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Trading Agreements and COVID-19: Addressing Force Majeure, Market Disruptions, and Traders Working Remotely

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The nearly global response to the spread of the deadly Coronavirus has led to governmental authorities at all levels issuing “stay-at-home orders,” “orders to close non-essential businesses,” and bans on gatherings of 10 people or more. The resulting shut-down, as well as the impact of widespread remote-working practices and displacement of personnel, may disrupt or interrupt trading and hedging activity. In the face of this uncertainty, financial counterparties, including swap dealers (“SDs”) and non-SDs (“**Financial Counterparties**”), and commercial end users (“CEUs”) are reviewing the potential impacts on derivatives markets and the availability of those financial markets to adequately hedge commercial risks and provide needed price discovery functions.

This alert highlights some key considerations that financial market participants should take into account in managing their hedging and trading activities, including when performance and regulatory obligations may be excused, what disruption fallbacks may be available,¹ and strategies to address regulatory compliance when trading personnel are working remotely.

Force Majeure Events

A party whose ability to perform under a financial derivative agreement is impacted due to COVID-19 events should consider whether its performance is actually delayed or prevented by a Force Majeure Event, as defined in its financial derivative agreement.

The standard 1992 ISDA Master Agreement (“**1992 ISDA**”) does not include a Force Majeure clause unless parties elect to adhere to the ISDA Illegality/Force Majeure Protocol (or otherwise modify the Schedule to their 1992 ISDA to include a bespoke force majeure provision). Under the standard ISDA 2002 Master Agreement (“**2002 ISDA**”), however, Termination Events include a Force Majeure Event, which would occur with respect to a party if, by reason of force majeure or act of state:

- (i) the Office through which such party (which will be the Affected Party) makes and receives payments or deliveries (whether absolute or contingent) with respect to a Transaction is prevented from making or receiving any such payment or delivery or from complying with any other material provision of the Agreement relating to such Transaction (or would be so prevented if such payment, delivery or compliance were required on that day) or (ii) it becomes impossible or impracticable for such Office so

¹ The scope of this alert focuses on force majeure and commodity disruption fallbacks set forth in standardized documentation published by the International Swaps and Derivatives Association (“**ISDA**”) and, unless otherwise specified herein, any capitalized terms used herein will have the meanings specified in the 2002 ISDA Master Agreement or, if not specified therein, in the ISDA 2006 Definitions and/or the ISDA 2005 Commodity Definitions. Market participants should also note that analogous provisions are also contained in other commonly-used physical commodity trading agreements, including the NAESB, EEI, NAEMA, WSPP, and various GTCs used for crude oil, refined petroleum products, ethanol and other liquid fuels markets (and in separate ISDA-published standard definitions used for equity derivative and FX derivative products), as well as more bespoke similar terms used in one-off trading agreements negotiated on a more ad-hoc basis. The ISDA standard provisions described herein, like other ISDA terms, are also subject to modification or amendment by the parties in any particular agreement and so market participants should take note to carefully review the terms applicable to their trading and hedging relationships, including any relevant amendments or modifications.

to perform, receive or comply (or would be if such payment, delivery or compliance were required on that day); or

- (i) such party or any Credit Support Provider of such party (which will be the Affected Party) is prevented from performing any absolute or contingent obligation to make or receive a payment or delivery which such party or Credit Support Provider has under any Credit Support Document relating to such Transaction or from complying with any other material provision of such Credit Support Document (or would be so prevented if such payment, delivery or compliance were required on that day), or (ii) it becomes impossible or impracticable for such party or Credit Support Provider so to perform, receive or comply (or would be if such payment, delivery or compliance were required on that day),

so long as the force majeure or act of state is beyond the control of such Office, such party or such Credit Support Provider, as appropriate, and such Office, 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 Force Majeure Event clause applies only after giving effect to any applicable provision, disruption fallback or remedy specified in the Confirmation or elsewhere in the ISDA Agreement.

Application of the Force Majeure Event Provisions

A determination of whether a force majeure clause excuses performance based upon a COVID-19 event is a fact-specific inquiry, even when specific events are expressly listed in the force majeure definition. Generally, U.S. courts have interpreted force majeure clauses narrowly and have held that economic changes, such as a decline in the price of the underlying commodities, or a disruption or diminution in the demand for certain products or goods (even if sudden or drastic), do not constitute force majeure events.

In general, for a party to be able to claim successfully that its performance was excused by a Force Majeure Event, that party must be able to demonstrate that its failure to perform was directly or indirectly prevented or delayed by the event alleged to be a Force Majeure Event and that such Force Majeure Event could not have been avoided by such party's reasonable diligence.

