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12 December 2013

Dear Sirs

European Commodity Clearing AG/Prudential Regulation/CCP interim opinion

You have asked us to give an opinion in respect of the laws of Germany ("**this jurisdiction**") as to the effect of certain netting provisions and collateral arrangements in relation to European Commodity Clearing AG, having its place of business at Augustusplatz 9, 04109 Leipzig and registered with the commercial register of the district court (*Amtsgericht*) of Leipzig under HRB 22362, (the "**Clearing House**") as between the Clearing House and its clearing members (each a "**Member**").

The Clearing House clears spot and futures transactions in products expressly approved by it (such as electricity, natural gas, emission rights and coal). Members may submit transactions to the Clearing House for clearing on their own account, on behalf of their clients or for an affiliated non-clearing member. Transactions which are eligible for clearing through the Clearing House must be traded on exchanges or multilateral trading facilities. In order to become a Member, an entity has to obtain a "clearing licence" (*Clearing-Lizenz*) from the Clearing House. The clearing licence is a contractual arrangement between the Clearing House and the Member under which the Member is granted access to the clearing services of the Clearing House, if the Member, amongst other things, is located in a Member State (as defined below) or Switzerland, holds the requisite banking or financial services licence to engage in the clearing process (or is an EEA branch of such an institution), is subject to supervision and meets specific own funds requirements. Under its Clearing Conditions (as defined below, paragraph 1.11(a)) the Clearing House requires Members to post collateral and to make contributions to a default fund as security for the performance of the clearing services.

Section 3.10.2 of the Clearing Conditions ("**Netting Provision**") provides (in an English translation provided by ECC on its website[1], that, if

"- *a circumstance which entitles ECC to terminate the Clearing Agreement with the Clearing Member for an important cause arises with regard to a Clearing Member or*

- a case of an insolvency arises with regard to this Clearing Member..."

then clause 7 (1) sentences 1 and 4 (right to terminate for a material reason[2] and exclusion of the right to a partial termination), clause 7 (2) and (3) (event of insolvency, compensation claims), clause 8 (claims to damages and compensation for benefits received) and clause 9 (1) of the German Master Agreement for Financial Derivatives Transactions (*Rahmenvertrag für Finanztermingeschäfte*, "**DRV**") as published by the German Bankers' Association ("**BdB**") shall apply with modifications as specified in the Clearing Conditions.

An English translation published by the BdB[3] of these clauses of the DRV reads as follows:

"*7. Termination*

(1) Where Transactions have been entered into and not yet fully settled, the Agreement can only be terminated by either party for material reason. [...]

A partial termination, in particular a termination of some, but not all Transactions is excluded, Clause 12 sub-Clause (5) (B) remains applicable.

(2) The Agreement shall terminate, without notice, in the event of an insolvency. An insolvency shall be given, if an application is filed for the commencement of bankruptcy or other insolvency proceedings against the assets of either party and such party either has filed the application itself or is generally unable to pay its debts as they become due or is in any other situation which justifies the commencement of such proceedings.

(3) In the event of termination upon notice by either party or upon insolvency (hereinafter called "Termination"), neither party shall be obliged to make any further payment or perform any other obligation under Clause 3 sub-Clause (1) which would have become due on the

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1 Available at http://cdn.ecc.de/document/18694/20131209_ECC_Clearing%20Conditions_V21a.pdf.

2 In this Opinion Letter we use the term "material reason" to translate the term "*wichtiger Grund*" into English as the BdB does in the English translation of the DRV published on its website (see next footnote). The translation provided by the Clearing House uses the term "important cause".

3 http://bankenverband.de/downloads/2003/rv-drv-engl.pdf

same day or later; the relevant obligations shall be replaced by compensation claims in accordance with Clauses 8 and 9.

8. Claims for Damages and Compensation for Benefits Received

(1) In the event of Termination, the party giving notice or the solvent party, as the case may be, (hereinafter called "Party Entitled to Damages") shall be entitled to claim damages. Damages shall be determined on the basis of replacement transactions, to be effected without undue delay, which provide the Party Entitled to Damages with all payments and the performance of all other obligations to which it would have been entitled had the Agreement been properly performed. Such party shall be entitled to enter into contracts which, in its opinion, are suitable for this purpose. If it refrains from entering into such substitute transactions, it may base the calculation of damages on that amount which it would have needed to pay for such replacement transactions on the basis of interest rates, forward rates, exchange rates, market prices, indices and any other calculation basis, as well as costs and expenses, at the time of giving notice or upon becoming aware of the insolvency, as the case may be. Damages shall be calculated by taking into account all Transactions; any financial benefit arising from the Termination of Transactions (including those in respect of which the Party Entitled to Damages has already received all payments and performance of all other obligations by the other party) shall be taken into account as a reduction of damages otherwise determined.

(2) If the Party Entitled to Damages obtains an overall financial benefit from the Termination of Transactions, it shall owe the other party, subject to Clause 9 sub-Clause (2) and, where agreed, Clause 12 sub-Clause (4), a sum corresponding to the amount of such benefit, but not exceeding the amount of damages incurred by the other party. When calculating such financial benefit, the principles of sub-Clause (1) as to the calculation of damages shall apply mutatis mutandis.

9. Final Payment

(1) Unpaid amounts and any other unperformed obligations, and the damages which are payable, shall be combined by the Party Entitled to Damages into a single compensation claim denominated in Euro, for which purpose a money equivalent in Euro shall be determined, in accordance with the principles set forth in Clause 8 sub-Clause (1) sentences 2 to 4, in respect of claims for performance of such other overdue obligations."

Section 3.10.2 of the Clearing Conditions provides that references to the "Agreement" shall be read as references to the Clearing Agreement (*Clearing-Vereinbarung*) (incorporating the Clearing Conditions) between the Clearing House and the respective Clearing Member and that each derivatives market transaction, each open delivery or acceptance obligation under

each derivatives market transaction which has not yet been fully settled and under each spot market transaction which has not yet been fully fulfilled by ECC shall be deemed a separate transaction shall be deemed to qualify as a Transaction as defined in the DRV ("**Transaction**"). Further, the term "event of insolvency" as used in the Clearing Conditions shall have the same meaning as in clause 7 para 2 DRV except that an event of insolvency "*shall also be given if a competent supervisory authority applies for bankruptcy or other insolvency proceedings to be initiated with regard to a Clearing Member or ECC or if such authority takes a measure which is likely to prevent the Clearing Member or ECC from fulfilling its payment obligations under transactions on account of provisions under bankruptcy or insolvency law or similar provisions which are material for the Clearing Member's or ECC's business operations; the insolvency of a company which can exercise control over a party within the meaning of Art. 17 AktG [German Companies Act] or of comparable national rules (ultimate parent) shall correspond to an event of insolvency regarding such party.*

Section 3.4.7 of the Clearing Conditions (the "**Set-Off Provision**") provides that the Clearing House shall, on each business day and *vis-à-vis each* of its Members, set off all accounts receivable and accounts payable from spot market transactions which have not been fulfilled as well as from expired futures contracts the clearing of which is effected by the Clearing House in accordance with the Clearing Conditions and calculate a single account receivable and/or a net account payable towards every Member. The Clearing House shall further set off all transaction on futures contracts and options contracts and other transactions which are cleared in accordance with the Clearing Conditions and calculate a single net position at the end of each business day. Positions on proprietary accounts and positions on client accounts of Clearing Members shall be set off separately.

We understand that your requirement is for the enforceability and validity of such netting, set-off and collateral arrangements to be substantiated by a written and reasoned opinion letter. As instructed, we only opine on the effects of an insolvency of the Clearing House but not on the default or insolvency of a Member.

References herein to "**this opinion**" are to the opinion given in paragraph 3 of this opinion letter.

1. TERMS OF REFERENCE

1.1 This opinion is given in respect of Members which are

1.1.1 Companies;

1.1.2 Partnerships;

1.1.3 Cooperatives;

1.1.4 Financial Services Institutions; and

1.1.5 Credit Institutions.[4]

1.2 This opinion also applies to a non-German Member which is a Member incorporated or formed under the laws of another jurisdiction.

1.3 The opinions given in paragraph 3 are in respect of a Member's powers under the Clearing House Documentation as at the date of this opinion. We express no opinion as to any provisions of the Clearing House Documentation (as defined below, paragraph 1.11(e)) other than those on which we expressly opine.

1.4 Where Trades (as defined below, paragraph 1.11(s),) are governed by laws other than the laws of this jurisdiction, the opinions contained in paragraph 3 are (to the extent this opinion relates to individual Trades) given in respect of only those Trades which are capable, under their governing laws, of being terminated and liquidated in accordance with the provisions of the Netting Provision.

1.5 The opinions given in the opinion relate only to German law as applied by the German courts as at today's date. We express no opinion on the laws of any other jurisdiction, even where, under German law, a foreign law would be applicable.

1.6 We do not express any opinion as to any matters of fact.

1.7 We give no opinion on regulatory, tax or accounting matters.

1.8 We do not advise on the suitability or appropriateness of the Clearing House Documentation or any Trade entered into thereunder or related issues including any advisory and related duties of care.

1.9 We do not opine on the enforceability of any net obligation resulting from any netting or set-off.

1.10 As instructed, we do not express any opinions on the legal implications on the relationship with or the involvement of any parties (such as non-clearing members

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[4] We do not opine on German Credit Institutions holding a licence as a covered bond bank (*Pfandbriefbank*) with respect to any transactions relating to or included in the cover register (*Deckungsregister*) and we do not give an opinion on general regulatory restrictions under the German Covered Bond Act (*Pfandbriefgesetz*).

(*Nicht-Clearing-Mitglieder* as defined under section 1 of the Clearing Conditions)) other than the Clearing House or Members in the clearing process with respect to the Clearing House Documentation.

1.11 Definitions

In this opinion, unless otherwise indicated:

(a) "**Assessment Liability**" means a liability of a Member to pay an amount to the Clearing House as a contribution to the clearing fund (*Clearing-Fonds*, "**Clearing Fund**") maintained by the Clearing House in accordance with section 3.8 of the Clearing Conditions. A Member's Assessment Liability includes

(i) the obligation to make contributions and to adjust contributions to the Clearing Fund in accordance with the calculation method published by the Clearing House (section 3.8.1 (2) sentences 1 to 3 of the Clearing Conditions);

(ii) the obligation to make additional contributions if the Member delivers collateral it has obtained as such itself (i.e. it utilises Collateral granted to it by its cutomers to collateralise its own obligations *vis-à-vis* the Clearing House) in accordance with section 3.5.6 of the Clearing Conditions (section 3.8.1 (2) sentence 4 of the Clearing Conditions); and

(iii) the obligation to make further contributions once contributions have been utilised by the Clearing House within 10 business days upon utilisation (section 3.8.3 of the Clearing Conditions).

(b) "**Cash Collateral**" means the cash collateral provided to the Clearing House in accordance with the Clearing Conditions and "**Collateral**" comprises Non-cash Collateral and Cash Collateral;

(c) "**Clearing Agreement**" means the Clearing Agreement (*Clearing-Vereinbarung*) dated 31 March 2008 entered into between each Member and the Clearing House in the form available at http://cdn.ecc.de/document/12606/20080331_CM02_Agreement.pdf;

(d) "**Clearing Conditions**" means the Clearing Conditions of the Clearing House (*Clearing-Bedingungen der European Commodity Clearing AG*) dated 9 December 2013 in the form available at

http://cdn.ecc.de/document/18691/20131209_ECC_Clearingbedingungen_V021a_change%20mode.pdf;

(e) "**Clearing House Documentation**" means the Clearing Conditions, the Clearing Agreement and the Collateral Agreement collectively;

(f) "**Client Position Accounts**" (*Kundenpositionskonten*) has the meaning given to such term under section 3.6.3 of the Clearing Conditions, i.e. it refers to accounts held by a Member with the Clearing House which is used to book positions of third parties;

(g) "**Collateral Agreement**" means the Collateral Agreement (*Besicherungsvereinbarung*) dated 12 September 2011 entered into between each Member and the Clearing House for the purpose of creating German law pledge in the form available at http://cdn.ecc.de/document/13676/NCM07_Collateral_Agreement_20110912.pdf;

(h) "**Company**" means a stock corporation (*Aktiengesellschaft*, "**AG**") established under the German Stock Corporation Act (*Aktiengesetz*, "**AktG**"), or a European public limited-liability company (*Societas Europaea*, "**SE**") established under the Regulation (EC) No 2157/2001 on the Statute for a European Company (SE), or a limited liability company (*Gesellschaft mit beschränkter Haftung*, "**GmbH**") established under the German Act on Limited Liability Companies (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung*, "**GmbHG**");

(i) "**Cooperative**" means a cooperative established under the German Act on Industrial and Economic Cooperatives (*Gesetz betreffend die Erwerbs- und Wirtschaftsgenossenschaften*);

(j) "**Credit Institution**" means a credit institution (*Kreditinstitut*) within the meaning of section 1 para 1 of the German Banking Act (*Kreditwesengesetz*, "**KWG**");

"**Financial Services Institution**" means a financial services institution (*Finanzdienstleistungsinstitut*) within the meaning of section 1 para 1a KWG and

"**Institution**" means Credit Institutions and Financial Services Institutions collectively. Institutions may be established in one of the forms set out under paragraphs 1.1.1 to 1.1.3 or may be organised under public law as an

institution under public law (*Anstalt des öffentlichen Rechts*) or as a corporation under public law (*Körperschaft des öffentlichen Rechts*).

(k) "**Deposit Taking Credit Institution**" means a deposit taking Credit Institution (*Einlagenkreditinstitut*) as defined in section 1 para 3d of the Banking Act which in turn refers to Article 4 para 1 of the EU Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (the "**Banking Directive**")[5], the home member state as defined in Article 2 WUD) of which is Germany;

(l) "**EEA**" means the European Economic Area;

(m) references to the word "**enforceable**" and cognate terms are used to refer to the ability of a Party to exercise its contractual rights in accordance with their terms. It does not mean that those rights will be enforceable in all circumstances. We do not opine on the availability of any judicial remedy;

(n) "**Equivalent Clearing Agreement**" means any agreement or other document entered into by or on behalf of a Member pursuant to which such Member agrees to be bound by the Clearing Conditions as a Member but which contains no other provisions which may be relevant to the matters opined on in this opinion letter.

(o) "**EUIR**" means the Council Regulation (EC) No.1346/2000 of 29 May 2000 on insolvency proceedings[6];

(p) "**Financial Collateral**" means to an arrangement defined as such in section 1 para 17 sentence 1 and 2 KWG[7];

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[5] OJ No L 177 of 30 June 2006, p. 1. Article 4 para 1 point 1 Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation 648/2012 (OJ No L 176 of 27 June 2013, p. 1, "**CRR**") replaces Article 4 para 1 point 1 Banking Directive and will become effective on 1 January 2014. While the definition remains the same, Deposit Taking Credit Institutions will be referred to as CRR Credit Institutions (*CRR-Kreditinstitute*) rather than as Deposit Taking Credit Institutions under section 1 para 3d KWG from 1 January 2014 onwards.

[6] OJ No L 160 of 30 June 2000, p. 1.

[7] Section 1 para 17 sentence 1 and 2 KWG reads in an English translation as follows:

(q) **"FCD"** (Financial Collateral Directive) means the Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements[8] as amended by Directive 2009/44/EC[9];

(r) **"Insolvency Event of Default"** (*Insolvenzfall*) has the meaning given to the term under section 3.10.2 para 1, sixth indent of the Clearing Conditions in conjunction with clause 7 para 2 of the DRV, i.e. it refers to (i) the filing of an application for the opening of bankruptcy, insolvency or similar roceedings over the assets of the Clearing House or a Member or (ii) the filing of an application for the opening of bankruptcy or insolvency proceedings or similar

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"Financial collateral within the meaning of this act are cash deposits (*Barguthaben*), cash amounts (*Geldbeträge*), securities, money market instruments and other credit claims within the meaning of Article 2 para 1 lit (o) of Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements (OJ No L 168 of 27 June 2002, p. 43) as amended by Directive 2009/44/EC (OJ No L 146 of 10 June 2009, p. 37) including all related rights or claims which have been transferred as collateral either by way of an in rem security arrangement (*beschränktes dingliches Sicherungsrecht*) or by way of a money transfer or by way of full title transfer on the basis of an agreement between a secured party and a security provider, each belonging to one of the categories named in Article 1 para 2 lit (a) to (d) of the Directive 2002/47/EC which has been amended by the Directive 2009/44/EC. Should the security provider be a person or business undertaking named in Article 1 para 2 lit (e) of the Directive 2002/47/EC, financial collateral is only given, if the collateral secures obligations that exist under contracts on or the procurement of agreements on (a) the acquisition and sale of financial instruments, (b) sale and repurchase, lending or similar transactions on financial instruments or, (c) loans to finance the acquisition of financial instruments.

As of 1 January 2014, an English translation of section 1 para 17 KWG will read as follows: "Financial collateral within the meaning of this act are cash deposits (*Barguthaben*), cash amounts (*Geldbeträge*), securities, money market instruments and other credit claims within the meaning of Article 2 para 1 lit (o) of Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements (OJ No L 168 of 27 June 2002, p. 43) as amended by Directive 2009/44/EC (OJ No L 146 of 10 June 2009, p. 37) and monetary claims which arise from an agreement based on which an insurance company as defined in section para 1 of the German Insurance Supervisory Act (*Versicherungsaufsichtsgesetz*) has granted credit in the form of a loan including all related rights or claims which have been transferred as collateral either by way of an in rem security arrangement (*beschränktes dingliches Sicherungsrecht*) or by way of a money transfer or by way of full title transfer on the basis of an agreement between a secured party and a security provider, each belonging to one of the categories named in Article 1 para 2 lit (a) to (e) of the Directive 2002/47/EC which has been amended by Directive 2009/44/EC; in the case of credit claims of an insurance company this only applies if the security provider has its seat in Germany. Should the security provider be a person or business undertaking named in Article 1 para 2 lit (e) of the Directive 2002/47/EC, financial collateral is only given, if the collateral secures obligations arising under agreements or the procurement of agreements which serve (a) the acquisition and sale of financial instruments, (b) sale and repurchase, lending or similar transactions on financial instruments or, (c) loans to finance the acquisition of financial instruments."

