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The trouble with trading venue shutdowns

Challenges and contractual rights relating to market shutdowns

April 17, 2020

Quick Take:

The economic consequences of the 'Spring 2020 shutdown' continue to cascade across markets, asset classes and jurisdictions. Calls, from issuers, intermediaries but also investors, have been steadily growing to close trading venues in a manner that is more permanent than using existing powers of circuit breakers, short-selling restrictions or suspension of individual financial instruments, which are designed as temporary measures and which aim to buffer volatility and prevent panic selling. Other industry associations have been calling for financial markets to stay open[1], while exchanges have been called upon to clarify their business continuity plans and pandemic contingency plans.

The debate on both sides raises considerable legal and regulatory issues that could exacerbate volatility and loss of confidence and firms may want to take proactive measures as discussed herein as restrictions on certain trading activity may more commonplace and talk of a 'trading venue shutdown" and related risks may become more of a recurrence.

1 See Joint Market Trade Associations Statement from March 2020 available **here**.

Shutdown to complement the lockdown?

Regulatory authorities in the EU-27[2] and the UK have during March 2020, as during the Global Financial Crisis (**GFC**), coordinated their measures in relation to restricting short selling[3]. The powers permitting such restrictions are set out in the EU's Short Selling Regulation (**SSR**). This, along with coordinated central bank, fiscal stimuli as well as operational relief (but not repeal) of certain compliance and regulatory but also market reporting obligations, has caused some further support in confidence but has not led to a cure to correct volatile, often self-reinforcing asset price corrections across markets. Overall and largely irrespective of short selling restrictions, the majority of global markets ended the first quarter of 2020 with more pronounced declines than those experienced during the GFC but have continued to function normally in allowing price formation.

Despite these developments, the GFC proved that financial markets are not only highly interconnected across asset classes and jurisdictions but are, while volatile, still capable of performing and this should act as an argument against a financial markets "shutdown to complement the lockdown". Any action on a shutdown, which would likely have to be sudden, might also transform disorderly markets into economy-wide disorder. This could be detrimental to that market and those trading on it but also to a much wider related set of stakeholders both in the jurisdiction where that market is located but further afield.

This Client Alert[4] looks at some of the shutdown-related risks and the measures firms may want to consider in relation to coordinated, possibly rolling, short-selling bans and coordinated circuit-breaker stoppages, ahead of further government and/or financial markets policymakers' discussion leading to determined action, possibly resulting in closures and changes in law. In summary, financial services firms may wish to consider performing a specific inventory review of their trading relationships, including the documented and undocumented terms, to take stock of their contractual rights and risks so that they are generally resilient and prepared, especially as a number of these relationships are likely to be subject to terms that did not contemplate pandemics or shutdowns. This might be prudent as in uncertain and extraordinary times it may be difficult to dismiss future political or economic circumstances where policymakers decide that such options might be feasible irrespective of arguments to the contrary.

2 In this instance, the ESMA and each of the national competent authorities (**NCA**s) of the EU-27 Member States and in the UK, the Financial Conduct Authority (**FCA**) as the UK NCA.

3 While this has provided some calm, there has been no moves to replace what are otherwise very diverse rules specific to individual trading venues with any form of EU-wide standard on volatility safeguard mechanisms such as circuit breakers or up-tick rules. ESMA Working Paper No.1, 2020 "Market impacts of circuit breakers – Evidence from EU trading venues", available **here**, while not official policy, concluded that circuit breakers and price collars, remain very heterogeneous across the EU and are linked to the discretionary powers of the relevant trading venue and that such power, which derives from the EU's MiFID II framework, is however largely harmonised but that it would be for future "...critical market incidences, such as flash crashes, will need to be analyzed and fully understood to ensure a robust market functioning going forward." That time may have arrived if current prevailing conditions could worsen.

4 Which should be considered in conjunction with the shorter snapshot available **here** as well as more specifically in relation to contract performance in Italy available **here**.

Fallouts from a shutdown

A shutdown of one trading venue or even a government /public sector-engineered "slowdown" in trading would likely cause a ripple of adverse effects across a range of financial services firms, including central counterparties (**CCP**s) and thus possibly cause disruption of OTC and exchange traded markets beyond the venue that had been shut. This could also lead to heightened risk transmission i.e., taking the risks from "Wall Street" and adding to pressures felt by "Main Street". It is also not clear at what point of a shutdown there is an ability to establish what is fair market value of assets that may become trapped by such measures and any losses even if assurances from public sector authorities may be provide.

Such risk propagation could lead to additional adverse effects on "real economy" end-users, including farmers and others who hedge commodities. Despite these concerns, this may not be enough to deter a decision in favor of a shutdown and the serious detriment that could for liquidity but confidence more generally. In the EU and globally, the debate on the extent of governments stepping in or using other forms of legislative intervention to protect "their" national economies and key infrastructure is not new, nor are the risks.

If for financial markets "this time is different", then buy-side and sell-side firms, as well as market operators, have an interest in preparing for the range of financial but also the legal risks connected to a shutdown. This applies whether a shutdown is voluntary, i.e., called for by the trading venue, or mandatory, i.e., called for by legislation or by a governmental and/or supervisory authority. Such measures can also come in various forms and in addition to action being sudden it is conceivable that it may not be applied uniformly across asset classes and jurisdictions as recent short-selling restrictions but also trading suspensions have shown. Any action authorizing a shutdown may not also be fully clear in its wording and/or coordinated with other connected market venues.

The financial fallout from such measures, whether due to an unscheduled payment holiday, moratorium, stays of enforcement and/or other forms of suspension of services will unlikely rest just with those parties trading on that trading venue. The relevant measures, even where primarily driven at the domestic level, may have multi-jurisdictional impact as they can cut across financial and legal exposures across a range of trading exposures but more importantly the breadth of contractual relationships, many of which are likely to be subject to any multiple of governing law and jurisdiction clauses. A disruption event or even a full shutdown on trading venue and availability of spot prices in one jurisdiction can cascade through to complications for a host of depositary receipts but equally derivatives that are related to those spot values or an index thereof. These considerations are in themselves likely to cause concern for various types of contractual arrangements, often with differing rules on when and who can call a default, including how force majeure suspends or otherwise supports arguments for a default event trigger.[5]

5 Please also see the Force Majeure section of Dentons' COVID-19 Hub available **here**.

So where are we now?

