Escape From the Island of the One-Way Termination: Expectations and Enron v. TXU

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The New South Wales Supreme Court case of Enron Australia v TXU Electricity [2003] NSWSC 1169 (TXU) has sparked significant recent interest and debate. Did the Supreme Court of a common law jurisdiction, by refusing to require a Non-defaulting Party under a two-way termination (or Second Method) ISDA to make any further payments due to the bankruptcy of the Defaulting Party, effectively turn the ISDA into a limited two-way termination (or First Method or “walk-away”) contract? Or did the Court simply enforce the ISDA in exactly the manner in which its drafters intended all along? Does this decision place the capital adequacy of some banks at risk? Or is the case’s outcome just a result of unusual counterparty conduct? And would a court reach the same result with a bankrupt party in the U.S.?

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Letter from the Editors:
Crystal Ball Gazing at the New Year

Once again, it is that time of year when it is popular to gaze into the crystal ball to foresee the events that will occur in the coming months. Our ball provides a unique mix of economic and social data. Before turning to the future, however, we can score ourselves on how well we performed in predicting 2004 at this time last year.

We won some; and lost some. And some are still outstanding. We said that former executives who drove their companies on to the rocks in accounting scandals (Enron, WorldCom, Tyco and Adelphia) would be indicted, convicted and incarcerated. Though there were some convictions this year (Adelphia), these cases remain mostly outstanding and no one has been incarcerated. That said, this prediction remains for 2005.

Eurex did buy BrokerTec, as we foretold, paving the way for its launch in the U.S. We were also right about the SEC’s adoption of hedge fund regulations; President Bush’s narrow re-election; Arafat’s death; the slow rise in interest rates and (unfortunately for a Yankee fan) the Red Sox World Series victory.

On the other hand, we missed the mark predicting the passage of an energy bill expanding the CFTC’s jurisdiction over electronic energy markets; Howard Dean’s Democratic party nomination (makes you want to scream, doesn’t it?); a merger of the Chicago Mercantile Exchange and the Chicago Board of Trade; and Saddam Hussein’s execution. The jury is still out on whether Chief Justice Rehnquist will resign in 2004 or the Dow close at 11,500.

With the past as prologue, what major events will occur in 2005? Here are our best guesses:

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How the Court Read the ISDA

Enron Australia went into voluntary administration on December 3, 2001, and then into liquidation on January 29, 2002. At the time, it had 78 open electricity swaps under a 1992 ISDA Master Agreement ("ISDA") with TXU Electricity Ltd., some with terms to the end of 2005, with an alleged mark-to-market value to Enron of A$3.3 million. Enron's administration and liquidation were Events of Default under §§5(a)(vi)(6) and (5), respectively, of the ISDA.

As the Non-defaulting Party, TXU had the option to designate an Early Termination Date under ISDA §6(a). Enron and TXU had elected to have the Termination Payment calculated using Second Method, under which the Non-defaulting Party calculates the Settlement Amount, and whichever party is out-of-the-money, whether or not it is the Defaulting Party, pays that value to the other. In contrast, under a First Method election, the Non-defaulting Party need not pay any money to the Defaulting Party, even if the Non-defaulting Party is out-of-the-money to the Defaulting Party. Since TXU's position was out-of-the-money, termination would have required it to pay Enron the net mark-to-market value of the 78 positions. So instead of declaring an Early Termination Date, TXU simply suspended payments under §2(a)(iii) of the ISDA. Enron sought to force an Early Termination and settlement of the swaps, but the Court refused to do so.

The Court noted that §2(a)(iii) conditions each party's payment obligations under each swap on the non-existence of any Event of Default with respect to the other party, and on the non-occurrence of an Early Termination Date. "[I]f either condition has not been met at any given time, there is no payment obligation under any of the trades ... . [A] payment obligation will spring up ... once the relevant condition is satisfied, and in that sense it might be said (with only approximate accuracy) that the payment obligation is 'suspended' while the condition remains unfulfilled, and that amounts 'accrue' notwithstanding that the condition is unfulfilled." (TXU 12) Enron's becoming subject to the appointment of an administrator (§5(a)(vi)(6)) or being placed into liquidation (§5(a)(vi)(5)) (TXU 13-14), were Events of Default "with the result that the payment obligations have continued to be 'suspended.'" (TXU 14)

"[T]hese clauses gave TXU, but not Enron, the contractual right to designate an Early Termination Date in respect of all outstanding Transactions, and then to settle by making or receiving a payment calculated under Section 6(e)(ii)(3), thereby terminating those Transactions. ... While the [ISDA] authorises TXU as the Non-defaulting Party to initiate the early termination procedure, it does not oblige TXU to do so ... . [I]n the absence of any such step being taken by TXU, there will continue to be no payment obligations in respect of any outstanding Transactions.” (TXU 18-20)

The Order Sought by the Liquidators

Enron’s liquidators sought an order requiring that TXU determine an amount payable in respect of an Early Termination Date, as though TXU had designated an Early Termination Date as the Non-defaulting Party. The Court's decision was relatively narrow and based on provisions of the Australian Corporations Act that are somewhat similar in purpose (if not in scope or application) to §365 of the U.S. Bankruptcy Code (the “Bankruptcy Code,” or the “Code”). Under §365, a U.S. debtor has substantial discretion and the benefit of the “business judgment rule” in deciding which executory contacts to keep and which to reject. An Australian debtor, however, “cannot disclaim a contract (other than an unprofitable contract or a lease of land) except with leave of the court?” Then, assuming the Australian Court allows the debtor to disclaim (reject) such a contract, the Court may also “make such orders in connection with matters arising under, or relating to, the contract as the court considers just and equitable.” Since the swap agreements were profitable contracts for Enron, it needed two things from the Court. First, it needed approval to disclaim them under §568, and second, it needed an additional order imposing their early termination and settlement, in which case TXU would immediately owe Enron the settlement amount.

