and the terms of any relevant documentation (including credit support documentation) between the Determining Party and the third party providing the quotations; (ii) relevant market data supplied by one or more third parties, including relevant rates, prices, yields, yield curves, volatilities, spreads and correlations; and (iii) information of the types described in (i) and (ii) above from internal sources (including any of the Determining Party's Affiliates) if that information is of the same type used by the Determining Party in the regular course of its business for the valuation of similar transactions.

In order to retain objectivity, the Determining Party is required to consider third party quotations or relevant market data (as described in (i) and (ii) above) unless it reasonably believes in good faith that such quotations or relevant market data are not readily available or would produce a result that would not satisfy the standards set out in the definition.

The definition states that a Determining Party may (in calculating a Close-out Amount) consider any loss or cost incurred in connection with terminating, liquidating or re-establishing any hedge related to a terminated transaction or group of terminated transactions (or any gain resulting from any of them) so long as there is no duplication of amounts otherwise calculated under the definition, and so long as it is commercially reasonable to do so. In the 1992 Agreement, this was included in the definition of "Loss" but not in the definition of "Market Quotation".

The definition acknowledges that "commercially reasonable procedures" used in determining a Close-out Amount may include the use of internal pricing or other valuation models (provided that such models are used by the Determining Party at that time in the regular course of its business in pricing or valuing transactions with unrelated third parties that are similar to the terminated transactions or group of terminated transactions) and the application of different valuation methods to terminated transactions (or groups of terminated transactions) depending on their type, complexity, size or number. This permits, for example, a Determining Party to distinguish between simple and complex transactions and between transactions where the underlying markets are liquid or illiquid.

Finally, it is worth noting that, under Section 6(e)(ii)(3) of the 2002 Agreement, the Close-out Amount calculated following the occurrence of certain Termination Events (including the new Force Majeure Event and Illegality) is to be calculated using mid-market quotations/values.

SET-OFF

The 1992 Agreement did not include a set-off provision. Section 6(f) of the 2002 Agreement provides a set-off provision substantially similar to the bilateral set-off provision which is often included by parties in their ISDA Schedule. It provides that an Early Termination Amount payable to one party (the "Payee") by the other party (the "Payer"), in circumstances where there is a Defaulting Party will, at the option of the Non-defaulting Party, be reduced by its set-off against any other amounts payable by the Payee to the Payer (whether or not arising under the Agreement, whether or not matured or contingent and irrespective of the currency, place of payment or place of booking of the obligation). The Non-defaulting Party is required to give notice to the Defaulting Party of any set-off effected under Section 6(f).

This set-off provision applies in the same way where there is one Affected Party in the case where either a Credit Event Upon Merger or any other Termination Event in respect of which all outstanding Transactions are Affected Transactions has occurred.

The set-off provision goes on to provide that either the Early Termination Amount or the other amounts may be converted into the currency in which the other is denominated at the rate of exchange at which such party would be able, in good faith and using commercially reasonable procedures, to purchase the relevant amount of such currency. If an obligation is unascertained, the Non-defaulting Party may in good faith estimate that obligation and set-off in respect of the estimate, subject to the relevant party accounting to the other when the obligation is ascertained. Finally, it provides that nothing in Section 6(f) will be effective to create a charge or other security interest, and that it will be without prejudice and in addition to any right of set-off, combination of accounts etc. to which any party is otherwise entitled or subject (whether by operation of law, contract or otherwise).

INTEREST AND COMPENSATION PROVISIONS

As well as consolidating the existing provisions in the 1992 Agreement for payments of interest and compensation, the 2002 Agreement has introduced new provisions relating to compensation for defaulted deliveries and for deferrals under the new Force Majeure Event and Illegality "waiting period" regime, and also provides for interest to be payable where a payment is withheld because a condition precedent under Section 2(a)(iii) is not satisfied. These provisions are now contained in Section 9(h) of the 2002 Agreement. This section, together with the related definitions of "Applicable Close-out Rate", "Applicable Deferral Rate", "Default Rate", "Non-default Rate" and "Termination Rate" provide very detailed and complex provisions relating to the interest and compensation payment obligations that arise in a number of different scenarios.

Section 9(h)(i) addresses various interest and compensation payments payable prior to Early Termination. These include: (1) Interest on Defaulted Payments, (2) Compensation for Defaulted Deliveries, (3) Interest on Deferred Payments and (4) Compensation for Deferred Deliveries. The basic rule is that, if there is a Defaulting Party, it will have to pay interest or compensation at the Default Rate. If there is no Defaulting Party, for example, where there are deferred payment and delivery obligations, interest is payable at the Applicable Deferral Rate. It is this defined term which applies a particular rate to the particular situation, distinguishing between deferrals due to the Section 2(a)(iii) conditions precedent not being satisfied, deferrals whilst a Waiting Period applies and deferrals whilst Illegality or Force Majeure Event continue to apply following the expiry of the Waiting Period but prior to early termination.

Section 9(h)(ii) addresses interest and compensation payable on Early Termination. It provides for interest on Unpaid Amounts and on Early Termination Amounts to be paid at the Applicable Close-out Rate. In respect of Unpaid Amounts, the definition of Applicable

Close-out Rate distinguishes between obligations payable or deliverable by a Defaulting Party (in which case the Applicable Close-out Rate is the Default Rate), obligations payable or deliverable by a Non-defaulting Party (in which case the Applicable Close-out Rate is the Non-default Rate) and all other cases (where the Applicable Close-out Rate is the Applicable Deferral Rate). The term "Applicable Rate" in the 1992 Agreement has, therefore, been replaced by the terms "Applicable Deferral Rate" and "Applicable Close-out Rate".

