The Companies and Allied Matters Act (Repeal and Re-Enactment) Bill 2019 – What you need to know (Part 6 - Netting)

Udo Udoma & Belo-Osagie

BACKGROUND

The Companies and Allied Matters Act (Chapter 28 of the CAMA) was enacted into law in 1990, and the most recent version is the Companies and Allied Matters Act (Repeal and Re-enactment) Bill 2019 (CAMA Bill), which passed into law in January 2019, passed into law. In this series, which is scheduled to run for 12 weeks, Udo Udoma & Belo-Osagie will provide insights and digestible excerpts on the effect of key changes proposed by the CAMA Bill.

WHAT IS NETTING?

Netting is the process by which a net obligation is reduced in financial contracts by aggregating two or more obligations or payments and offsetting them against each other in order to achieve a reduced single net obligation. Chapter 28 of the CAMA Bill deals with the subject of netting and is one of the innovations of the CAMA Bill (the CAMA does not contain any provisions on netting). Netting is an essential element of many qualified financial contracts such as repurchase contracts and derivatives. Netting is used in the financial market to hedge risks. In insolvency, the mandatory rules relating to insolvent set-off, preferences and disclaimers are, to some extent, inconsistent with netting. It is, therefore, necessary to protect obligations arising under financial contracts entered into pursuant to netting agreements. The netting provisions of the CAMA Bill are based on the International Swaps and Derivatives Association, Inc. (ISDA) 2006 Model Netting Act.

PREFERENCES – NEW PARAMETERS

Under section 485(1) of the CAMA and section 46(1) of the Bankruptcy Act LFN 2004, a liquidator can invalidate any payment made by an insolvent party to a creditor within 3 months of its insolvency if it was made with a view to giving that creditor a preference over other creditors. Chapter 28 of the CAMA Bill, however, provides that the liquidator of an insolvent party may not avoid a payment or transfer of collateral under a netting agreement on the grounds that it constitutes a preference by the insolvent party of the non-insolvent party to the netting agreement, unless there is evidence that the non-insolvent party made such payment or transfer with intent to hinder, delay or defeat an entity indebted to the insolvent party. This provision seeks to ensure that any payment or transfer of collateral made by the insolvent party under the netting agreement during any ‘preference period’ is not treated as a preference, and would, therefore, not be void.

SINGLE AGREEMENT

Chapter 28 of the CAMA Bill reinforces the single agreement nature of a netting transaction, which is often set out expressly in netting agreements and, to that extent, reinforces the general affirmation of the enforceability of netting agreements in the insolvency of a party.

PROHIBITION OF TERMINATION

Regardless of any insolvency in the financial markets, the CAMA Bill provides that a liquidator will not be able to prevent the termination of any qualified financial contracts or the acceleration of any payment owed under these qualified financial contracts.

ENFORCEABILITY OF QUALIFIED FINANCIAL CONTRACTS

Despite the fact that derivatives are legitimate financial contracts, there are certain elements of their structure that could appear to be similar to gaming contracts. To avoid the risk of legitimate financial contracts being treated, under the law, as gaming contracts, the netting provisions of the CAMA Bill provide that a qualified financial contract shall not be void or unenforceable by reason of laws relating to gaming, gambling, wagering or lotteries.

CHERRY-PICKING

The netting provisions also prevent a liquidator from accepting, pursuant to the netting agreement, only those contracts that benefit the insolvent party and disclaiming (under section 499 of the CAMA) the contracts that do not favour the insolvent party in a manner often referred to as ‘cherry-picking’.

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Udo Udoma & Belo-Osagie actively participated in the drafting of the CAMA Bill. Corporate Partner, Ozofu ‘Latunde Ogjemudia was the chairperson of the Technical Advisory Committee set up by the office of the Senate President to advise on the CAMA Bill and the bill to amend the Investments and Securities Act 2007.

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