The Enron/TXU ISDA Schedule provided for an Additional Termination Event: a party having satisfied all payment and delivery conditions under §2(a)(i) and having no future payment or delivery obligations could declare an Additional Termination Event if the other party refused to make a payment based on §2(a)(iii). The liquidators' position was that with this provision, upon the expiration of the last outstanding Transaction, Enron would be entitled, under ISDA §§6(b) and (e), to declare an Early Termination Date anyway, even though it would still be in default under §5(a)(vii). Since it was “in-the-money” with respect to the swap agreements, Enron argued that they were assets of the estate and that it was in the best interest of the estate to realize on those assets now, rather than waiting until the expiration of the last trade. However, if the swap agreements were disclaimed without further orders, Enron was concerned (with good reason) that it would forfeit its right to recover the net settlement value. Accordingly, it asked the Australian Court to enter an order that would, in effect, make Enron's disclaimer an event triggering final settlement of all open trades, pursuant to the terms of the swap agreements and on the same basis as if TXU had designated an Early Termination Date. The only issue decided by the Court was whether it had the power to enter such an order.
The Court considered a number of statutory sections in its analysis but, in the end, concluded that it lacked statutory authority to enter an order altering the parties’ substantive rights and obligations with respect to the swap agreements.

“The order sought by the plaintiffs against TXU would ... require TXU to take a step under the Agreement that it would not otherwise be obliged to take, namely the step of designating an Early Termination Date and thereby causing final net payment to be calculated ... It is ... a term of the Agreements that for as long as an Event of Default continues there will be no liability on the Non-defaulting Party to make any payment pursuant to any trade or Confirmation. ... The wording of [Corporations Act §568(1)(B)] does not permit the Court to bestow on the company in liquidation substantive rights that it did not have under the contract to be disqualified. It does not ... permit the Court to deprive the counterparty of its contractual ... right not to designate an Early Termination Date ... after an Event of Default occurs and the right under section 2(a)(iii) not to make a payment under section 2(a)(i) while an Event of Default continues.” (TXU 41-44)

The Court left unanswered whether TXU had merely postponed the inevitable, but acknowledged the issue of whether Enron might (or might not) be entitled to payment upon the expiration of the final trade.12 In the meantime, however, Enron had no right to payment and no way to trigger early termination.

In a Legal Vacuum, Everyone Screams

The most delightful aspect of a case such as this is the disproportionate global ripples that it sets off. Intense analysis and speculation as well as broad, formal reviews have been set in motion by a case that, in large, part, enforced a contract as written in a manner close enough to what must have been intended.13 From Canada came news that “there is concern about whether [banks] will be able to net transactions documented under the Master Agreement. The impact that this would have on derivatives markets is so severe that the Financial Services Authority of the United Kingdom has asked the Bank of England’s Financial Markets Law Committee to assess the impact of [TXU] on regulatory capital netting requirements in the United Kingdom.”14 The fear is that if application of §2(a)(iii) could change Second Method contracts into First Method, it would compromise banks’ rights to net for capital adequacy purposes.15 The Financial Markets Lawyers Group of the Federal Reserve Bank of New York is joining with the Financial Market Law Committee of the Bank of England in a joint working group to review what the outcomes of the case would have been if decided under US and UK law, and to consider potential regulatory issues arising from such outcomes, including from a regulatory capital perspective.

Was a Second Method Contract Converted into First Method?

At first glance, it is unclear whether the Court converted the contract into a First Method contract. It did not specifically address whether or not TXU would eventually have to pay in accordance with the provision of the language in the Schedule, or if the non-bankrupt party’s payment obligations can remain “suspended” indefinitely.

Despite the hue and cry, Kimberly Summe, general counsel of ISDA, advises that ISDA is “happy with the decision, which is nothing terribly new, in the sense that it affirms how §2(a)(iii) has been thought to operate for the past 15 years.” She explains that, “although TXU decided not to designate an Early Termination Date, the obligations never disappear.”16 Most non-defaulting counterparties want to declare the Early Termination Date, because they want to get the transaction off their books, and avoid exposure to further market moves. If these counterparties had collateralized their relationships, which were allegedly in-the-money for Enron, Enron would have been able to call on that collateral. The automatic stay would have prevented TXU from getting back any of the collateral, and if collateral had to stay with Enron, TXU would have been incented to name an Early Termination Date. The obligations are still there, and most firms as a practical matter would have declared the Early Termination Date.”

Under §2(a)(iii), the payment (or delivery) obligation is merely suspended, and does not disappear. Some have interpreted the decision as a victory for the enforceability of the “flawed asset approach,” which is the suggestion that the 1992 ISDA “could be amended to provide that a [T]ermination [P]ayment owed to a Defaulting Party would be calculated by subtracting from the amounts otherwise owed to the Defaulting Party any amounts owed by the Defaulting Party and its Affiliates under other agreements,”17 claiming the decision “represents one of the few cases which supports the enforceability of flawed asset provisions on insolvency. The ... ‘flaw’ of a flawed asset cannot be disclaimed without disclaiming the ‘asset’ as well.”18 In other words, §2(a)(iii) can be viewed as part of the netting, and a step separate from, and preceding, application of First or Second Method.

Some have suggested that if Enron were to emerge from administration, rather than being liquidated, or that if Enron’s insolvency case was closed such that Enron was no longer “in bankruptcy,” the payment obligation would also revive. However, in those instances, an Event of Default might still be continuing and thus the §2(a)(iii) condition unsatisfied and the obligation to pay not revived. For example, because the bankruptcy condition lasted more than 30 days (§5(a)(vii)(4)(B)), the default is incurable, and not cured by emerging from bankruptcy. Or, absent a confirmed plan or scheme and a reorganized debtor, the
Defaulting Party may still be “insolvent or … unable to pay its debts” (§5(a)(vii)(2)), or it may be liquidated (§5(a)(vii)(5)) or dissolved (§5(a)(vii)(1)). These defaults may be continuing even if the case is closed or dismissed and the Defaulting Party is no longer in bankruptcy. The end of the administration or bankruptcy process does not necessarily mean the end of the default, and, depending on the parties’ additional scheduled terms, if any, the Non-defaulting Party might still be entitled to suspend the obligation to pay under §2(a)(iii)(1). The answer may hinge on whether the provisions of ISDA §2(a)(iii) are modified or overridden, as Enron argued in TXU.