While rare, short-selling restrictions and triggering of circuit breakers[6] are not new[7]; nor are market disruption events. Equally, markets (large and small, exchange and OTC) have closed due to a number of technical but also legal reasons in the past, ranging from natural (mostly typhoons and hurricanes) or man-made disasters through to war. However, the risks of, or at least serious debate on, market shutdowns, certainly on a coordinated and prolonged basis, are comparatively new – as it the thinking on an engineered slowdown. While current consensus is that any shutdown would stoke rather than calm uncertainty, there is still a risk that this could happen and could also be combined with legislative measures that supersede and/or change contractual positions in trading documentation, as well as suspending certain rights for a period of time.

Due to the spread of health issues at major market operators, a number of trading venues' main operations, notably open outcry venues, have "closed the floor"[8] and transitioned to back-up electronic trading systems but have not "closed the market" and trading. However, irrespective of the above, some market operators have already gone a step further but then taken a step back. This in its own right has caused concerns over confidence but also continuity. The Philippines Stock Market was the first operator, on March 17, 2020, to press ahead with a complete closure of stock, bond and currency trading on a permanent basis before deciding to re-open on March 19, 2020. This close merely paused and possibly accentuated declines in a plunging index, in addition to central bank activity. Sri Lanka considered the Philippines' plans but has also since returned to trading.

Unlike short-selling restrictions and/or circuit breakers[9], which dampen price plunges (and for breakers, in theory, also rises) for short-periods, market shutdowns are counterproductive for a number of reasons.[10] Firstly, they halt any price discovery and limit liquidity, thus prolonging if not worsening instead of resolving the underlying issues. Secondly, they disenfranchise and possibly expropriate investors' capital (and for many their savings and pension funds) for the foreseeable future, without recourse for investors, and possibly create a problem for asset managers who might still need to meet redemption requests. Thirdly, they may mutualize market losses of international and domestic investors at the cost of the taxpayer in the jurisdiction where the market is located. Lastly, given the three

6 Which are a tool, mostly used outside of the EU-27 and UK markets, to halt trading for a given period of time following the trigger of a certain percentage changes in values.

7 Circuit breakers were introduced on certain United States based execution venues, notably the New York Stock Exchange, following the 1997 Asian Financial Crisis. The EU's SSR came into force in the EU on November 1, 2012, (and were slightly amended through various technical standards and advice from ESMA during 2017) and the UK retained this EU law through the Short Selling (Amendment) (EU Exit) Regulations 2018 as part of its Brexit measures that took effect from February 1, 2020.

8 As of March 21, 2020, this includes most notably the NYSE (starting March 23, 2020).

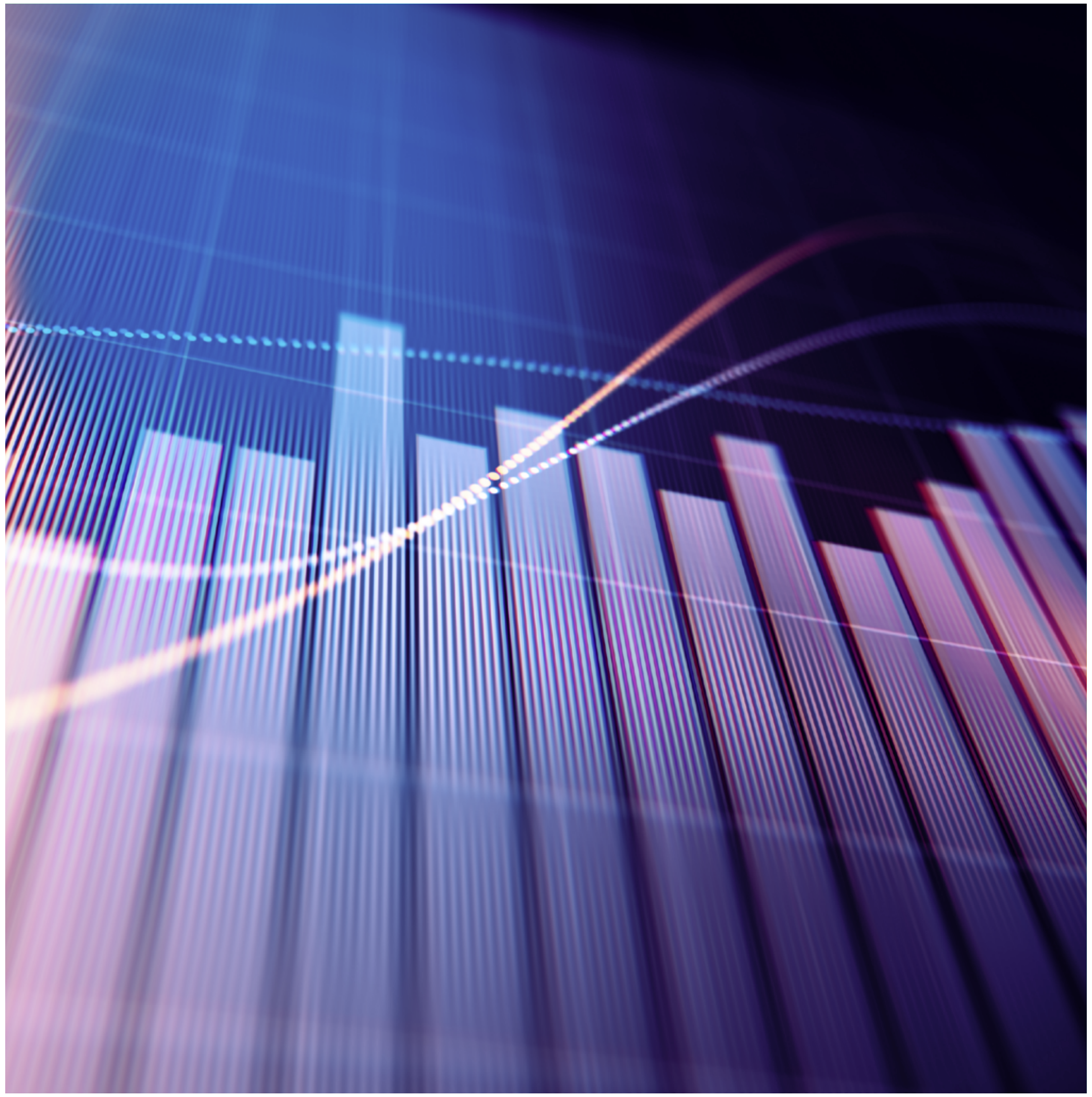
9 General EU rules on system resilience, circuit breakers and electronic trading including trading halts are set out in Art. 48 MiFID II.