In respect of an Early Termination Amount, the definition draws a distinction between two periods: first, the period from (and including) the relevant Early Termination Date to (but excluding) the date on which that amount is payable and, secondly, the period from (and including) the date on which that amount is payable to (but excluding) the date of actual payment. In respect of the first period, the Applicable Close-out Rate is the Default Rate (if the Early Termination Amount is payable by a Defaulting Party), the Non-default Rate (if the Early Termination Amount is payable by a Non-defaulting party) and the Applicable Deferral Rate (in all other cases). In respect of the second period, the starting point is that the Applicable Deferral Rate will apply if a party (whether a Defaulting Party or a Non-Defaulting Party) fails to pay the Early Termination Amount due to the occurrence of an event or circumstance which would (had it occurred with respect to a payment or delivery under a transaction) constitute or give rise to an Illegality or Force Majeure Event and for so long as the Early Termination Amount remains unpaid due to the continued existence of such event or circumstance. In other cases, the Applicable Close-out Rate is the Default Rate (if the Early Termination Amount is payable by a Defaulting Party), the Non-default Rate (if the Early Termination Amount is payable by a Non-defaulting Party) and the Termination Rate (in all other cases). As under the 1992 Agreement, the "Termination Rate" means the cost to the party of funding such amount.

Section 9(h)(iii) states that any interest to be paid pursuant to Section 9(h) will be calculated on the basis of daily compounding and the actual number of days elapsed.

CHANGES TO REPRESENTATIONS AND WARRANTIES

The Absence of Litigation representation and warranty in Section 3(c) of the 1992 Agreement relating to a party's "Affiliates" has always been the subject of negotiation because of the broad definition of "Affiliate" in Section 14. In the 2002 Agreement, Section 3(c) has been amended to apply only to a party, its Credit Support Providers or any of its applicable Specified Entities (thereby reflecting the position that is often reached in the ISDA Schedule after negotiation on this point).

The 2002 Agreement also introduces, in a new Section 3(g), a "No Agency" representation and warranty. This representation and warranty, that a party is acting as principal and not as agent, has invariably been included by parties in Part 5 of the ISDA Schedule.

The introductory paragraph to Section 3 of the 2002 Agreement now draws a distinction between the representations and warranties specified in Sections 3(a) to (g) (inclusive) in the main body of the 2002 Agreement and any "Additional Representations" that may be specified by the parties in the ISDA Schedule or Confirmation. Under the 1992 Agreement, any such additional representations and warranties which were included in the Schedule were deemed to be repeated on the same dates as the representations and warranties in the main body of the 1992 Agreement - i.e. the introductory paragraph provided that all representations and warranties were deemed to be repeated on each date on which a Transaction is entered into (and, in the case of certain tax representations and warranties, at all times until termination of the Agreement). Under the amended introductory paragraph in Section 3, it is now provided that any "Additional Representations" specified in the Schedule or a Confirmation will be deemed to be repeated at the time or times specified for such Additional Representation in the Schedule or Confirmation.

SECTION 10(a)

Section 10(a) of the 2002 Agreement includes changes which clarify the role of a party's home or head office in terms of the obligations of its branch office through which it enters into transactions. It now provides that each party which enters into a transaction through an office other than its head or home office represents to and agrees with the other party that its obligations are the same in terms of recourse against it as if it had entered into the Transaction through its head or home office. A consequential change has been made to Section 10(a) to clarify that, in circumstances where an Illegality or Force Majeure Event applies to a branch office of a party, the other party cannot have recourse to the head or home office of the first-mentioned party in respect of any payment or delivery deferred pursuant to Section 5(d) for so long as the payment or delivery is so deferred. A new Section 5(e) has been introduced to make clear that, in the foregoing circumstances, such non-payment or non-delivery will not constitute an Event of Default.

JURISDICTION CLAUSE

The jurisdiction clause in Section 13(b) has been amended to reflect the provisions of Article 17 of the Brussels Convention and Article 17 of the Lugano Convention relating to jurisdiction and enforcement of judgments. Section 13(b)(i) provides that (where the Agreement is expressed to be governed by English law), each party submits to (1) the non-exclusive jurisdiction of the English courts if the Proceedings do not involve a Convention Court and (2) the exclusive jurisdiction of the English courts if the Proceedings do involve a Convention Court. "Convention Court" means any court which is bound to apply to the Proceedings either Article 17 of the Brussels Convention or Article 17 of the Lugano Convention. This means that if the court is bound to apply Article 17, it will constitute a "Convention Court" and the clause will confer exclusive jurisdiction on the English courts. If it is not bound to apply Article 17 (for example, because neither party to the proceedings is domiciled in a Contracting State to those Conventions), it will not constitute a Convention Court, and the clause will confer non-exclusive jurisdiction on the English courts.

NOTICES

The notices provisions in Section 12(a) have been changed in two respects. First, it expressly recognises the right to give notices (other than Section 5 or 6 notices) by e-mail. Notice give by e-mail is deemed effective on the date it is delivered. Secondly, the 1992 Agreement did not permit Section 5 or 6 notices to be given by facsimile transmission. This restriction has been removed in the 2002 Agreement.

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