[8] OJ No L 168 of 27 June 2002, p. 43.

[9] OJ No L 146 of 10 June 2009, p. 37

regulatory or similar measures which are relevant for the Clearing Houses or the Member's business and are likely to prevent the Clearing House or the Member from meeting payment obligations under Trades. An Insolvency Event of Default in respect of an undertaking which exercises dominant influence (*beherrschenden Einfluss*) as defined under section 17 of the Stock Corporation Act on a Party shall have the same effect as an Insolvency Event of Default in respect of such Party;

(s) "**Member State**" means to a member state of the European Union ("**EU**");

(t) "**Non-cash Collateral**" means the non-cash collateral provided to the Clearing House under the Collateral Agreement in the form of (i) transferable securities which may be collectively held or held in dematerialised form or (ii) credit entries for securities held outside Germany (*Gutschriften in Wertpapierrechnung*);

(u) "**Party**" means the Clearing House or the relevant Member;

(v) "**Proprietary Accounts**" (*Eigenpositionskonten*) has the meaning given to such term under section 3.6.2 of the Clearing Conditions, i.e. it refers to accounts held by a Member with the Clearing House for the prupose of booking the Member's own positions;

(w) "**Partnership**" means a commercial partnership (*offene Handelsgesellschaft*) or a limited partnership (*Kommanditgesellschaft*) (including any permutations thereof) organised under the German Commercial Code (*Handelsgesetzbuch*, "**HGB**") or a European Economic Interest Grouping (*Europäische Wirtschaftliche Interessenvereinigung*) established in accordance with Regulation (EEC) No 1237/85 of 25 July 1985 on the European Economic Interest Grouping and the German Act on the Implementation of the EEC Regulation on the European Economic Interest Grouping (*Gesetz zur Ausführung der EWG-Verordnung über die Europäische wirtschaftliche Interessenvereinigung*) but excluding a civil law partnership (*Gesellschaft bürgerlichen Rechts*) and excluding a partnership of professionals (*Partnerschaftsgesellschaft*);

(x) "**System**" means a system (*System*) as defined in section 1para 16 KWG.

An English translation of section 1 para 16 sentences 1 and 2 KWG reads as follows: "A system within the meaning of section 24b is a written agreement within the meaning of Article 2 lit (a) of the Directive 98/26/EC of the

European Parliament and of the Council of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems (OJ No L 166 of 11 June 1998, p. 45) [(Settlement Finality Directive) "**SFD**"] as amended by Directive 2009/44/EC (OJ No L 146 of 10 June 2009, p. 37), including an agreement between a participant and an indirectly participating credit institution which has been notified by Deutsche Bundesbank or a competent authority of a member state of the EEA to the European Securities and Markets Authority [("**ESMA**")]. Systems from third countries are treated similar to the systems referred to in sentence 1 if they largely correspond with the requirements enumerated in Article 2 lit (a) of the Directive 98/26/EC."

Article 2 lit (a) SFD defines "system" as follows:

"'system' shall mean a formal arrangement

- between three or more participants, excluding the system operator of that system, a possible settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant, with common rules and standardised arrangements for the clearing, whether or not through a central counterparty, or execution of transfer orders between the participants

- governed by the law of a Member State chosen by the participants; the participants may, however, only choose the law of a Member State in which at least one of them has its head office, and

- designated, without prejudice to other more stringent conditions of general application laid down by national law, as a system and notified to the Commission by the Member State whose law is applicable, after that Member State is satisfied as to the adequacy of the rules of the system.

Subject to the conditions in the first subparagraph, a Member State may designate as a system such a formal arrangement whose business consists of the implementation of transfer orders as defined in the second indent of (i) and which to a limited extent executes orders relating to other financial instruments, when that Member State considers that such a designation is warranted on grounds of systemic risk.

A Member State may also on a case-by-case basis designate as a system such a formal arrangement between two participants, without counting a possible

settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant, when that member state considers that such a designation is warranted on grounds of systemic risk.

An arrangement entered into between interoperable systems shall not constitute a system."

(a) "**Trade**" means a trade (*Geschäft*) as defined at section 1 of the Clearing Conditions, i.e. a spot, forward or futures transaction in products admitted by the Clearing House which is cleared by the Clearing House;

(b) "**WUD**" (Winding Up Directive) means the Directive 2011/24/EC of 4 April 2001 on the reorganisation and winding up of Credit Institutions[10];

1.11.2 references to a "**paragraph**" are (except where the context otherwise requires) to a paragraph of this opinion letter;

1.11.3 any reference to legislation shall be construed as a reference to such legislation as the same may have been re-enacted on or before the date of this opinion letter; and

1.11.4 headings are for ease of reference only and shall not affect the interpretation of this opinion letter.

2. ASSUMPTIONS

We assume the following:

2.1 That the Clearing House Documentation has been validly agreed between the Clearing House and its Member and that the Clearing Conditions have been validly agreed and incorporated and form part of the legal relationship between the Clearing House and its Members.

2.2 That the Clearing House Documentation is enforceable in accordance with its terms (other than those provisions of the Clearing House Documentation on which we express an opinion).

[10] OJ No L 125 of 5 May 2001, p. 15.

2.3 That each Party has the capacity, power and authority under all applicable law(s) to enter into the Clearing House Documentation and Trades, to perform its obligations under the Clearing House Documentation and Trades, and that each Party has taken all necessary steps to execute and deliver and perform the Clearing Agreement, the Collateral Agreement and Trades.

2.4 That each Party has obtained, complied with the terms of and maintained all authorisations, approvals, licences and consents required to enable it lawfully to enter into and perform its obligations under the Clearing House Documentation and Trades and to ensure the legality, validity, enforceability or admissibility in evidence of the Clearing House Documentation in this jurisdiction.

2.5 That both Parties have properly executed either a) the Clearing Agreement, in substantially identical form to that attached at Annex 2 or b) an Equivalent Clearing Agreement.

2.6 That each Party acts in accordance with the powers conferred by the Clearing House Documentation and Trades and that (save in relation to any non-performance leading to the taking of action by the Members under the Netting Provision) each Party performs its obligations under the Clearing House Documentation and each Trade in accordance with their respective terms.

2.7 That each Member is at all relevant times solvent and not subject to any regulatory pre-insolvency, reorganisation or insolvency proceedings under the laws of any jurisdiction.

2.8 That there is no stoppage of payment situation (including German law *Zahlungsunfähigkeit*) and no status of over-indebtedness (including German law *Überschuldung*) in respect of the Clearing House and that the Clearing House is not subject to any regulatory pre-insolvency, reorganisation or insolvency proceedings under the laws of any jurisdiction as of the date of this opinion.

2.9 That the obligations assumed under the Clearing House Documentation and Trades are mutual between the Parties, in the sense that the Parties are each personally and solely liable as regards obligations owing by it and is solely entitled to the benefit of obligations owed to it. "**Mutuality**" (*Gegenseitigkeit*) generally exists where each party is personally and solely liable as regards obligations owed by it and is solely entitled to the benefit of obligations owed to it. Circumstances in which the requisite mutuality is missing include, without limitation, where a party is acting as agent for another person, or is a trustee, or in respect of which a party has a joint interest (including partnership) or such in respect of which a party's rights or obligations or

any interest therein have been assigned, charged or transferred (whether in whole or in part) whether unilaterally, by agreement or by operation of law.

2.10 That the Clearing House does not qualify as a Deposit Taking Credit Institution.[11]

2.11 That none of the Parties qualifies as a consumer (*Verbraucher*) within the meaning of section 13 of the German Civil Code (*Bürgerliches Gesetzbuch*, "BGB"), i.e. a natural person entering into a legal transaction for a purpose which belongs neither to its commercial business nor to its self-employed business, but qualifies – as appropriate – as a merchant (*Kaufmann*) within the meaning of section 1 HGB or as an entrepreneur (*Unternehmer*) within the meaning of section 14 BGB, i.e. any natural or legal person or partnership entering into a legal transaction in the course of its commercial business or its self-employed business.

2.12 That any money transfers or direct debits between the Clearing House and any Member are made in accordance with statutory provisions on the transfer of moneys (*Überweisungsrecht*) and in accordance with all provision applicable to direct debits (*Lastschriften*).

2.13 All dispositions of securities between the Clearing House and any Member are made in accordance with German property law (*Sachenrecht*).

3. OPINION

On the basis of the foregoing terms of reference and assumptions and subject to the qualifications set out in paragraph 4 below, we are of the following opinions.

3.1 Insolvency Proceedings under German law

3.1.1 The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which the Clearing House could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion, are the procedures laid down in the German Insolvency Code (*Insolvenzordnung,* "**InsO**"). A Party who is subject to Insolvency

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[11] Based on the companies database (*Unternehmensdatenbank*) provided by the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "**BaFin**") on its website (http://www.bafin.de/DE/DatenDokumente/Datenbanken/Unternehmenssuche/unternehmenssuche_node.html) we understand that the Clearing House does not qualify as a Deposit Taking Credit Institution. We have not investigated this further and we note that BaFin expressly disclaims liability for the information it provides in its companies database.

Proceedings is called an "**Insolvent Party**" and its counterparty is called the "**Solvent Party**".The main insolvency proceedings (*Hauptinsolvenzverfahren*) under the InsO are referred to as "**Insolvency Proceedings**". When using the term Insolvency Proceedings we do not refer to any opening proceedings (*Eröffnungsverfahren*), in particular we do not to any provisional insolvency measures (*vorläufige Maßnahmen*) taken under section 21 InsO ("**Provisional Insolvency Measures**") (see also paragraph 3.3).

3.1.2 Generally, Insolvency Proceedings may be opened by a the competent insolvency court (*Insolvenzgericht)* upon the filing of an application by the debtor itself or any creditor provided such creditor has a legal interest in the opening of Insolvency Proceedings and substantiates (*glaubhaft machen*) a reason for the opening of Insolvency Proceedings (sections 13 para 1 and 14 para 1 InsO) and provided further a reason for the opening of Insolvency Proceedings exists. The InsO enumerates the following reasons for the opening of Insolvency Proceedings:

(a) Illiquidity (*Zahlungsunfähigkeit*) is defined as the debtor's inability to settle its payment obligations when due (section 17 para 1 InsO). This is generally indicated if the debtor has ceased to make payments (*Zahlungseinstellung*) (section 17 para 2 sentence 2 InsO). Illiquidity does not exist if there is only a temporary delay in payments (*Zahlungsstockung*), which according to the German Federal Supreme Court (*Bundesgerichtshof,* "**BGH**"), means the debtor's inability to make payments does not last for more than three weeks and then the debtor's gap in liquidity will be closed by expected payments, newly provided financing by other parties or the proceeds from the liquidation of assets.[12]

(b) Impending illiquidity (*drohende Zahlungsunfähigkeit*) means that the debtor will not be able to fulfil existing payment obligations when they become due (section 18 para 1 InsO). Since the assessment whether there is an impending illiquidity is based on a prognosis, the insolvency court may require the debtor to submit a liquidity plan (*Liquiditätsplan*). An application to open Insolvency Proceedings on

[12] BGH NZI 2005, 547. The BGH further held that as a rule a debtor is not illiquid if the debtor is able to fulfil its payment obligations when due, except for a marginal amount of up to 10% of the whole sum. The 10% threshold is, however, not a fixed limit which would automatically allow the conclusion that the DEBTOR is illiquid if it is exceeded or that it is not illiquid where the threshold is not reached.

the basis of an impending illiquidity may only be filed by the debtor itself.

(c) Over-indebtedness (*Überschuldung*) exists if the debtor's assets no longer cover its liabilities unless the existence of the debtor as a going concern is likely under the given circumstances (section 19 para 2 InsO). Over-indebtedness only applies to legal entities (*juristische Personen*) (section 19 para 1 InsO) and is determined on the basis of an insolvency balance sheet test. Claims for the repayment of shareholder loans or equivalent claims will not be considered as liabilities in this context, if the shareholder has subordinated its claim (section 19 para 2 sentence 2 InsO).

As the Clearing House is a Credit Institution only BaFin may file an application for the opening of Insolvency Proceedings (section 46b para 1 sentence 4 KWG). BaFin may file an application for the opening of Insolvency Proceedings by reason of impending illiquidity in respect of the Clearing House only upon the Clearing House's approval (section 46b para 1 sentence 5 KWG).

3.1.3 For purposes hereof, the opening of Insolvency Proceedings refers to the time of the issue of an opening order (*Eröffnungsbeschluss*) for the opening of main insolvency proceedings (*Hauptverfahren*) by the competent insolvency court. In the opening order the insolvency court appoints an insolvency representative (*Insolvenzverwalter*, "**Insolvency Representative**"). Upon the opening of Insolvency Proceedings the Insolvent Party's right to manage and transfer assets belonging to the insolvency estate will be vested in the Insolvency Representative (section 80 InsO). Any dispositions of the Insolvent Party over its property made after the opening of Insolvency Proceedings are void unless the relevant insolvency court otherwise orders otherwise (section 81 para 1 InsO).[13] If a creditor of the insolvent debtor obtained a security in respect of assets that form part of the insolvent debtor's assets by means of enforcement measures (*Zwangsvollstreckungsmaßnahmen*) up to one month prior to the opening of Insolvency Proceedings or after the opening of Insolvency Proceedings, such security is void (section 88 InsO).

[13] Please refer to paragraph 3.4.2(g) with respect to exemptions for "Financial Collateral" (as defined therein).

3.1.4 Where an insolvency court has, upon application of the Insolvent Party, ordered the management of the Insolvent Party to continue its activities in accordance with section 270 InsO (*Eigenverwaltung,* "**Self Administration Proceedings**"), numerous rights of the Insolvency Representative are exercised by the creditors' trustee (*Sachwalter*) (including any challenge in insolvency rights under sections 129 *et seq.* InsO as referred to in paragraph 4.2 below, see section 280 InsO). The Insolvent Party may also exercise certain rights itself but in consultation with the creditors' trustee (including the Selection Right as defined in paragraph 3.6.1(b) below, see section 279 InsO). Self Administration Proceedings are not limited to a certain type of Insolvent Parties and are therefore generally available in respect of Credit Institutions. An insolvency court may order Self Administration Proceedings when it releases an order for the opening of Insolvency Proceedings provided the Insolvent Party has applied for Self Administration Proceedings and provided further there are no circumstances which would give rise to the assumption that Self Administration Proceedings would be detrimental to the Insolvent Party's creditors (section 270 para 2 InsO).

3.2 Territorial Scope of Application of Insolvency Proceedings

Whether or not German insolvency courts have jurisdiction for opening Insolvency Proceedings over the assets of a Clearing House depends on the rules governing the relevant proceedings. The international scope of application of Insolvency Proceedings and any Provisional Insolvency Proceedings and Regulatory Proceedings is governed by the Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings ("**EUIR**")[14], Article 102 of the German Introductory Act to the InsO (*Einführungsgesetz zur Insolvenzordnung*, "**EGInsO**"), sections 3, 335 *et seq.* InsO, sections 46d to 46f KWG and section 7 para 5 of the German Bank Reorganisation Act (*Kreditinstitute-Reorganisationsgesetz*, "**KredReorgG**"). As per your instructions, we opine solely on the insolvency of the Clearing House.

The EUIR applies to insolvency proceedings as specified in Article 1 para 1, Annex A EUIR. The EUIR is, *inter alia*, not applicable to insolvency proceedings concerning credit institutions[15] (Article 1 para 2 EUIR). As the Clearing House is not a Deposit

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[14] OJ No L 160 of 30 June 2000, p. 1.

[15] Article 1 para 1 EUIR refers to credit institutions generally but since the EUIR must be construed in light of applicable European Union law, we take the view that it only refers to credit institutions as defined in Article 4 para 1 point 1 Banking Directive.

Taking Credit Institution the conflicts of laws provisions of the EUIR rather than the InsO should apply to the Clearing House. Irrespective thereof, given that the Clearing House is a German stock corporation having its centre of its independent economic activity (section 3 InsO) and its centre of main interest (Article 3 EUIR)[16] in Germany, the German insolvency courts have jurisdiction for opening Insolvency Proceedings over the assets of the Clearing House. All assets which belong to the Clearing House when Insolvency Proceedings are opened or which the Clearing House acquires during Insolvency Proceedings form part of the Insolvency Proceedings (section 35 para 1 InsO). According to German court decisions, Insolvency Proceedings apply universally, i.e. they would cover all the assets of the Clearing House irrespective of whether or not they are located within Germany.[17]

As the Clearing Conditions are governed by German law and to the extent Collateral is located in Germany, even if special insolvency conflict of law provisions were applicable they would likely not affect the German law analysis.[18]

Whether or not territorial or secondary proceedings can be opened in jurisdictions other than Germany is not a matter of German law. As a result of the implementation of Article 10 WUD, the opening of secondary or territorial insolvency proceedings should be excluded in respect of Deposit Taking Credit Institutions (section 46e para 2 KWG). Insolvency Proceedings may only be opened by the competent authorities of the home Member State (*Herkunftsmitgliedsstaat*). However, we understand that the Clearing House does not qualify as a Deposit Taking Credit Institution due to its limited licence.

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16 The ECJ has specified that the "centre of main interests" should correspond to the place where the debtor conducts the administration of his interests on a regular basis and which is therefore ascertainable by third parties (Case C-341/04, Eurofood, IFSC Ltd, [2006] ECR I-3854, I-3868). Objective facts ascertainable by third parties also have to be present in order to rebut the presumption, e.g. where the location of a company's central administration and of its registered office are not identical (Case C-396/09 of 20 October 2011, *Interdil Srl, in liquidation v. Fallimento Interdil Srl, Intesa Gestione Crediti SpA*, recital 51).

