

Malta Bankers' Association  
48/2, Birkirkara Road,  
Attard BZN 02

20<sup>th</sup> April, 2006

Dear Sirs,

**Re: Validity and Enforceability of the 1992 and 2002 ISDA Master Agreements**

We have been instructed to give an opinion as to the validity and enforceability under the laws of Malta of the 1992 ISDA Master Agreements (both (i) the Multicurrency Cross-Border and (ii) the Single Currency – Local Jurisdiction forms) (the “**1992 ISDA Master Agreements**”) and the 2002 ISDA Master Agreement (the “**2002 ISDA Master Agreement**” and together with the 1992 ISDA Master Agreements, the “**ISDA Master Agreements**”).

Unless we indicate otherwise, when we use the term ISDA Master Agreement, our opinion applies equally to all the forms of ISDA Master Agreements referred to above. Terms defined in the ISDA Master Agreement have the same meaning in this opinion in relation to that ISDA Master Agreement.

In this opinion:

- (a) “**Malta**” means the Republic of Malta and “**Maltese**” shall be construed accordingly;
- (b) “**Insolvency Proceedings**” means:
- (i) Dissolution and consequential winding-up in terms of Article 214 *et seq.* of the Companies Act, 1995 (Chap. 386 of the Laws of Malta)(the “**Companies Act**”). This can either take the form of a Winding-up by the Court or a Voluntary Winding-Up;
  - (ii) Company Recovery Procedure in terms of Article 329B *et seq.* of the Companies Act;
  - (iii) Company Reconstructions in terms of Article 327 *et seq.* of the Companies Act; and
  - (iv) The provisions analogous to those set out above in paragraphs (i) to (iii) in the Merchant Shipping (Shipping Organisations – Private Companies), Regulations, 2004 (Legal Notice 223 of 2004).

This opinion is given in respect of parties which are the following entities, namely:

- (a) a limited liability company (a *societe anonyme*), whether constituted as a public limited company or a private limited company, established under or regulated by the Companies Act, which company could be a credit institution, an investment firm, an insurance undertaking or a trading company;

- (b) an investment company with variable share capital (SICAV), whether constituted as an umbrella or multi-class investment company or otherwise, and whether constituted as a public limited company or a private limited company, established under or regulated by the Companies Act; and
- (c) a company established under or regulated by the Merchant Shipping (Shipping Organisations – Private Companies), Regulations, 2004 and qualifying as a shipping organisation in terms of article 84Z of the Merchant Shipping Act (Cap. 234 of the Laws of Malta),

and to branches of same established or located in Malta (the “**Parties**”).

For the purposes of this opinion, we have not analysed other entities which are subject to special insolvency regimes. Nor have we analysed the insolvency of collective investment schemes which are not organised as SICAVs under the Companies Act.

This opinion is confined to matters of Maltese law as at the date hereof and we express no opinion with regard to any system of law other than the laws of Malta. This opinion is not being delivered to you in connection with any specific transaction.

#### **Assumptions**

We have assumed that:

- (a) each party is able lawfully to enter into and has all requisite capacity and corporate power to execute, deliver and perform its obligations under the ISDA Master Agreement and each party has taken all necessary steps to execute, deliver and perform the ISDA Master Agreement and all Transactions carried out under the ISDA Master Agreement;
- (b) neither party is prohibited or restricted by applicable regulatory laws or regulations from entering into an ISDA Master Agreement or Transactions thereunder;
- (c) other than as stated in this opinion, none of the terms of the ISDA Master Agreement has been varied, waived or discharged in any material respects and Transactions have been entered into as specified in the ISDA Master Agreement;
- (d) the ISDA Master Agreement is legal, valid, binding and enforceable under the law specified in the Schedule, being either English law or the laws of the State of New York;
- (e) the ISDA Master Agreement has been entered into at arms’ length by each of the parties;
- (f) in relation to the 1992 ISDA Master Agreement, the Parties have elected Second Method to apply;
- (g) the ISDA Master Agreement and all Transactions carried out under the ISDA Master Agreement are entered into prior to the formal commencement of insolvency proceedings against either party;

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(h) at the time at which a Transaction is entered into under the ISDA Master Agreement, neither party has actual notice of the insolvency of the other party;

### Opinion

Subject to the above and the qualifications set out below, we are of the opinion that under the laws of Malta:

#### 1.1 Set-Off and Netting on Insolvency Act, 2003

In terms of Maltese private international law rules, Maltese law would uphold the governing law clause of the ISDA Master Agreement (whether English or New York law).

However, insolvency issues of a party organised in Malta will as a general rule be governed by Maltese law, as the *lex fori*. So, subject to what is stated below, Maltese insolvency law will be relevant to this analysis.

The provisions of the ISDA Master Agreement providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of a counterparty are valid and enforceable under the laws of Malta by virtue of the provisions of the Set-off and Netting on Insolvency Act, 2003 (Chap. 459 of the Laws of Malta) (the “Set-Off Act”). The said Act provides that close-out netting provisions, such as that contained in the ISDA Master Agreement, are valid and enforceable under Maltese law, whether such close-out netting takes place before or after bankruptcy provided that such mutual debts, mutual credits or mutual dealings have arisen or occurred before the bankruptcy of one of the parties. The Set-Off Act defines a “close-out netting provision” as:

“a provision of a contract under which on the occurrence of a specified event, whether through the operation of netting or set-off or otherwise –

- (a) the benefit of time for the performance of relevant obligations by the debtor may no longer be claimed and, or the relevant obligations become immediately due and expressed as an obligation to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount, and, or
- (b) any obligation of a party to deliver property to the other is immediately performable notwithstanding any benefit of time granted to the debtor and expressed as an obligation to pay an amount representing its estimated current value or replacement value or is terminated and replaced by an obligation to pay such an amount, and
- (c) an account is taken of what is due from each party to the other in respect of such obligations and those obligations fall to be discharged by the payment of an aggregate net sum equal to the balance of account by the party from whom the larger amount is due.”