Interestingly, even if faced with a First Method contract, Enron would have likely continued undaunted. Enron Power Marketing Inc., in its U.S. bankruptcy, also pursued a strategy claiming ability to change the terms of swap agreements containing terms that no longer suited it, for example by claiming that the First Method, even though chosen by the parties at the outset, was unenforceable as a penalty.20

**A Financially Firm Diamond Isn’t Forever: Limiting the Flaws to the Asset**

There is no contractual limit in the ISDA on the time that a Non-defaulting Party can suspend its obligations whilst an Event of Default is continuing. Interestingly, this result would not obtain in the case of physical power traded under the Edison Electric Institute (“EEI”) Master Power Purchase and Sale Agreement (and Power Transactions under the EEI/ISDA Power Annex), which has a 10 business day limit on a Non-defaulting Party’s suspension rights. The drafters of the EEI recognized that the ISDA had an indefinite suspension right under Section 2 and for that very reason imposed a time limit on the right to suspend, keeping in mind the need to cover physical obligations with specified times and places for delivery. Even so, they did not limit the time to exercise the termination right contractually. Kimberly Summe, general counsel of ISDA, notes that when ISDA drafted the 2002 ISDA Master Agreement, the concept of a “window” for termination was discussed extensively, and the overwhelming majority of entities participating opposed any type of window for exercising a Non-defaulting Party’s termination rights, because they wanted to give the Non-defaulting Party breathing room to assess what other creditors were doing with respect to the Defaulting Party before deciding when (if ever) termination would be in the Non-Defaulting Party’s best interest.

Additionally, parties to an ISDA can address concerns respecting the effect of the “flawed asset” provision through adding specific terms to their ISDA Schedules, by electing Automatic Early Termination, through Additional Termination Events (as Enron apparently tried to do), or other strategies.21

Also of note, under the 1992 ISDA, when the Non-defaulting Party’s obligations are suspended, for example under §2(a)(iii), interest continues to accrue against the Defaulting Party but not the Non-defaulting Party, because the Defaulting Party’s obligations are not suspended. Under the 2002 ISDA Master Agreement, interest does accrue against the Non-defaulting Party.

**What Would Have Happened in U.S. Bankruptcy Court?**

Could a non-debtor counterparty achieve the same result in a U.S. Bankruptcy Court, or would the *ipso facto* provisions of the Bankruptcy Code dictate a different outcome? The Code contains several provisions prohibiting the enforcement of contract terms that are triggered by the insolvency or financial condition of the debtor, the commencement of a bankruptcy case, or the appointment of a trustee, receiver or custodian. Such terms, generally referred to as “*ipso facto* clauses,” are disfavored because they run contrary to the philosophical goal of the Code to encourage continued dealing with the debtor so that it has a fair opportunity to reorganize its affairs.

For example, as noted above, a U.S. debtor appears to have more flexibility under §365 of the Bankruptcy Code than its Australian counterpart has under §568 of the Corporations Act. In general, the U.S. debtor’s decision whether to assume or reject a contract is governed by the business judgment rule, and courts are reluctant to substitute their judgment for the good faith business judgment of the debtor’s management. If the contract is rejected, it is as if the debtor had breached the contract immediately before the bankruptcy was filed, and the non-debtor party is left with a claim for breach of contract, usually unsecured, but is excused from further performance of the contract. If the contract is assumed, the debtor must cure all defaults, or provide adequate assurance of such cure, as a precondition to assumption. The contract can then (with limited exceptions) be assigned to a third party, notwithstanding any provision in the contract that would limit assignment without the consent of the other party. There are exceptions to the cure requirement, the primary example of which is that the debtor is not required to cure a pre-bankruptcy default that is based on a breach of a provision in the contract relating to insolvency or having filed bankruptcy, i.e., an *ipso facto* clause.

On the other hand, §560 of the Bankruptcy Code provides that the “exercise of any contractual right of any swap participant to cause the termination of a swap agreement because of a condition of the kind specified in §§365(e)(1), i.e., insolvency, filing bankruptcy, or the appointment of a trustee] or to offset or net out any termination values or payment amounts arising under or in connection with any swap agreement shall not be stayed.”

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avoided, or otherwise limited by any provision of” the Bankruptcy Code. Thus, the existence of an *ipso facto* termination clause in swap agreements is an exception to the general rule, in that it can be enforced; if the contract so provides, the non-defaulting counterparty can terminate and net out existing swap transactions if the other party becomes insolvent, files bankruptcy or has a trustee appointed. But that does not address the situation here, where TXU has not terminated, but has simply stopped paying due to a failed condition precedent. In other words, we know the Code’s *ipso facto* prohibition does not apply to termination of swaps, but does the Code ban “*ipso facto*” conditions precedent?

TXU ceased making payments to Enron before the commencement of the voluntary administration, but the decision does not disclose the basis for pre-bankruptcy suspension of payments. However, it seems clear from the Australian Court’s decision that the “Events of Default” relied on by TXU were §5(a)(vii)(6)after December 3, 2001 and §5(a)(vii)(5) after January 29, 2002. (TXU 14)

In short, TXU suspended performance of the agreements on the basis of Enron having entered into voluntary administration and subsequent liquidation. The Bankruptcy Code, however, prevents the non-debtor party from modifying its post-bankruptcy performance of a contract on the basis of an *ipso facto* clause. The Australian Corporations Act apparently has no such provision, which is a significant difference that may keep a U.S. counterparty from achieving what TXU did. Furthermore, although §560 allows the non-debtor counterparty to exercise *ipso facto* rights to terminate, offset and net out, thus avoiding the effect of the automatic stay, it makes no provision for suspending performance. Given the express listing of specific termination rights in §560 and the fact that §560 is an exception to the general rule of the automatic stay, the express prohibition against *ipso facto* modification of performance in §365(e) makes it unlikely that §560 would allow for *ipso facto* suspension of performance, even if allowed under the parties’ contract.

As noted above, a debtor under the Bankruptcy Code has the option to assume and assign (i.e., sell) its executory contracts. Section 365(b)(2) provides that the debtor does not have to cure, as a prerequisite to assumption, any default that is a breach of a provision in the contract relating to (1) the insolvency or financial condition of the debtor at any time before the closing of the case, (2) filing bankruptcy, (3) the appointment of a trustee or (4) a penalty rate or default arising from the failure to perform a non-monetary obligation. With the exception of the non-monetary default provision, §365(e) parallels §365(b), except that subsection (e) prohibits the non-debtor counterparty from terminating or modifying the contract or any right or obligation under the contract after commencement of the case “solely because” of a provision in the contract that is conditioned on these same factors. Thus, if the only basis for suspension of post-petition performance is the default under an *ipso facto* clause in the contract, the suspension would violate §365(e).