The specific Force Majeure Event clause in the 2002 ISDA would likely have very narrow application with respect to payments or deliveries for either a financial institution counterparty or a CEU under any financially-settled derivative unless that party's Office were truly unable to communicate with its financial institution or financial institutions were incapable of receiving or sending wires or making transfers of securities or other financial assets. While many jurisdictions have issued COVID-19-related shelter-in-place orders, most such orders in the U.S. as of the date of this alert have provided exemptions for employees in the financial services sector within the category of "essential services" or "essential businesses," so in the absence of additional extenuating factors, it currently appears unlikely that financial institutions would be prevented from sending or receiving, or unable to send and receive, wires or make transfers of securities or other financial assets.

As described above, any counterparty that is a financial institution would find it particularly difficult to claim that its ability to perform a payment or delivery obligation under a financially-settled derivative agreement is prevented or delayed by a COVID-19 event. The same is true for most CEUs under a financially-settled derivative agreement. However, for various types of CEUs, the impact of a governmental authority's order closing non-essential businesses could conceivably have an adverse impact on such CEUs ability to perform a payment or delivery obligation under a financially-settled derivative agreement that could satisfy the definition of Force Majeure Event. We note that any such assessment would be fact-specific and the CEU attempting to claim force majeure as an excuse for its failure to perform a payment or delivery obligation under a financially-

settled derivative agreement would likely bear a difficult burden of proving that it was prevented from performing its payment or delivery obligation by an event that constitutes a Force Majeure Event.

The Force Majeure Event clause may have greater applicability, on the other hand, for certain physically-settled derivatives transactions—for example, a party may be unable to perform, or may be prevented from performing, its obligation to make or take delivery of a physical commodity because of a shortage of workers, if such workers are not deemed “essential critical infrastructure workers,” or by a required closure of certain factories or plants, or facilities required to process, ship or deliver relevant products or commodities.

In the United States, most COVID-19 related “shelter-in-place,” “stay-at-home,” or “closure of non-essential business” orders refer to the “Advisory Memorandum on Identification of Essential Critical Infrastructure Workers During COVID-19 Response” dated March 28, 2020, and published by the U.S. Department of Homeland Security’s Cybersecurity & Infrastructure Security Agency (“CISA”), found [here](#), or its predecessor memorandum dated March 19, 2020 (collectively, together with each other update or amendment thereto, the “CISA Memo”), found [here](#), as establishing the list of essential critical infrastructure workers that are exempt from those various State and Local governmental orders. Accordingly, market participants that are CEUs, who may be contemplating asserting the existence of a Force Majeure Event as an excuse for a failure to timely perform an obligation under a physically-settled derivative agreement should carefully review the State and Local governmental orders issued in response to the COVID-19 outbreak in the applicable jurisdictions in conjunction with a review of the CISA Memo, to determine if a Force Majeure Event under the 2002 ISDA is occurring and has delayed or prevented such CEU’s performing its obligations under such physically-settled derivative agreement. Market participants should note that the ISDA North American Gas Annex and the ISDA North American Power Annex, which govern physically settled gas and power transactions, have independent Force Majeure provisions that supersede the standard ISDA Force Majeure Event provisions described in this section, and so parties whose transactions are subject to such annexes should make sure to carefully review such alternative Force Majeure provisions.

Even if an event constitutes a Force Majeure Event, under the Hierarchy of Events in the 2002 ISDA, a Force Majeure Event would only prevent Events of Default where the underlying event or circumstance consists of (i) a party’s failure to perform its payment or delivery obligations (Section 5(a)(i)); a party otherwise breaching the Agreement (following the 30-day grace period) (Section 5(a)(ii)(1)); and a party’s or its Credit Support Provider’s failure to comply with any of the terms of any Credit Support Document (after giving effect to any applicable grace period) (Section 5(a)(iii)(1)).

Market Disruption Events

A party whose ability to perform under a financial derivative agreement is impacted by COVID-19 events should also consider whether its performance can be said to have been delayed or prevented by a Market Disruption Event, such as when a particular market that sets the floating price under a particular Transaction ceases to operate as a result of COVID-19.

The ISDA 2005 Commodity Definitions (“**Commodity Definitions**”) contain Market Disruption Events and Disruption Fallback provisions so that parties can agree on the circumstances under which market disruptions will be deemed sufficient to suspend (among other things) the use of an initially agreed commodity reference price, and on an alternative mechanism to calculate commodity prices and “floating price” payments in effect under (or, if applicable, adjust or terminate) relevant commodity derivative transactions.