The Set-Off Act does not set out any restrictions as to the type of legal person that can enter into such close out netting provisions nor does it set out any restriction as to the type of contracts or

transactions to which it can relate. Accordingly, close-out-netting will be enforceable in relation to all the transactions as set out in Annex A to this opinion.

The above conclusion on the validity of the provisions of the ISDA Master Agreement providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of a counterparty is subject to the following:

- (a) the netting of termination values to determine a single lump-sum termination amount can only take into account mutual debts, mutual credits or mutual dealings which have arisen or occurred before the insolvency of the counterparty. This involves two elements: (i) the debts, credits and dealings must have arisen or occurred before the insolvency of the other party, and (ii) the element of mutuality. In terms of the Set-Off Act, set-off and netting can only take place in respect of mutual claims. Accordingly, each Party to the ISDA Master Agreement must be personally liable for its obligations under the ISDA Master Agreement and each Transaction and must in addition be the sole beneficial holder of any rights it has under the ISDA Master Agreement and each Transaction;
- (b) the rules on claw-backs as described below in paragraph 1.6 of this opinion;
- (c) there is also another general rule found in Malta's Civil Code which is applicable across the board. This rule, called the *actio pauliana*, basically establishes that it is competent to any creditor to impeach any act made by the debtor in fraud of his claims;
- (d) when determining the Close-Out Amount in terms of Section 6(e) of the 2002 ISDA Master Agreement, the Non-defaulting Party must do so in good faith and in a commercially reasonable manner; and
- (e) when, in the 1992 ISDA Master Agreement, the method of valuation is calculated by reference to Market Quotation or Loss, the Non-defaulting Party must do so in good faith and in a commercially reasonable manner.
- (f) the Set-Off Act also lays down the following exceptions to the validity and enforceability of a close-out netting provision:
  - (i) any close-out netting agreement entered into at a time at which the other party knew or ought to have known that an application for the dissolution and winding-up of the company (or analogous provisions in the case of other commercial partnerships) by reason of the insolvency was pending, or that the company has taken formal steps under any applicable law to bring about its dissolution and winding-up by reason of insolvency (see Art. 3(4) of the Set-Off Act); and
  - (ii) fraud or any similar ground (see Art. 3(7) of the Set-Off Act).

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It is further noted that a liquidator cannot assume the profitable Transactions and reject the non-profitable ones (a process commonly referred to as “cherry-picking”), since the ISDA Master Agreement contains wording which makes the ISDA Master Agreement (including all Transactions) a single agreement and therefore contractually only a single net claim is due under Section 6(e). Article 4(c) of the Set-Off Act also provides that it is lawful for parties to a contract to agree that any transactions or other dealings carried out pursuant to any contract, whether identified specifically or by reference to a type or class of transactions or dealings, shall be treated as a single transaction or dealing for the purpose of the set-off or netting provisions in the contract.

## 1.2 Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings

As of 1<sup>st</sup> May, 2004, the date when Malta became a full member of the European Union, one must also take into consideration the overriding provisions of Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings (the “**Insolvency Regulation**”). The Insolvency Regulation has had a significant effect on Maltese insolvency laws, in so far as private international laws relating to insolvency are concerned. The Insolvency Regulation provides in substance that the courts with jurisdiction to open insolvency proceedings are those of the Member State where the debtor has his “centre of main interests”. The Insolvency Regulation limits the instances when secondary proceedings in another Member State can be opened. In addition, the Insolvency Regulation provides that, unless otherwise stated, the law of the Member State of the opening of the proceedings should be applicable (the *lex concursus*) to a series of issues as outlined in the Insolvency Regulation. Therefore, in virtue of the “centre of main interests” rule, the fact that a company is incorporated or governed by the laws of Malta does not mean that Maltese insolvency laws would automatically apply, since Malta may not be the centre of main interests of such a company. In addition, the centre of main interests may change from time to time and all this has a bearing on the applicable conflict of laws rule.

It must be noted that the Insolvency Regulation does not apply to insolvency proceedings concerning insurance undertakings, credit institutions, investment undertakings which provide services involving the holding of funds or securities for third parties, or to collective investment undertakings.

One of the exceptions to the general rule of the *lex concursus* which is relevant to this opinion is set out in Article 6 of the Insolvency Regulation which reads as follows:

*“1. The opening of insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim.*

*2. Paragraph 1 shall not preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2)(m).”*

Article 6 effectively provides that where set-off is not permitted under the *lex concursus*, creditors may rely on the provisions of the law applicable to the debtor's claim, if the latter law allows such set-off. Accordingly, this exception will only be of relevance if the *lex concursus* does not permit such a set-off. As we have seen above, Maltese law allows set-off within the context of the ISDA Master

Agreements, and accordingly creditors of a company whose centre of main interests is in Malta should have no need to refer to the law applicable to the insolvent debtor's claim to enforce their set-off claim.

A reading of Article 6 of the Insolvency Regulation raises legal doubts as to whether close-out netting is fully included within the parameters of Article 6 of the Insolvency Regulation or otherwise. We are aware of the arguments in European legal circles that the process of close-out netting involves elements in addition to set-off, such as early termination and acceleration of claims, and therefore the doubt as to whether the early termination mechanisms and the acceleration of claims are covered or otherwise by the exception to set-off in the Insolvency Regulation. We are also aware of the parallel argument that set-off and netting are two distinct legal concepts and that the lack of protection for netting in the Insolvency Regulation indicates that the latter did not intend to protect close-out netting.