17 BGH NJW 1983, 2147; BGH NJW 1992, 2026, 2027.

18 Such as for set-off (section 338 InsO and Article 6 EUIR), netting agreements (section 340 para 2 InsO), Systems (section 340 para 3 InsO and Article 9 EUIR) or insolvency clawback (section 339 InsO and Article 23 EUIR). For an overview see *Ehricke*, Zum anwendbaren Recht auf ein in einem Clearing-System vereinbartes Glattstellungsverfahren im Fall der Insolvenz ausländischer Clearing-Teilnehmer, WM 2006, 2109, 2111.

3.3 Provisional Insolvency Measures

3.3.1 Upon an application for the opening of Insolvency Proceedings but before the opening of Insolvency Proceedings a German insolvency court may appoint a provisional insolvency representative (*vorläufiger Insolvenzverwalter*) and issue Provisional Insolvency Measures to protect the insolvent Clearing House's assets in accordance with section 21 InsO.

3.3.2 Provisional Insolvency Measures are limited to attachments (freezing injunctions) that prevent the insolvent Clearing House from disposing of its assets and, thus, jeopardise the purpose of Insolvency Proceedings. Such freezing injunction may cover all assets of the insolvent Clearing House or parts thereof. The insolvency court may impose a general prohibition of dispositions (*Verfügungen*) on the insolvent Clearing House (section 21 para 2 sentence 1 no 2 InsO), order that the insolvent Clearing House's dispositions of property require the consent of the provisional insolvency representative (section 21 para 2 sentence 1 no 2 InsO) or order a restriction (or temporary restriction) on certain measures of enforcement (*Zwangsvollstreckungsmaßnahmen*) against the insolvent Clearing House (section 21 para 2 sentence 1 no 3 InsO).

3.3.3 According to the BGH, Provisional Insolvency Measures pursuant to section 21 para 2 sentence 1 nos 2 and 3 InsO do not exclude the ability of a party to set off claims since the provisions concerning insolvency set-off pursuant to sections 94 through 96 InsO (see paragraph 3.7.2) are deemed as both comprehensive and exclusive. [19] Nor is a provisional insolvency representative entitled to the exercise of a "cherry picking" right, i.e. to choose whether or not to perform certain contracts as stipulated by the Selection Right under section 103 InsO (see paragraph 3.6.1(b) below). The application of section 103 InsO is in terms of timing restricted to the opening of Insolvency Proceedings. According to the BGH, section 119 InsO protects the Insolvency Representative's Selection Right (please refer to paragraph 3.6.1(b)) under section 103 InsO following the opening of Insolvency Proceedings and, in the view of the BGH also applies prior to the opening of Insolvency Proceedings from the point in time in which, based on a valid application for the opening of Insolvency Proceedings, such opening of Insolvency Proceedings is to be seriously expected (*mit der Eröffnung eines Insolvenzverfahrens ernsthaft zu*

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[19] BGH NJW 2004, 3118, 3119; BGH ZIP 2005, 181.

rechnen ist).[20] This means that an early termination may still be invalid even if it occurred prior to the opening of Insolvency Proceedings.

3.4 Regulatory Proceedings

To avoid the failure of the Clearing House, various regulatory measures under the KWG and the KredReorgG may be taken prior to the occurrence of a situation that would justify the opening of Insolvency Proceedings.

3.4.1 Federal Moratorium

In respect of Credit Institutions, the German Federal Government (*Bundesregierung*) may, if it determines that a Credit Institution is in economic difficulties which give rise to the assumption that the national economy, in particular payment transactions in general, are severely endangered, it may under section 46g KWG, among others, grant the Credit Institution a payment moratorium by the legal instrument of a regulation (*Rechtsverordnung*) and order that enforcement proceedings or Provisional Insolvency Measures against such Credit Institution or Insolvency Proceedings over its assets may not be opened for as long as the moratorium persists. It may also order that Credit Institutions must be closed for business with customers and may neither make nor accept payments or remittances with customers; such order may be restricted to a limited number of Credit Institutions or types of banking activities. The Federal Government may also order the closure of exchanges within the meaning of the German Exchange Act (*Börsengesetz*, "**BörsG**").

3.4.2 Regulatory Measures by BaFin

BaFin may take various measures in respect of Credit Institutions and more far-reaching measures that specifically apply to CCPs.

(a) Under section 45 KWG BaFin may take measures for the reinforcement of a Credit Institution's own funds and liquidity. In particular, BaFin is empowered to prohibit withdrawals by shareholders and the distribution of dividends, restrict or prohibit the granting of loans, order the Institution to take measures to reduce risks to the extent these risks result from certain types of transactions or

[20] BGH WM 2013, 274, 276.

products or the use of certain systems or order that the Credit Institution implement measures laid down in its recovery plan (*Sanierungsplan*).

Under section 45c KWG, BaFin may appoint a special representative (*Sonderbeauftragter*), who may assume certain functions within a Credit Institution (including management functions) and confer the requisite powers on it.

(b) Regulatory measures that specifically apply to CCPs

Under the KWG BaFin is empowered to take measures for the reinforcement of a CCP's own funds and liquidity that go beyond its regulatory powers v*is-à-vis* Credit Institutions. Amongst other things, BaFin may order that a CCP must comply with increased own funds requirements and allocate financial resources, which exceed the requirements under EMIR (section 53g KWG). BaFin may impose appropriate and necessary requirements to ensure compliance with EMIR. In particular, to ensure the due and proper organisation of business, BaFin may order, that a CCP takes action to reduce risks which arise from specific types of transactions and products or the use of specific systems or from outsourcing activities and processes, or that a given CCP is not or only to a limited extent permitted to perform individual types of transactions or services (section 53l KWG). BaFin may take measures for the reinforcement of a CCP's own funds and liquidity if a CCP's development in net worth, financial position and financial performance or other circumstances justify the assumption that the CCP will not be able to satisfy the requirements provided for under Articles 41 *et seq.* EMIR and delegated and implementing legislation thereunder (section 53n KWG).

(c) Where the fulfilment of an Institution's obligations towards its creditors and, in particular, the security of the assets entrusted to it are jeopardised or if effective supervision is no longer possible, BaFin may take temporary measures under section 46 para 1 KWG, in particular:

(1) issue instructions for the management of the Institution's business;

(2) prohibit the acceptance of deposits or funds or securities from customers and the granting of loans;

(3) prohibit owners and managers from carrying out their activities or limit such activities;

(4) temporarily prohibit the disposition of assets or the making of any payments by the Institution (such prohibitions (which are different from those under a federal moratorium referred to in the preceding paragraph) collectively referred to as a "**Moratorium**")

(5) close the Institution for ordinary business with customers and

(6) unless an applicable deposit or customer protection scheme ensures full satisfaction of the customers, prohibit the Institution from accepting payments except those made in respect of obligations owed to the Institution.[21]

(d) Restructuring and Reorganisation Procedures

The KredReorgG contains a further set of regulatory restructuring and reorganisation measures in order to limit systemic risks resulting from financial difficulties of Credit Institutions having their seat in Germany.

The KredReorgG provides for restructuring proceedings (*Sanierungsverfahren*) involving the appointment of a restructuring advisor (*Sanierungsberater*) to implement a restructuring plan. Restructuring proceedings can only be voluntarily initiated by the

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[21] As a result of the entry into force of the German Act on the Ring Fencing of Risks and the Planning of the Recovery and Resolution of Credit Institutions (Gesetz zur Abschirmung von Risiken und zur Planung der Sanierung und Abwicklung von Kreditinstituten, "**Ring-Fencing Act**") on 13 August 2013, Credit Institutions which are declared to be potentially systemically important by BaFin must draw up recovery plans and update them on a regular basis (section 47 KWG). The recovery plans must be submitted to BaFin and Deutsche Bundesbank (section 47b para 1 KWG). BaFin must assess the resolvability of all Credit Institutions (section 47d KWG) and is empowered to remove obstacles to the resolvability of those Credit Institutions it has declared to be potentially systemically important (section 47e KWG). BaFin is required to draw up resolution plans for each potentially systemically important Credit Institution which is not part of a potentially systemically important financial group. From 2 January 2014, the other provisions of the Ring Fencing Act will gradually become effective. Amongst other things, Credit Institutions will when exceeding a certain threshold be obliged to transfer certain trading activities to a stand-alone financial trading institution. As of 1 January 2014 BaFin will further be empowered under the KWG as amended by the German Act to Implement CRD IV (*CRD IV-Umsetzungsgesetz*) to require Credit Institutions to draw up and update recovery plans, if disruptions of their business, threats to their existence or their insolvency may endanger the stability of the financial system.

Credit Institution itself by notifying BaFin and will be commenced by a court order of the Higher Regional Court (*Oberlandesgericht*, "**OLG**") Frankfurt upon application by BaFin (section 2 KredReorgG). The Credit Institution must submit a restructuring plan when notifying BaFin. If the application is permissible and not obviously inappropriate the OLG Frankfurt will order the implementation of restructuring proceedings and appoint a restructuring advisor (*Sanierungsberater*) to implement the restructuring plan (sections 3 para 1 and 6 para 1 KredReorgG). Restructuring plans may not affect creditors' rights (section 2 para 2 sentence 2 KredReorgG).

If restructuring proceedings have failed or are without prospect of success, reorganisation proceedings (*Reorganisationsverfahren*) may be opened (section 7 KredReorgG). Reorganisation proceedings will be initiated by the Credit Institution itself, or, if a restructuring proceeding has failed, by the restructuring advisor with the Credit Institution's consent, by notifying BaFin. The Credit Institution or the restructuring advisor must submit a reorganisation plan when notifying BaFin. Following the notification, reorganisation proceedings may be opened by the OLG Frankfurt upon an application by BaFin if the Credit Institution is likely to fail (*Bestandsgefährdung*) and this in turn may threaten the stability of the financial system (*Systemgefährdung*). Reorganisation proceedings may involve measures that affect the rights of the Credit Institution's creditors and/or its shareholders.

Pursuant to section 12 KredReorgG the reorganisation plan if approved by the OLG Frankfurt may provide that claims of creditors are partially reduced, deferred or modified in another way. The modification of salary and pension claims and claims that are protected by a statutory or voluntary deposit protection scheme is excluded. This right to reduce, defer or modify claims may also be extended to creditors' rights with respect to collateral provided as security interest if under such security interest the relevant creditors are entitled to separate satisfaction (*absonderungsberechtigt*) such as pledges over securities by applying section 223 InsO analogously to the reorganisation proceeding. Section 9 KredReorgG provides that claims of a creditor may be converted into equity ("debt-equity-swap"), however, this would be subject to the affected creditors' consent.

Furthermore, the KredReorgG provides for certain mandatory temporary limitations of the rights of counterparties to terminate contractual relationships with a Credit Institution that becomes subject to reorganisation proceedings (section 13 KredReorgG). Contracts may not be terminated from the day on which the notification pursuant to section 7 para 1 KredReorgG is filed with BaFin until the end of the following business day.[22] The effect of any termination events (for example in case of a payment default) occurring during this period is suspended until the expiration of that period. Contractual clauses that provide for the contrary (i.e. for an immediate termination) are invalid.

The measures proposed in the reorganisation plan are subject to a positive majority vote of the creditors and shareholders of the respective Credit Institution accepting such measures and final approval by the OLG Frankfurt. If the OLG Frankfurt orders the implementation of reorganisation proceedings, it must make the reorganisation plan available to affected creditors and determine a meeting for discussion and voting within one month following the issue of the order; simultaneously it must determine a date for a shareholders' meeting which should follow the date of the meeting of the affected creditors (section 16 KredReorgG). Affected creditors are to be divided into groups according to their legal status. There is no indication in the KredReorgG what legal status might mean in this context. The different groups of creditors vote in the meeting ordered by the OLG Frankfurt. The shareholders vote in a shareholders' meeting on the reorganisation plan. The majority which is required depends on the effects of the reorganisation plan (section 18 KredReorgG). In order for the reorganisation plan to be passed the shareholders' vote must be positive, the majorities of all groups of creditors must be in favour and the value of the claims of the creditors in favour must exceed half of the value of the claims of those creditors who voted (section 19 KredReorgG). Section 19 KredReorgG further provides that a positive vote in a group of creditors is deemed to exist even though the requisite majority has not been reached if the creditors of such group will presumably not be worse off than they would be in the absence of a reorganisation plan, these creditors adequately

[22] Section 13 KredReorgG refers to the business day of a System as defined in section 1 para 16b KWG which comprises the usual business cycle of the System including day and night settlement.

participate in the economic value that is created under the reorganisation plan and the majority of all creditor groups has approved the reorganisation plan. Similarly, despite the approval of the shareholders not having been reached their approval will be deemed to exist if the necessary majorities within the respective groups have been reached and the measures in the reorganisation plan serve to prevent significant negative effects on other financial undertakings as a result of the credit institution's existence being endangered and on the stability of the financial system.

If the votes have been positive, the reorganisation plan must be approved by the OLG Frankfurt. The reorganisation plan becomes effective upon such approval (section 21 KredReorgG). If the reorganisation plan as approved by the OLG Frankfurt affects rights which are governed by non-German law, recognition of such measures will be a matter of applicable law. The German legislator takes the view that reorganisation proceedings constitute reorganisation measures for purposes of Article 2 point 7 and Article 3 WUD.[23]

(e) Transfer Order

Where BaFin determines that the ongoing existence of a Credit Institution under the KWG is endangered (*Bestandsgefährdung*) and this in turn may jeopardise the stability of the financial markets (*Systemgefährdung*), [24] BaFin is entitled to issue a transfer order (*Übertragungsanordnung*) pursuant to sections 48a *et seq.* KWG ("**Transfer Order**").[25] By issuing a Transfer Order BaFin may transfer all or parts of the Credit Institution's property to another entity

[23] BT-Drucksache 17/3024, p. 49. The authorities of other Member States in which the WUD has been implemented are obliged to recognise the effects of the reorganisation plan.

[24] BaFin must consult with Deutsche Bundesbank in assessing whether the ongoing existence of a Credit Institution under the KWG is endangered and this in turn may endanger the stability of the financial markets (section 48b para 3 KWG).

[25] The Transfer Oder must be issued in consultation with the steering committee (*Lenkungsausschuss*) established under section 4 of the German Financial Markets Stabilisation Fund Act (*Finanzmarktstabilisierungsfondsgesetz*) and be prepared by the German Federal Financial Markets Stability Agency (*Finanzmarktstabilisierungsanstalt*) if funds under the Restructuring Fund (*Restrukturierungsfonds*) established under the German Restructuring Fund Act (*Restrukturierungsfondsgesetz*) are used.

("**Bridge Bank**"). The Transfer Order may only be issued if this is necessary to maintain or restore the stability of the financial system. If possible, given the facts of the specific case, the BaFin has to consider less intrusive measures. In particular, prior to the issue of a Transfer Order BaFin may (if possible under the given circumstances) request the submission of a plan as to how to eliminate the danger to the Credit Institution's existence as a going concern from the Credit Institution and determine a deadline prior to the expiry of which such reconstruction plan (*Wiederherstellungsplan*) must be submitted (section 48c para 1 KWG). A reorganisation plan which has been submitted in reorganisation proceedings under the KredReorgG may be considered as a reconstruction plan if it is appropriate to eliminate the danger to the Credit Institution's existence as a going concern (section 48c para 2 KWG).

If BaFin has decided to issue a Transfer Order, the Transfer Order becomes effective on the day of its notification to the Credit Institution and the Bridge Bank (section 48 para 1 KWG). If assets which are not subject to German law need to be transferred to the Bridge Bank, and the transfer of such assets requires additional steps under the relevant applicable laws, the Credit Institution is obliged to support such transfer by any necessary legal actions (section 48i para 1 KWG). When required, the Credit Institution has to hold the assets as a fiduciary for the account of the Bridge Bank.

The Transfer Order may not give rise to a termination of legal relationships (*Schuldverhältnisse*) (section 48g para 7 KWG; section 13 KredReorgG and section 48g para 7 KWG collectively, the "**Termination Restrictions**"). Contractual clauses that provide for the contrary are invalid. As described below (paragraph 3.9.3) the Termination Restrictions may therefore affect the Netting Provisions. However, if the reason for the termination is related to the Bridge Bank being the counterparty after the transfer (for example with respect to a potential breach of the large exposure limits), or if a termination is not simply based on the transfer itself (for example in case of a breach of contractual obligations or other reasons) termination is permitted.

Assets which have been transferred under a Transfer Order may be re-transferred upon the BaFin's order from the Bridge Bank to the Credit Institution under section 48j KWG ("**Re-Transfer Order**") within 4

months after the Transfer Order without further requirements or within ten business days after receipt of the termination notice if a counterparty of the Credit Institution purports to terminate or claims that an automatic termination of a transaction between the counterparty and the Credit Institution has occurred by reason of the Transfer Order. The Re-Transfer Order becomes effective upon its publication *vis-à-vis* both the Credit Institution and the Bridge Bank.

In the case of a partial transfer, i.e. where the Transfer Order provides that only part of the business of the Credit Institution will be transferred, section 48k para 2 KWG provides that Financial Collateral (as defined above, paragraph 1.11(p)) must be transferred together with the business parts it relates to. Where assets are part of a System (as defined below, paragraph 3.4.2(h)) such assets must be transferred together with any collateral which has been provided in respect of such assets. Where assets are part of an eligible netting agreement within the meaning of section 206 para 1 of the German Solvency Regulation (*Solvabilitätsverordnung*, "**SolvV**")[26] such assets must be transferred in their entirety and together with the relevant netting agreement and the relevant master agreements which the assets are subject to. Where a partial Re-Transfer Order covers an eligible netting agreement all legal relationships to which the netting agreement applies, the netting agreement and underlying master agreement as well as claims resulting

[26] Pursuant to section 206 para 1 SolvV, eligible netting agreements are netting agreements on derivatives in accordance with section 207 SolvV, netting agreements on monetary claims and monetary debt in accordance with section 208 SolvV, netting agreements on non-derivative transactions with re-margining in accordance with section 209 SolvV and cross-product netting agreements (as defined in section 210 SolvV).

