

DERIVATIVES LAW SYLLABUS, FALL 2015

Gary E. Kalbaugh
Classroom: RSVLT 0010
6:10 PM – 8:00 PM
Gary.E.Kalbaugh@hofstra.edu

Purpose of the Course: The purpose of this course is to teach the current law and practice regarding the documentation, negotiation, regulation and enforcement of derivatives and other related financial products. Subjects covered include: (i) the Commodity Exchange Act's regulatory regime for commodity futures, exchange-traded commodity options and foreign exchange; (ii) the swaps regulatory regime imposed by Title VII of the Dodd-Frank Act; (iii) the registration categories of markets, such as designated contract markets and swaps execution facilities, and market participants, such as futures commission merchants, derivatives clearing organizations, swap dealers and major swap participants; (iv) the drafting and negotiation of ISDA Master Agreements; (v) inter-jurisdictional differences in regulation and the extraterritorial application of U.S. regulation; and (vi) enforceability issues in bankruptcy. By the end of the course, you should be familiar with the regulatory regime applying to derivatives and be able to draft and negotiate a derivatives contract.

Course Materials: Kalbaugh, Derivatives Law and Regulation (Aspen 2014). Other materials will be made available via TWEN or class handouts.

Classes: This class (CRN: 94743) is scheduled to meet for two credit hours per week, on Mondays from 6:10 – 8 PM in RSVLT 0010.

Attendance and Preparation: Students are expected to attend classes regularly and to prepare for classes conscientiously. If you miss class frequently or are unprepared several times, your grade may be lowered. Alternatively, I may ask the Registrar to withdraw you from the course. Sometimes you cannot avoid missing a class. If you know in advance that you will be missing a class for a compelling reason, or if you have missed a class due to illness or emergency, please send me an e-mail, briefly explaining the situation.

Lateness: Students are expected to be on time to class. However, it is better to come to class late than not at all. You may walk in late if you have a good reason, as long as you do not abuse this privilege.

"TWEN" (The West Education Network): A course page for this class is set-up on TWEN. TWEN gives me a quick way to reach all of you with any announcements, Syllabus changes, handout materials and interesting links. It also gives me a way to extend class discussion beyond the classroom hours.

Final Grade for the Course: The course is a hybrid of lectures and the experience of drafting and negotiating derivatives contracts. Therefore, 25% of the final grade will be

derived from the drafting of two derivatives contracts (potentially satisfying the Writing II requirement) and 15% of the grade will be derived from mock negotiations of these contracts. The remaining 60% of the final grade will be derived from the results of a final exam with the potential for a one-level grade “bump up” for exemplary class participation.

Drafting of Derivatives Contract: An important component of this class will be the drafting and negotiation of a derivatives contract. The drafting of these contracts – which will require substantial legal analysis and reasoning – may be used to fulfill Writing Requirement II. The following schedule is expected to apply:

Sometime on or before Week 4*	Beginning of drafting of derivatives contract from perspective of derivatives dealer or end-user.
Sometime on or before Week 6*	Initial draft of derivatives contract due.
Sometime on or before Week 7*	Comments provided.
Sometime on or before Week 9*	Final derivatives contract due.

* Exact date and time to be specified in class or via TWEN.

For the contract to satisfy the Writing II requirement you must receive a grade of at least C+.

Negotiation of Derivatives Contract: The derivatives contracts are due significantly before the end of the semester because we will use these contracts as the starting point for negotiations. Each student will be paired in mock negotiations, to be conducted outside of the classroom by arrangement between paired students sometime between Weeks 9 and Week 11 (or on a date and time otherwise specified in class or via TWEN). The outcome of the negotiation will be evidenced by an e-mail sent by each party and received by me by the Wednesday of Week 11 (or on a date and time otherwise specified in class or via TWEN) containing either: (i) an agreed-upon derivatives agreement between the parties; or (ii) a draft indicating the clauses which have been agreed upon and which are still in contention.

It should be noted that a completed contract which may not obtain all of your side’s objectives is better than one where items are not agreed upon. Moreover, derivatives contracts lend themselves to “win-win” outcomes. Accordingly, an adversarial “zero sum” negotiation style may not be necessary or desirable and the ability to construct “win-win” outcomes will be given added weight with respect to the grading of this portion of the class.

Final Exam: The final exam will consist of a mixture of short essay questions.

Computer Policy: Computers are to be used during class for taking notes and no other purpose. Violations of this rule may lead to you being prohibited from using a laptop during class.

Communications: The best way to communicate with me is by e-mail at the above address. I will get back to you within 24 hours. While I do not maintain regular office hours, if you need to speak with me in person, we can set up an appointment either before or after class.

Summary of Course:

Due to the dynamic nature of derivatives law and regulation, it may be necessary to update reading materials or to modify class content. Nonetheless, the below is a good guide to the topics we will cover.

Week 1: *Introduction to Derivatives*

- What are derivatives and why do we use them?
- The basic building blocks: options, forwards and swaps.
- The economic fundamentals of an interest rate swap and an illustration of “hedging.”

Required Reading: Deriv. Law, pp. 1-23.

Recommended Reading: None.