Although this lack of clarity may raise doubts as to the applicable conflict of laws rule relating to close-out netting, it would appear that the provisions of the Insolvency Regulation do not adversely affect the validity of close-out netting under Maltese law. If Maltese law is applicable, then close-out netting is valid, whereas if Maltese conflict of laws rules defer to the law applicable to the insolvent debtor's claim, then it is the law of the debtor's claim which must determine whether such close-out netting is valid or otherwise.

### 1.3 Insurance Business (Reorganisation and Winding Up of Insurance Undertakings) Regulations, 2004

In the case of insurance undertakings, regard must be paid to the Insurance Business (Reorganisation and Winding Up of Insurance Undertakings) Regulations, 2004 (the "**Insurance Undertakings Regulations**"), which transpose the provisions of Directive 2001/17/EC on the reorganisation and winding-up of insurance undertakings ("**Insurance Undertakings Winding-Up Directive**"). The Insurance Undertakings Regulations apply to member states of the European Union and to countries within the European Economic Area ("**EEA**"), namely Norway, Iceland and Liechtenstein (collectively "**Member State**").

The Insurance Undertakings Regulations broadly provide that it is the home Member State of an insurance undertaking which will have exclusive jurisdiction to open winding-up proceedings and reorganisation measures in relation to an insurance undertaking (and their branches set up in host Member States). All the winding-up proceedings will be governed by the insolvency law of the home Member State (the *lex concursus*), subject to specified exceptions. In contrast to the provisions of the Insolvency Regulation, it is not possible for Member States where the insurance undertaking has a branch to open any local secondary insolvency proceedings in relation to the insolvent insurance undertaking.

One of the exceptions to the rule of the *lex concursus* is that set out in Regulation 24 which lays down that the opening of reorganisation measures or winding-up proceedings does not affect the rights of creditors to demand the set-off of their claims against the claims of the Maltese insurance undertaking, where such a set-off is permitted by the law of the Member State or EEA State which is applicable to the claim of the Maltese insurance undertaking. Regulation 24 however does not

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preclude actions for voidness, voidability or unenforceability of legal acts detrimental to all the creditors.

In parallel with Article 6 of the Insolvency Regulation, Regulation 24 effectively provides that where set-off is not permitted under the *lex concursus*, creditors may rely on the provisions of the law applicable to the debtor's claim, if the latter law allows such set-off. Accordingly, this exception will only be relevant if the *lex concursus* does not permit such a set-off. As noted above, Maltese law allows set-off within the context of the ISDA Master Agreements.

#### 1.4 Credit Institutions (Reorganisation and Winding Up) Regulations, 2004

Directive 2001/24/EC on the reorganisation and winding-up of credit institutions ("**Credit Institutions Winding-Up Directive**") has been transposed in Malta by virtue of the Credit Institutions (Reorganisation and Winding Up) Regulations, 2004 (the "**Credit Institutions Winding-Up Regulations**"). The Credit Institutions Regulations apply to member states of the European Union, and to countries within the EEA (collectively "**Member State**").

The Credit Institutions Winding-Up Regulations broadly provide that it is the home Member State of a credit institution which will have exclusive jurisdiction to open winding-up proceedings and reorganisation measures in relation to the credit institution (and their branches set up in host Member States). All the winding-up proceedings will be governed by the insolvency law of the home Member State (the *lex concursus*), subject to specified exceptions. In contrast to the provisions of the Insolvency Regulation, it is not possible for Member States where the credit institution has a branch to open any local secondary insolvency proceedings in relation to the insolvent credit institution.

The Credit Institutions Winding-Up Regulations also apply to credit institutions not having a head office within a Member State, where such institution has branches in at least two Member States. The said regulations imply that each such branch would be treated individually, although there must be co-operation between the respective authorities of each Member State where a branch is located.

Regulation 25 of the Credit Institutions Winding-Up Regulations provides that "the adoption of reorganisation measures or the opening of winding-up proceedings shall not affect the rights of creditors to demand the set-off of their claims against the claims of the Maltese credit institution where such a set-off is permitted by the law of the Member State or EEA State which is applicable to the claim of the Maltese credit institution." Regulation 25 however does not preclude actions for voidness, voidability or unenforceability of legal acts detrimental to all the creditors.

In addition, Regulation 27 of the said regulations provides that: "Pursuant to the provisions of the Set-Off and Netting on Insolvency Act, netting agreements shall be governed by the law of the contract which governs such agreements." The reference in Regulation 27 to the provisions of the Set-Off Act adds nothing to this clause, since in fact the Set-Off Act contains no such conflict of laws rule. However, this does not detract anything from the conflict of laws rule that netting agreements are to be governed by the law of the contract which governs such agreements.

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We believe that the ISDA Master Agreement falls within the meaning of 'a netting agreement'. Effectively therefore the practical effect of Article 27 is that, on an Insolvency Proceeding of a Maltese bank, under Maltese conflict of laws rules, the validity and enforceability of an ISDA Master Agreement (including the provisions on close-out netting on insolvency) will be governed by the governing law of the ISDA Master Agreement, and in our view the said governing law would apply without regard to the effect of any mandatory insolvency rules of Malta.

Neither Regulation 25 nor Regulation 27 of the Credit Institutions Winding-Up Regulations is limited in its scope of application to the law of an EU or EEA Member State, and therefore the above analysis will apply to an ISDA Master Agreement governed by both English or New York law.

### **1.5 Moratoria and Stays**

In the case of a company recovery procedure, there is an automatic general moratorium for the duration of the procedure (i.e. up to 12 months, which can be extended by another 12 months), during which generally creditors cannot take actions against a Maltese counterparty. Such stays are also applicable to secured creditors. The law does not contemplate any stay or moratorium in connection with company reconstructions, but since such a compromise / arrangement contemplates a court sanctioning, effectively the compromise / arrangement could impose such a stay or moratorium.