Pursuant to section 206 para 2 SolvV a netting agreement is only considered to be "eligible" if (i) it is a bilateral netting agreement between an institution and its counterparty with regard to the included transactions, (ii) it is in standard use either domestically or internationally or has been recommended for use by a central association of credit institutions, (iii) it ensures that, if Insolvency Proceedings are opened, only a single net amount is owed by one party to the other from the netting of all claims and liabilities, (iv) it gives the institution the right to terminate all transactions under the agreement unilaterally with effect pursuant to number (iii) above if the counterparty defaults under an individual transaction, and (v) it contains no provisions which permit a non-defaulting party to make limited payments only, or no payments at all, to the estate of the defaulting party if the defaulting party is a net creditor.

As of 1 January 2014, references in section 48j and 48k KWG to section 206 SolvV will, following the repeal of section 206 SolvV, be replaced by a reference to Articles 195, 196 and 295 CRR.

upon exercise of any netting rights will be deemed to have been re-transferred (section 48j para 3 sentences 2 and 3 KWG).

The consequences of a breach of section 48k para 2 KWG are not addressed comprehensively under the KWG but section 48k para 2 sentence 3 KWG provides that section 48j para 5 sentence 2 KWG shall apply analogously. Pursuant to this provision, where BaFin, contrary to section 48k para 2 KWG, does not transfer assets that are part of an eligible netting agreement within the meaning of section 206 para 1 SolvV in their entirety, the eligible netting agreement, legal relationships in relation to it and transactions under it are deemed to have been transferred in their entirety as far as the legal relationship between the Credit Institution and its counterparty is concerned.[27]

Assets for which Financial Collateral has been provided must not be transferred under a Transfer Order or a Re-Transfer Order without such Financial Collateral and where assets are included in a System they must be transferred together with any collateral which has been provided in respect of these assets (section 48k para 2 KWG).

Transfer Orders and Re-Transfer Orders may be challenged by the Credit Institution before the Higher Administrative Court (*Verwaltungsgerichtshof*) Kassel ("**VGH Kassel**") within one month upon their publication (section 48r KWG). The law does not expressly foresee any appeal against any such judgment, although legal remedies may from time to time be available under German constitutional law. The filing of a law suit does not suspend or otherwise affect the validity of the Transfer Order or the Re-Transfer Order.

(f) Treatment of branches

It is unclear whether and to what extent Regulatory Proceedings under the KWG and the KredReorgG apply to German branches of Institutions outside the EEA. Section 53 para 1 KWG provides that branches of non-EEA CRR Credit Institutions in Germany are deemed to be German credit institutions. However, the reason why section 53

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[27] *Fridgen*, in: Boos/Fischer/Schulte-Mattler, KWG, 4th ed. (2012), § 48k no. 6, suggests that in other cases of infringements of section 48k para 2 KWG section 134 BGB would apply, i.e. the transfers would be void as a matter of contract law.

para 1 KWG provides for the treatment of non-EEA branches as separate legal entities is that these branches are subject to prudential supervision under German law. It appears that the German legislator did not consider whether the same should apply with respect to bank restructuring measures. There is therefore currently no legal certainty as to the treatment of non-EAA branches in Germany.

For purposes hereof, the procedures described in this paragraph 3.4 are collectively referred to as "**Regulatory Proceedings**".

(g) Exemptions for Financial Collateral

Exemptions from the above restrictions apply to Financial Collateral (paragraph 1.11(p) above).

We understand Members are normally Institutions licensed in accordance with the Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC ("**MiFID**")[28] or the Banking Directive they normally fall within the scope of Article 1 para 2 lit (c) FCD. It should be noted that the term "Institution" reflects German law definitions which are not fully identical with the EU law definitions referred to in the FCD. When checking whether certain entities are within the scope of the FCD, this should therefore be done by referring to the applicable EU Directives or Regulations rather than German implementing legislation. This may also be relevant where Members are established in third countries and do not fall within the definition in Article 1 of the FCD.

It is not entirely clear whether Members established outside the EEA fall within the scope of Article 1 para. 2 lit (a) to (d) FCD as the references in Article 1 para 2 lit (c) FCD may be construed to refer to institutions which are licensed in accordance with the respective EU legislation. However, Article 1 (2) lit (c) FCD appears to list such institutions only as examples ("including") and to include financial institutions generally, i.e. it should cover third country institutions

[28] OJ No L 145 of 30 April 2004, p. 1.

where these are regulated similar to an institution licensed in accordance with MiFID or the Banking Directive. Even where a Member falls within the scope of Article 1 para 2 lit (e) FCD, collateral posted in connection with the Clearing Conditions can still constitute Financial Collateral if such Member is not a natural person and the collateral secures obligations arising under agreements or the procurement of agreements which serve (a) the acquisition and sale of financial instruments, (b) sale and repurchase, lending or similar transactions on financial instruments or (c) loans to finance the acquisition of financial instruments. As the Clearing Conditions involve the sale of financial instruments in the form of derivatives security interests created in favour of and full title transfers made to the Clearing House (which falls within the scope of Article 1 para 2 lit (d) FCD) to secure obligations thereunder will therefore qualify as Financial Collateral as in all likelihood Members fall within the required categories of eligible counterparties.

Section 21 para 2 sentence 2 InsO provides that the institution of Provisional Insolvency Measures under section 21 InsO must not affect the validity of dispositions (*Verfügungen*) over Financial Collateral. The same applies, if Financial Collateral is created on the day on which such order was released, provided the secured party can prove that it neither had been aware of, nor should have been aware of, such release. Dispositions over Financial Collateral effected after the opening of Insolvency Proceedings are valid (notwithstanding any challenge in insolvency (paragraph 4.2)), provided that such dispositions were effected on the day of the opening of Insolvency Proceedings and the other party proves that it did not know, nor should have known, of the opening of the Insolvency Proceedings (section 81 para 3 sentence 2 InsO). Financial Collateral further benefits from certain exemptions in respect of insolvency-related set-off and challenge in insolvency (below, paragraphs 3.7 and 4.2) the enforcement of security. Such exemptions apply analogously to measures under section 46 para 1 sentence 2 no. 4 to 6 KWG (section 46 para 2 sentence 6 KWG) and to restructuring and reorganisation proceedings (section 23 KredReorgG). Further, section 104 InsO expressly refers to Financial Collateral as types of arrangements that are in scope of such section and therefore not subject to the Insolvency Representative's Selection Right (see the detailed analysis of section 104 InsO below at paragraphs 3.6.1(b) to 3.6.1(i)).

(h) Exemptions for Systems

Further exemptions from restrictions under the InsO apply to Systems.

Under German law it is not entirely clear what constitutes a System. We note that the "Payment system of European Commodity Clearing AG as Central Counterparty and Clearinghouse for spot and derivatives commodity markets like European Energy Exchange (EEX) and ENDEX European Energy Derivatives Exchange N.V." operated by the Clearing House is included in the list of Designated Payment and Security Settlement Systems maintained by the European Commission.[29] If the list of Systems had constitutive legal effect, a system entered into the list would in our view constitute a System for purposes of German law. The European Commission and the European Central Bank take the view that the list of Designated Payment and Settlement Systems provides legal certainty with respect to the qualification of Systems.[30] Such view would appear to be based on the idea that an entry into the list does have constitutive effect. However, there is no statutory provision which expressly provides for a constitutive legal effect of the entry which would result in such legal certainty. Based on the wording of Article 2 lit (a) SFD an entry into the list is one of several requirements that must be met for an arrangement to be treated as a System. The legal effects of the notification and the entry into the list of Designated Payment and Security Settlement Systems are thus not entirely clear. We therefore analyse the clearing services operated by the Clearing House on the basis of the definition under section 1 para 16 KWG.

On the basis of the wording of section 1 para 16 KWG in connection with Article 2 lit (a) SFD, it could be argued that the Clearing Conditions establish a System since they consist of standardised terms, are intended to be used with various Members and, amongst other

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[29] Available at http://ec.europa.eu/internal_market/financial-markets/settlement/dir-98-26-art10-national_en.htm.

[30] Opinion of the European Central Bank of 7 August 2008 on a proposal for a directive amending Directive 98/26/EC and Directive 2002/47/EC (CON/2008/37), OJ No. C 216 of 23 August 2008, p. 1 ("**ECB Opinion**"), item 4.2 at p. 3; Report from the European Commission – Evaluation report on the Settlement Finality Directive 98/26/EC (EU 25) of 27 March 2006 (COM(2005) 657 final/2) ("**European Commission Report**"), p. 5.

things, provides for the clearing through a central counterparty[31] and for the execution of transfer orders of participating Members in course of the settlement. The Clearing Conditions are, however, not entered into between Members but between the Clearing House and each of its Members or customers separately.[32] We understand that, based on the ECB Opinion which was published in 2008 and assuming that the European Parliament and the Council were aware of the concerns expressed in the ECB Opinion when making the amendments to the SFD under Directive 2009/44/EC (as quoted above) in 2009, a System within the meaning of the SFD does not necessarily require that all contractual relationships are bilateral agreements but rather that three or more participants are bound by the same formal arrangements, such as the Clearing Conditions. Whilst the legislative history indicates that the EU legislator does not necessarily draw a clear distinction between clearing and settlement, the wording of Article 2 lit (a) SFD and legislative materials[33] indicates that Article 2 lit (a) SFD comprises clearing services.

To summarise, given that the European Commission and the European Central Bank take the view that the list of Designated Payment and Settlement Systems provides legal certainty, the Clearing House's payment systems should be considered as a System by competent authorities. Given that often no clear distinction is made between payment, settlement and clearing systems, the Clearing House's clearing services might be treated similarly. This view is supported by Article 17 para 4 of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, "**EMIR**")[34] as we would

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[31] We note however that the material provisions of the SFD such as Articles 3 and 5 SFD refer to transfer orders.

[32] See also the ECB Opinion, item 4.1 at p. 2 which concludes that "the current definition in the first and second indents of Article 2 (a) does not accurately reflect the way in which a majority of systems are established".

[33] The European Commission concludes its evaluation report on the SFD by stating that "... in the area of payment and securities settlement systems, some important changes may be underway which could have an influence on the SFD. The European Commission may propose legal instruments to increase the efficiency and safety of clearing and settlement services..."

[34] OJ No L 201 of 27 July 2012.

construe the reference to the notification as a System pursuant to the SFD as a reference to the clearing function rather than to the settlement or payment function by processing transfers orders. We are not aware of any court decisions and a court may not follow our analysis. We will discuss exemptions that are available to Systems where relevant. If the Clearing Conditions do not establish a System, then these exemptions are not applicable.

In Insolvency Proceedings exemptions for Systems apply with respect to insolvency-related set-off (paragraph 3.7.2 below) and the enforcement of security. Such exemptions apply analogously to measures under section 46 para 1 sentence 2 no. 4 to 6 KWG (section 46 para 2 sentence 6 KWG) and to restructuring and reorganisation proceedings (section 23 KredReorgG).

(i) Exemptions for clearing

If Insolvency Proccedings are opened over the assets of the Clearing House, Article 102b EGInsO might create an exemption with respect to Insolvency Proceedings and Provisional Insolvency Measures. Article 102b EGInsO was introduced into German law to ensure that the implementation of certain measures under Article 48 EMIR will not be hindered by the opening of Insolvency Proceedings. For Article 48 EMIR, and, consequently, Article 102b EGInsO, to be applicable the Clearing House must have obtained the requisite licence to act as a central counterparty (*zentraler Kontrahent*, "**CCP**") within the meaning of Article 2 point 1 EMIR from BaFin and comply with applicable laws and regulations.

In accordance with Article 102b section 1 para 1 EGInsO the opening of Insolvency Proceedings must not affect (1) the performance of the necessary (*gebotene*) measures to administer, close out or otherwise settle client positions and own account positions of a clearing member in accordance with Article 48 para 2, para 3, para 5 sentence 3 and para 6 sentence 3 EMIR, (2) the necessary transfer of client positions in accordance with Article 48 paras 4 to 6 EMIR and (3) the necessary utilisation and disbursement of clients' collateral in accordance with Article 48 para 7 EMIR where such measures have been taken in accordance with Article 48 EMIR. Furthermore, Article 102b section 2 EGInsO provides that the measures referred to in section 1 of

Article 102b EGInsO will not be subject to insolvency challenge (see paragraph 4.2 below). Article 102b EGInsO also applies to Provisional Insolvency Measures.

Based on its wording and on the legislative reasoning according to which Article 102b EGInsO is intended to ensure the validity of certain measures a CCP takes upon the default of one of its clearing members in order to mitigate such default,[35] we construe Article 102b EGInsO as a provision of substantive law rather than as a conflict of laws provision.[36] Therefore, Article 102b EGInsO only applies if German insolvency law applies. Article 102b EGInsO is an insolvency law provision and does therefore not address any property or contractual law aspects in connection with Article 48 EMIR and any necessary measures thereunder.

Article 48 EMIR largely addresses the relationship between a CCP and its clearing members. Systematically, Article 48 EMIR is a risk management provision and pursues for the main part regulatory goals. Some of the measures upon a default of a clearing member also serve the interests of clearing clients but this will not necessarily result in a legal relationship between CCP and a relevant clearing client. Rather, the clearing client's interests are protected by Article 39 EMIR by requiring the segregation of assets and positions. It is therefore not entirely clear whether Article 102b EGInsO was also intended to govern the relationship between a clearing member and its clearing clients and with a view to also protecting the positions of a clearing client from the application of mandatory insolvency laws, if such mandatory insolvency laws will limit the enforceability of necessary measures instituted under the relevant clearing conditions or clearing rules. This question is a matter to be determined under German law, as the reference in Article 102b EGInsO to Article 48 EMIR will not result in Article 102b EGInsO becoming a provision of EU law and the question at hand is not a question on the interpretation of Article 48 EMIR.

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35 BT-Drucksache 17/11289, p. 28.

36 See also *Holzer*, DB 2013, 444, 445.

The wording of Article 102b section 1 para 1 no. 1 EGInsO refers to the performance of the necessary (*gebotene*) measures to administer, close out or otherwise settle client positions and own account positions of a clearing member. In Article 102b section 1 para 1 no. 2 and 3 EGInsO the necessary transfer of clients' positions and the necessary utilisation and disbursement of clients' collateral is addressed. In those cases where it is not entirely clear whether the relationship between clearing member and clearing client is directly addressed or whether this is a mere function of the "clearing cascade", the reference to "necessary measures" is in our view intended to ensure that both relationships in the clearing cascade, CCP with clearing member and clearing member with clearing client, are covered. A different treatment of those relationships producing different results would in our view not be in line with the intention and purpose of Article 102b EGInsO.

In the following, we therefore assume and understand that all necessary measures of a CCP under Article 102b section 1 para 1 no. 1 and 2 EGInsO and the utilisation and disbursement of clients' collateral under Article 102b section 1 para 1 no. 3 EGInsO are not hindered by the opening of Insolvency Proceedings and, as a consequence, some provisions under the InsO either do not apply at all or to a limited extent only. As a result, the provisions of the Clearing Conditions prevail over mandatory provisions under the InsO, however, only to the extent the measures under the Clearing Conditions correspond to the measures referred to under Article 48 EMIR and Article 102b EGInsO or implement such measures provided that these measures are necessary (*geboten*) within the meaning of Article 102b section 1 para 1 EGInsO. In our view, the exemptions implemented by Article 102b EGInsO go beyond the generally applicable exemptions for Financial Collateral and Systems. Where we discuss in the following the effects of Insolvency Proceedings we refer to Article 102b EGInsO.

Please note that our interpretation of Article 102b EGInsO has not been confirmed in any court decisions and given that Article 102b EGInsO was only recently introduced into German law we cannot exclude that our understanding of Article 102b EGInsO would not be shared by legal commentators or will be treated differently in any court decisions.

3.5 Recognition of choice of law

3.5.1 The choice of German law to govern the Clearing Conditions[37] and the Clearing Agreement would, as a matter of contract law, be recognised under the laws of this jurisdiction, even if the Member is not incorporated, domiciled or established in this jurisdiction in accordance with Article 3 para 1 of Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations (Rome I) ("**Rome I**").[38]

3.5.2 To the extent the Clearing Conditions provide for the creation of security interests, it should be noted that the Clearing Conditions establish a contractual obligation to create these security interests. The creation of the security interests has to be effected independently to fulfil such obligations. Depending on the type of security interest, it should be noted that different legal and factual requirements must be fulfilled to ensure the validity and, as a separate matter enforceability of as well as the possibilities to enforce such security interest. The Clearing Conditions do provide for certain of the requisite legal requirements but further steps in addition to the valid agreement on the incorporation of the Clearing Conditions may be necessary to create a relevant security interest.

Where Rome I does not apply, the rules on the conflict of laws in respect of the creation of *in rem* security interests are governed by the provisions of the German Introductory Act to the Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch*, "**EGBGB**") and the German Safe Custody Act (*Depotgesetz*, "**DepotG**")), under which a choice of law is not permissible. See paragraph for further details.

3.6 The Netting Provision: General

3.6.1 Netting in general

Under German law, "netting" does not qualify as a technical term referring to a specific and clearly defined legal concept. Instead, "netting" may denote a variety of legal concepts such as payment or settlement netting (*Staffelkontokorrent*), netting by novation *(Schuldersetzung),* and close-out

[37] Section 6.4. para 1 of the Clearing Conditions.

[38] Rome I applies to contracts concluded on or after 17 December 2009 (Article 28 of Rome I as amended by the corrigendum published in OJ No. L 309 of 24 November 2009, p. 87).

netting (*Liquidations-Netting*). In the context of the Clearing Conditions, the legal concept that is most relevant under German law is "close-out netting". Contractual close-out netting provisions provide for a method of reducing the parties' exposure by terminating outstanding transactions, calculating their values and determining compensation payments for all outstanding transactions that are subsequently netted against each other. Accordingly, they are subject to both the laws applicable to early termination and to set-off.