However, even if §365(e) would force the non-debtor to continue performing the swap contract, that’s not the result that Enron tried to achieve in the TXU case. Enron was not trying to assume its swap agreement with TXU; it was, in effect, trying to reject the contract but still keep the benefit of its bargain by netting out the forward position as if the swap agreements had been terminated according to the early termination provisions, i.e., to capture the value inherent in its positions based on then-current market conditions. Continued performance without the declaration of an Early Termination Date would not achieve the immediate netting benefit that Enron was after and neither would §365(e), which simply requires the parties to continue performing. So long as the non-debtor cannot be forced to declare an Early Termination Date and the debtor lacks the contractual right to declare an Early Termination Date, each one is simply enjoying the benefit of its bargain, and both are in the same situation as if there had been no bankruptcy. Thus, Enron might have been able to compel TXU to resume performance of the swap agreements in a U.S. Bankruptcy Court, but it could not have forced the declaration of an Early Termination Date. Absent election of the “Automatic Early Termination” provision in the ISDA Schedule, it seems that the debtor in a U.S. bankruptcy proceeding would have no better luck than Enron did in trying to force an early termination and netting.

However, that’s not necessarily the end of the story. The Australian court decision was a very narrow decision and held only that the Court did not have the power to modify the parties’ agreement without the consent of both parties. A U.S. Bankruptcy Court would likely reach the same conclusion. But what if there were another default that did not run afoul of the *ipso facto* provisions? Could the non-defaulting, non-debtor counterparty suspend performance and not be forced to resume payments? Several situations come to mind that are readily foreseeable in the ISDA context.

The provisions of §365(e) are only intended to protect the debtor and the debtor’s contracts. They do not apply to the financial condition of one not a party to the contract, and they do not protect a non-debtor. For example, what if the default relied upon by TXU had been the bankruptcy or insolvency of a Credit Support Provider, rather than the bankruptcy of Enron Australia? Many entities entered into swaps and other commodity trading relationships with Enron subsidiaries with the requirement of a guarantee from Enron Corp. Enron Corp.’s bankruptcy filing would be a breach of the credit support obligation and an Event of
Default under ISDA §§5(a)(iii) and/or 5(a)(vii), regardless of whether the subsidiary was in bankruptcy. Suspension of performance based on the bankruptcy of the Credit Support Provider would not be a modification of the contract based on the financial condition or bankruptcy of the subsidiary and would therefore not fall within the reach of §365(e).

Likewise, the decision to liquidate a counterparty that was not itself the debtor in bankruptcy (e.g., Enron Canada, which never filed bankruptcy), or was a “Specified Entity” identified in the ISDA Schedule, would likely be an Event of Default under ISDA §§5(a)(vii)(5). Nothing in §365(e), or anywhere else in the Bankruptcy Code, would prevent *ipso facto* suspension of performance owed to a party not in bankruptcy, even if every other member of the corporate family was in bankruptcy.

But that’s still not the end of the story. What about §365(b) and the requirement to cure the non-*ipso facto* defaults? Eventually, the debtor must assume or reject the contract, either in conjunction with a plan of reorganization or as part of a liquidation. If an in-the-money contract can be assumed and assigned to a creditworthy third party, the debtor gets at least part of its liquidated value. But what if the contract cannot be assumed due to a default not excused by §365(b)? There is a split in the circuits as to whether the debtor must cure all non-monetary defaults as a precondition to assumption.39 Would not the bankruptcy of a Specified Entity or the failure of a Credit Support Provider be such a non-monetary default? If so, in some Circuits, at least, the inability to cure that default might also prevent assumption of the contract. The contract could then neither be assumed as part of the debtor’s plan of reorganization or assigned (sold) as part of a liquidation.

Although a contract may be out-of-the-money at the time of the bankruptcy filing, the Non-defaulting Party may not want to terminate, hoping that the equity could swing in its favor with time. If the market moves in favor of the Non-defaulting Party, it could arguably reduce its exposure to zero by timely termination. Alternatively, the debtor’s rejection of that contract prior to the Non-defaulting Party’s termination could potentially limit the debtor’s liability to the Non-defaulting Party, or the claim of the Non-defaulting Party on the debtor’s estate, since rejection would be a breach as of, under §365(g)(1), “immediately before the date of the filing of the petition.” A non-debtor worried about the debtor’s ability to use this de jure breach to set damages as of the filing date could terminate when it receives notice of the motion to reject, if damages as of that date were more favorable to it.30 Admittedly, this would achieve the debtor’s goal of having a termination declared and a termination payment due. If the debtor plays the rejection card early, it might take away the non-debtor’s potential claim on the estate due to a contract moving into the money for the Non-defaulting Party or leave it with a prepetition claim; but while it’s not likely, the authors are not aware of any cases deciding whether the debtor can use rejection to give itself the right to have the Termination Payment calculated as of a filing date chosen by the debtor, a right it specifically gives the Non-defaulting Party in the ISDA. Further questions are presented, not addressed here, if either Party made post-petition payments to the other on the contract prior to its termination or rejection.

The New South Wales Supreme Court answered the precise question presented, and in so doing, reached the same conclusion that a U.S. Bankruptcy Court would likely reach if presented with the same question—may an in-the-money debtor/insolvent Defaulting Party collect the current mark-to-market value of its positions as if an Early Termination Date had occurred, even if not declared by the Non-Defaulting Party? Answer: no, the courts cannot re-write the parties’ contract without their consent. Not answered, however, is the subsequent question: what happens to the swap (and its value) in the ensuing liquidation? Can it be assumed and sold as under the U.S. Bankruptcy Code? Or is the §2(a)(iii) condition, combined with a literal reading of the §5(a)(vii) bankruptcy events of default, a bar to enforcement by the debtor/insolvent (prior to liquidation) or by a transferee?31 The answer is also important to any swap market participant that would not reorganize under chapter 11, such as a U.S. bank or insurance company, and to any non-U.S. market participant subject to an insolvency regime not permitting assignment of executory contracts. What market participants (and their regulators and auditors, to name a few interested constituencies) want to know is, in the end, will TXU have to pay up?

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2 See ISDA at §6(c)(i)(3).

3 “Each obligation of each party under Section 2(a)(i) is subject to (1) the condition precedent that no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing, (2) the condition precedent that no Early Termination Date in respect of the relevant Transaction has occurred or been effectively designated and (3) each other applicable condition precedent specified in this Agreement.”