Article 3(6) of the Set-Off Act provides that nothing shall limit or delay the application of any provision of any contract providing for or relating to set-off or netting which would otherwise be enforceable and no order of or any court nor any warrant or injunction or similar order issued by a court or otherwise and no proceedings of whatever nature shall have any effect in relation thereto. In addition, Article 3(1)(c) states that the close-out netting provision is enforceable in accordance with its terms against the liquidator, receiver, curator, controller, special controller or other similar officer of either party to the contract. Accordingly, on the basis of the said provisions of the Set-Off Act, it is our view that no stay or moratorium should block the enforcement of the close-out netting provision.

### **1.6 Claw-Backs**

It must be pointed out that Article 303 of the Companies Act broadly provides that any obligation incurred by a company within six months before the dissolution of the company is void, if it constitutes a "transaction at an undervalue" or if a "preference" is given.

A company enters into a transaction at an undervalue if:

- the company makes a gift or otherwise enters into a transaction on terms that provide for the company to receive no consideration; or
- the company enters into a transaction for a consideration the value of which, in money or money's worth, is significantly less than the value in money or money's worth of the consideration provided by the company.

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A company gives a preference to a person if:

- that person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities; and
- the company does anything or suffers anything to be done which, in either case, has the effect of putting that person into a position which, in the event of the company going into insolvency winding-up, will be better than the position he would had been had that act or omission not occurred.

The only exception to this so-called fraudulent preference rule is where the other party proves that it did not know and did not have reason to believe that the company was likely to be dissolved by reason of insolvency. In its turn Article 3(8) of the Set-Off Act lays down that the said Article 303 of the Companies Act shall only be applicable in relation to a close-out netting provision where there is fraud on the part of the party to the ISDA Master Agreement not being the insolvent party. Effectively, therefore, the Set-Off Act has laid down an additional test which needs to be satisfied before a close-out netting provision can be declared void on the basis of the six month fraudulent preference rule.

In the case of credit institutions in respect of which the MFSA has appointed a controller to assume control of same in terms of the Banking Act, the provisions of the Controlled Companies (Procedure for Liquidation) Act, 1995 (Cap. 383 of the Laws of Malta) are also relevant. This Act makes the provisions of Article 485 of the Commercial Code applicable to such credit institutions. Article 485 basically lays down that any act under onerous title made by the credit institution for the purpose of defrauding its creditors can be annulled if there also be fraud on the part of the other party. Any such act shall be deemed to be fraudulent as regards the other party, if it is proved that such party knew of the bankruptcy or of the existence of circumstances giving rise to a declaration of bankruptcy.

It must be pointed out that companies established under or regulated by the Merchant Shipping (Shipping Organisations – Private Companies), Regulations, 2004 do not have equivalent rules relating to claw-backs, although the Maltese Courts always retain a general remedy to annul actions which are tainted with fraud.

Malta's private international law issues relating to claw-backs must also be taken into consideration for a complete analysis of this matter. In terms of Article 4(2)(m) of the Insolvency Regulation, rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors (such as those discussed in Article 303 of the Companies Act above) are governed by the law of the Member State of the opening of the proceedings. However, Article 13 of the Insolvency Regulation lays down that where the person who benefited from an act detrimental to all the creditors provides proof that:

- the said act is subject to the law of a Member State of the European Union other than that of the state of the opening of the proceedings; and
- that law does not allow any means of challenging that act in the relevant case,

then the laws on claw backs of the Member State of the opening of the proceedings will not apply.

Effectively therefore where the ISDA Master Agreement is governed by English law, the Maltese rules set out in Article 303 of the Companies may not always be applicable. This exception would however not apply when the ISDA Master Agreement is governed by New York law. The above principles also find reflection in Regulation 31 of the Credit Institutions Winding-Up Regulations and Regulation 26 of the Insurance Undertakings Winding-Up Regulations, with the difference that the said act may be governed by the law of a Member State of the European Union or those of an EEA State. ISDA Agreements governed by New York law would still not qualify for this exception.

### 1.7 Flawed Asset Analysis

We now pass on to examine the so-called “flawed asset” analysis of the ISDA Master Agreement. Under the ISDA Master Agreement, a payment on early termination can be viewed as consisting of the following three components:

- (i) payments for obligations which became payable or deliverable but which were not paid or delivered prior to the Early Termination Date;
- (ii) payments for obligations which would have been payable or deliverable prior to the Early Termination Date if all conditions to payment or delivery had been satisfied or if the Early Termination Date had not been designated; and
- (iii) payment for the future value of the Terminated Transactions.

The amounts referred to in (i) and (ii) above are included within the definition of “Unpaid Amounts” in the ISDA Master Agreement.

We understand that under English and New York law the provisions of Sections 2(a)(iii) and 6(c) of the ISDA Master Agreement, which make performance of payment and delivery obligations in respect of individual Transactions conditional upon the fact that an Early Termination Date has not occurred or been effectively designated, are valid and enforceable. In either case, therefore, the effect of the designation of an Early Termination Date under the ISDA Master Agreement is that no further payments or deliveries will be required to be made in respect of the Terminated Transactions and the obligation to pay or deliver in respect of a Transaction is never anything more than a conditional obligation. Accordingly, Section 6 (e), which provides for payments to be made under Early Termination, may be viewed, except to the extent that it relates to Unpaid Amounts, as a mere accounting exercise between the parties which does not involve set-off, as the obligations never materialise. The insolvency set-off regime would still however be applicable for the Unpaid Amounts.