(a) Non-insolvency-related netting

(i) The right of a Member to terminate the Clearing Conditions and Trades for material reason (*aus wichtigem Grund*) would be given in the absence of contractual specifications and would even be given despite of contractual provisions to the contrary.[39] Under mandatory statutory law in this jurisdiction, the termination of continuous obligations (*Dauerschuldverhältnisse*, in particular contracts which are intended to exist for a significant period of time) for material reason is admissible if, having regard to all circumstances of the specific case and balancing the interests of both parties, the terminating party cannot reasonably be expected to continue the contractual relationship until the agreed termination date or until the end of a notice period (section 314 para 1 BGB).[40]

(A) The notion of reasonableness implies a responsible use of the termination right. A reasonable party to a contract would not carry its own legal interest to an extreme, i.e. a reasonable party would not misuse its rights. Therefore, German courts would examine the adequacy and proportionality of both the agreement on termination rights for material reason and the exercise of the termination right. Generally, a material reason pursuant to section 314 para 1 BGB is given if, having regard to all circumstances of the specific case and

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39 BT-Drucksache 14/6040, S. 176; BGH WM 1973, 694.

40 Prior warning generally has to be given before effecting the termination by giving notice thereof (*Kündigungserklärung*) (section 314 para 2 BGB) but the warning is, in particular, not required, if on the facts of an individual case, the warning would be pointless (sections 314 para 2 sentence 2 in conjunction with 323 para 2 no. 3 BGB).

balancing the interests of both parties, the terminating party cannot reasonably be expected to continue the contractual relationship until the agreed termination date or until the end of a notice period (section 314 para 2 BGB). When considering the materiality of the cause, the conflicting interests of the parties, in particular the interest of one party to continue the contract and the interest of the other party to terminate the contract, as well as all other individual circumstances of the case have to be balanced on the facts of the relevant case. The decisive criteria are the purpose of the contract, the type of the contract and the nature, quantity and quality of the event of default, if any.When considering the materiality of the reason, the conflicting interests of the parties, in particular the interest of the defaulting party to continue the contract and the interest of the non-defaulting party to exercise its termination right, as well as the individual circumstances have to be taken into account. Therefore, the determination and definition of the threshold of materiality, which allows to abandon the contractual bond and to terminate the contract, have been established on a case-by-case basis. In this regard, the decisive criteria are the purpose of the contract, the type of the contract and the nature and quality of the event of default.

(B) Contractual agreements as to which events shall constitute material reason for termination are generally permissible.[41] If the Parties agreed on certain events to constitute material reason, the occurrence of a specified event would give rise to a right to terminate without a weighing of interests.

(C) Depending on the nature of the event of default triggering the termination right for a material reason, the non-defaulting party might be required to give a

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[41] BGH NJW-RR 1988, 1381, 1382.

warning to the defaulting party (*Abmahnung*) before the termination right can actually be exercised (section 314 para 2 BGB). However, it is not required to set such additional period of time if (i) the defaulting party seriously and definitely refuses to perform, (ii) the defaulting party fails to perform by a date specified in the contract or within a specified period and, in the contract, the non-defaulting party has linked the continuation of its interest in performance to the punctuality of that performance, or (iii) special circumstances exist which, after each party's interests have been weighed, justify immediate termination.[42]

(D) In addition, termination rights may not be exercised at an inappropriate point in time (*Kündigung zur Unzeit*), i.e. the point in time when the termination right is executed should not impose an additional significant burden on the other party to the contract.[43]

(ii) Under section 158 para 2 BGB, parties to a contract may validly agree on the occurrence of an automatic early termination upon a certain condition being satisfied. Such an agreement qualifies as a condition subsequent (*auflösende Bedingung*) within the meaning of section 158 para 2 BGB which will be triggered without any notice being given. The agreement on the Insolvency Event of Default as such condition subsequent does not violate or circumvent the legal principle contained in section 314 para 1 BGB. [44] The automatic early termination upon the filing of an application for the opening of bankruptcy, insolvency or similar proceedings over the assets of the Clearing House may hence be validly agreed under contract law (as to the treatment under insolvency laws, see paragraph (b)).

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42 Section 314 para 2 BGB in conjunction with section 323 para 2 no. 3 BGB.

43 BGH NJW 2003, 2674, 2675; BGH WM 1985, 1136, 1136.

44 Under section 7 para 2 sentence 2 DRV, the filing of an application for the opening of Insolvency Proceedings only constitutes an Insolvency Event of Default, if the Clearing House itself files the application.

(iii) Under German statutory law, set-off (*Aufrechnung*) is understood as the mutual discharge of two corresponding obligations of the same nature. The rules relating to set off are contained in sections 387 *et seq.* BGB. According to this provision, a party that demands payment – or of whom payment is demanded – is entitled to unilaterally declare that the debt is extinguished by a set-off provided that the legally defined set-off requirements are met. The statutory right to set off requires that (i) both parties have claims against each other (mutuality - *Gegenseitigkeit*), (ii) such claims are of similar nature (similarity - *Gleichartigkeit*) and (iii) the claim against which set-off is to be effected is valid, due and enforceable (*Wirksamkeit, Fälligkeit und Durchsetzbarkeit der Gegenforderung*) and (iv) the other claim (with which set-off is to be effected) can be fulfilled (*Erfüllbarkeit der Hauptforderung*). Pursuant to section 388 para 1 BGB, a set-off right is exercised by giving notice of set-off to the other party (*Aufrechnungserklärung*). The right to set off may only be exercised if set-off is neither excluded by law[45] nor by agreement[46].

However, according to the principles of contractual freedom and party autonomy, contractual set-off agreements (*Aufrechnungsvertrag* or *Aufrechnungsvereinbarung*) such as the Set-Off Provision are permissible. To the extent that the arrangements do not conflict with mandatory provisions of German law, the parties are allowed to deviate from the statutory requirements for set-off (such as the requirement that the claim against which set-off is to be effected is due and payable or the requirement to give notice) by agreement. Such an agreement can modify or waive requirements for set-off or

[45] We do not give an opinion on German corporate law where, in specific cases, restrictions on set-off apply (sections 19 GmbHG and section 66 AktG which restrict the right of a shareholder to set off against its obligation to provide equity contributions). Set-off is subject to restrictions in specific circumstances, for example, according to section 392 BGB in case of confiscated claims or if an obligation arises from a claim for compensation for an intentional tort (section 393 BGB) or if one of the debts is not subject to attachment (*unpfändbar*) (section 394 BGB).

[46] For an overview see *Schlüter*, Münchener Kommentar zum BGB, 6th ed. (2012), § 387 nos. 56 *et seq.*

extend the right to set off (for example, by enabling the party to set off against a claim of a third party).

Therefore, on the assumption that a non-insolvency related termination event has occurred in relation to the Clearing House, Section 3.10.2 of the Clearing Conditions which provides for the early termination of the Clearing Agreement and all transactions and delivery claims thereunder due to the occurrence of a Failure to Pay Event or an Insolvency Event as well as the calculation of a single compensation claim is enforceable under contract law within the limitations set out above.

(b) Insolvency-related netting

The Netting Provision provides that following an Insolvency Event in respect of the Clearing House, all obligations referred to in the Netting Provision (including the obligation to deliver Margin in accordance with the Netting Provision) shall expire). Such obligations shall be replaced by a compensation claim.

Following the opening of Insolvency Proceedings, executory contracts[47] which have not been effectively terminated prior to such opening of Insolvency Proceedings are, pursuant to section 103 InsO, subject to the Insolvency Representative's right to decide whether to assume or reject such contracts;[48] i.e. to refuse performance of unprofitable contracts and to enforce profitable ones ("**Selection Right**", such Selection Right by the Insolvency Representative often being referred to as "cherry-picking" right) pursuant to section 103 InsO unless an exemption (such as section 104 InsO which is discussed below) applies.

An English translation of section 103 InsO reads as follows:

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[47] Executory contracts are mutual contracts (*gegenseitige Verträge*) which have not or not (yet) fully been performed (*nicht oder nicht vollständig erfüllt*) by either party.

[48] The opening of Insolvency Proceedings does not trigger the (automatic) termination of the contractual obligation to perform. Rather, the opening of Insolvency Proceedings only affects the enforceability of the respective claims since both parties to a contract may raise the objection of non-performance of a contract (BGH ZIP 2002, 1093, 1095).

"Section 103

Option to be exercised by the Insolvency Representative

(1) If a mutual contract was not or not fully performed by the debtor and the other party at the date when the insolvency proceedings were opened (executory contract), the insolvency representative may perform such contract in place of the debtor and claim performance by the other party.

(2) If the insolvency representative refuses to perform such contract the other party is entitled to a claim for non-performance only as a creditor in the insolvency proceedings. If the other party requires the insolvency representative to decide whether he is choosing performance or non-performance the insolvency representative is obliged to state his intention to claim performance without undue delay. If the insolvency representative does not give his statement he may no longer insist on performance."

Under section 103 InsO, the Insolvency Representative therefore is entitled to exercise its Selection Right, i.e. to refuse performance of unprofitable contracts and to enforce profitable ones. In the event that the Insolvency Representative refuses to perform, the contracts are terminated and the Solvent Party may assert claims arising from non-performance. Such claims rank *pari passu* with the claims of all other unsecured creditors. Section 119 InsO provides that agreements excluding or limiting the application of sections 103 to 118 InsO in advance are invalid and therefore protects the Insolvency Representative's Selection Right (see further below). As an early termination restricts the Selection Right an early termination under (see paragraph 3.6.1(b) of this Opinion Letter) may be invalid if it violates sections 103, 119 InsO. In the following we will analyse the scope of sections 103, 119 InsO with respect to termination rights under the Clearing Conditions and any potential exceptions.

Section 104 InsO provides for two major exceptions to this principle. One exception relates to outstanding contracts on the sale of tangible goods where the obligations must be fulfilled by a particular date as otherwise their fulfilment becomes worthless for the purposes of the receiving party (*Fixgeschäfte*) (section 104 para 1 InsO) and the other relates to financial transactions within the meaning of section 104

para 2 InsO (below, paragraph 4.1.2(c)). To the extent that section 104 InsO applies, it overrides the Insolvency Representative's Selection Right under section 103 InsO and therefore there is no need to protect the Selection Right under section 119 InsO, even in cases where an insolvency-related termination right has been exercised.

To the extent section 103 InsO applies to exclude any contractual or statutory termination of contracts, the portfolio of contracts under the Clearing Conditions may be subject to disparate treatment. Pursuant to section 103 InsO, transactions which have not, or not fully, been performed by either of the parties and which have not been effectively terminated prior to the opening of Insolvency Proceedings are subject to the Insolvency Representative's Selection Right, unless such transactions would fall under an exception.

By way of background, it is disputed amongst German legal authors whether and to what extent German insolvency law prohibits contractual termination rights based on insolvency-related events (see paragraphs 3.6.1(a)(i) and 3.6.1(a)(ii) on termination rights generally. As the early termination (indirectly) prevents the Insolvency Representative from exercising its Selection Right under section 103 InsO to disclaim or enforce outstanding transactions it may be regarded as a circumvention of mandatory insolvency provisions regarding executory contracts. The majority of German insolvency law commentators[49] advocate a narrow application of sections 103 and 104 InsO and, hence, view a contractual early termination right as very likely to be held valid by a German court provided that it is based on non-insolvency-related events or on a Party's application to commence Insolvency Proceedings against its assets and/or the existence of any material reason for such an application.[50] A termination right directly

49 See *v. Wilmowsky*, ZIP 2007, 553, 554 *et seq.*; *Jahn/Fried*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 nos. 163 *et seq.*; *Huber*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 119 nos. 39 *et seq.*; *Huber*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 119 nos. 39 *et seq.*; *Huber*, NZI 1998, 97, 99; *Bosch*, in: Kölner Schrift zur Insolvenzordnung, 2nd ed. (1999), 1009 *et seq.*; *Wortberg*, ZInsO 2003, 1032 *et seq.*

50 Legal commentators assume that contractual termination provisions based on insolvency-related events should principally be enforceable with respect to several (albeit only persuasive) precedents of the BGH under the former Bankruptcy Code (*Konkursordnung*, "**KO**"), the predecessor of the InsO. In a decision (BGH NJW 2006, 915, 917), the BGH held, *inter alia*, that a contractual provision did not violate

based on an actual opening of Insolvency Proceedings is, however, considered to be legally ineffective. This dispute has now been solved by the BGH.[51]

In its judgment of 15 November 2012[52] the BGH held that an insolvency-related termination in a contract is invalid, because it would exclude the Selection Right of the Insolvency Representative under section 103 InsO and therefore violate section 119 InsO.[53] Whilst the

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section 119 InsO in which the parties agreed on a "right of termination for material reason" (*Kündigungsrecht bei Vorliegen eines wichtigen Grundes*). The parties in that case, however, did not specify in detail the events that would constitute material reason for the purpose of their agreement. The decision therefore does not constitute an authoritative precedent with regard to an insolvency-related termination right. Both legal authors supporting a restrictive interpretation of section 119 InsO and legal commentators advocating an extensive interpretation reclaim the legislator's intention to support their respective views. The official draft of the InsO that was published by the German Federal Government (BT-Drucksache 12/2443) contained a provision (section 137 para 2 sentence 1 of the official draft of the InsO) pursuant to which contractual agreements on the automatic termination of a contract that was not (or not fully) performed by the parties to the contract upon the opening of Insolvency Proceedings were void. The Committee on Legal Affairs of the German Federal Parliament, however, proposed to waive this prohibition. While the Committee on Legal Affairs of the German Federal Parliament conceded that such contractual early termination rights indirectly restrict the Insolvency Administrator's right to request or reject performance of the contractual obligation. It was the opinion of the Committee on Legal Affairs that this indirect impact on the Insolvency Administrator's option does not justify such a far-reaching restriction of the parties' freedom to contract (Bericht des Rechtsausschusses des Deutschen Bundestages, BT-Drucksache 12/7302, p. 170). The committee's amendment to the official draft was unanimously accepted by the plenum of the German Federal Parliament. Accordingly, proponents of the restrictive interpretation of section 119 InsO emphasise that the legislator rejected an explicit prohibition by adopting the amended version of the act. This intention requires a restrictive interpretation of section 119 InsO (see *Huber*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 119 nos. 39 *et seq.*). On the other hand, the proponents of an extensive interpretation purport that section 137 para 2 sentence 1 of the official draft of the InsO did not have a constitutive effect such that its deletion does not have an impact on the scope of application of section 119 InsO (see *Berscheid* in an earlier edition of the legal commentary: Uhlenbruck, in: Insolvenzordnung, 12th ed. (2003), § 119 nos. 15 *et seq.*, however, a different view is now taken by *Sinz*, in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010), § 119 nos. 13 *et seq.*; *Tintelnot*, in: Kübler/Prütting, InsO (55th ed. (10/13)), § 119 nos. 15 *et seq.*).

[51] BGH WM 2013, 274.

[52] BGH WM 2013, 274.

[53] BGH, WM 2013, 274. With respect to the legislative procedure, both legal authors supporting the an restrictive interpretation of section 119 InsO and legal commentators advocating its an extensive interpretation reclaim the legislator's intention to support their respective views. The official draft of the InsO that was published by the German Federal Government (BT-Drucksache 12/2443) contained a provision (section 137 para 2 sentence 1 of the official draft of the InsO) pursuant to which contractual agreements on the automatic termination of a contract that was not (or not fully) performed by the parties to

BGH's judgment related to a contract for the supply of energy, we understand that the BGH intends to apply its reasoning to any other agreements as long as an early termination under such agreements results in the exclusion of an Insolvency Representative's Selection Right.

According to the BGH, insolvency-related termination provisions are provisions under which a contract may be terminated upon a stoppage of payment (*Zahlungseinstellung*), the filing of an application for the opening of Insolvency Proceedings (*Insolvenzantrag*) or the opening of Insolvency Proceedings (*Insolvenzeröffnung*).[54] In this judgment the BGH has also decided that section 119 InsO applies from the point in time in which, based on a valid application for the opening of Insolvency Proceedings, such opening of Insolvency Proceedings is to be seriously expected (*mit der Eröffnung eines Insolvenzverfahrens ernsthaft zu rechnen ist*).[55]

According to the BGH insolvency-related termination provisions will only be upheld if the contractual insolvency-related termination right

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the contract upon the opening of Insolvency Proceedings were null and void. The Committee on Legal Affairs of the German Federal Parliament, however, proposed to waive this prohibition. The Committee on Legal Affairs of the German Federal Parliament conceded that such contractual early termination rights indirectly restrict the Insolvency Representative's right to request or reject performance to of the contractual obligation. According to the Committee on Legal Affairs of the German Federal Parliament, however, this indirect impact on the Insolvency Representative's option does not justify such a far-reaching restriction of the parties' freedom to contract (*Bericht des Rechtsausschusses des Deutschen Bundestages*, BT-Drucksache, 12/7302, p. 170). The committee's amendment to the official draft was unanimously accepted by the plenum of the German Federal Parliament. Accordingly, proponents of the restrictive interpretation of section 119 InsO emphasise that the legislator rejected an explicit prohibition by adopting the amended version of the act. This intention necessitates a restrictive interpretation of section 119 InsO (*see Huber,* in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 119 nos. 39 *et seq.*). On the contrary, the proponents of the extensive interpretation purport that section 137 para 2 sentence 1 of the official draft of the InsO did not have a constitutive effect and, hence, its deletion does not have an impact on the scope of application of section 119 InsO (see *Berscheid*, in: Uhlenbruck, Insolvenzordnung, 12th ed. (2003), § 119 nos. 15 *et seq*., however, a different view is now taken by Sinz, in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010), § 119 nos. 13 *et seq.*; *Tintelnot*, in: Kübler/Prütting, InsO (55th ed. (10/13)), § 119 nos. 15 *et seq.*). The BGH (WM 2013, 274, 274 *et seq.*) has now clarified that section 119 InsO cannot be construed in light of the official draft of the InsO as such provisions have ultimately not been adopted and did not become law. The BGH therefore follows an extensive interpretation of section 119 InsO.

[54] BGH WM 2013, 274.