10 These issues are explored, in an Italian context, by Professor Luca Enriques' contribution from March 12, 2020, "Stock Exchange Shutdowns in the Time of Coronavirus, in the Oxford Business Law Blog available **here**.

outcomes, a shutdown reduces the credibility and confidence in that market to ever recover to the values that existed prior to the shutdown.

All of this compounds anxiety in the short-term and in the longer- term and may cause a considerable negative barrier that fuels a wall of further selling certainly if and when the market venue reopens for trading. It also causes spillover effects for depository receipts, dual listings, transactions on market and trading venues, including OTC, that are beyond the reach of government action and generally, regardless of any return to normal, increases "trading venue risk" in much the same way as the 2008 GFC raised the fear that banks and prime brokers could fail to perform. Unlike the GFC and market practice since then, it is difficult to hedge or take credit protection on the trading venue and taking those out in respect of the financial instruments traded thereupon may actually accelerate price pressures downwards.

If uncertainties caused by the length and breadth of various shutdowns are here to stay, then so are possibly the range of financial and legal risks that may arise prior to, during and following the end of any temporary or permanent actions taken in respect of financial markets and traded instruments that may follow on from short-selling restrictions.



Spotlight on short-selling restrictions and disclosure requirements in the EU-27 and UK

During the GFC, regulators around the world, notably in the UK and what is now the EU-27, formalized short-selling restrictions by introducing the SSR and put the European Securities and Markets Authority (ESMA) in a central and coordinating role. ESMA and NCAs of the Member States received powers to set notification thresholds as well as to set prohibitions or impose conditions on investors entering into a short sale of any type of financial instrument. These measures operate in a fairly Europeanized and centralized fashion.

On March 16, 2020, ESMA published a Decision[11], i.e. a legal instrument, temporarily lowering the regulatory notification thresholds for holders of net short positions in shares traded on an EU regulated market from 0.2% of the issued share capital of the company concerned to a threshold of 0.1% and each 0.1% above that threshold. This notification threshold is disclosed only to NCAs/ESMA. ESMA justifies this as a precautionary step to permit NCAs to monitor market developments relating to the impact of the uncertainty over widespread shutdowns on market confidence.

This EU regulatory notification requirement applies for an initial three-month period (i.e., to June 16, 2020) to any natural or legal person, irrespective of their country of residence. The notification requirement does not apply to the trading of shares where the principal value for the trading of shares is located in a third country i.e., non-EEA, or is related to market making or stabilization activities. The UK agreed to mirror i.e., apply the ESMA Decision to its own regime on March 17, 2020. ESMA's changes to the (private) regulatory disclosure obligation does not change public disclosure obligations under the SSR, which begin to apply from an "Initial Public Disclosure Threshold" of 0.5% (and every subsequent 0.1% thereafter).

While the EU-27 Member States and the UK had first issued restrictions/bans limited to a single trading day and a list of designated financial instruments, they have, as March 2020 drew to a close, moved to mid-term restrictions that are much wider in scope, applying to all legal and natural persons domiciled or established within the EU or in a non-EU "third country". These orders have by and large imposed a ban on all transactions that might constitute or increase net short positions on shares admitted to trading to the respective Member State's trading venues for which the respective national regulator is the competent authority, and applied to all trading venues in that Member State as well as OTC trading. Exceptions are mostly applying to market-making activities, as well as index-related instruments.

Up until April 17, 2020, the following EU-27 Member States had introduced the following mid-term short-selling restrictions that apply to any natural or legal person domiciled or established in the EU or a non-EU country. These restrictions were first introduced in March and some were due to expire in April. Italy's measures are in place until June. On April 15, ESMA issued renewed opinions agreeing to but also aligning the renewal of the restrictions originally expiring in April which are now extended until May 18 with a possibility of further renewal. The bans apply irrespective of activity is exchange-traded or over-the-counter.

The UK's FCA had in March communicated an acknowledgement of such measures as it applies to activity on markets within its mandate. **Importantly**, please note that the length and the scope of the restrictions, thresholds and exclusions detailed below may be subject to additional and/or amended terms as communicated to by the competent authorities at possibly short notice. The following table is thus a non-exhaustive selection of recent announcements and it is advisable to engage external counsel to assess the implications of such restrictions, thresholds and availability of any exclusions as it applies to one's own activity and that of counterparties and clients.