On the assumption that this interpretation using the “flawed asset” analysis is valid under the respective provisions of English or New York law, Maltese law would respect this interpretation in terms of the governing law of the ISDA Master Agreement and such interpretation would not run counter to any public policy or mandatory rule of Malta, provided no unjustified enrichment occurs. Indeed, had the ISDA Master Agreement, for argument’s sake, been governed by Maltese law, the provisions of Sections 2(a)(iii) and 6(c) of the ISDA Master Agreement would probably be classified by a Maltese Court as suspensive conditions. Article 1063 of the Civil Code defines a suspensive

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condition as that which makes the existence of the obligation dependent upon a future and uncertain event. The Civil Code also provides that an obligation under a suspensive condition does not exist before the event happens.

To sum up on this point, Maltese law poses no problems for the termination provisions of the ISDA Master Agreement, whether English or New York law views the termination and close-out as an issue of insolvency netting or the flawed asset analysis.

### **1.8 Automatic Early Termination**

In the event that the parties select Automatic Early Termination to apply upon certain insolvency events to the insolvent counterparty established in Malta, an Early Termination Date will occur automatically for all outstanding Transactions, so that no notice is required.

The Set-Off Act, in its definition of a close-out netting provision, refers to the occurrence of a specified event, and makes no distinction between whether notice is sent to the other party or otherwise. Accordingly, in terms of the wording of the law, no notice is required. Under Maltese law, we perceive no advantage of opting for Automatic Early Termination, since under Maltese insolvency laws it is clear that the exercise of close-out netting and set-off provisions are valid whether before or after insolvency. Our view is strengthened by the fact that the Events of Default specified in Section 5(a)(vii)(1), (3), (5), (6) are in each case objectively verifiable by the parties. If Automatic Early Termination applies, it is, from a practical perspective, advisable for the non-defaulting party not to act in a manner which conflicts with the Early Termination for purposes of avoiding any argument as to whether there has been any waiver or otherwise of the Automatic Early Termination.

### **1.9 Transactions entered into on a Multi-Branch Basis**

The conclusions set out above concerning the enforceability of close-out netting under the ISDA Master Agreements also apply when a Maltese party has entered into ISDA Master Agreements on a multibranch basis. We have already explained the concept of mutuality as a prerequisite for the application of the Set-Off Act. In the case of Multibranch parties, the fact that two claims to be set-off are owed respectively by different branches of the insolvent party has no bearing on the issue of mutuality. This is because under Maltese law, as a general rule (and subject to what is stated below), a branch of a company does not have a legal personality separate from that of another branch or the head office of the company.

### **1.10 Gaming and Betting**

Article 1717A of the Civil Code provides that contracts such as the ISDA Master Agreement are not void or unenforceable by reason of any Maltese law on gaming and betting.

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### 1.11 Investment Companies with Variable Share Capital (SICAV) constituted as an Umbrella or Multi-class Company

It must be pointed out that an investment company with variable share capital (SICAV) constituted as an umbrella or multi-class company may, in terms of the Companies Act (Investment Companies with Variable Share Capital) Regulations, 1996 (as amended), in its memorandum and articles of association, elect to have the assets and liabilities of each sub-fund comprised in that company treated for all intents and purposes of law as a patrimony separate from the assets and liabilities of each other sub-fund of such company. The said regulations provide that where the umbrella or multi-class company makes such an election, the assets and liabilities of each sub-fund of that company shall, for all intents and purposes of law, be deemed to constitute a patrimony separate from the assets and liabilities of each other sub-fund of such a company. In addition, the said regulations also provide that save for such proportion of the liabilities of an umbrella or multi-class company which by virtue of the memorandum or articles of the company or by virtue of the terms of issue of the shares constituting a sub-fund are, or are to be attributable to, one or more sub-funds in the proportions established therein, the liabilities incurred in respect of each sub-fund shall be paid out of the assets forming part of its patrimony and the creditors in respect thereof shall have no claim or right of action against the other assets of the company.

In such an event, the said regulations provide that insolvency proceedings in relation to the company must respect the legal status of each sub-fund as a patrimony separate from the assets and liabilities of each other sub-fund of the company and the insolvency proceedings under the Companies Act, 1995 will apply *mutatis mutandis* to the sub-fund as though it were a distinct legal entity, and with such modifications as are necessary to accommodate the fact that the sub-fund is not a company. The regulations also make it clear that any proceedings in relation to one sub-fund will not have any effect on the assets of any other sub-fund of the company or on the assets of the company itself.

### 1.12 Jurisdiction Clauses

The jurisdiction clauses as expressed in the ISDA Master Agreement are both valid and binding and will be given effect to by the courts of Malta.

The Maltese courts may be required to decline jurisdiction, in relation to matters falling within the scope of the Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters signed in Lugano in 1988 (the “**European Judgments Convention**”)<sup>1</sup> or EC Regulation 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (the “**European Judgments Regulation**”), where the courts of another Contracting State under the European Judgments Convention or another Member State as defined in the European Judgments Regulation are first seized of the matter or have exclusive or mandatory jurisdiction. In matters not falling within the scope of the European Judgments Convention or the European

<sup>1</sup> The Legal Procedures (Ratification of Conventions) Act, 2002 which ratifies *inter alia* this Convention is not yet in force and accordingly the provisions of the Convention will only be applicable in Malta as from the date of the bringing into force of this Act.

Judgments Regulation, the jurisdiction of the courts of Malta is not however excluded by the fact that a foreign court is seized with the same cause of action or with a cause connected with it.

Saving the overriding provisions of the European Judgments Convention and the European Judgments Regulation, in the case of an exclusive jurisdiction clause referring to a foreign jurisdiction, the courts of Malta have reserved the right and discretion to exercise a residual jurisdiction in cases where it would be just and expedient to hear the cause of action in Malta; such cases arise typically where, for instance, evidence is more readily available in Malta.