[55] BGH WM 2013, 274.

corresponds to a statutory termination right. In the view of the BGH, "non-insolvency-related" termination provisions are not intended to "erode" the Selection Right and therefore non-insolvency-related termination provisions will generally not be covered by section 119 InsO.

We understand that termination rights and automatic termination events under the Netting Provision may be triggered upon the occurrence of an insolvency-related event of default. The BGH argues that insolvency-related termination provisions will only be upheld if the contractually agreed insolvency-related termination right corresponds to a statutory termination right. Whilst the BGH does not refer to section 104 InsO, in our view, section 104 InsO should be regarded as such a corresponding statutory termination right as section 104 InsO operates as a statutory termination and close-out netting provision which under any circumstances excludes the Selection Right of the Insolvency Representative under section 103 InsO.[56] Accordingly, section 104 InsO is not only a termination right but even provides for an automatic termination of the contracts falling within its scope of application. Consequently, in our view, where the relevant agreement or any transactions thereunder fall within the scope of section 104 InsO, an insolvency-related contractual termination right should not be regarded as a circumvention of section 103 InsO.

(c) Exceptions under section 104 InsO

Upon the opening of Insolvency Proceedings *(Eröffnung des Insolvenzverfahrens)*, section 104 InsO provides for a mandatory automatic termination of those transactions which fall within the scope of section 104 InsO. If the relevant date for early termination falls after the opening of Insolvency Proceedings the provisions of section 104 InsO would govern the close-out netting of those contracts which fall within its scope.

Section 104 InsO would have no effect on those obligations, which fall outside its scope and the analysis described above in this paragraph would apply thereto, i.e. section 103 InsO would apply to Trades if

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[56] *Obermüller*, ZInsO 2013, 476.

they qualify as executory contracts and the Insolvency Representative is entitled to exercise the Selection Right.

An English translation of section 104 InsO[57] reads as follows:

"Section 104

Fixed date transactions, financial transactions

(1) In the event that a particular time or period was agreed upon for delivery of goods with a market or exchange price, and such time occurs or such period lapses after the opening of insolvency proceedings, specific performance may not be demanded, but rather only a claim for non performance may be asserted.

(2) Where a specified time or a specified period has been agreed for the delivery of financial transactions which have a market or listed price, and where this time, or the expiry of this period, is not until after the institution of insolvency proceedings, performance may not be demanded, but rather only damages for non performance may be claimed. The term "financial transaction" includes in particular, transactions on:

1. the delivery of precious metals,

2. the delivery of securities or comparable rights, except where there is an intention to acquire an interest in another enterprise with the aim of establishing a lasting connection with that enterprise,

3. payments of money which are to be made in a foreign currency or in a unit of account,

4. payments of money the amounts of which are calculated, directly or indirectly by referencing to the exchange rate of a foreign currency or a unit of account, to the interest rate for borrowings or to the price of other goods or services,

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[57] In the current version as amended by Article 1 of the Act for the Implementation of the Directive 2002/47/EC of 6 June 2002 on Financial Collateral and on the Amendment of the Mortgage Bank Act and other Acts (*Gesetz zur Umsetzung der Richtlinie 2002/47/EG vom 6. Juni 2002 über Finanzsicherheiten und zur Änderung des Hypothekenbankgesetzes und anderer Gesetze*) dated 5 April 2004 (BGBl. I, p. 502).

5. options and other rights to demand delivery of something or performance of payment obligations within the meaning of sub paragraphs 1 to 4 above, or

6. financial collateral within the meaning of section 1 para 17 KWG.

Where the contracts involving financial transactions are combined in a master agreement for which it has been agreed that, where reasons for the opening of insolvency proceedings exist, it can only be terminated in its entirety, then such contracts shall together be deemed to form one single mutual agreement within the meaning of sections 103, 104.

(3) The amount of the claim for non performance is the difference between the agreed price and such a market or exchange price which is applicable at the place of performance to an agreement with the stipulated time for performance on the date agreed between the parties, but no later than the fifth working day after the opening of insolvency proceedings. In the absence of an agreement between the parties, the second working day after the opening of insolvency proceedings shall apply. The other party may assert such claim only as an insolvency creditor."

Section 104 para 1 InsO applies to fixed date transactions (*Fixgeschäfte*) on tangible goods. Section 104 para 2 InsO applies to "financial transactions". As section 104 InsO is a special rule to section 103 InsO, a Trade must be mutual and qualify as an "executory contract" to fall within its scope. There is an exemption from this requirement under section 104 para 2 sentence 3 InsO with respect to financial transactions entered into under a master agreement (see below, paragraph 3.6.1(f)) provides for a calculation method following the early termination of transactions by section 104 InsO which applies when no overriding agreement is in place.

Any automatic termination by virtue of section 104 InsO results in a claim for non-performance calculated on the basis of market or exchange prices. The parties may agree on the point in time which is decisive for determining the market or exchange prices; such date may not exceed five working days after the opening of Insolvency Proceedings. The claim for non-performance would, irrespective of the law governing the relevant transaction or agreement, be governed by

German law and would generally rank pari passu with claims of all other unsecured creditors in the absence of any agreements. The claim for non-performance will be expressed in Euro and may be subject to set-off.[58]

(d) Fixed date transactions (*Fixgeschäfte*)

Section 104 para 1 InsO applies to fixed date transactions (*Fixgeschäfte*) on tangible goods with a market or exchange price only. Fixed date transactions are transactions where performance has to occur at a specific point of time because the creditor puts special emphasis on the timeliness of the performance. Commodities such as electricity qualify as goods under section 104 para 1 InsO.[59] A market or exchange price is (at least also) given if the price can be determined by an expert.[60] Fixed date transactions can be classified in "absolute" fixed date transactions (*absolute Fixgeschäfte*) and "relative" fixed date transactions (*relative Fixgeschäfte*).

Regarding absolute fixed date transactions, the agreed date of performance has such an importance for at least one of the contracting parties that, in case of failure to perform in time, subsequent performance after the performance date stipulated in the contract cannot be considered as a performance of the contractual obligation anymore. Performance in time is the central point of the entire agreement (*die Leistung steht und fällt mit der Einhaltung der Leistungszeit*).[61] Delayed performance would not constitute performance in accordance with the agreement but instead a complete different performance.[62] The question as to whether a transaction

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[58] Please note that section 104 para 3 InsO does in our view not provide for a set off but, by transforming the former payment and delivery claims into a Euro denominated payment claim, provides a basis for set off (subject to the general set off restrictions under contract and insolvency law, as applicable). However, *von Hall*, Insolvenzverrechnung in bilateralen Clearingsystemen, 2010, p. 152, 156 *et seq.* takes the view that section 104 para 2 sentence 3 contains such statutory close-out netting provisions.

[59] *Kroth*, in: Braun, InsO, 5th ed. (2012), section 104 no. 3.

[60] See *von Hall*, WM 2011, 2161.

[61] BGHZ 110, 96; BGH NJW-RR 1989, 1373.

[62] *Grüneberg*, in: Palandt BGB, 72nd ed. (2013), § 271 no. 17, *Krüger*, in: Münchener Kommentar zum BGB, 6th ed. (2012), § 271 no. 14; *Wiedemann*, in: Soergel, BGB, 12th ed. (1990), Vor § 275 no. 21.

qualifies as an absolute fixed date transaction depends on the terms of the agreement, the interests and intention of the parties and the circumstances of the single case, also taking customary practice into consideration.

With respect to relative fixed date transactions, timely performance is crucial as well. Relative fixed date transactions are transactions where, due to the importance to receive performance in time, the creditor may no longer be interested in receiving performance by the other party if such performance has not been made on the agreed date. In contrast to absolute fixed date transactions, however, subsequent delivery (*Nachlieferung*) of performance is still possible and the purpose of the agreement can still be achieved.[63] As delayed performance will often not be in the interest of creditors, the BGH grants a revocation right for the non-defaulting party in such cases (section 323 para 2 no. 2 BGB). Nevertheless, the non-defaulting party does not necessarily have to exercise its revocation right. It can also choose to claim for performance and claim damages, too, provided that the obligor is in payment or delivery default pursuant to section 286 BGB.

By and large, where German law applies, the courts are reluctant to treat a transaction as a fixed date transaction merely because the agreement provides for a fixed performance or delivery date.[64] According to existing court precedents, an initial indication for the treatment of a transaction as a fixed date transaction is the wording of the agreement, in particular the use of terms such as "fix", "precise", "exactly", "without any grace period", etc.[65] In contrast, the exclusion of any grace period alone (i.e. the immediate liability for damages in case of default) does not necessarily entail the treatment as a fixed date transaction.[66]

Relative fixed date transactions fall under section 104 para 1 InsO. With regard to absolute fixed date transactions, however, this is

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[63] *Ernst*, in: Münchener Kommentar zum BGB, 6th ed. (2012), § 286 no. 40.

[64] *Ibid.*

[65] *Grüneberg*, in: Palandt BGB, 72nd ed. (2013), § 323 no. 20.

[66] *Ernst*, in: Münchener Kommentar zum BGB, 6th ed. (2012), § 323 no. 117.

disputed in legal literature.[67] The wording of section 104 para 1 InsO itself does not give any further guidance but the purpose of section 104 para 1 InsO to minimise the Insolvency Representative's ability to speculate can only be achieved if section 104 para 1 InsO also applies to absolute fixed date transactions.[68] In the absence of any court decisions, we would construe section 104 para 1 InsO to cover both, absolute and relative fixed date transactions. The question whether Trades can be considered as fixed date transactions pursuant to section 104 para 1 InsO depends largely on the characteristics of the contract and the intention of the parties.

(e) Financial transactions within the meaning of section 104 para 2 InsO

Section 104 para 2 InsO applies to financial transactions as defined in section 104 para 2 sentence 2 InsO. As section 104 InsO is a special rule to section 103 InsO, to qualify as a "financial transaction" pursuant to section 104 para 2 InsO, a transaction must also be an "executory" contract (as defined in footnote 47 above). However, an exception to this rule applies to transactions which have been entered into under a master agreement (see paragraph 3.6.1(f) below). To qualify as a financial transaction, the relevant transaction must provide for a specific time at which or period of time in which the performance has to be made.[69] Furthermore, the transaction needs to have a market

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[67] *Andres*, in: Andres/Leithaus, Insolvenzordnung, 2nd ed. (2011), § 104 no. 3 and *Köndgen*, in: Kübler/Prütting/Bork, InsO, 55th ed. (10/13), § 104 no. 5, argue that section 104 para 1 InsO covers absolute and relative fixed date transactions whereas according to *Lüer*, in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010) § 104 no. 6, section 104 para 1 InsO only covers relative fixed date transactions. We also note, however, that most legal commentators do not distinguish between absolute and relative fixed date transactions or at least not addressing this issue; see: *Balthasar*, in: Nerlich/Römermann, Insolvenzordnung, 24th update (2012), § 104 no. 16; *Jahn/Fried*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 no. 37 *et seq.*; *Braun*, in: Insolvenzordnung, 5th ed. (2012), § 104 no. 5; *Häsemayer*, in: Insolvenzrecht, 4th ed. (2007), p. 495 no. 20.34. This does also hold true with respect to legal commentaries on the KO; see *Kilger*, in: Karsten Schmidt, Konkursordnung, 16th ed. (1997), p. 126, 127; *Kuhn*, in: Uhlenbruck, Konkursordnung, 11th ed. (1994), § 18 no. 3, 5. See also BT-Drucksache 12/2443, p. 145; BT-Drucksache 12/7302, p. 167.

[68] BT-Drucksache 12/2443, p. 145.

[69] Section 104 para 2 sentence 1 InsO requires that the transaction is due to be performed at a certain time or within a certain period of time. This is broader than the fixed date requirement in section 104 para 1 InsO (*Lüer*, in: Uhlenbruck, InsO, 13th ed. (2010), § 104 no. 18). At the same time, undated transactions (e.g.

or exchange price.[70] This is the case if a replacement transaction on equivalent terms can be entered into even if the price quotations for the entering of such replacement transaction vary. If the price of a transaction can be determined by (indirectly) referring to an objective price, the transaction is considered to have a market or exchange price within the meaning of section 104 InsO.[71] Where a transaction falls within the scope of section 104 para 1 InsO, section 104 para 2 InsO does not apply.[72]

According to the majority of German legal authors section 104 para 2 InsO may also apply to spot transactions which are settled in two or more days (*Kassageschäfte*).[73] We are not aware of any court decisions on this matter. Spot transactions are transactions with short term delivery respectively fulfilment dates which are not entered into at a futures or forward market. The participants in a spot transaction agree to buy and sell, respectively, at the present market value and to settle the transaction a few days later (usually not more than two business

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transactions which are due upon the giving of notice or transactions with an undetermined period of time) are outside the scope of application of section 104 para 2 InsO.

[70] According to the reasoning of the German legislator (see *Bericht des Rechtsausschusses*, BT-Drucksache 12/7302, p. 168), the term "market or exchange price" within the meaning of section 104 para 2 sentence 1 InsO has to be construed broadly.

[71] *Jahn/Fried,* in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 no. 57.

[72] *Lüer,* in: Uhlenbruck, InsO, 13th ed. (2010), § 104 no. 3.

[73] One of the arguments brought forward is that there may be a risk of loss in between signing of a contract and settlement due to market movements similar to forward transactions covered by section 104 para 2 InsO. Furthermore, the wording of section 104 para 2 InsO only provides for a "specified time or a specified period (has been) agreed for the performance of financial transactions", i.e. requires a specified period or time to be agreed for performance of the obligations does, however, not stipulate a minimum period and therefore only excludes cash transactions. By reference to section 104 para 1 InsO it is argued that for fixed date transactions no difference between forward fixed date transactions and spot fixed date transactions is made. Finally, the official heading of section 104 InsO changed from originally "financial futures transactions" (*Finanztermingeschäfte*) to "financial transactions" (*Finanzleistungen*) and the legislative materials do not reveal any intention of excluding spot transactions from section 104 para 2 InsO. For more details please refer to: *Jahn/Fried*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 nos. 88 *et seq*; *Jahn*, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, 4th ed. (2011), § 114 no. 140; *Wegener*, in: Frankfurter Kommentar InsO, 7th ed. (2013), § 104 no. 21; *Bosch*, in: Kölner Schrift zur Insolvenzordnung, 2nd ed. (2009), p. 1027 no. 72; different view: *Meyer*, in: Smid, Insolvenzordnung, 2nd ed. (2001), § 104 no. 11.

days).[74] Spot transactions, however, have to be distinguished from mere cash transactions (*Bargeschäfte*) which are settled same-day and not covered by section 104 para 2 InsO.

Section 104 para 2 sentence 2 InsO gives examples of financial transactions. The wording of section 104 para 2 sentence 2 InsO appears to indicate that the enumeration of covered financial transactions is not conclusive (indicated by the words "in particular").[75] However, if these enumerations were interpreted as mere examples, the scope of section 104 para 2 InsO could become limitless and the enumerated examples would be arbitrary and unhelpful.[76] The wording of section 104 para 2 sentence 2 InsO does not provide for any further guidance how broadly such provision can be construed with respect to any covered financial transactions not explicitly enumerated. Whilst other German legal provisions relating to forwards, futures and options define their scope on the basis of certain elements or building blocks (for example, section 1 para 11 KWG) which could be applied to any instruments developed after such provision entered into force, section 104 para 2 sentence 2 InsO does not follow such modular approach.

As a further consequence of such different approach there is not much value in analysing other German legal provisions to define the scope of section 104 para 2 InsO. The legislative material, however, shows clearly that the words "in particular" were intended to address any

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[74] BGH NJW 2002, 892, 892; *Bosch*, in: Kölner Schrift zur Insolvenzordnung, 2nd ed. (2009), p. 1027 no. 72. The term spot transaction is also defined in Article 38 para 2 of Regulation 1287/2006 implementing Directive 2004/39/EC defining a spot contract for the purposes of paragraph 1 as a contract for the sale of a commodity, asset or right, under the terms of which delivery is scheduled to be made within the longer of the following periods:

(a) two trading days;

(b) the period generally accepted in the market for that commodity, asset or right as the standard delivery period.

[75] *Jahn/Fried*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 no. 59.

[76] With respect to generally applicable limitations on the interpretation of general provisions and enumerations intended as statutory examples, see: BGH GRUR 2001, 1181, 1183; *Schünemann,* JZ 2005, 271, 275 with further references. Please also refer to *Zimmer/Fuchs*, ZGR 2010, 597, 625 expressing a rather restrictive view in construing section 104 para 2 sentence 2 InsO.

future developments with respect to financial transactions.[77] Furthermore, based on the purpose of section 104 InsO to limit the Insolvency Representative's ability to speculate on price or market developments with respect to volatile instruments by not deciding whether to assume or reject any obligations subject to the Selection Right,[78] a court may accept that transactions, which show comparable features to the enumerated financial transactions and in respect of which the same concerns may arise which the legislator has raised to justify the exemptions from the Selection Right under section 104 InsO, could be covered by section 104 para 2 sentence 2 InsO even though not explicitly mentioned.[79] However, a German court would likely balance the impact of any such decision on the Selection Right and the ability of the Insolvency Representative to administer the estate.

(f) Financial Collateral as financial transaction

Under section 104 para 2 sentence 2 no. 6 InsO, Financial Collateral within the meaning of section 1 para 17 KWG also qualifies as a financial transaction. This provision is according to the legislative reasoning intended to implement Article 7 FCD by ensuring that Financial Collateral can also be enforced by set-off under a close-out netting arrangement.[80] The wording of section 104 para 2 sentence 2 no. 6 InsO only refers to Financial Collateral, i.e. the asset constituting the Financial Collateral, but it does not state that transactions which are secured by Financial Collateral are within the scope of this provision. The legislative reasoning is not clear either as reference is made to the creation of Financial Collateral and that Financial Collateral, other than transactions covered by section 104 para 2 sentence 2 nos 1 to 5 InsO, are not regarded as "main obligations" forming part of an executory contract. This appears to protect Financial Collateral as such against the Selection Right but it does not create an exemption for the

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[77] BT-Drucksache 12/7302, p. 168.