11 Decision ESMA70-155-9546 available here.

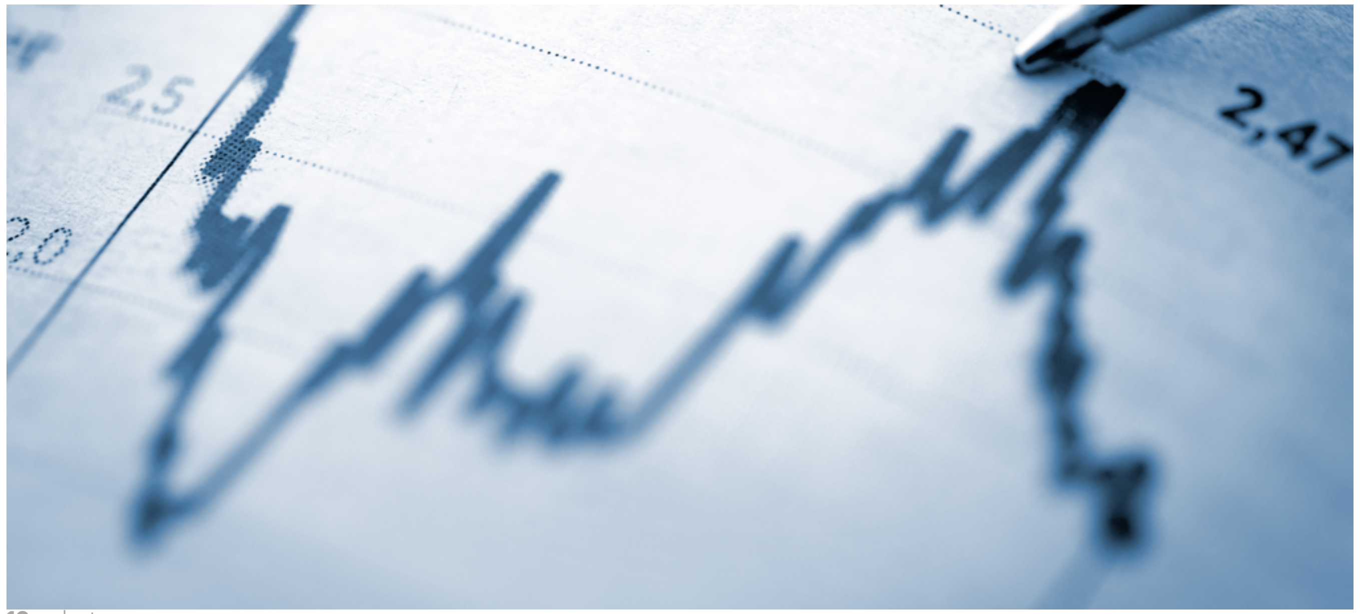
Juris-diction	Start	Expiration (unless lifted beforehand)	Financial instruments	Trading venues	Exclusions

Austria (FMA)	March 18, 2020 at 20:00
	
	Renewal begins April 17, 2020
		May 18, at 23:59 CET	Shares admitted to treading on the Regulated Market of the Vienna Stock Exchange for which the FMA is the relevant competent authority.
			
			Shares for which the principal venue for trading is located in a third country are not covered by the above-mentioned ban.
				Austrian trading venues and OTC	• market making activities, as defined in the SSR;
					• transactions that only lead to an indirect short position pursuant to SSR, that is assessed by the FMA as being immaterial, namely positions:
					  • held via the composition of an index or a basket of securities or an exchange traded fund, and
					  • this composition is such that the total weight of financial instruments concerned by the mea sure in this index, basket or ETF is at all times less than 50 percent.

Belgium (FSMA)	Originally March 18, before the opening of the trading session and is to expire on Renewal begins April 17, 2020	May 18, at 23:59 CET	Shares admitted to trading on Euronext Brussels or Euronext Growth for which the FSMA is the relevant competent authority, provided that the principal venue for trading those shares is in the EU as well as to all related instruments relevant for the calculation of the net short position	all Belgian trading venues and OTC	• market making activities, as defined in the SSR; • the creation of, or increase in, net short positions through index-related instruments or baskets of financial instruments, as far as the shares covered by the ban do not represent more than 50% of the index or basket weight; • the creation of, or increase in, net short positions when the investor who acquires a convertible bond has a delta-neutral position between the equity component of the convertible bond and the short position taken to cover that component; • the creation of, or increase in, net short positions where the creation of, or increase in, the short position in shares is hedged by a purchase that is equivalent in terms of proportion on subscription rights.
France (AMF)	March 18, 2020 00:00 hours Renewal begins April 17, 2020	May 18, at 23:59 CET	Shares admitted to trading to French trading venues for which the AMF is the relevant competent authority, provided the principal trading venue of the shares is located in the EU as well as to all related instruments relevant for the calculation of the net short position	All French trading venues and OTC	• market making activities, as defined in the SSR; • the creation of, or increase in, net short positions through index-related instruments or baskets of financial instruments, as far as the shares covered by the ban do not represent more than 50% of the index or basket weight; • the creation of, or increase in, net short positions when the investor who acquires a convertible bond has a delta-neutral position between the equity component of the convertible bond and the short position taken to cover that component; • the creation of, or increase in, net short positions where the creation of, or increase in, the short position in shares is hedged by a purchase that is equivalent in terms of proportion on subscription rights.
Greece (HCMC)	March 18, 2020 00:00:01 hours (CET) Renewal begins April 25, 2020 i.e. following end of original period of April 24	May 18, at 23:59 CET	All shares admitted to trading on the Athens Stock exchange for which the HCMC is the relevant competent authority as well as to all related instruments relevant for the calculation of the net short position	All Greek trading venues and OTC trading, explicitly including sales of shares covered by subsequent intraday purchases	• The creation of, or increase in, net short positions through index-related instruments or baskets of financial instruments, provided that the shares affected by the ban do not represent more than 50% of the index or basket weight. • Market makers performing transactions on the above shares, performing transactions on the stock derivatives of the above shares, performing transactions on warrants of the above shares and performing transactions on ETFs and index derivatives where the above shares are part of their composition. The exemptions with regard to market making activities are permitted only when the short selling transactions are conducted for hedging purposes.