### **1.13 Recognition and Enforcement of Foreign Judgements**

A judgement awarded by a competent court outside Malta would be recognised as a valid judgement and enforceable in the courts of Malta without re-examination of the merits of any matters treated in that judgement, subject to the following:

(a) in the case of judgments falling within the scope of the European Judgments Convention or the European Judgments Regulation, the recognition and enforcement would be subject to the provisions contained in the said European Judgments Convention or the European Judgments Regulation;<sup>2</sup> &

(b) in the case of judgments not falling within the scope of the European Judgments Convention or the European Judgments Regulation, the recognition and enforcement would be subject to the applicable law of Malta imposing judgement registration or confirmation in Malta, provided that the judgement (i) does not contain dispositions contrary to public policy and (ii) cannot be set aside on any of the grounds for re-trial as contemplated in the law of Malta on civil procedure.

### **Qualifications**

This opinion is subject to the qualifications outlined below:

2.1 the enforceability of the rights and remedies provided for in the ISDA Master Agreements are limited by and subject to:

(i) except as herein provided, insolvency, bankruptcy, moratorium and other similar laws affecting the enforceability of creditors' rights generally;

(ii) the pleas of set-off and counter-claim; and

(iii) the plea of prescription;

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<sup>2</sup> Malta also has a reciprocal enforcement agreement with the United Kingdom but this operates in relation to money judgements only. Judgements are registered, by application, with the Court of Appeal in accordance with and subject to the terms of the British Judgements (Reciprocal Enforcement) Act (Cap. 52 of the Laws of Malta).

- 2.2 Save in circumstances where it is required to exercise jurisdiction under the European Judgments Convention or the European Judgments Regulation, where a foreign court has a concurrent jurisdiction, the courts of Malta have a discretion to declare a defendant non-suited or to stay proceedings in Malta on the ground that if the action were to continue in Malta it would be vexatious, oppressive or unjust to the defendant;
- 2.3 Money judgements awarded by the courts of Malta, as well as any precautionary and executive warrants, are denominated in the lawful currency for the time being of Malta. In cases involving a foreign currency, the established principle is that the courts of Malta order that payment be made in Maltese Liri and that the rate of exchange be that obtaining at the time when the obligation was due and not that obtaining at the time of delivery of the judgment. There have been instances however where the courts of Malta have ordered that payment in Maltese Liri be made using the rate of exchange obtaining at the time of the delivery of the judgement.
- 2.4 Exchange control limitations have been abolished in Malta<sup>3</sup> and Maltese persons may enter into foreign currency transactions without limitation. The only requirement in this regard is that statistical data relating to certain foreign currency transactions has been submitted by Maltese credit institutions on the appropriate forms to the Central Bank of Malta in terms of the External Transactions Act, 1972 (Chap. 233 of the Laws of Malta). Failure to so notify will not impinge on the ability of the non-Maltese counterparty to claim payment and will have no impact on the validity of the underlying transaction.
- In the event however that for any reason a party needs to prove / claim in a Maltese liquidation, the solvent party's claim must be expressed in Maltese Liri.
- 2.5 The waiver by any of the Parties of certain procedural rights and remedies in the ISDA Master Agreement may not be valid due to the fact that all procedural laws are treated as rules of public policy.
- 2.6 With reference to section 8 (b) and (c) of the 1992 ISDA and 2002 ISDA, and to section 9(h) of the 2002 ISDA, a judgement at law amounts to a novation of the debt and so, to the extent, if at all, that the judgement provides, such provision will not be effective.<sup>4</sup>
- 2.7 As a general rule, under the Civil Code, interest can only be charged up to 8% per annum. In addition, the compounding of interest is not enforceable in Malta unless the obligation to pay interest is due for a period of more than one year and certain procedures prescribed in the Civil Code are followed. However, in virtue of the recently enacted Interest Rate (Financial Transactions) Order, 2005 (Legal Notice 323 of 2005), issued under the Civil Code, a number of transactions were liberalised. In particular, where the interest rate or the compounding of

<sup>3</sup> There are two exceptions to this rule relating to (i) exceptional circumstances, namely a sudden crisis in Malta's balance of payments or serious difficulties for the stability of the financial system; and (ii) powers under the National Interest (Enabling Powers) Act (Cap. 365 of the Laws of Malta);

<sup>4</sup> This is a very technical point on which there is no consensus.

interest rates arises in relation to debts and other obligations from so-called “financial transactions” and where one of the parties is a “designated entity”, the said limitations have been completely liberalised. The definition of “financial transaction” includes: contracts for differences, derivative contracts including options, forwards, swaps, foreign currency exchange contracts and similar agreements, securities lending transactions, sale and buy back agreements, repurchase and reverse repurchase agreements and similar agreements, as well as any pledges, hypothecs and other charges and any other collateral agreements, whether by way of title transfer or otherwise, which are entered into for the purpose or in connection with any of the foregoing transactions. The definition of “designated entity” includes amongst others a credit institution as defined in Article 1(1) of the Directive 2000/12/EC and a collective investment scheme which is licensed, recognised or otherwise exempt in terms of the Investment Services Act. Accordingly, to the extent that one of the parties to the ISDA Master Agreement qualifies as a “designated entity” under the said Order, and in view of the fact that the ISDA Master Agreements should qualify as “financial transactions”, no limitation arises under Maltese law in connection with interest rates or the compounding thereof.