4 Note that “[t]he conditions precedent in this provision apply only to obligations under Section 2(a)(i)—the scheduled payments and deliveries relating to specific Transactions—and not to obligations that arise by virtue of early termination of Transactions under the Agreement.” 2 A. Gooch & L. Klein, *Documentation for Derivatives* at 803-04 (4th ed. 2002).

5 With respect to whom previously, in the Parliament of New South Wales, the Deputy Leader of the Opposition had asked the Treasurer, “Now that proceedings brought against Integral Energy by the liquidators of Enron Australia have concluded, … can he guarantee that the company is not simply pursuing legal action and wasting taxpayers’ money in an effort to avoid its contractual obligations?” NSW Legislative Council Hansard, 17 September 2002, Page 4771 (article 12).
11 U.S.C §365 governs the debtor’s right, subject to certain limitations, to pick and choose among its leases and other executory contracts, keep those that are favorable or otherwise desirable for reorganization, and reject the rest. Rejection is treated as if the Debtor had breached the contract immediately prior to the bankruptcy filing.

See Division 7A §566 (A) of the Corporations Act of 2001 (Ch).

11 Interestingly, prior to enactment of the current U.S. Bankruptcy Code in 1978, some courts had interpreted the prior Bankruptcy Act in the same manner, requiring a contract to be burdensome, i.e., involve some loss or disadvantage to the estate, before it could be rejected.

12 Potentially, some of the Transactions were in-the-money for Enron, and some were not, but on an aggregate basis netting all Transactions one against the other, as permitted by the architecture of the ISDA, there seems likely that Enron could have declared an Early Termination Date. In fact, there was an alleged A$3.3 million value to Enron.

13 One experienced practitioner observed, "Suggesting the proposition that a payment or performance obligation was an alleged A$3.3 million value to Enron.

14 InOpHistoric/bankone.TC.WPD.pdf.

15 Initially, the parties framed two questions: (1) whether the terms of the Additional Termination Event shall occur under: “(i) An Event of Default occurs with respect to a party (‘Party X’), if Party X has satisfied all its payment and delivery obligations under Section 2(a)(i) with respect to all Transactions and has no future payment or delivery obligations to the other party (‘Party Y’) whether absolute or contingent under Section 2(a)(ii), and Party Y refuses to make a payment to Party X based upon the condition precedent in Section 2(a)(iii). For the purpose of the foregoing Termination Event, the Affected Party shall be Party X. However, despite Section 6(b)(iv) which would only allow Y as the non-Affected Party, to designate and Early Termination Date, Party X is the party entitled to give the notice under Section 6(b)(iv) designating the Early Termination Date for the foregoing Termination Event.” (TXU 22)

16 Significantly, the narrow question presented to the Australian Court did not require the Court to consider this issue. See note 11, infra.

17 Initially, the parties framed two questions: (1) whether the terms of the swap agreements themselves would result in the designation of an Early Termination Date upon Enron’s disclaimer; and (2) if not, whether the Corporations Act empowered the Court to enter an order appropriating such an effect to a disclaimer. Prior to the hearing, the parties stipulated that the answer to the first question was “no,” leaving only the second question for the Court. The Court was careful to point out that even if it had decided that it did have such power, further proceedings would have been necessary before it decided whether to exercise its discretion to do so.

18 Given the Additional Termination Event apparently included on the Enron/TXU ISDA Schedule, and assuming Enron’s liquidation could have been delayed until 2005—after the expiration of the final trade—it seems likely that Enron could have declared an Early Termination Date and TXU would have been compelled at that juncture to pay up (assuming the net value at that time continued to be in Enron’s favor). It seems anomalous, to say the least, that Enron’s creditors, by forcing or accepting a liquidation prior to the expiration of the last swap agreement, would be deprived of the economic benefit of Enron’s bargain. Notably, however, they would have foregone any continuing exposure to market risk—if the position had reversed prior to the liquidation, TXU would have become a creditor and all creditor recoveries would have been diluted.

19 One experienced practitioner observed, “I think it stands for the unenviable position that a defaulting party cannot terminate a contract based on its own default.”

20 McMillan Binch LLP, Derivatives Bulletin: Australian Court Decision Has Troubling Implications for Netting Under the ISDA Master Agreement (Sept. 2004). A moderation of this statement is rumored to be forthcoming.

21 And a host of other substantial potential direct and indirect consequences to regulatory accounting, credit risk management, and mark-to-market income, among many issues. Cf. Bank One v. Commissioner, 120 T.C. No. 11 (2003), available at http://www.ustaxcourt.gov/opinions/dml/03-46590_20031223.pdf (contract in question was not an ISDA, but rather a self-bastardizing stepchild forward contract. Because the DOE is a governmental unit, which is not a “person” as defined in §101(41), it could not be a “forward contract merchant” under §101(26).


23 Although Bankruptcy Code §560 probably does not permit an ipso facto termination of a swap entered into post-petition, see Speiser & Venokur, “Doing Business with Chapter 11 Entities,” Derivatives Report, Oct. 2003 at 1-4, a debtor-in-possession will likely wish to document any such swaps to avoid the risk of its own bankruptcy as a reason for the non-bankrupt counterparty to suspend performance.

24 “(6) seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all of its assets;”

25 “(5) has a resolution passed for its winding-up, official management or liquidation (other than pursuant to a consolidation, amalgamation or merger);”

26 As noted below, infra at note 29, there is a split of authority among the U.S. Circuit Courts of Appeal as to the meaning and application of the “non-monetary” default provision.

27 Some parties appear to have responded to TXU by adding to trading contracts: (a) bankruptcy as an Automatic Termination Event and (b) a rather transparent (to our readers at least) clause reading: “If Bank-
Australia's New Financial Services Licensing Regime

By Edward Kerr & Alexander Morris

Introduction

Entities outside Australia intending to provide financial services to persons in Australia need to be aware of recent developments in Australian financial services regulation.

Entities that have no connection with Australia, other than entering into derivative or foreign exchange transactions with Australian counterparties, may be required to obtain an Australian financial services licence or take active steps to ensure that they enjoy the benefit of an exemption from this requirement.

Breaches of the Australian financial services licensing regime can give rise to criminal sanctions and the possibility that Australian counterparties can rescind transactions.