The standard set of Market Disruption Events in the Commodity Definitions include triggers for:

- price source disruption (including failure to publish, temporary or permanent discontinuance, or failure to obtain sufficient dealer quotes (if dealer quotes are the selected source));
- trading disruption (including material suspension or limitation of trading on the specified exchange);
- disappearance of commodity reference price (permanent discontinuance or disappearance of the relevant commodity, trading of it or the commodity reference price);
- material change in formula or method of calculating commodity reference price;
- material change in content, composition or constitution of the commodity or futures contract; and
- tax disruption (imposition or change in or removal of a specified tax).

If the relevant ISDA Agreement and Confirmation are silent, each of the above will apply as Market Disruption Events (other than the tax disruption event, which will only apply if elected by the parties in the relevant Confirmation)². Parties should carefully review their existing ISDA Agreements and Schedules as well as any other modifications that may have been made to the applicable Market Disruption Events, whether in an amendment to the ISDA Agreement or a Confirmation, in order to determine whether a particular event or unavailability of any pricing source information would constitute a Market Disruption Event for purposes of any financial hedging transaction between two counterparties.

If the Calculation Agent, after consulting with the counterparty, determines in good faith that a Market Disruption Event (or any other Additional Market Disruption Event the parties may have agreed upon) has occurred, it will apply the Disruption Fallbacks (as outlined in the default order of priority shown below, or such other order of priority as may be agreed by the parties in the applicable Schedule) in order to determine a replacement for the relevant “floating price” payment or any relevant component thereof that is unavailable due to a Market Disruption Event.

The standard Disruption Fallbacks under the Commodity Definitions include:

- fallback reference price (if any is specified);
- three methods to be attempted concurrently³:
 - delayed publication or announcement;
 - postponement; and
 - negotiated fallback;
- fallback reference dealers⁴;
- no fault termination⁵; and
- calculation agent determination (only if elected by the parties)

² For bullion transactions, only the first three Market Disruption Events listed above will apply by default under the Commodity Definitions.

³ The Calculation Agent will attempt to determine the commodity reference price through the delayed publication or announcement method for up to two Commodity Business Days, following which it will use the postponement method, or negotiated fallback if unable to determine using either method.

⁴ The Calculation Agent will use the fallback reference dealer’s method if unable to determine using negotiated fallback within five Commodity Business Days (or any other period specified as the “**Maximum Days of Disruption**”).

⁵ The Calculation Agent will use the no fault termination method if unable to determine using quotes from fallback reference dealers within three Business Days after ceasing to use the negotiated fallback method.

If the relevant ISDA and Confirmation are silent, the first six methods above will be attempted, in the sequence set forth above (with delayed publication or announcement, postponement and negotiated fallback attempted concurrently), while the calculation agent determination method will only be used if it is specified in the applicable Confirmation.

The parties may also specify different Disruption Fallbacks other than those listed above, or modify the hierarchy to skip certain fallbacks, move others higher or lower in the priority, or designate alternative fallbacks. Again, parties should carefully review all relevant documents (including amendments and Confirmations) to verify whether any material modifications have been made to the Market Disruption Events and Disruption Fallback provisions for a particular Confirmation, and to analyze what (if any) fallbacks should be applied to any Transactions for which a Market Disruption Event occurs as a result of COVID-19.

It is important to note that the same underlying events could potentially constitute both a Market Disruption Event under the Commodity Definitions and a Termination Event (including a Force Majeure Event) under the 2002 ISDA. ISDA's standard hierarchy rules specify that, in such a scenario, the Disruption Fallbacks outlined above would apply in priority to the Force Majeure Event or other Termination Event provisions⁶.

London Metals Exchange Suspension of "Ring" Trading

A recent market suspension arising out of the Coronavirus/COVID-19 pandemic, and the related social distancing and temporary displacement of personnel experienced by financial institutions and exchanges, has provided the derivatives market with an opportunity to view how the parties to an ISDA Agreement would apply the Market Disruption Event and Disruption Fallback provisions of a typical ISDA Agreement to COVID-19 related events.

On March 23, 2020, the London Metals Exchange ("**LME**") temporarily suspended open outcry trading (in the "**Ring**"⁷) for non-ferrous base metals trading until such time as conditions normalize in respect of COVID-19, at which time Ring trading would be expected to resume⁸. Trading in non-ferrous base metals will now occur solely electronically on the "LMEselect" platform and via inter-office trading (prior to the suspension, open outcry trading in the Ring was used to set daily lunchtime and closing prices for base metals, with electronic trading occurring during the remainder of the trading day).

Under the Market Disruption Event framework under a typical ISDA Agreement, a suspension such as the LME's suspension of Ring trading could potentially fall under multiple categories, such as a price source

⁶ By contrast, the ISDA hierarchy rules also specify that, in case of an event constituting both a Force Majeure Event and an Event of Default (e.g., Failure to Pay, Breach of Agreement or Credit Support Default), the Event of Default provisions would apply in priority to the Force Majeure provisions.