Juris-diction	Start	Expiration (unless lifted beforehand)	Financial instruments	Trading venues	Exclusions

Italy (CONSOB)	March 18, 2020 before the opening of the trading session	June 18, 2020 after the close of the trading session	All transactions that increase net short positions on all shares (the **Restricted Shares**) traded on the Italian MTA-regulated market, for which CONSOB is the relevant competent authority	Italian trading venues and OTC	The following instruments: index-related instruments if the Restricted Shares represent less than 20% of the index weight (in other words, the ban applies to index-related instruments only if the restricted shares represent 20% or more of the index weight), and
					The following activities are excluded:
					• market making activities, as defined in SSR, with reference to market makers included on the list maintained by ESMA.
					• Transactions:
					  • the creation of, or increase in, net short positions when the investor who acquires a convertible bond has a delta-neutral position between the equity component of the convertible bond and the short position taken to cover that component;
					  • the creation of, or increase in, net short positions where the creation of, or increase in, the short position in shares is hedged by a purchase that is equivalent in terms of proportion on subscription rights.



Juris-diction	Start	Expiration (unless lifted beforehand)	Financial instruments	Trading venues	Exclusions
Spain (CNMV)	March 17, 2020 before the opening of the trading session Renewal begins April 18, 2020	May 18, at 23:59 CET	The ban applies to any transaction in shares or indices, including spot transactions, exchange-traded derivatives or OTC derivatives, which involves creating a net short position or increasing a pre-existing one, even if it is on an intraday basis. CNMV clarifies that net short position are meant to include short sales even if they are hedged by securities lending.	Spanish trading venues and OTC	• market making activities, as defined in the SSR; • the creation of, or increase in, net short positions when the investor who acquires a convertible bond has a delta-neutral position between the equity component of the convertible bond and the short position taken to cover that component; • the creation of, or increase in, net short positions through weighted index related instruments or baskets of financial instruments, where the weight of the 3 Spanish constituents subject to the ban does not reach more than 50% of the total index or basket; • the creation of, or increase in, net short positions where the creation of, or increase in, the short position in shares is hedged by a purchase that is equivalent in terms of proportion on subscription rights. ESMA noted that the renewed measure extended the exemption that now refers to weighted index-related instruments or baskets of financial instruments where the weight of the Spanish constituents subject to the ban does not reach more than 50% of the total index or basket. This revised exemption aligns it with those undertaken by other states and aims, certainly in ESMA's views, to be not overly restrictive to trading strategies of market participants.

As in ESMA's earlier opinions in March, those of April 15 affirm the restrictions taken by the NCA pursuant to the SSR and that these are justified due to the "...current adverse events or developments, which constitute a serious threat to market confidence and financial stability".

What steps should firms take now in light of short-selling restrictions and/or market shutdowns?

Most financial services transaction documentation aims to preserve ongoing performance of transactions during most scenarios. Epidemics and pandemics are generally no exception to that aim, unless certain agreed exemptions, including market disruptions, apply. Much of the detail on when and how exposures may be terminated and/or suspended have been drafted without pandemics and prolonged market-disruption and/or closures, whether government-led or not, in mind.

While much of financial markets regulation in the EU-27 and the UK may be shaped and harmonized by EU regulatory standards and common rulemaking principles, documentation governing the trading, settlement and custody of financial instruments is still subject to principles of national laws. The level of harmonization differs according to the area of law. Equally, the freedom of parties to transact on terms they agree to is an issue that allows such terms to be unique to their relationship, regardless of whether a trading relationship, whether documented or undocumented is based upon "market standard" practice and/or terms that exist in master agreement documentation suites. All of these considerations matter in terms of who has which rights under a contract, but also in terms of the enforcement of a contract and any assets, as well as who values and when these can be valued. Where market values are not available, including in the absence of an auction process,[12] counterparties may need to ensure they have policies and protocols in place on how to mark-to-market relevant exposures where there is a risk that no market may exist.

Even among master agreement documentation suites, the right of who can terminate a trading relationship, when and on what grounds including with what speed and with what consequences, is crucial to risk management. So too is the issue of who may deal with collateral assets or any forms of security interest and on what basis and for how long. This matters for both recipient of the collateral assets and/or security interest as well as the provider. All of this will depend on what is set out contractually and any trading terms agreed with counterparties, as influenced by each parties' priorities. These considerations may have knock-on effects both for unwinding of exposures pre-default but also in situations of default and/or cross-default in one relationship cascading across other exposures, transactions and collateral assets that may be linked to one another.

Consequently, in-house legal teams, working with their external counsel, may, to the extent they have not already done so, want to create and periodically monitor an inventory of their exposures to relevant counterparties, custodians and financial market infrastructure providers, segmented by the governing law of the contract and the jurisdiction of the counterparty and/or execution venue, as well as the booking center for relevant transactions, and therefore assess:

1. types of:
   a. **relationship-specific documentation** such as (prime-) brokerage (or other trading relationship general terms and conditions) as well as clearing and netting arrangements;
   b. **transaction-specific documentation** such as those that are transacted under or based on master agreement (for example GMRA, GMSLA, ISDA – or other types such as DRV, FBF) documentation suites, but equally may also include bilateral agreement (for example LMA) documentation suites, as well as any array of protocols, side letters and any other documented or undocumented arrangements that are relevant to the exposure(s);
   c. industry association curated definition sets, where they exist, as is the case for ISDA documentation, and any amendments undertaken[13];
2. the hierarchy of documentation described in point 1 to establish whether one exists, and if yes, which documents and/or specific terms take precedence over one another i.e., transaction-specific documentation is typically subject to the terms of relationship specific documentation but may also include carve-outs for certain types of transactions etc., but equally assess whether linked documentation i.e., hedging and loan documentation terms are connected;
3. whether there are any material divergences in agreed terms to those that are considered market standard;
4. whether the documentation described in point 1 has the following clauses, and whether they refer to business/market disruption caused by pandemic or crisis situations and what they mean for one's own exposure and counterparties:
   a. market suspension and/or market disruption;
   b. cross-acceleration and/or cross-default;
   c. force majeure clauses – see also below regarding doctrine of frustration; and/or
   d. non-performance clauses and punitive damages or penalty clauses (which may be held by certain courts as being void);
5. which positions are marked-to-market and which are marked-to-model and what fallbacks could be put in place;
6. how margining would work in the event of a market shutdown, does a collateral receiver have a right to refuse accept non-cash collateral that is marked-to-model and not to market, and if yes, at which and whose model, as reference points to the model may be missing? Are there arbitrage opportunities and can these be acted upon in a compliant manner?
7. timing, thresholds and extent of margin call requirements to be provided and by whom, along with type of collateral and whether any haircuts need to be amended;
8. the amount of collateral assets provided and/or received that are subject to activated and/or potential rights of re-use and/or rehypothecation and the amount which is segregated (at what type of segregation) and how much of a party and/or its counterparty's funding is reliant on collateral assets rehypothecated from others and the possibility that such collateral assets may be withdrawn;
9. the various business day count conventions for valuation and payment dates, as well as what likely fallbacks might mean;
10. whether service of notice is required and the differing permitted methods of notification for:
    a. trading and reconciliation relevant notifications;
    b. close-out notices; and/or
    c. other contractual notices and dispute resolution;