Week 2: *The Origins of Derivatives Regulation*

- The history of derivatives regulation in the US.
- Origins of the Commodity Exchange Act and Commodity Futures Trading Commission.
- From gambling to hedging, prohibition to laissez-faire economics to regulation.

Required Reading: Deriv. Law, pp. 28-62.

Recommended Reading: Deriv. Law, pp. 25-28.

Week 3: *How Off-Facility Swaps are Documented*

- The role and history of the International Swaps and Derivatives Association (“ISDA”).
- The way derivatives are documented and negotiated: The ISDA Master Agreement, Schedule, Confirmation, Credit Support Annex, Paragraph 13 and Definitions.
- Payment netting and close-out netting with economic examples.

Required Reading: Sample ISDA Master Agreement, Schedule and Confirmation; Drafting and Negotiation Background Memo.

Recommended Reading: None.

Week 4: *Negotiating Derivatives*

- Negotiating derivatives agreements.
- Review of commonly negotiated clauses in ISDA Schedule and Credit Support Annex.
- Parameters for derivatives contract drafting assignment.

Required Reading: Deriv. Law, pp. 297-314.

Recommended Reading: Deriv. Law, pp. 316-319.

Week 5: *The Commodity Exchange Act and Commodity Futures Trading Commission*

- The Commodity Exchange Act.
- Jurisdiction: Untangling the Commodity Futures Trading Commission, Securities and Exchange Commission, Department of the Treasury, Federal Energy Regulatory Commission, and the states.
- The Great Divide: Exchange-traded and off-exchange derivatives.

Required Reading: Deriv. Law, pp. 63-86; 90.

Recommended Reading: Deriv. Law, pp. 86-89.

Week 5: *Contract Markets*

- The operation of boards of trade designated as contract markets or exchanges.
- Regulatory “core principles” as means of oversight.
- Derivatives clearing organizations.
- Questions and discussion regarding draft of contracts due.

Required Reading: Deriv. Law, pp. 91-123; 126 (initial drafts of contracts due next week).

Recommended Reading: Deriv. Law, pp. 123-126.

Week 6: *Market Intermediaries*

- Futures commission merchants and their regulation; comparison of futures commission merchants to securities broker-dealers.
- Introducing brokers.
- Floor Brokers.

Required Reading: Deriv. Law, pp. 127-165.

Recommended Reading: None.

Week 7: *Commodity Investment Vehicles*

- What constitutes a hedge fund?
- Relevance of commodity pools.
- Commodity pool operators and their regulation; absence of securities law analogue.
- Commodity trading advisors and First Amendment issues.

Required Reading: Deriv. Law, pp. 167-208.

Recommended Reading: None.

Week 8: *Introduction to the Dodd-Frank Regime*

- Swaps dealers and major swap participants.
- Entity-level requirements, e.g., Chief Compliance Officer reports, risk management and capital.
- Central importance of eligible contract participant status.
- Shifting public policy justifications underlying eligible contract participant requirements.
- Swap push-out and the Volcker Rule.
- Questions before final draft of derivatives contracts due next week.

Required Reading: Deriv. Law, pp. 209-251.

Recommended Reading: None.

Week 9: *Transaction-Level Swap Regulations*

- Clearing and on-facility trading requirements.
- The end-user and inter-affiliate exceptions to clearing requirements.

- Clearing designations and available to trade determinations.
- Trade reporting requirements.
- Reporting hierarchies.
- External business conduct requirements.
- Parameters for negotiations and assignment of negotiation pairs.

Required Reading: Deriv. Law, pp. 253-299.

Recommended Reading: Gary E. Kalbaugh, *Including Derivatives Providers in Intercreditor Arrangements*, 44 No. 4 UCC L. J. Art 2 (Nov. 2012).

Week 10: *Derivatives in Bankruptcy/The Lehman Brothers Experience*

- “Futures” model v. “LSOC” model.
- Bankruptcy for futures and cleared swaps.
- The contractual termination process and the U.S. bankruptcy code.
- The right of “set-off.”
- Overview of the “*ipso facto*” rule and payment subordination in structured vehicles.
- The “walk away” clause enforceability controversy.
- Section 2(a)(iii) “payment suspension.”
- Modifications to payment priorities.

Required Reading: Deriv. Law, pp. 321-351.

Recommended Reading: None.

Week 11: *Public Policy Issues and Derivatives*

- Panel style discussion.
- Further discussion regarding negotiations.

Required Reading: Deriv. Law, pp. 373-424.

Recommended Reading: Peruse the Financial Crisis Inquiry Commission Report.

Week 12: *Market Manipulation and Enforcement*

- Commodity Exchange Act’s criminal provisions.
- CFTC’s enforcement authority.
- Fraud in the derivatives marketplaces.
- Market manipulation and its variations.

- Private rights of action.
- Reparations proceedings.

Required Reading: Deriv. Law, pp. 424-443.

Recommended Reading: None.

Week 13: *Cross-Border Issues*

- CFTC's jurisdictional limits.
- Application of futures regulatory regime outside the United States.
- The Dodd-Frank Act's cross-border provisions relation to swaps.

Required Reading: [TBD]

Recommended Reading: None.

Week 14: Final exam.