⁷ Named for the distinctive ring of curved red-leather benches that form its open outcry trading ring, continuing the tradition begun when metals merchants traded around a circle on the sawdust floor of a London coffeehouse in the early 19th century. "[LME Fines Copper Traders for 'Standing' in the Ring](#)," by Xan Rice, Financial Times, July 21, 2014.; "[Historic LME Trading 'Ring' to Fall Silent Under Virus](#)," by Henry Sanderson and Neil Hume, Financial Times, March 17, 2020.

⁸ See [LME Notice 20_067](#), dated 17 March 2020, [LME Notice 20_069](#), dated 19 March 2020; and [LME Notice 20_073](#), dated 23 March 2020.

disruption, trading disruption, or a material change in formula; careful consideration of the facts and circumstances and the parameters of each such trigger event would be needed.

As the Calculation Agent specified in each ISDA Agreement or Confirmation would generally have the duty to determine whether a Market Disruption Event had occurred for each related trade, neither ISDA nor LME nor any other centralized body had the authority to declare whether this suspension constituted a Market Disruption Event.

Looking at the publicly acknowledged facts⁹, however, indicates that temporary recourse to electronic trading in case the Ring is not available was contemplated in the LME's current business continuity policy, which some market participants have argued would be inconsistent with a finding that a material change in formula or method of calculating commodity reference price(s) had occurred as a result of the suspension. Similarly, an argument that a price source disruption or trading disruption had occurred would require evidence that the LME had failed to publish pricing data or that trading had been materially suspended or limited. Ultimately, such determinations will have to be made by the relevant Calculation Agents under the applicable parameters set forth in the applicable ISDA Agreements as described above, in good faith and after consultation with the relevant counterparties.

Regulatory Compliance Plans When Trading Personnel Work Remotely

As noted in our recently published client **alert**, the Staff of the U.S. Commodity Futures Trading Commission ("CFTC") recently published several no-action letters issuing temporary relief to various entities registered with the CFTC from certain regulatory compliance obligations made difficult by the fact that employees of registered entities were working remotely (e.g., relief from a registered swap dealer's obligation to record phone calls of trading personnel while such personnel are working from their homes). Notwithstanding the temporary relief afforded to registered entities by the CFTC Staff's no-action letters, all market participants, including Financial Counterparties, CEUs and speculators, should still ensure that they have processes and systems in place to monitor, detect, mitigate and prevent market manipulation and other disruptive behavior by their trading personnel.

To that end, a few practices that all financial market participants, whether registered entities (such as SDs) or CEUs, may consider implementing in their internal regulatory compliance programs include:

- Requiring that trading personnel working remotely may only negotiate and execute trades when she/he is alone in a secured work area at a person's home and not in any public space (e.g., no trading by email, instant message ("IM") or phone while visiting Starbucks);
- Ensuring that multiple people, including legal counsel, are copied on all material correspondences delivered by trading personnel using email or IM relating to Transactions, including submitting a written request to each counterparty stipulating that all correspondence include multiple designated people on all email and IM communications;
- Requiring personnel to use only company-issued laptops, iPads, phones, e-mail addresses, and mobile phone numbers to correspond with counterparties, negotiate material terms, make or receive material pre-trade communications regarding quotes, estimates and/or indicative terms, and execute trades;

⁹ See footnotes 7 and 8, *supra*.

- Requiring personnel to use commercially reasonable efforts to comply with all company recordkeeping and record retention policies (in addition to any other such policies or requirements under applicable laws, regulations and/or rules of self-regulatory bodies or exchanges), subject to any applicable modifications contemplated in relevant business continuity plans;
- Placing any printed confidential materials into a locked drawer or cabinet and logging out of or locking computers when leaving workspaces in the homes of trading personnel for any extended period of time, and ensuring that any discarded materials are first shredded before they are discarded; and
- Consider having a two-person signing/approval process for all trades executed while trading personnel are working remotely, or, at a minimum, requiring Swap Dealer counterparties to send all Confirmations generated by such Swap Dealers to at least two different employees of any market participant that is a CEU.

Market participants should then ensure that they continue to monitor all phone, email and IM communications of their trading personnel, as well as any open bids, open offers, or executed trades (either continuously or from time to time) to detect any inappropriate trading strategies or any manipulative or market disruption behavior affecting the derivatives markets. Market participants should also monitor all inquiries and other communications from the CFTC and other relevant regulatory agencies made to any of its trading personnel.

For more information or any questions on the matters covered in this publication, please contact any of the lawyers listed below.

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