Australia's New Financial Services Licensing Regime

As a result of the Financial Services Reform Act 2001 (Cwlth), Australia has a unified financial services licensing regime. Since 11 March 2004 anyone carrying on a financial services business in Australia must have an Australian Financial Services licence or enjoy the benefit of an exemption from this requirement.¹

Importantly:

- a person may be taken to be carrying on a financial services business in Australia even though they have no physical presence in Australia;² and
- an exemption does not arise merely because a person deals only with institutional Australian counterparties (e.g. Australian banks, financial services licenceholder, insurers, fund managers and other financial service providers).

Consequences of Contravention

A person who carries on a financial services business in Australia without the benefit of an Australian financial services licence or applicable exemption, commits an offence which is punishable by fines of up to A$22,000 and 2 years imprisonment (natural persons) or fines of A$110,000 (corporations).³ In addition, ASIC may seek to injunct a person who they think is contravening the licensing regime.⁴ There have also been instances of officers of a foreign body corporate being restrained from leaving Australia pending investigations relating to a failure to hold a Australian financial services licence.⁵

Furthermore, Australian counterparties to financial services transactions with unlicensed persons may be entitled to rescind those transactions.⁶ It might be expected that liquidators of insolvent Australian companies will look to this remedy as a method of maximising returns to other creditors. This possibility may be a significant credit issue for foreign entities that have dealings with persons in Australia.

When Will an Offshore Entity Be Caught by This Regime?

On ASIC’s view of the new licensing regime, an entity must comply with the regime if they provide “financial services” to Australia clients with a degree of continuity and repetition.

Although there is some relief for offshore persons who provide financial services only to Australian “wholesale clients,”³ the Australian regulator (ASIC) takes the view that an offshore person who regularly provides financial services to Australian wholesale clients still requires an Australian financial services licence or an exemption.⁴

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“Financial services” include:
• providing “financial product” advice;
• dealing in a “financial product” (dealing also includes “arranging” for someone else to deal in a financial product);9
• making a market for a “financial product”;
• operating a registered scheme; and
• providing a custodial or depository service in respect of a “financial product.”10

“Financial products” are broadly defined as facilities through which a person makes a financial investment, manages a financial risk or makes a non-cash payment.11

Furthermore, certain products are deemed to be financial products, including derivatives (which include spot, swap, repo, option, or forward transactions in currency, commodities, metals, rates and indexes), foreign exchange contracts, securities, managed investment products, government debentures, stocks or bonds and certain types of insurance.12

Therefore, an offshore entity13 that regularly enters into “dealings” with Australian counterparties in derivatives (which are not entered into or acquired on a financial market) or foreign exchange contracts (whether or not they are entered into on a financial market) must hold an Australian Financial Services licence or fall within an exemption to this requirement.

In addition, given the broad definition of the term “making a market,” it is almost inevitable that a person will “make a market” in derivatives or foreign exchange contracts if they regularly effect dealings in derivatives or foreign exchange contracts with an Australian counterparty in the manner that is normally adopted on the international financial markets.14 Outside of forming a view on the international over-the-counter markets for derivatives and foreign exchange contracts.

Possible Solutions for Offshore Entities That Are Caught by This Regime

There are a number of exemptions that may be of use to offshore entities who regularly transact derivatives or foreign exchange contracts with persons in Australia. The following is an outline of some of the commonly used exemptions. Importantly, these exemptions apply only where the Australian counterparty is a “wholesale client.” If an offshore entity provides financial services (regularly or otherwise) to Australian “retail clients,” it is almost certain that an Australian financial services licence is required.15

(a) Transactions arranged, effected or mediated by an Australian financial service licensee

There are a number of licensing exemptions that apply where an Australian financial services licensee is involved or concerned with a unlicensed offshore entity providing financial services to a person in Australia.16 Whether these exemptions apply turns on the circumstances of the particular transaction and its parties. However, except where an offshore entity has a standing arrangement with an appropriately licensed related body corporate or joint venturer, these exemptions are of limited application in the bilateral over-the-counter markets for derivatives and foreign exchange contracts.

(b) Offshore entities that have a limited connection with Australia

As mentioned above, ASIC Class Order 03/824 has granted some relief from the broad jurisdiction provisions of the licensing regime to offshore entities that provide financial services only to Australian “wholesale clients.” The precise effect of this relief is controversial and ASIC has shown an inclination to interpret it narrowly.

Nevertheless, this relief may be of use to offshore entities that:
• provide financial services to Australian wholesale clients from outside Australia;
• never undertake onshore activities within Australia; and
• take certain steps to minimise further their connection with Australia.

(c) Dealing in derivatives by an offshore person with an Australian licensee ( Corporations Regulation 7.6.01(ma) )

There is also a licensing exemption that arises where an offshore entity enters into principal to principal dealing in derivatives with an Australian financial services licensee and the transaction is governed by a master agreement that was “initiated” by the Australian financial services licensee.17 However, this exemption does not extend to any “market making” in derivatives that is carried on by the offshore entity or to foreign exchange contracts (these include Spot foreign exchange contracts and any foreign exchange derivative that is settled in less than three business days). Furthermore, the meaning of “initiate” is problematic.

(d) Offshore entities that are regulated by an approved foreign regulator

ASIC has announced a policy under which it will grant licensing relief to offshore entities that provide financial services to Australian wholesale clients and are regulated by foreign regulators that are approved by ASIC.18
To date, ASIC has issued class order relief to certain types of entities that are regulated by:

- the Securities Exchange Commission (United States of America);\(^{19}\)
- the Federal Reserve Board and Comptroller of the Currency of the United States (United States of America);\(^{20}\)
- the Commodity Futures Trading Commission (United States of America);\(^{21}\)
- the Financial Services Authority (United Kingdom);\(^{22}\)
- the Bundesanstalt für Finanzdienstleistungsaufsicht (Germany);\(^{23}\)
- the Monetary Authority (Singapore);\(^{24}\) and
- the Securities and Futures Exchange (Hong Kong).\(^{25}\)

In order to take advantage of the licensing exemptions contained in these class orders, an eligible offshore entity must take certain measures, including lodging a deed with ASIC that contains prescribed undertakings, appointing an Australian agent for service of legal process or registering as a foreign company in Australia and making certain prescribed disclosures to Australian clients.

Each of these class orders was granted following the submission of a detailed application by either an industry body or individual entity. In order for ASIC to grant relief it must be demonstrated that there are satisfactory cooperation arrangements between ASIC and the foreign regulator and that the foreign regulatory regime is sufficiently equivalent to the Australian regime. ASIC is amenable to granting similar exemptions to entities that are regulated under other foreign regimes provided that adequate cooperation and sufficient regulatory equivalence are demonstrated.

