



The More You Know

Turmoil in the crypto currency markets has provided a reminder of the importance of a party knowing the terms of its agreements and how to use them when a counterparty fails to meet its obligations.

The following points should help a party act expeditiously when their counterparty fails to perform.

In all circumstances:

1. Ensure that your systems clearly denote which transactions or other arrangements are entered into under which agreement so the correct contractual terms can be reviewed;
2. When confirming a transaction ensure that, as far as possible, it references the relevant agreement and any terminology in the confirmation matches the agreement (ISDA, MLA, MSLA, etc. as the case may be);
3. Have your various trading agreements, in electronic and hard copy form, easily accessible and make sure any communications changing notice addresses or requirements are in the file;
4. Make sure that crisis management responsibilities (*e.g.*, who is responsible for monitoring and who has authority to make the calls) are clear and decisive and that there is always a decision-maker around;
5. Consider whether you should have form default notices ready to be completed should a default scenario arise; and
6. Either have alternative counterparties or trading venues in place or identify appropriate alternatives to contact in line with your needs and volume of business.

Where your counterparty has failed, or seems as if they will fail, to perform:

1. Your risk manager or senior executive should take charge of the response and your processes should bring them in promptly. Relationship managers and traders are pulled in too many directions. Any missed payment or delivery can be a warning of counterparty stress.
2. Your inhouse lawyer or outside counsel should review the relevant agreement and any transaction confirmation as soon as possible, to determine what actions you can take and when you need to take them. They should also review any other agreements with the counterparty to determine if there are cross-defaults, netting and set-off terms, and other provisions that affect your total credit position with the counterparty.
3. Determine what provisions of the agreements are relevant to your circumstances: do you hold collateral and, if so, when and in what circumstances can you realize on it? Do the agreements provide for rights of set-off and netting that could be relevant if each party owes obligations to the other? Note that master type agreements might not be worded in such a way that your situation is clearly covered, but construing them in the light of a particular fact pattern may still mean they apply.

4. Keep careful track of your collateral positions. If you can, reclaim your excess collateral and make sure your margin call your counterparty for all collateral deficits. Make sure your mark-to-market pricing for counterparties is conservative and in line with market realities.
5. Carefully monitor all communications with the counterparty and its public and private statements. Some agreements contain provisions allowing you to exercise remedies if the counterparty indicates that it will not or cannot perform.
6. Even if you are discussing a missed performance date with your counterparty with a view to resolving it, prepare and send any notice required by the agreement to be sent to trigger your rights under that agreement. Ensure that the notice complies with any relevant terms of the agreement, relating to form, timing and/or method of delivery. Negotiations should typically not delay this as, should they fail, you will be delayed in taking the action necessary to limit any loss to which you are exposed (and the situation of your counterparty may have deteriorated or the counterparty may disable itself from receiving notices).
7. A notice of default might trigger defaults under other agreements (a cross-default) between you and the defaulting counterparty and potentially in agreements between that counterparty and third parties, such as a bank. While your counterparty may claim that this should keep you from sending a notice, if they wish to avoid this happening they should perform under the agreement. If you do not declare the default, it is likely someone else will. If your counterparty cannot perform, then you want to be able to close out those other agreements too and as expeditiously as possible.

In short, you need to know which transactions relate to which agreements, be able to easily access those agreements if something goes wrong and be prepared to act quickly to enforce your rights, even if you are in negotiations with a party that has defaulted or is about to default. It may be possible to withdraw a notice that you have sent but it will not be possible to get back the days lost when other parties to your defaulting counterparty may have already started exercising their default rights.

Questions regarding the above may be directed to GuyLaine Charles at guylaine@charleslawpllc.com or Joe Heyison at joe@charleslawpllc.com. This client update is prepared for the general information of our clients and other interested persons. It is not, and does not attempt to be, comprehensive in nature. Due to the general nature of its content, it should not be regarded as legal advice. If you have not received this publication directly from us, you may be added to our distribution list and/or obtain a copy of any past or future publications by sending an e-mail to Maria Castle at castle@charleslawpllc.com.

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