



The Singapore International Commercial Court considers the quantification of the Close-Out Amount under the ISDA Master Agreement

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In *Macquarie Bank Ltd v Graceland Industry Pte Ltd* [2018] SGHC(I) 5, the Singapore International Commercial Court ("SICC") considered how the Close-Out Amount under Clause 14 of the ISDA Master Agreement ("ISDA MA") is to be calculated.

Macquarie Bank Ltd ("Macquarie") had commenced proceedings against Graceland Industry Pte Ltd ("Graceland"), a subsidiary of a Chinese state-owned enterprise. The proceedings arose out of an "over-the-counter" ("OTC") commodity swap agreement which was governed by a Long Form Contract ("LFC"). In turn, Graceland counterclaimed against Macquarie and its Executive Director, Mr Wolfe, for, among other things, misrepresentation and breach of fiduciary duty.

The team of Mr Abraham Vergis, Mr Lim Mingguan and Ms Kim Shi Yin from Providence Law Asia LLC successfully represented Mr Wolfe in the proceedings.

I. Background

Sometime in May 2014, Graceland entered into a back-to-back swap transaction with Macquarie. Graceland placed an order to sell 30,000 megatonnes ("mt") of urea to be settled in July 2014 at a minimum price of US\$275 per mt ("**Transaction**"). Under the Transaction, if the market price of urea for July 2014 fell under US\$275, Macquarie would pay Graceland the difference between the July market price and US\$275. Conversely, if the market price of urea for July 2014 exceeded US\$275, then Graceland would pay Macquarie the difference between the July 2014 market price and US\$275.

On 4 June 2014, Macquarie completed Graceland's order to sell the 30,000 mt of urea at US\$275 per mt. Macquarie subsequently

provided Graceland with a finalised LFC for Graceland's execution. The LFC provided, among other things, that the terms of the ISDA MA were incorporated into the LFC. The LFC also provided that the ISDA MA was to be executed 30 days from 4 June 2014.

Graceland did not execute the LFC or the ISDA MA within 30 days from 4 June 2014. By that time, the price of urea had risen above US\$275.

Clause 6(b)(iv) of the ISDA MA, read with Clause 9B of the LFC, provided that if the ISDA MA was not executed within 30 days from the trade date (i.e. by 4 June 2014), Macquarie may "designate a day not earlier than the day such notice is effective as an Early Termination Date." Clause 6(e) of the ISDA MA further provided that an "Early Termination Amount" would be payable if an Early Termination Date occurred, and that the "Early Termination Amount" would include, among other things, the Close-out Amount as determined by the Non-defaulting Party (i.e. Macquarie).

Thus, on 8 July 2014, Macquarie sent a letter to Graceland designating 8 July 2014 as the Early Termination Date in respect of the Transaction. On 11 July 2014, Macquarie sent another letter to Graceland claiming for the Close-Out Amount of US\$1.2 million. The sum was calculated as follows:

1. On 8 July 2014, Macquarie went into the market in order to determine the cost of obtaining the economic equivalent of the material terms of the Transaction. On that day, Macquarie bought 20,000 mt of urea at US\$310 per mt and obtained a further quote from a third-party broker for the balance of 10,000 mt of urea at US\$320 per mt ("**US\$320 Quote**").
2. This produced an average figure of US\$313.34 per mt. After taking into account the brokerage cost of US\$0.50 per mt and Macquarie's operations costs of US\$1.00 per mt, the average cost amounted to US\$314.84 per mt of urea. For the purposes

of calculating the Close-out Amount, this figure was rounded up to US\$315 per mt of urea.

3. Accordingly, the Close-out Amount was US\$1.2 million, being the difference between US\$315 and US\$275 (ie, US\$40) multiplied by 30,000 mt.

II. The Decision

The court found that there was a binding agreement between Macquarie and Graceland on the terms of the LFC which incorporated the ISDA MA. As Graceland failed to sign and execute the LFC and ISDA MA within 30 days from 4 June 2014, Macquarie was entitled to terminate the Transaction by its letter dated 8 July 2014 pursuant to Clause 6(b)(iv) of the ISDA MA, and to designate 8 July 2014 as the Early Termination Date. The court also dismissed all of Graceland's counterclaims.

Graceland had also objected to Macquarie's calculation of the US\$1.2 million Close-Out Amount. Under Clause 14 of the ISDA MA, the "Determining Party" (in this case Macquarie) was required to use "commercially reasonable procedures" to determine the Close-Out Amount. Graceland argued that, among other things, Macquarie did not use "commercially reasonable procedures" to obtain the US\$320 Quote for the 10,000 mt of urea. In particular, Graceland argued that Macquarie should have waited until 9 July 2014 (where the market price for urea was found to be edging lower) to obtain a quote for the remaining 10,000 mt of urea.

Graceland also argued that:

1. There was no documentary evidence to prove that the amount of US\$1 per mt was actually incurred by Macquarie in respect of the 30,000 mt of urea. Therefore, the sum did not constitute an out-of-pocket expense which Macquarie might claim.
2. The brokerage cost of US\$0.50 per mt for the 10,000 mts urea swaps not bought from the market was also not incurred by Macquarie and therefore not an out-of-pocket expense which Macquarie might claim.
3. There is no basis for Macquarie to round up the sum of US\$314.84 per mt to US\$315 per mt.

The court held Macquarie's calculation of the Close-Out Amount was commercially reasonable. In particular, it was not commercially unreasonable that Macquarie did not wait until 9 July 2014 to determine the Close-Out Amount for the remaining 10,000 mt of urea, for the following reasons:

1. It was impossible to predict the direction of the fertiliser swap market from 8 to 9 July 2014.
2. The fact that it was commercially reasonable to transact or obtain a quote on 9 July 2014 does not *ipso facto* mean that it was not commercially reasonable for Macquarie to rely on the US\$320 Quote obtained on 8 July 2014.
3. The US\$320 Quote was not commercially unreasonable. The court agreed with Macquarie's expert that the US\$10 premium over the US\$310 per mt price transacted in respect of 20,000 mt on 8 July 2014 represented a commercially reasonable "market risk buffer".

The court also held that the US\$1 per mt in respect of operation costs in the calculation of the Close-Out Amount was not commercially unreasonable. Clause 14 of the ISDA MA allowed parties to identify the losses it would incur in replacing the material terms of the terminated Transaction, without needing to prove its actual costs incurred.

The court also found the US\$0.50 in brokerage to be reasonable as the evidence in relation to the 20,000 mt of urea confirmed the figure of US\$0.50 per mt for brokerage. As for the 10,000 mt, even though no brokerage fees were in fact incurred, customary brokerage fees could be included in the determination of the Close-Out Amount.

Lastly, the rounding up of US\$314.84 to US\$315 per mt was also accepted by the court to be legitimate, as it reflected a "real figure in reality", given that the prices of urea "only trade in multiple of 50 cents" in the market.

For the above reasons, the court found that Macquarie was entitled to recover the sum of US\$1.2 million.

III. Conclusion

The decision is of particular interest as it provides clarification on how the Close-Out Amount under Clause 14 of the ISDA MA, a

widely used document in the derivatives market, is to be calculated. In particular, it is significant that the court found that Macquarie was not obliged to wait for an extra day before determining the Close Out Amount, even in circumstances where the price of urea had eventually edged downwards.

Further, and as highlighted by the court, when calculating the Close-Out Amount, the

determining party is simply required to identify the losses or costs which it *would have* incurred in replacing the material terms of the terminated transaction. There is no need for the determining party to prove its actual loss or costs.

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