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1. Section 911A(1) of the Corporations Act 2001 (Cwlth).
2. Section 911D of the Corporations Act 2001 (Cwlth).
3. ASIC Class Order 03/824. Section 761G of the of the Corporations Act 2001 (Cwlth) defines the term “wholesale client.”
4. ASIC QFS 130 “I am a foreign entity providing financial services to Australian wholesale clients. Are there any exemptions from the AFS licensing requirement that apply to me?”
8. Part 7.6, Division 11 Corporations Act 2001 (Cwlth). An Australian counterparty will not be allowed to rescind a contract if it is itself the holder of an Australian financial services licence.
9. There is an “own dealing” exception pursuant to which a person will not be regarded as dealing in a financial product for the purposes of the licensing regime if they are dealing on their own behalf. However, this exception generally does not apply where a person is the issuer of a financial product or is dealing in the financial product as agent or trustee: section 766C of the Corporations Act 2001 (Cwlth). This restriction on the “own dealing” exception is of particular significance in relation to derivatives and foreign exchange contracts because both parties to a derivative that is not entered into on a financial market will be regarded as its issuer and it is likely that the same is true of foreign exchange contracts (whether or not they are entered into on a financial market): section 761E of the Corporations Act 2001 (Cwlth).
10. Section 766A of the Corporations Act 2001 (Cwlth).
11. Section 763A(1) of the Corporations Act 2001 (Cwlth).
12. Section 764A(1) of the Corporations Act 2001 (Cwlth).
13. It is assumed that the offshore entity and its Australian counterparties are not related bodies corporate and the offshore entity is not hedging a business risk that arises in the course of a business that is not a financial services business.
14. c.f. QFS 122 “What guidance can ASIC give me about when I ‘make a market’?”
15. The terms “retail client” and “wholesale client” are defined in section 761G of the Corporations Act 2001 (Cwlth).
16. Corporations Regulation 7.6.01(1)(n) & 7.6.01(1)(na); sections 911A(2)(b) & 911B(3) of the Corporations Act 2001 (Cwlth).
17. Corporations Regulation 7.6.01(1)(ma).
19. ASIC Class Order 03/1100.
20. ASIC Class Order 03/1101.
21. ASIC Class Order 04/0829.
22. ASIC Class Order 03/1099.
23. ASIC Class Order 04/1313.
24. ASIC Class Order 03/1102.
25. ASIC Class Order 03/1103.
Hedge Fund Update: SEC Adopts Hedge Fund Adviser Registration Proposal

By Milton K. Buckingham

Well, the day of reckoning finally has arrived—the Securities and Exchange Commission has spoken. Hedge fund managers, get your Forms ADV and Chief Compliance Officers ready!

The SEC Acts

As has been widely reported, including in this column and elsewhere in this publication, hedge funds have been high on the SEC’s very active radar screen for several years now. On the heels of the SEC staff report, Implications of the Growth of Hedge Funds, this summer the SEC requested public comment on a proposed rule and rule amendments that would require most hedge fund managers to register as investment advisers under the Investment Advisers Act of 1940. A little over one month after the comment period closed, at an open meeting on October 26, 2004, the SEC commissioners voted, on a controversial 3 to 2 count, to adopt these rule and rule amendments substantially as proposed. The new rule and rule amendments will become effective on February 1, 2006. Thus, hedge fund managers will have over a year to become registered and put in place the compliance procedures and other formal controls required of registered advisers.

What Is Changing: An Overview

Under Section 203(b) of the Advisers Act, an investment adviser that holds itself out to the public as such and has 15 or more “clients” during any 12-month period must register as an investment adviser. Currently, Advisers Act Rule 203(b)(3)-1 permits advisers to count a pooled investment vehicle, such as a hedge fund, as a single client. Many hedge fund managers have relied on this rule to manage up to 14 funds without registering with the SEC. Now, the new rule, Rule 203(b)(3)-2, provides that advisers to “private funds” may no longer rely on the counting rules of Rule 203(b)(3)-1 to count a fund as a single client. Instead, the new rule will require advisers to private funds to “look through” the fund and count each investor in the fund as a client for registration purposes. This is so regardless of whether the adviser participated or assisted in the formation of the fund. Rule 203(b)(3)-2 will have the effect of requiring a hedge fund manager with $25 million or more of assets under management (the jurisdictional threshold for application of the Advisers Act registration requirement) and 15 or more investors in funds it manages to register with the SEC as an investment adviser.

Rationales for the New Rule and the Dissenting Views

By now, the stated rationales for “mandatory registration” are well known, as are the arguments against the rule and the assumptions underlying the rule. In adopting the new rule, the commissioners in the majority and the SEC staff stressed that the new rule would (1) permit the SEC to collect information about hedge funds and their managers that previously have been generally unavailable, (2) permit the SEC to conduct examinations of managers to identify compliance issues and deter questionable practices, (3) require managers to comply with recently adopted compliance requirements, and (4) prevent felons and other “bad apples” from managing hedge funds.

Two SEC commissioners opposed the new rule for the same reasons they previously stated when the rule was proposed. Their opposition was based, among other things, on (1) the lack of a clearly articulated problem that would be addressed by mandatory registration, (2) the likely unintended consequences of the new rule, and (3) the diversion of significant staff inspection and enforcement resources from other areas under the SEC’s jurisdiction.

In response to the dissenting commissioners’ argument regarding the lack of staff resources, the staff stated at the open meeting that a staff task force will be formed to develop a risk-based inspection model to allow the staff to allocate optimally its inspection resources. The staff has indicated that the risk-based inspection model will be completed by the mandatory compliance date, February 1, 2006.

Summary of New Rule

As of press time, the new rule and rule amendments have not been published. The full text of the adopting release is expected to be available on the SEC’s web site shortly. However, the following is a summary of the major features of the new rule and rule amendments based upon oral statements made by the SEC staff and commissioners at the open meeting. The discussion below is qualified in its entirety by the final text of the new rule and rule amendments.

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**Private Funds.** As mentioned above, Rule 203(b)(3)-2 will require advisers to private funds to count each investor in a fund as a client for registration purposes. Under the new rule, a “private fund” is a company (1) that would be an investment company under the Investment Company Act of 1940 but for the exemption provided by either Sections 3(c)(1) or 3(c)(7) under that Act, (2) that permits its owners to redeem any portion of their ownership interests within two years of the date purchased, and (3) the ownership interests of which are offered based on the advisory skills, ability or expertise of the investment adviser.