- 2.8 With reference to Section 13 (c) of the ISDA Master Agreement, under our Civil Code, mandate is of its nature revocable, unless it can be shown that the appointment was made as part of the security to the other party; furthermore, under our Civil Code, mandate is terminated by virtue of a declaration of bankruptcy of either the mandator or the mandatary. However, in terms of Article 3(3) of the Set-Off Act, any authority or mandate in a contract to implement any close-out netting provision is not revoked by the declaration of bankruptcy or insolvency of any party to the contract.
- 2.9 The law of Malta requires that a debtor acknowledges or be judicially notified of any assignment of a right for the assignment to be effective in barring the application of certain legal effects relative to the assignor (e.g. set-off); consequently, should any interest in an ISDA Master Agreement be transferred, it is advisable that judicial notification of the transfer be effected or an acknowledgement in writing of the transfer sought from the other party. This acknowledgement need not take any specific form so long as it is clear that the other party is acknowledging the assignment of any right under the ISDA Master Agreement.
- 2.10 Certain provisions in the ISDA Master Agreements relating to pre-liquidated damages may be re-characterised by the courts of Malta as other agreements (such as an agreement on interest or as a penalty clause), which would then be subject to certain limitations or discretions applicable to the re-characterised transaction; with reference to penalties and by way of elucidation, the courts of Malta have a discretion to abate the penalty, particularly in case of part-performance by the debtor so as to ensure that the penalty faithfully reflects the loss suffered by the non-defaulting party.
- 2.11 Directive 2002/47/EC of the European Parliament and Council of the 6<sup>th</sup> June 2002 on financial collateral arrangements (the “**FC Directive**”) was transposed into Maltese law by the Financial Collateral Arrangements Regulations, 2004 (the “**Financial Collateral Regulations**”) - Legal Notice (LN) 177 of 2004 (as amended). The Financial Collateral

Regulations were issued under the Set-Off Act and came into force on the 1<sup>st</sup> May, 2004. In view of recent amendments, the parameters of the Financial Collateral Regulations have been made wider than those of the FC Directive. Broadly speaking, the Financial Collateral Regulations apply so long as one of the parties to the financial collateral arrangement is either:

- (i) a credit institution as defined in Article 1(1) of Directive 2000/12/EC;
- (ii) an investment firm as defined in Article 1(2) Council Directive 93/22/EC; or
- (iii) one of the other institutions as laid down in Article 1(2)(a – d) of the FC Directive; or
- (iv) any other collective investment scheme which is licensed or recognised in terms of the Investment Services Act or otherwise licensed or authorised by a competent authority in a recognised jurisdiction (this is not found in the FC Directive).

The only caveat to this is that the other party must be a legal person (rather than a natural person).

The Financial Collateral Regulations have a number of important effects in so far as so-called ‘financial collateral arrangements’ are concerned. The Financial Collateral Regulations may possibly be relevant to the ISDA Master Agreement, to the extent that the latter may in certain instances be classified as a ‘financial collateral arrangement’.

One of the purposes of the Financial Collateral Regulations is to protect close-out netting from the potential adverse effect of various insolvency rules. Since, however, under Maltese law, close-out netting and set-off in insolvency are in any case valid and enforceable in terms of the Set-Off Act, the Financial Collateral Regulations, if applicable, would not have any material impact on our analysis and conclusions set out above.

- 2.12 No opinion is expressed by us to the extent that the ISDA Master Agreement or a Transaction under it is or gives rise to either: (a) a “transfer order” or netting effected through payments or securities settlement systems or action taken under the rules of a designated system, or (b) constitutes “collateral security” provided in relation to the participant’s operations within such systems, in each case as defined in the Central Bank of Malta Directive No. 2 (the “**Settlement Finality Directive**”) issued under the Central Bank of Malta Act (Chapter 204 of the Laws of Malta), which transposes the provisions of Directive 98/26/EC on settlement finality in payment and securities settlement systems.

The purpose of the Settlement Finality Directive is to preserve the validity of certain instructions (transfer orders) and to enable collateral security to be realised in priority to the application of certain insolvency laws.

A “transfer order” is, broadly, any instruction by a participant to place at the disposal of a recipient an amount of money by means of a book entry on the accounts of a credit institution, settlement agent or the Central Bank of Malta, or any instruction which results in the assumption or discharge of a payment obligation, or any instruction by a participant to

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transfer the title to, or interest in, a security or securities by means of a book entry on a register, or otherwise.

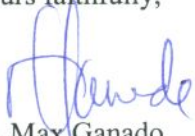
“Collateral security” means, broadly, all realisable assets provided under a pledge (including money provided under a pledge), a repurchase or similar agreement, or otherwise, for the purpose of securing rights and obligations potentially arising in connection with a system.

- 2.13 To the extent that any transactions set out in Annex A may be classified as a promise to purchase or promise to sell under the Civil Code of Malta (this is particularly relevant for options), then specific formalities apply for the preservation of rights and their enforcement. The formalities arise in terms of Article 1357(2) of the Civil Code and failure to observe them within the strict time limits stated in the Civil Code will result in the loss, under Maltese Law, of the remedy of specific performance and possibly also the lapse of the right to damages for non-performance of the promise to re-sell. On the assumption that a remedy for specific performance in terms of the option is sought in Malta, these rules may be deemed to be of a procedural nature and as a result Maltese law as the law of the forum would override the choice of law in the ISDA Master Agreement limited to these formalities.
- 2.14 We are aware of the debate as to whether certain derivative transactions may be recharacterised as an insurance contract. This could possibly have two major implications: (a) any person carrying on the business of insurance in or from Malta needs to be authorised by the Malta Financial Services Authority (as the Competent Authority); and (b) such a derivative may have to comply with the requisites of an insurance contract under Maltese law. Maltese law does not throw any light as to whether a derivative contract entered into in breach of the above Maltese insurance laws would still be enforceable or otherwise by the ‘insured’, but it does state that no contract of insurance is void or voidable by an ‘insurer’ by reason only that there has been a breach of Maltese insurance regulatory laws. Derivative transactions such as credit derivatives and weather derivatives are still rather uncommon in Malta and accordingly this debate as to their real nature under Maltese law is still in its infancy. If the matter were ever to be determined by the Malta Financial Services Authority or by the Maltese Courts, regard will be paid to the interpretation and usage of foreign jurisdictions, particularly the United Kingdom, Italy and France, in order to determine whether a particular derivative contract should be recharacterised as an insurance contract or otherwise. We express no opinion as to whether a derivative transaction could be recharacterised as an insurance contract.
- 2.15 In terms of the Investment Services Act, 1994 (Cap. 370 of the Laws of Malta) (the “ISA”), a person who provides or holds himself out as providing an investment service “in or from within Malta” must be in possession of a valid investment services licence or otherwise comply with the applicable rules governing the exercise of passporting rights in Malta. Swaps and other contracts for differences fall within the parameters of the ISA. There are no local guidance notes as to what constitutes the provision of services *in* or *from* Malta. The ISA lays down that an investment service entered into in breach of the said licensing requirement would be unenforceable by such person in breach against the other party. For the purposes of this opinion, we assume that no person entering into the ISDA Master Agreement