[78] BT-Drucksache 12/2443, p. 145; BT-Drucksache 12/7302, p. 167.

[79] *Jahn/Fried,* in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 no. 52; *Balthasar* in: Nerlich/Römermann, Insolvenzordnung, 24th update (2012), § 104 no. 40 *et seq.*; *Kroth*, in: Braun, Insolvenzordnung, 5th ed. (2012), § 104 no. 6; *Lüer*, in: Uhlenbruck, InsO, 13th ed. (2010), § 104 no. 11.

[80] BT-Drucksache 15/1853, page 11 *et seq.*

transaction secured by Financial Collateral. Section 104 para 2 sentence 2 no. 6 InsO implements Article 7 FCD providing that Member States shall ensure that a close-out netting provision can take effect in accordance with its terms. To achieve the purpose of Article 7 FCD there are good arguments to construe section 104 para 2 sentence 2 no. 6 InsO broadly. However, the definition of "close-out netting" under the FCD[81] refers to financial collateral arrangements and such term again refers in our view to the collateral asset as such but not to the secured obligation or any transaction to be secured. We would therefore limit the interpretation of section 104 para 2 sentence 2 no. 6 InsO to ensure that also Financial Collateral may be included in the close-out netting and is therefore not subject to, if any, Selection Right.[82] To summarise, in our view the mere collateralisation of a transaction normally not covered by section 104 para 2 sentence 2 or sentence 3 InsO will not result in the application of section 104 para 2 sentence 2 InsO. However, as far as we are aware, no court precedents exist in respect of the interpretation of section 104 para 2 sentence 2 no. 6 InsO.

(g) Section 104 InsO and the Clearing Conditions

Section 104 para 2 sentence 3 InsO provides that where contracts relating to financial transactions are combined in a master agreement for which it has been agreed that, where reasons for the opening of Insolvency Proceedings exist, it can only be terminated in its entirety, then such contracts shall together be deemed to form one single mutual agreement within the meaning of sections 103, 104 InsO.

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[81] Pursuant to Article 2 para 1 lit (n) FCD "close-out netting provision" means a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise: (i) the obligations of the parties are accelerated so as to be immediately due and expressed as an obligation to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount; and/or (ii) an account is taken of what is due from each party to the other in respect of such obligations, and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party.

[82] See also *Jahn/Fried*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 no. 27 and no. 75a. We do not discuss whether Article 7 FCD has been properly implemented into German law and whether or not Article 7 FCD may be directly applicable.

The InsO does not provide for a more detailed definition of the term "master agreement" (please refer to paragraph 4.3.1(d)(iv) above). Express precondition is only that the master agreement must provide for a termination of the entire agreement (including all transactions under the master agreement) where reasons for the opening of Insolvency Proceedings exist with respect to one party. While the Clearing Conditions are intended to be used by several parties they mostly create two-party relationships. Still, this would in our view not suffice for the Clearing Conditions to qualify as a master agreement (however, see paragraph 3.4.2(i) above with respect to Systems). Section 104 para 2 sentence 3 InsO has been enacted to address bilateral master agreements and does not apply to documentation which provides for the central clearing of transactions concluded under master agreements for derivative transactions or to multilateral netting arrangements. [83] While the Clearing Agreements are bilateral agreements, they do not include provisions on netting but only incorporate the Clearing Conditions by reference.

While the Clearing Conditions should not qualify as a master agreement within the meaning of section 104 para 2 sentence 3 InsO, the Trades would nonetheless terminate by virtue of law under the precondition that (i) they are considered executory contracts and (ii) they qualify either as fixed date transactions on tangible goods or as financial transactions within the meaning of section 104 InsO.

If the Clearing Conditions were considered master agreements, a further question would have to be considered: there is a debate in legal literature (in the absence of any court precedents) as to what legal consequences arise if some Trades fall within the scope of section 104 InsO and others do not. If the Clearing Conditions were to qualify as a master agreement, which in our view would not be correct, the relevant considerations in relation to section 104 para 2 sentence 3 InsO would be as follows:

The Clearing Conditions may cover Trades falling within the scope of section 104 InsO but might also cover Trades not falling within the relevant categories. For the latter types of Trades, an insolvency-

[83] *Jahn,* in: Schimansky/Bunte/Lwowski, Bankrechtshandbuch, 4th ed. (2011), § 114 no. 143.

related termination provision is invalid based on section 119 InsO. If some of the Trades under a master agreement fall within the scope of section 104 para 2 sentence 3 InsO while other Trades do not fall within the scope of section 104 para 2 sentence 3 InsO, the question arises whether such a "mixed" master agreement falls within the scope of section 104 para 2 sentence 3 InsO. We are not aware of any court decision on this question. Among legal commentators, three different views have been discussed: [84] (1) According to the first view, section 104 para 2 InsO does not apply at all, i.e. one non-qualifying Trade would also prevent the application of section 104 para 2 InsO for such Trades which would qualify as financial transactions. (2) According to the second view, the master agreement is split into two parts where those Trades which qualify as financial transactions (including those Trades under which one of the parties has already fully discharged its obligations) are covered by section 104 para 2 InsO, whereby those Trades which do not qualify as financial transactions remain outside the scope of section 104 para 2 InsO and therefore each of them would be individually subject to the Selection Right. (3) According to the third view, section 104 para 2 InsO would applies to all Trades, even if only one or some of the Trades qualify as financial transactions.[85]

In our view, the view expressed under item (1) above is not convincing as it would completely negate the exceptions for financial transactions under section 104 para 2 InsO and be against the purpose of such provision to limit the Insolvency Representative's ability to speculate.[86] The second view is more in line with the wording as the other views, because section 104 para 2 sentence 3 InsO refers to financial transactions.[87] Section 104 para 2 sentence 3 InsO does not provide that all transactions entered into under a master agreement are deemed to constitute one single agreement. Rather, it refers to financial

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[84] See *Jahn/Fried*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 no. 176 *et seq.*; *Obermüller*, in: Insolvenzrecht in der Bankpraxis, 8th ed. (2011), no. 8.402 *et seq.*

[85] *Jahn/Fried*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 no. 180 *et seq.*; *Obermüller*, Insolvenzrecht in der Bankpraxis, 8th ed. (2011), no. 8.402 *et seq.*

[86] This was the primary intention for enacting section 104 InsO, see BT-Drucksache 12/2443, p. 145.

[87] Where the wording refers to the "single mutual agreement" it still refers to "such contracts", i.e. financial transactions as referred to at the beginning of section 104 para 2 sentence 3 InsO.

transactions and provides that "such contracts are together deemed to form one single mutual agreement" [(emphasis added)]. Thus, section 104 para 2 sentence 3 InsO does not intend to "convert" transactions under a master agreement. Rather, its purpose is to exlude financial transactions from the Insolvency Representative's Selection Right generally[88] but to include financial transactions into the single agreement which would otherwise not be covered by section 104 InsO because one of the parties has already fully discharged its obligations under such transaction. Thus, only those transaction are deemed to form a single mutual agreement, but section 104 para 2 sentence 3 InsO does not "convert" such transactions into financial transactions which would, even if they had not been performed by either party, not be covered by section 104 InsO.

To summarise, whilst the first view is not convincing, the second and the third views are both founded, but in balancing the arguments and given that no court decisions are available, we think that the second view has more merits than the third view.[89] With respect to the view expressed under item (3) in a second step one would have to consider under contract law whether with respect to a mixed master agreement a partial invalidity of the insolvency-related termination clause (with respect to non-qualifying transactions) would extend to the insolvency-related termination clause as a whole, leading to a "contamination" of a mixed master agreement.

We are not aware of any court decisions discussing whether an invalid insolvency-related termination of transaction falling outside the scope of section 104 InsO may "contaminate" the termination of transactions for which an insolvency-related termination is permissible (as they generally fall within the scope of application of section 104 InsO), i.e. whether the invalid insolvency-related termination would render the termination of all transactions invalid even though the insolvency-

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[88] *Jahn/Fried*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 104 no. 141; see also *Kroth*, in: Braun, Insolvenzordnung, 5th ed. (2012), § 104 no. 8; *Lüer*, in: Uhlenbruck, InsO, 13th ed. (2010), § 104 no. 36.

[89] For further background see also *Lüer*, in: Uhlenbruck, InsO, 13th ed. (2010), § 104 no. 37 *Marotzke*, in: Heidelberger Kommentar InsO, 5th ed. (2008) § 104 no. 6 (end); *von Hall*, Insolvenzverrechnung in bilateralen Clearingsystemen (2010), p. 152 *et seq.*

related termination would be permissible for those transactions which fall within the scope of application of section 104 InsO.

According to a view expressed in legal literature[90], section 119 InsO is a statutory prohibition (*Verbotsgesetz*) within the meaning of section 134 BGB. Pursuant to section 134 BGB and to the extent German law applies, any legal transaction (*Rechtsgeschäft*) which violates a statutory prohibition is void (i.e. the relevant insolvency related termination provision is regarded as not validly agreed), unless a contrary intention appears from such statute. However, in our view, section 119 InsO has to be construed narrowly as it limits the parties' freedom of contract. If section 119 InsO were to be construed as a statutory prohibition of agreements which exclude or limit the application of sections 103 to 118 InsO, the relevant termination right would be void pursuant to section 134 BGB from the point in time such termination right has been agreed. Hence, there would be no room for the application of section 119 InsO, as the contemplated termination of the agreement would already be invalid pursuant to section 134 BGB. Therefore, in our view section 119 InsO cannot be regarded as a statutory prohibition in the meaning of section 134 BGB. The better view is therefore that section 119 InsO should be treated as procedural insolvency provision.

(h) Calculation of the termination amounts

Section 104 para 3 InsO provides for a method for calculating damages based on an abstract figure by determining the amount of any claim for non performance on the basis of the difference between the agreed price and such market or exchange prices, applicable at the place of performance to an agreement with the stipulated time for performance on the date agreed between the parties, but no later than the fifth working day after the opening of Insolvency Proceedings.

If Tranactions fall within the scope of section 104 InsO but the insolvency-related reason for termination has occurred prior to the opening of Insolvency Proceedings, it is not entirely clear whether the interpretation of section 119 InsO set out in the BGH's judgment of

[90] *Andres*, in: Andres/Leithaus, Insolvenzordnung, 2nd ed. (2011), § 119 no. 3.

15 November 2012 [91] may also affect the results of such early termination and, accordingly, the determination of any close-out or the calculation of any difference claim under the Clearing Conditions. Section 104 InsO, which is equally protected by section 119 InsO, could be considered a mandatory provision which must not be contracted out either. If such interpretation holds true, the results of a contractual automatic early termination would have to be equal to the results after the application of section 104 InsO in order to be valid. However, there is no explicit statement in the BGH's judgment supporting such a strict interpretation of section 119 InsO. In particular as section 104 InsO has been designed as a statutory "close-out netting" rule, which in para 2 sentence 3 explicitly refers to contractual close-out netting in master agreements upon an insolvency-related trigger event ("*bei Vorliegen eines Insolvenzgrundes*"), the German legislator has accepted the concept of insolvency-related contractual close-out netting generally. Furthermore, whilst the BGH held that section 119 InsO also applies to early termination rights exercised prior to the opening of Insolvency Proceedings, we are of the view that the BGH will likely uphold the results of the operation of contractual netting provisions if they are essentially comparable to the results under section 104 InsO.

To summarise, in our view, section 104 InsO should be regarded as equivalent to a statutory termination right as referred to by the BGH in its judgment of 15 November 2012 excluding the Insolvency Representative's right to "cherry pick".[92] Therefore, parties may agree on an insolvency-related termination right if the relevant transactions fall within the scope of section 104 InsO. With respect to the valuation of Transations within the scope of section 104 InsO following a termination, it is not entirely clear whether contractually agreed methods of valuation are recognised but we think the better arguments support the view that they should be.

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[91] BGH WM 2013, 274.

[92] BGH WM 2013, 274.

(i) Summary

The impact of sections 103 and 104 InsO on the Clearing Conditions can be summarised as follows:

(i) Section 104 InsO should qualify as a "corresponding" statutory termination as referred to by the BGH in its judgement of 15 November 2012.

(ii) Therefore, parties may agree on insolvency-related termination provisions with respect to Trades falling within section 104 InsO.

(iii) However, if according to the contractual termination provision the Trade is not terminated prior to the opening of Insolvency Proceedings, section 104 InsO overrides any contractual termination provision. Accordingly, fixed date transactions and financial transactions falling within the scope of section 104 InsO terminate automatically upon the opening of Insolvency Proceedings, unless such transactions have been terminated before.

(iv) If the relevant financial transaction is included in a master agreement (as referred to in section 104 para 2 sentence 3 InsO) the scope of section 104 para 2 InsO is extended to cover transactions which have already been fully performed by one party. The Clearing Conditions, however, should not qualify as a master agreement.

(v) Trades which do not fall within the scope of section 104 InsO may be subject to the Insolvency Representative's Selection Right pursuant to section 103 InsO, even if the Clearing Conditions provide for a termination of such Trades upon the filing for Insolvency Proceedings.

(vi) In our view, the calculation of termination values can be contractually agreed between the Clearing House and its Members. However, if the relevant Trade is not terminated prior to the opening of Insolvency Proceedings, the valuation method provided for in section 104 para 3 InsO overrides any contractually agreed valuation method.

(vii) Article 102b section 1 para 1 no. 1 EGInsO provides that the performance of necessary measures to administer, close out or otherwise settle client positions and own account positions of a clearing member in accordance with Article 48 paras 2 and 3, 5 sentence 3 and 6 sentence 3 EMIR shall not be affected by the opening of Insolvency Proceedings. The relationship between Article 102b EGInsO and section 104 InsO is not entirely clear but it would appear that Article 102b EGInsO would, where its requirements are met, prevent the application of restrictions under the InsO including sections 103 and 104 InsO.

3.7 Set -Off

The Set-Off Provisions apply irrespective of a close-out netting under the Netting Provision.

3.7.1 Non-insolvency-related set-off

Outside Insolvency Proceedings, a set-off would be recognised by the German courts in accordance with the principles set out under paragraph 3.1 above.

3.7.2 Insolvency-related set-off

Where a Clearing House Insolvency Event occurs, the following provisions would govern insolvency-related set-off by the Member of claims against the Clearing House with claims of the Clearing House against the Member:

(a) Set-off after the opening of Insolvency Proceedings

The right of a Solvent Party to effect set-off after the opening of Insolvency Proceedings is governed by sections 94 through 96 InsO.[93]

[93] Sections 94 through 96 InsO read in their English translation as follows:

"Section 94 – Preservation of the Right to Set off a Claim

If by force of law or on the basis of an agreement a creditor of the insolvency proceedings had a right to set off a claim on the date when the insolvency proceedings were opened such right shall remain unaffected by the proceedings.

Section 95 – Acquisition of the Right to Set off a Claim During the Proceedings

(1) If on the date when the insolvency proceedings were opened one or more of the claims to be set off against each other were conditional, were immature or did not cover similar types of performance such set-off may not be effected before its conditions are met. Sections 41 and 45 shall not apply. Set-off shall be

The extent to which a set-off after the opening of Insolvency Proceedings is permissible mainly depends on the point in time when the situation giving one party the right to set off comes into existence (*Entstehung der Aufrechnungslage*). This point in time is determined by substantive civil law.

Pursuant to section 94 InsO and subject to the restrictions and prohibitions of set-off pursuant to sections 95 and 96 InsO, a right to set off a claim is preserved after the opening of Insolvency Proceedings if by force of law or on the basis of an agreement the Solvent Party was already entitled to set off the claim at the time the Insolvency Proceedings were opened irrespective of whether or not the declaration to set off the claim was made before or after the opening of such Insolvency Proceedings.

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excluded if the claim against which a set-off is to be effected will become unconditional and mature before it may be set off.

(2) Set-off shall not be excluded by the claims being expressed in different currencies or mathematical units if these currencies or mathematical units are freely exchangeable at the place of payment of the claim against which a set-off is to be effected. They shall be converted according to the exchange value applicable to this place at the time of receipt of the declaration of set-off.

Section 96 – Prohibition of Set-off

(1) Set-off shall be prohibited if

1. a creditor of the insolvency proceedings has become a debtor of the insolvency estate only after the opening of insolvency proceedings;

2. a creditor of the insolvency proceedings acquired his claim from another creditor only after the opening of insolvency proceedings;

3. a creditor of the insolvency proceedings acquired the opportunity to set off his claim by a transaction subject to challenge;

4. a creditor with a claim to be satisfied from the debtor's free property is a debtor of the insolvency estate.

(2) Paragraph 1 as well as section 95 para 1 sentence 3 shall neither restrict the transfer of financial collateral as defined pursuant to section 1 para 17 KWG nor the set-off of claims and benefits from transfer, payment or assignment agreements between payment services providers and intermediates or orders for transfers of securities included into a payment system as defined by section 1 para 16 KWG serving to implement such agreements where set-off is effected at the latest on the day of opening of the insolvency proceedings if the other part is an operator or participant in the system, the day of opening of insolvency proceedings shall be determined in accordance with the definition of business day as stipulated by section 1 para 16b KWG."

In contrast to the former KO, the InsO explicitly preserves rights to set off a claim under valid contractual agreements. With respect to the overall intention of the InsO in general and the purpose of section 94 InsO in particular, i.e. the aim to protect the legitimate expectations of the creditors of the Insolvent Party, the preservation of contractual rights to set off is criticised since it enables the parties to extend the rights to set off to the detriment of creditors of the Insolvent Party as such agreements might reduce the assets involved in insolvency. Hence, the validity of contractual agreements concerning set-off is called into question by some legal authors that advocate a restrictive interpretation of section 94 InsO according to which agreements concerning set-off may not override prohibitions of set-off that aim at protecting third parties' rights.[94] According to these legal authors, such agreements also have to comply with section 95 and 96 InsO and might be challenged pursuant to sections 129 *et seq.* InsO (below, paragraph 4.2).