    and whether email is permitted for the above, if not (as is the default case for most ISDA documentation unless amended), whether postal/courier services are likely to be reliable and/or whether fax or other permitted electronic notification means (SWIFT) are permitted and reliable. Firms may need to consider amending agreed methods of communication and service as well as, when sending/receiving notifications, checking that these are to the correct address. It is likely that even where documentation hierarchy may dictate that (prime-) brokerage documentation terms supersede those of transaction-specific documentation, such as ISDA, that parties will still need to follow the ISDA terms to ensure service is valid;
11. what a party may wish to do in respect of it being able to continue its own performance of obligations if its counterparty cannot perform its own obligations. This may include also taking proactive risk management and mitigation steps; and
12. any scope of protection that may arise under the EU's Settlement Finality Directive, as implemented in each EU-27 jurisdiction and in the UK.

While financial market transactions can be closed-out, termination of the master agreement is usually due to a breach or an inability to perform. Termination

12 whether arranged by a market operator or market dealers.

13 Such as the measures undertaken by ISDA in respect of the Chinese Lunar New Year Holiday market closure action published by ISDA in January 2020 as well as the more recent Philippines market closures published in March 2020.

for cause, i.e. because the contract is no longer profitable, is generally not permitted[14]. This is usually not problematic as parties can simply choose not to trade. Importantly, if a party decides to abandon performance, or otherwise deprive the other party of the whole or substantially the whole of the benefit that was the intention of the parties as expressed in the contract, this may amount to repudiation or anticipatory repudiation and thus may constitute a breach for which damages may be due to the party not abandoning its performance.

14 An exception exists in Paragraph 15 in GMSLA documentation.

Force majeure clauses and the doctrine of frustration in the context of health emergencies

In the event that the trading documentation is governed by English[15] or Irish law, then parties should recall that contracts that require ongoing performance of obligations are absolute and continuing. However, there are exceptions to this, and part of any inventory review may need to consider the operation of force majeure clauses and the availability of the common law doctrine of frustration. These are areas of law that pre-date modern financial market transaction documentation. In simple terms, a force majeure clause excuses at least one (possibly both) contractual parties from performance of its obligations in some way upon and following the occurrence of certain events.

Unless defined contractually, force majeure has no recognized meaning in English law. When compiling the inventory review, firms should check whether any standard or party-specific negotiated terms cover a pandemic or crisis in the force majeure definition, and whether the intended operation of such a clause has a trigger event that prevents the ability of the party seeking to rely on the clause to perform its obligations. In such instances, that party would need to be prevented legally or physically from performing; a mere difficulty or unprofitability related to the performance will in most instances not be sufficient.

Additionally, EU and national rules (as well as possibly consumer protection measures) may also apply to trading relationships that involve those counterparties that are categorized as retail clients.

It is also important to note that the majority of courts are inclined to uphold the performance of the commercial arrangements so that a party wishing to rely onforce majeure will be faced with a stringent test to satisfy that a force majeure event, whether occurring or continuing, is actually preventing or hindering it from performance of its obligations.

Discussions on force majeure, both when drafting as well as disputing clauses, will typically deal assess whether:

- the clause includes or excludes:
  - events that are foreseeable;
  - events already existing at the date of the contract or indeed a transaction executed under a contractual relationship;
- the length of how long a force majeure event is continuing i.e., temporary versus indefinite periods of time – and what this means also for the doctrine of frustration;

15 It is also important for counterparties and indeed traders to note which documentation they are trading on. 1992 ISDA Master Agreements' standard wording does not contain a *force majeure* clause.

- a force majeure clause contemplates and/or requires compliance with government or public authority requests/orders; and
- a situation has arisen whereby one party is prevented from performance because of the other party's breach, if so, then the innocent party cannot rely on a force majeure clause;

Generally, as a matter of law, and indeed in the trading documentation suites discussed below, the burden of proof rests with the party wishing to rely on the force majeure clause. That party must prove that an event falls within the clause and that its non-performance was due to that event, as well as that the defaulting party has taken (reasonable) endeavors to prevent, or at least mitigate, the effects of the force majeure.

In addition, civil law jurisdictions recognize similar concepts that work in comparable fashion, requiring as a general rule that the fulfilment of obligations has become impossible either due to legal or actual reasons. Under German law, for instance, a force majeure event would lead to the termination of the contractual obligation, leaving the contract as a whole untouched and triggering complex rules with regard to the allocation of the pricing risk. As a complement to this, German law acknowledges the defense of "grossly disproportionate effort to the creditor's interest in performance", as well as "gross disturbances" in the equivalent of the contract. While there are some conceptual similarities in how civil law and common law based legal systems interpret these principles, trading documentation terms, notably those based on master agreement documentation suites may have certain divergences from or displacement of those principles.

The following table provides a non-exhaustive overview of standard industry documentation across different jurisdictions with regard to market shutdown and force majeure clauses, as well as the recommended course of action firms may wish to consider.