requires a licence under the ISA, or to the extent that they are operating in or from Malta, they are in possession of such a licence.

This opinion is given for the sole benefit of the Malta Bankers' Association and its members and may not be relied upon by any other person without our prior written consent.

Yours faithfully,



Dr. Max Ganado  
Ganado & Associates



Dr. Conrad Portanier  
Ganado & Associates

**Annex A - Transactions under ISDA Master Agreements**

**Basis Swap.** A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

**Bond Option.** A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

**Bullion Option.** A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

**Bullion Swap.** A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the New York Commodity Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

**Bullion Trade.** A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a 'spot' or two day basis or on a specified future date. A Bullion Trade maybe settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price.

For purposes of Bullion Trades, Bullion Options and Bullion Swaps, 'Bullion' means gold, silver, platinum, or palladium and 'Ounce' means, in the case of gold, a fine troy ounce, and in the case of silver, platinum and palladium, a troy ounce.

**Buy/Sell-Back Transaction.** A transaction in which one party purchases a security (in consideration for a cash payment) and agrees to sell back that security to the other party (in consideration for the original cash payment plus a premium).

**Cap Transaction.** A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap) or commodity price (in the case of a commodity cap).

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Collar Transaction. A collar is a combination of a cap and a floor where one party is the floating rate or floating commodity price payer on the cap and the other party is the floating rate or floating commodity price payer on the floor.

Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. The payment calculation is based on the quantity of the commodity and is settled based, among other things, on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g., Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

Credit Protection Transaction.<sup>5</sup> A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a 'Reference Obligation') issued, guaranteed or otherwise entered into by a third party (the 'Reference Entity') upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. Credit protection transactions may also be physically settled by payment of a specified fixed amount by one party against delivery of specified Reference Obligations by the other party. A credit protection transaction may also refer to a 'basket' of two or more Reference Entities.

Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument.

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<sup>5</sup> Some market participants may refer to credit protection transactions as credit swaps, credit default swaps or credit default options.

Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and or final exchanges of amounts corresponding to the notional amounts.

Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

Currency Swap. A transaction in which one party pays periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity of shares of an issuer to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

Equity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation to purchase (in the case of a call) or sell (in the case of a put) shares of an issuer or a basket of shares of several issuers at a specified strike price. The share option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

Equity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor's 500 Index.

EU Emissions Allowance Transaction. A transaction in which one party agrees to purchase a specified quantity of emissions allowances at a future date at an agreed price and the other party agrees to deliver that quantity of emissions allowances for that agreed price.<sup>5</sup>

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<sup>5</sup> EU Emissions Allowances are a very recent concept, which concept finds no analogy under Maltese law. Such allowances can be viewed from a public law perspective, in that they regulate the state vis-à-vis the operator, as

Floor Transaction. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in the case of an interest rate floor) or commodity price (in the case of a commodity floor).

Foreign Exchange Transaction. A transaction providing for the purchase of one currency with another currency providing for settlement either on a 'spot' or two day basis or a specified future date.

Forward Rate Transaction. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

Freight Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency based on a fixed price and the other party pays an amount or periodic amounts of the same currency based on the price of chartering a ship to transport wet or dry freight from one port to another; all calculations are based either on a notional quantity of freight or, in the case of time charter transactions, on a notional number of days.

Inflation Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency by reference to interest rates or other factors and the other party pays an amount or periodic amounts of a given currency based on a specified rate of inflation.

Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation to receive a payment equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of put option) a specified strike rate.

Interest Rate Swap. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

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well as from a private law perspective, in that Allowances create rights in the hands of the operator. We will assume for the purposes of this opinion that such emission allowances are private law rights. In any case, we are of the opinion that this interpretation should be the better view. The reason for this assumption is that if an emission allowance is deemed to be a public law right, then arguably it cannot form the subject of sale or of a collateral arrangement. However, such an interpretation would in our view run counter to the spirit and wording of the law in that the EU Directive clearly states that such allowances are to be tradeable.

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Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a commodity, such as coal, electricity or gas, at a fixed or floating price for actual delivery on one or more dates.

Repurchase Transaction. A transaction in which one party agrees to sell securities to the other party and such party has the right to repurchase those securities from such other party at a future date.

Securities Lending Transaction. A transaction in which one party transfers securities to a party acting as the borrower in exchange for a payment or a series of payments from the borrower and the borrower's obligation to replace the securities at a defined date with identical securities.

Swap Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to enter into a swap with certain specified terms. In some cases swap option maybe settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a 'Reference Obligation') issued, guaranteed or otherwise entered into by a third party (the 'Reference Entity'), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation.

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.

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