A guide to close-out netting, set-off, contractual subordination and non-petition provisions under Jersey law

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The Bankruptcy (Netting, Contractual Subordination and Non-Petition Provisions) (Jersey) Law 2005 (the "**Netting Law**") is a short piece of legislation of particular significance to financing transactions involving Jersey counterparties.

The Netting Law establishes a clear statutory framework of universal applicability to transactions in which close-out netting, set-off, contractual subordination and/or non-petition provisions (each a "**Relevant Provision**" and together, "**Relevant Provisions**") are a key component. It provides that, notwithstanding any other enactment or rule of law to the contrary, a Relevant Provision is enforceable in accordance with its terms despite (a) the bankruptcy of a party to the agreement or any other person and (b) the lack of any mutuality of obligations. The Netting Law therefore provides certainty to participants in a broad range of financing transactions, including syndicated loan, derivative, debt capital markets and structured finance transactions as to the enforceability of Relevant Provisions.

Close-out netting

"Netting", as defined in the Netting Law, means the conversion, into one net claim or one net obligation, of all claims and obligations arising under an agreement, whilst a "close-out netting provision" is defined so as to include automatic termination of an agreement on the occurrence of a specified event, for example insolvency. The Netting Law therefore expressly confirms that close-out netting provisions such as the following are enforceable in accordance with their terms:

- close-out netting provisions of the type used in derivative transactions (including hedging transactions entered into based on standard ISDA documentation);
- transactions where one party's exposure to another party's insolvency is kept at manageable levels by operation of close-out netting provisions (for example, transactions between financial institutions where it is important for regulatory capital purposes to be able to report net exposure); and
- close-out netting provisions that enable financial institutions to report group account overdraft exposures of their customers on a net (as opposed to gross) basis.

Set-off

Set-off for the purposes of the Netting Law is broadly defined, and distinct from, close-out netting. A set-off provision means so much of an agreement, other than a close-out netting provision, as relates to the netting of amounts due from one party to any other party to that agreement. A set-off clause typically allows one party to set-off (or deduct) amounts owed by it to another party, to (or from) amounts owed to it by that other party. The Netting Law removes any doubt that provisions of this type are enforceable in accordance with their terms both prior to and after the onset of insolvency.

Contractual subordination

Contractual subordination frequently plays a role in syndicated loan, debt capital markets and structured finance transactions involving Jersey entities. The parties typically enter into intercreditor agreements that regulate the rights and ranking of multiple funders such that one funder may agree to subordinate its right to repayment to that of another funder. Arrangements of this type fall within the definition of "contractual subordination" under the Netting Law and are therefore generally enforceable in accordance with their terms.

Non-petition

A non-petition provision ordinarily takes the form of an undertaking by a party, or a number of parties, not to petition for the bankruptcy of another involved in a transaction. Rating agencies assess the bankruptcy remoteness of special purpose vehicles used in certain structured finance transactions to determine the impact that the risk of insolvency of the special purpose vehicle has on the credit rating. Non-petition provisions in transaction documents under which creditors and other transaction parties contractually agree not to initiate insolvency proceedings against the special purpose vehicle play a role in this analysis. The Netting Law provides clarity to transaction parties and rating agencies as to the enforceability of contractual non-petition provisions applicable to Jersey special purpose vehicles.

Persons to whom the Netting Law applies

A close-out netting, set-off or contractual subordination provision is enforceable against the parties to the agreement in which it is set out, any guarantor or person providing security for a party to that agreement and any creditor of a party to that agreement. In addition, any person dealing with the affairs of a bankrupt party or person must give effect to any such provision.

In relation to a non-petition provision, the Netting Law specifically provides that the Royal Court will refuse to grant any application which would be inconsistent with that Law. In addition, a non-petition provision is enforceable despite the bankruptcy of a party to the relevant agreement or any other person, so any person dealing with the affairs of a bankrupt must also give effect to a non-petition provision.

In order to ensure that transaction parties have certainty in their dealings with entities operating within Jersey, the Netting Law applies to a Jersey branch of a body corporate established outside Jersey despite any other enactment or rule of law to the contrary that may apply to that body corporate, including any law of its jurisdiction of establishment.

Transactions and agreements within the scope of the Netting Law

The Netting Law does not prescribe the types of transactions to which it applies but is of general application. In addition, an "agreement" for the purposes of the Netting Law includes a "series of inter-related agreements", which is helpful in the context of, for example, ISDA transactions. Ancillary provisions of an agreement which contains a close-out netting, set-off or contractual subordination provision (for example, one that sets out the method to be used to establish the currency in which a net payment should be made), are also enforceable in accordance with their terms.

Fraud/misrepresentation

An agreement containing a Relevant Provision may be held to be unenforceable in the event of fraud or misrepresentation applying usual legal principles.

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