Type of documen-tation (assumes no retail clients)	*Force majeure clause?*	Market shutdown clause?	Recommended course of action
ISDA 2002 English Law ISDA Irish 2002 Law	Yes – Section 5(b) (ii) (Force Majeure Event), as amended/supplemented in the Schedule and in any Credit Support Document states that a Force Majeure Event and thus an ISDA Termination Event will occur and thus permit close-out: • after giving effect to any applicable provision, disruption fallback or remedy specified in or pursuant to, the relevant Confirmation or elsewhere in the ISDA, by reason of force majeure or act of state after a Transaction is entered into, on any day that: t 1. The "Office" (booking center), through which such party makes and receives payments or deliveries with respect to such Transaction is prevented from performing any absolute or contingent obligation to make a payment or delivery in respect thereof or receiving such payment or delivery or from complying "with any other material provision" of the ISDA relating to such Transaction or if it becomes impossible or impracticable for such Office so to perform, receive or comply; 2. such party or any Credit Support Provider of such party is prevented in such manner as in point 1. The Section states, unless altered or amended, that in addition to the points above, a Force Majeure Event will occur so long as the force majeure or act of state is beyond the control of such Office, such party or Credit Support Provider, and that it could not, after using all reasonable efforts, overcome such prevention, impossibility or impracticability. A party will not be required to incur loss, other than immaterial incidental expenses in overcoming such prevention, impossibility or impracticability.	No – unless language is included in the Schedule in supplementing Section 5(b)(ii) Force Majeure Event or adding an Additional Termination Event.	Parties will want to look at how these terms apply to a specific Office but also the counterparty as a whole. Counterparties may need to consider their own position and that of the other party in relation to: • causation i.e., whether the events that are to be claimed as force majeure or an act of state have actually hindered or prevented it from performance and for what time – as certain time limits may exist or be implied by reference to market operations • after the potential or actual impact of any applicable provision, disruption fallback or remedy, what they and what the other party may have to do to overcome in meeting the "all reasonable efforts to overcome such prevention, impossibility or impracticability." • what mitigation duties apply • the impact of any change in law on any obligations in respect of the Transaction but also the Credit Support i.e. the collateral

Type of documen-tation (assumes no retail clients)	*Force majeure clause?*	Market shutdown clause?	Recommended course of action
ISDA 2002 French Law	Same as with English and Irish Law ISDAs except that from October 1, 2016, the provisions of Article 1218 of the French Civil Code defines force majeure as: "In contractual matters, there is force majeure where an event beyond the control of the debtor, which could not reasonably have been foreseen at the time of the conclusion of the contract and whose effects could not be avoided by appropriate measures, prevents performance of his obligation by the debtor. If the prevention is temporary, performance of the obligation is suspended unless the delay which results justifies termination of the contract. If the prevention is permanent, the contract is terminated by operation of law and the parties are discharged from their obligations under the conditions provided by articles 1351 and 1351-1" For force majeure to apply, Article 1218 states that the following elements need to all be satisfied: 1. Externality (l'extériorité); that is the invoking party had nothing to do with the happening of the event. 2. Unforeseeability (l'imprévisibilité); that is, if the event could have been foreseen then the invoking party should have prepared for it. 3. Inevitability (l'inévitabilité); that is, the consequences of the event were unpreventable.	Same as with English and Irish Law ISDAs except as to the French Civil Code definition of force majeure.	Same as with English and Irish Law ISDAs except as to the French Civil Code definition of force majeure.
GMRA 2000 and 2011 versions	No, unless amended in the Annex. But please note that, unlike in ISDA documentation, an Event of Default will occur under: • Paragraph 10(a)(vii) any representations may by seller or buyer are incorrect or untrue in any material respect when made or repeated or deemed to have been made or repeated. • Paragraph 10(a) (viii) where the seller or buyer admits to the other that it is unable to, or intends not to, perform any of its obligations under the GMRA or in respect of any transaction. It should be noted that unlike the 2011 version, the 2000 version requires the non-defaulting party to serve notice in order to trigger the event of default.	No.	Take measures as described herein.

Type of documen-tation (assumes no retail clients)	*Force majeure clause?*	Market shutdown clause?	Recommended course of action
GMSLA 2000, 2010 and 2018 – Security Interest Over Collateral Versions	No, unless amended in the Annex an event of default will occur in the 2010 Version under: • Paragraph 10.1(e) when any warranty made in paragraph 13 or paragraphs 14(a) to and including 14(d) that is incorrect or untrue in any material respect when made or repeated or deemed to be repeated. • Paragraph 10.1(f) when the lender or the borrower admitting to the other that it is unable to, or intends not to, perform any of its obligations under the GMSLA or in respect of any loan where such failure to perform would with the service of notice or lapse of time constitute an event of default. • Paragraph 10.1(i) when the lender or the borrower failing to perform any other of its obligations under the GMSLA and not remedying such failure within 30 days after the non-defaulting party serves written notice requiring it to remedy such failure. • Paragraph 10.2 – each party shall notify the other (in writing) if an event of default, or an event which, with the passage of time and/or upon the servicing of a written notice as referred to above, would be an event of default, occurs in relation to it. It should be noted that unlike the 2018 version, the 2000 and 2010 versions requires the non-defaulting party to serve notice in order to trigger the event of default. The limbs of Paragraph 10 described above in relation to the 2010 Version are set out in Paragraph 14.1 of the 2000 Version. Paragraph 15 of the 2010 Version is set out in Paragraph 17 of the 2000 Version.	No.	Take measures as described herein.