**Two-Year Lock-Up.** Rule 203(b)(3)-2 will exclude certain funds from the new look-through provisions if they maintain a two-year “lock-up” before redemptions are permitted. The main purpose of this requirement is to exclude managers of private equity and venture capital funds from the registration requirement. Hedge fund managers that impose a two-year lock-up may continue to count each of these funds as a single client. It appears that the two-year lock-up will be required only for new investors after the mandatory compliance date of February 1, 2006 and will include additional investments by existing investors. Pre-existing investors not subject to the two-year lock-up will be grandfathered. However, redemptions will be permitted under extraordinary circumstances, which are not yet fully defined.

**Elaboration of Counting/Assets Requirements.** In the open meeting approving the rule, the SEC staff said that, for purposes of counting the hedge fund manager’s number of clients, the manager will not be required to count “insiders” of the manager who invest in the manager’s funds. In addition, amounts invested by those insiders will not be counted toward the $25 million jurisdictional threshold. At this time, it is unclear how the SEC will define an “insider” for this purpose.

**Further Look-Through for Funds-of-Funds.** Advisers also will be required to count as clients the investors in private funds-of-funds and registered investment companies that invest in the private funds they manage. The result is a double “look-through” for hedge funds with registered and unregistered funds-of-funds as investors, making it virtually impossible for managers of funds accepting fund investors to avoid registration.

**Books and Records.** To facilitate the transition for hedge fund managers who will be required to register under the new rule, the SEC has amended the Advisers Act recordkeeping rule, Rule 204-2, to permit a newly registered adviser to use performance information relating to the period prior to its registration without being subject to the requirement that it maintain records supporting that performance information. The SEC also has amended the recordkeeping rule to clarify that the books and records of a hedge fund manager will include records of the hedge fund for which the manager acts as general partner, managing member or in a similar capacity.

**Performance Fees.** Under Advisers Act Rule 205-3, SEC-registered advisers may only charge performance-based compensation to “qualified clients” (generally, persons or entities with a net worth of more than $1.5 million or at least $750,000 under the adviser’s management). The SEC has amended Rule 205-3 to permit hedge fund managers to continue to charge performance-based fees to investors who were invested in private funds prior to the manager’s SEC registration, even if the investors are not qualified clients.

**Custody Rule.** Advisers Act Rule 206(4)-2 requires registered advisers to pooled investment funds who are deemed to have custody of the assets of the funds to maintain those assets with a qualified custodian and provide quarterly statements of the assets and securities in the fund’s account. The adviser is exempt from this requirement if the fund is subject to an annual audit and the adviser distributes audited financial statements of the fund to investors within 120 days of the end of the fund’s fiscal year. Responding to concerns raised by fund-of-fund managers about their timely receipt of financial statements from the funds in which they invest, the SEC has extended the 120-day period to 180 days for managers of funds-of-funds.

**Non-U.S. Advisers.** Currently, investment advisers located outside of the United States must count as clients persons that are U.S. residents. Under the new rule, a hedge fund manager located outside the U.S. will be required to “look through” the private funds it manages and count as its clients all U.S. resident investors for purposes of determining the number of its clients. This requirement will not apply to publicly offered offshore funds that are regulated as investment companies under non-U.S. law.

In addition, in response to concerns raised should a non-U.S. person later move to the United States, the SEC staff stated that an investor’s residency status for purposes of the rule would be determined solely at the time of the investor’s investment in the fund.

The SEC also is limiting the extraterritorial application of the Advisers Act for non-U.S. advisers of offshore funds. Rule 203(b)(3)-2(c) will exempt non-U.S. advisers from complying with the substantive provisions of the Advisers Act with respect to the non-U.S. investors of its offshore funds. This is consistent with prior SEC no-action letters.

**Form ADV Amendments.** The SEC is amending Form ADV, the basic registration form for investment advisers, to identify advisers to hedge funds. The current Form ADV collects information about advisers to pooled investment vehicles without distinguishing hedge fund managers from other advisers.
State Registration Requirements

Under the bifurcated federal-state system of investment adviser regulation in the United States, advisers with assets under management of less than $25 million are unable to register with the SEC under the Advisers Act. Instead, those smaller advisers must register with one more states, unless an exemption is available under the relevant state’s or states’ laws. Many states have registration exemptions similar to the exemption at the federal level, whereby a private adviser with fewer than a minimum number of clients is not required to register under state law. The adoption of new Rule 203(b)(3)-2 does not directly change any state investment adviser registration requirements. However, it is possible that certain states might seek to adopt “look-through” rules similar to Rule 203(b)(3)-2, under which hedge fund managers not registered with the SEC would be required to register in those states.

Implications of the New Rule

By most accounts, the majority of hedge fund managers are not registered as investment advisers under the Advisers Act or the law of any state. Requiring most hedge fund managers to register as investment advisers will pose significant implications for managers, including requiring managers to comply with several major new or substantially revised SEC requirements. These requirements include, among other things, preparing written compliance procedures, codes of ethics, and proxy voting policies, and appointing a chief compliance officer. Hedge fund managers with at least $25 million under management would be well served to begin thinking about the registration process, which can take up to 2 to 3 months, and how they will satisfy these and other ongoing compliance requirements once they become registered.

Letter from the Editors: (continued from page 2)

- CFTC re-authorization will pass Congress with only minor revisions to the Commodity Exchange Act, including enhanced CFTC authority over electronic energy markets.
- Hedge funds will continue their growth in assets unabated.
- The CBOT will follow the CME and become a publicly traded company.
- The CFTC finishes the year still without a full compliment of five commissioners.
- The Dow closes 2005 at 13,000 as interest rates continue a slow ascent.
- Everyone will be talking about China and the futures industry’s interest in developing markets in the world’s fastest growing economy. To that end, the Futures Industry Association announces that it will hold an Asian derivatives and futures conference in China.
- Chief Judge J. Harvie Wilkinson III of the United States Court of Appeals, Fourth Circuit, is confirmed as Chief Justice of the United States Supreme Court.
- The Eagles win the Super Bowl (we also made that prediction for 2004 … wrong) and the Red Sox repeat (ugh.)
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