Type of documen-tation (assumes no retail clients)	*Force majeure clause?*	Market shutdown clause?	Recommended course of action
DRV Deutscher Rahmenvertrag für Finanzter-mingeschäfte in ist DRV 2018 and 2001/1993 Version. Deutscher Rahmenvertrag für Wertpapier-darlehen 1999 Version Deutscher Rahmenvertrag für Wertpapier-pensionsgeschäfte (Repos) 2005 Version	No. Please note that for the Bankenverband: • The DRV's Clause 7 addresses the termination of the agreement (as a whole). It distinguishes between the regular termination for cause (sub-Clause (1)) and the automatic early termination in the event of an insolvency (sub-Clause (2)). • Termination for cause: sub-Clause (1) sets out that the agreement can only be terminated for material cause (material cause / "*wichtiger Grund*") being an established German law concept central to German contract law based on statutory law (Sec. 314 of the German Civil Code) and shaped by a large body of court decisions. Under German law, the right to terminate contracts for the performance of continuing obligations ("*Dauerschuldverhältnis*" - the master agreement qualifying as such) for material cause cannot be contractually waived. Since the parties to the agreement can rely on the established principles and concepts concerning the understanding of material cause developed over time by German courts, the provision does not contain a list of specific events triggering the right to terminate for material cause. Please note that in the DRV Repo 2005 Version Clause 11 follows the DRV Clause 7.	No	Take measures as described herein.

In all instances above, even if pandemics or epidemics generally or even specific health emergencies are referred to in a force majeure clause, a number of other circumstances will have to be considered, including whether any notification requirements exist, whether any duty to mitigate loss applies or whether a party is subject to any tests of the reasonableness of actions or circumstances. Where force majeure applies, this will relieve performance, thereby avoiding a risk of a default termination, and cause an extension of time to target dates, but this may just be pushing a problem further down the line instead.

In addition to force majeure clauses, English and Irish law recognizes the doctrine of frustration. This doctrine will arise and applies permanently, as opposed to on a temporary basis, in situations where a significant change of circumstances means a party's ability to perform its obligations has been radically altered compared to when originally undertaken. Contractual performance will typically not be frustrated where it becomes more difficult or more expensive for a party or where such performance has been prevented due to a failing of a third party. Where frustration is found by a court to apply, then the parties are excused from further performance and not liable for damages for non-performance.

Similar doctrines may exist in civil law based jurisdictions. For instance, the German law principle of the disruption of the foundation of contracts (Störung der Geschäftsgrundlage) is very similar to the common law doctrine of frustration in that it allows for the amendment and, ultimately, the termination of contractual relationships in cases of substantial changes to the foundations of the contract. Under German law, this foundation of the contract comprises, among others, such circumstances, the existence or continuation of which are necessary in order for the contract to provide a meaningful regulation in terms of the intentions of both parties to the contract. This may even apply to cases in which the parties have not addressed a certain issue expressively, but rather took it for granted.

Going forward, internal legal counsel, risk management and traders, working together with external counsel, will want to review the inclusion of force majeure and illegality provisions as well as be prepared for potentially a combination of close-outs but possibly also revisions to trading arrangements, irrespective of whether these are initiated by market participants or as a result of governmental action.

What about business interruption insurance protection?

The current various shutdowns to economic sectors around the globe has raised a number of questions on business interruption insurance and in many cases these policies may not cover disruption caused by pandemic-related interruption or crisis. The same would also apply in relation to financial market disruptions. While most of these insurance policies are designed to protect losses caused by damages to property, or in the case of contingent business interruption insurance, the loss of customers or suppliers, insurance policies are dependent on terms set by the insurers and the insurable interests as well as exclusion – notably for communicable diseases and thus many epidemics or pandemics.

As with a timely and periodic assessment of the inventory above, firms will need to carefully review their insurance policies, and possibly the resilience of their insurers, to ensure whether losses would be covered by policies.

Are there alternatives?

With the above in mind, should policymakers and proponents of both sides of the debate, in the event that trading could become more fractious, instead look to working towards preserving continuity during a pandemic in a sustained form rather than hastily deciding on discontinuation? If yes, then this could point towards implementing measures to support liquidity at certain agreed and regular "single auction points" during the trading day e.g. every two hours from the cash open from 8:00 to say the close at 18:00). The discussion on shutdowns alone also may dissuade activity from going on-exchange. This is counterproductive for a number of reasons, both economically as well as it going contrary to the majority of changes since the GFC that have reshaped how certain corners of the market are designed to function.

The discussion on shutdowns however also allows for new risks and opportunities as well as for the birth of new "alternative execution venues" that could operate beyond the current financial regulatory perimeter in much the same way that restrictions or needs gave rise to depository receipts. One question that has remained relatively unanswered by both policymakers and market participants is what happens if parties[16] decide to tokenize financial instruments that are at risk of being trapped in what could be a possibly prolonged suspension of financial markets and facilitates trading on a blockchain-enabled trading venue. Does this create a "pirate market" that operates outside the shutdown? Does it make a difference if that market is regulated in the jurisdiction in which it is based? All of this is conceivable given the emergence of crypt-depository receipts and blockchain wrappers, but even if it were desirable, what are the new risks for issuers and investors? Should it perhaps not be pushed to develop in a planned and prudent manner as opposed to reacting to pandemic panic – especially if markets, while volatile are working?

Outlook

Markets are likely to remain volatile for the foreseeable future. This volatility should not be grounds that justify prolonged or rolling short-selling bans and/or more invasive measures such as market closures, but if they do, then market participants will want to take the proactive measures discussed herein.

Our Financial Institutions Regulatory lawyers are advising a number of financial services firms in various stages of their business continuity and contingency measures, as well as their outreach efforts in respect of counterparties, clients and other stakeholders relating to their financial markets trading activity. We have a wealth of experience in assisting sell-side and buy-side institutions with large-scale, complex multijurisdictional documentation stocktaking and re-papering projects, whether as a result of Brexit, Benchmark Regulation, MiFID II/MiFIR, EMIR and/or SFTR compliance.

16 Taking this thought experiment a step further, one would presume that issuers would tokenize their existing financial instruments or use a blockchain wrapper, but in theory it is possible that investors could tokenize rights to and interest in their holdings even if the token trades at a deep discount.

Our Eurozone Hub continues to monitor developments from the EU-level and 27+ NCAs as well as communications from other key financial centers. If you would like to receive further analysis on any other issues raised herein, please contact one of our key contacts.

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