However, this restrictive approach particularly applies to agreements deviating from the requirement of mutuality of the claims under German statutory law and should not affect the validity of the contractual provision of automatic aggregation and set-off of all existing mutual payment obligations of the Parties under the transactions where the relevant contractual provisions do not contain a contractual deviation from the requirement of mutuality of the claims.

(b) "Tri-party"-set-off

According to the BGH section 96 para 1 no. 2 InsO applies to agreements which provide for the right to set off claims of an affiliated company by another company against the claims of a third party (*Konzernverrechnungsklausel*).[95] The BGH takes the view that after the opening of Insolvency Proceedings, a set-off with claims not owned by the offsetting party but by its affiliate is ineffective. This applies even if such "tri-party" set-off had been agreed upon by the three parties involved before the opening of Insolvency Proceedings.

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[94] *Kroth*, in: Braun, Insolvenzordnung, 5th ed. (2012), § 95 no. 20.

[95] BGH NJW 2004, 3185.

(c) Restrictions under section 95 InsO

Where the right to set off emerges after the opening of Insolvency Proceedings, set-off will only be permissible if the mutual claims originated before the opening of Insolvency Proceedings. If on the date when Insolvency Proceedings are opened one or more of the claims to be set off against each other are conditional, not yet due or do not cover similar types of obligations, such set-off will not be effected before such conditions are met (section 95 para 1 sentence 1 InsO). Pursuant to section 95 para 1 sentence 2 InsO, section 41 InsO[96] concerning claims not yet due at the date when Insolvency Proceedings are opened and section 45 InsO[97] concerning the conversion of certain claims do not apply.

Set-off is excluded if the claim against which a set-off is to be effected becomes unconditional and mature before it may be set-off (section 95 para 1 sentence 3 InsO). With respect to set-off after the opening of Insolvency Proceedings, timing, therefore, is of fundamental importance. Set-off is permissible if the Solvent Party's claim is unconditional and matures prior to the Insolvent Party's claim or at the same time at the latest.[98]

Pursuant to section 95 para 2 InsO, the fact that claims are expressed in different currencies or mathematical units would not exclude set-off, if these currencies or mathematical units are freely exchangeable at the place of payment of the claim against which the set-off is to be

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[96] Section 41 InsO in an English translation reads as follows: "(1) Unmatured claims shall be deemed to be mature. (2) If such claims do not bear interest they shall be discounted at the statutory rate of interest. Thereby they shall be reduced to the amount corresponding to the full amount of such claim if the statutory rate of interest for the period from the opening of the insolvency proceedings to its maturity is added."

[97] Section 45 InsO in an English translation reads as follows: "Non-liquidated claims shall be filed at the value estimated for the date when the insolvency proceedings were opened. Claims expressed in foreign currency or in a mathematical unit shall be converted into German currency according to the exchange value applicable at the time of the opening of the proceedings at the place of the payment."

[98] Moreover, section 95 para 1 sentence 3 InsO has been interpreted restrictively by the BGH in BGH NJW 2005, 3574, 3575 *et seq.* According to the BGH, section 95 para 1 sentence. 3 InsO does not apply if the Insolvent Party's claim, against which set-off is declared, has become mature and unconditional before the Solvent Party's claim but at the same time was not enforceable due to a right to refuse performance by the Solvent Party against such claim.

effected.[99] The claims have to be converted according to the exchange value applicable to this place at the time of receipt of the declaration to set-off.

(d) Set-off and insolvency challenge

In the event an insolvency creditor acquired the right to set off his claim by a transaction which may be challenged as void, set-off is prohibited pursuant to section 96 para 1 no. 3 InsO. This prohibition applies irrespective of whether or not the Insolvency Representative actually challenged the transaction. The BGH has decided that a legal act will not be prevented from becoming subject to insolvency challenge and, consequently, the prohibition on set-off under section 96 para 1 no 3 InsO is not excluded if the legal act at hand caused the claim against which set-off is declared to come into existence.[100] In particular, the BGH rejected the argument that the fact that such a legal act does not only create the right to set-off but also the claim against which set-off is declared and which becomes part of the Insolvent Party's assets should be taken into account in determining whether the legal act is detrimental to creditors (as required by section 129 para 1 InsO (paragraph 4.2). Therefore, a German court could reach the conclusion that the exercise of powers of the Clearing House to bring claims into existence as a result of a Member's default constitute legal acts which are subject to challenge in insolvency and therefore prevent set-off in respect of claims created by such legal acts pursuant to section 96 para 1 no 3 InsO.

(e) Further restrictions under section 96 InsO

Set-off is statutorily prohibited if (i) a creditor in the Insolvency Proceedings has become a debtor of the insolvency estate only after the opening of Insolvency Proceedings, (ii) a creditor in the Insolvency Proceedings acquired his claim from another creditor only after the opening of Insolvency Proceedings, (iii) a creditor in the Insolvency Proceedings acquired the opportunity to set off his claim by a legal act

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[99] This provision is generally understood to relate to a question of principle of German insolvency law and, hence, applies to both section 94 InsO and section 95 InsO (*Höhn/Kaufmann* JuS 2003, 751, 753).

[100] BGH WM 2013, 1132, 1133.

subject to challenge in insolvency (below, paragraph 4.2) or (iv) a creditor with a claim to be satisfied from the debtor's free property is a debtor of the insolvency estate (section 96 para 1 InsO).

(f) Further restrictions under section 96 InsO

Set-off is prohibited if (i) a creditor in the Insolvency Proceedings has become a debtor of the insolvency estate only after the opening of Insolvency Proceedings, (ii) a creditor in the Insolvency Proceedings acquired his claim from another creditor only after the opening of Insolvency Proceedings, (iii) a creditor in the Insolvency Proceedings acquired the opportunity to set off his claim by a legal act subject to insolvency challenge (below, paragraph 4.2) or (iv) a creditor with a claim to be satisfied from the debtor's free property is a debtor of the insolvency estate (section 96 para 1 InsO).

(g) Exemptions for Financial Collateral and Systems

The prohibitions of set-off pursuant to section 95 para 1 sentence 3 InsO and section 96 para 1 InsO do neither apply to the transfer of Financial Collateral nor to the set-off of claims and benefits from transfer, payment or settlement agreements introduced into a System where set-off is effected at the latest on the day of opening of the Insolvency Proceedings (section 96 para 2 InsO).

3.8 Provisional Insolvency Measures

Upon an application for the opening of Insolvency Proceedings being filed but before the opening of Insolvency Proceedings a German insolvency court is entitled to appoint a provisional insolvency representative (*vorläufiger Insolvenzverwalter*) and to release court orders in respect of the allegedly Insolvent Party.

3.8.1 When taking Provisional Insolvency Measures, however, the insolvency court's competences are restricted to attachments (freezing injunctions) that prevent the Insolvent Party from disposing of his assets and thus jeopardising the purpose of Insolvency Proceedings. Such a freezing injunction may apply to all the assets of the Insolvent Party or parts thereof.

3.8.2 The insolvency court may impose a general prohibition of transfers on the debtor (section 21 para 2 sentence 1 no. 2 InsO), order that the debtor's transfers of property require the consent of the provisional insolvency representative (section 21 para 2 sentence 1 no. 2 InsO) or order a restriction

(or temporary restriction) in certain measures of enforcement (*Zwangsvollstreckungsmaßnahmen*) against the Insolvent Party (section 21 para 2 sentence 1 no. 3 InsO). According to the BGH, Provisional Insolvency Measures pursuant to section 21 para 2 sentence 1 nos. 2 and 3 InsO do not exclude the permissibility of set-off since the provisions concerning insolvency set-off pursuant to sections 94 through 96 InsO (see paragraph 3.4 above) are deemed as both comprehensive and exclusive. [101]

3.8.3 A provisional insolvency representative does not have any powers which would entail a "cherry-picking" right in accordance with section 103 InsO.

3.8.4 Provisional Insolvency Measures do not affect the validity of dispositions over Financial Collateral and the validity of the netting of obligations based on transfer orders that have been entered into a System (section 21 para 2 sentence 2 InsO).

3.9 Regulatory Proceedings

The Netting Provision and the collateral arrangements under the Clearing Conditions may be affected by restructuring measures under the Bank Restructuring Act and the KWG.

3.9.1 BaFin may - prior to the petition for the opening of Insolvency Proceedings - issue certain measures under section 46 para 1 KWG (above, paragraph 3.1.2) which include the imposition of a Moratorium.

(a) It has been suggested that a Moratorium has the effect of a deferral (*Stundung*), i.e. extension of the due date.[102] Accordingly, set-off of obligations would not permissible in such circumstances (as set-off may not be effected where the claim against which it is to be effected is not due).

(b) In its decision of 12 March 2013, the BGH has confirmed that a ban on payment and sales by BaFin under section 46 para 1 sentence 2 no. 4

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[101] BGH NJW 2004, 3118, 3119; BGH ZIP 2005, 181.

[102] See OLG Frankfurt ZinsO 2013, 388 *et seq.* The judgment has been given in respect of the former section 46a para 1 sentence 1 no. 1 KWG but the wording of section 46 para 1 sentence 2 no. 4 of the revised KWG is identical. This view has also been shared by the German legislator (BT-Drucksache 7/4631, p. 8 and BT-Drucksache 14/8017, p. 141). See also *Schwennicke/Haß/Herweg*, in: Schwennicke/Auerbach, Kreditwesengesetz mit Zahlungsdiensteaufsichtsgesetz, 2nd ed. (2013), § 46 no. 39.

KWG would not result in a deferral.[103] Rather, the ban creates a temporary obstacle to specific performance and would entitle the Clearing House to refuse specific performance for as long as the ban continues to exist (based on an analogous application of section 275 para 1 BGB). As an administrative act (*Verwaltungsakt*) directed against the Clearing House it would have to be published *vis-à-vis* the Clearing House to become effective (section 43 para 1 sentence 1 of the German Act on Administrative Proceedings (*Verwaltungsverfahrensgesetz*) but would not become effective *vis-à-vis* its creditors as a publication *vis-à-vis* the creditors is not provided for under applicable laws.[104] Moreover, the counterparty's set-off right which is a protected property right under the German Constitution (*Grundgesetz*) cannot be restricted without a clearly defined legal basis.[105]

(c) Whilst the BGH has left this question open, it has made *obiter* remarks indicating that a ban on payment and sales does not prevent set-off. The BGH points out that the purpose of section 46 para 1 sentence 2 no. 4 KWG to secure the assets of the institution concerned (e.g. the Clearing House) and prevent its insolvency would not prevent set-off. Even pre-insolvency measures by an insolvency court and the opening of Insolvency Proceedings would generally not prevent set-off (above, paragraphs 3.7.1 and 3.7.2) and section 46 para 1 sentence 2 no. 4 KWG is not intended to impose restrictions beyond the restrictions Insolvency Proceedings entail.[106] While these remarks are, in our view, convincing, the BGH does, however, not address the question whether a temporary obstacle for the performance of a claim would still prevent set-off against such claim given that German statutory law allows for set-off only, if the claim against which set-off is to be effected can be performed (above, paragraph 3.6.1(a)(iii)).

3.9.2 BaFin may further issue a Transfer Order where the existence of the Clearing House is endangered and this in turn endangers the stability of the Financial

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[103] BGH WM 2013, 742, 748.

[104] BGH WM 2013, 742, 747.

[105] BGH WM 2013, 742, 744.

[106] BGH WM 2013, 742, 747.

System. As mentioned a Transfer Order (or a Re-Transfer Order) must transfer eligible netting agreements in their entirety (above, paragraph 3.4.2(e)) but it is doubtful whether the Clearing Conditions constitute an eligible netting agreement. Similarly, assets for which Financial Collateral has been provided must not be transferred without such Financial Collateral and where assets are included in a System they must be transferred together with any collateral which has been provided in respect of these assets.

3.9.3 The Termination Restrictions may further affect netting outside an insolvency but an exemption is, with respect to section 13 KredReorgG, available if the Clearing Conditions establish a System and in respect of any Financial Collateral.

3.10 Netting: Client Position Accounts and Proprietary Accounts

3.10.1 Section 3.6 of the Clearing Conditions describes the various types of accounts to be maintained by the Clearing House and the booking of positions in this context. The Netting Provision is silent on the inclusion of obligations under different types of accounts. General provisions and principles of German law hence apply with respect to the question which positions under which account will be subject to the close-out netting in accordance with the Netting Provision. The Set-Off Provisions distinguish between proprietary and client account positions.

3.10.2 We do not opine on whether the Netting Provision would apply to the Client Position Account or any claims attributable to other persons than the Clearing House. It is not clear from the Clearing Conditions how the Netting Provision relates to different types of accounts upon an Insolvency Event of Default of the Clearing House. Whether positions can be attributed to Members or other persons would under German law depend on whether it is sufficiently clear who is entitled under the respective accounts, i.e. whether the Member or another person can be identified as the account holder or the beneficial owner[107] and, thus, whether the assets booked in the account belong to the Member or a third party.[108] This requires that the account are kept separate and

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[107] An account holder may act as a fiduciary of the owner of certain assets. In such case, it would under German law be decisive whether the fiduciary account holding can be identified as such.

[108] Section 3.6 of the Clearing Conditions deals with the different types of accounts Members maintain for their own or their clients' positions. The Netting Provision does not contain a section similar to section 3.4.6 (2) of the Clearing Conditions which expressly provides that the daily netting to be performed by the clearing

positions are booked accordingly to avoid any commingling. Where assets or claims booked to accounts can be identified as belonging to clients of Members, they would therefore not form part of the close-out netting under the Netting Provision.[109]

3.11 Cross-Product Netting and Set-Off

The Netting Provision covers all Trades cleared by the Member with the Clearing House as it does not draw a distinction between different types of products which are eligible for clearing with the Clearing House. It therefore applies to all obligations which are outstanding between the Clearing House and the Member and, under section 3.10.2 sentence 2 second indent, expressly provides for the treatment of any outstanding claim for delivery or acceptance (*Liefer- oder Abnahmeverpflichtung*) from outstanding forward or future Trades and any spot Trade which has not been fully performed by the Clearing House as a transaction (*Einzelabschluss*) for purposes of the DRV (i.e. as a Trade covered by the close-out netting).

3.12 Collateral in the insolvency estate

Where Members have validly fulfilled their obligations to create a security interest or to pay cash in accordance with their obligations under the Clearing Conditions the principles discussed below apply as regards the treatment of collateral upon the Clearing House's insolvency. In the following we will describe applicable German conflict of laws principles and substantive civil and insolvency laws governing the creation of security interests and the provision of cash by means of full title transfer. We note that section 3.5.4 of the Clearing Conditions provides that Collateral provided by the Member may take the form of cash credited to an account but it is not clear whether such transfer of cash is intended to constitute a full title transfer arrangement.

We further note that the Netting Provision does not provide for the inclusion of claims for the delivery or re-delivery of Collateral in the close-out netting.

We understand that the Clearing Conditions envisage the creation of certain security interests over collateral which is governed by non-German law. The law governing

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House in accordance with section 3.4.6 (1) of the Clearing Conditions shall be performed separately with respect to Own Position Acounts, on the one hand, and Proprietary Accounts, on the other hand.

[109] There is no comprehensive legal set of rules on client asset segregation in Germany. Rather, various statutory rules and general principles of German law have to be taken in account.

(including applicable conflict of laws provisions) the relevant account determines the requirements to be satisfied to validly create a pledge or comparable security interest over such accounts. As this opinion is limited to German law, we only address German law requirements in the following:

3.12.1 Security under German law

Under German law, a distinction has to be drawn between the contractual obligation to create security and the creation of the security itself. The obligation to provide security and the choice of German law to govern such obligations is recognised by the German courts under Article 3 para 1 Rome I.

The law applicable to the creation of the security interest itself (i.e. the property law or in rem aspect) needs to be determined on the basis of applicable German conflict of laws principles and would, amongst other things, depend on the nature of the relevant asset, its location and the rights the security provider gives to the secured party in respect of the relevant collateral asset. From a German law perspective the law governing the creation of the relevant security interest also determines the rights of the secured party under such security interest. Depending on the type of security interest, different legal and factual requirements must be fulfilled to ensure the validity and, as a separate matter enforceability of as well as the possibilities to enforce such security interest.

(a) Security over cash

Cash credited to an account is represented by the repayment claim of the relevant account holder against the entity maintaining the account, such as a bank or a custodian. Therefore, under German law, a security interest over cash credited to an account is established by creating a security interest in the relevant repayment claim of the account holder against the relevant account bank. However, where the account is held in the name of the secured party, any transfer of cash made into such account *prima facie* constitutes an asset of the secured party and no security interest needs to be created over such account. In other words, where the cash is transferred to an account opened in the name of the secured party it is treated as an "full title transfer" arrangement (*Vollrechtsübertragung*), rather than as a security interest (*Sicherheit*

or *beschränkt dingliches Recht*).[110] Where the cash is booked in an account held in the name of the security provider, a security interest over such account needs to be created.[111]

(b) Security over contractual claims

Article 14 Rome I contains the relevant conflict of laws provisions for security over contractual claims. Article 14 para 1 Rome I provides that the relationship between assignor and assignee is governed by the law that applies to the contract between the assignor and assignee under Rome I, i.e. the parties may choose the governing law under Article 3 para 1 Rome I. Recital 38 Rome I makes it clear that this also covers the property aspects of the assignment in countries such as Germany where these aspects are legally separate from the law of obligations. The same applies in respect of pledgor and pledgee in case a claim is pledged (Article 14 para 3 Rome I). The law governing the pledged claim is relevant in determining whether the claim can be pledged, the relationship between the pledgee and the pledgor, the conditions under which the pledge can be invoked against the pledgor and whether the pledgor's obligations have been discharged (Article 14 para 2 Rome I).

In principle, if cash collateral is not provided by way of a full title transfer, depending on the parties' agreement, different types of security interests over cash held in an account can be created under German law, such as a pledge (*Pfandrecht*) or an assignment for security purposes (*Sicherungsabtretung*). As mentioned above, transfer

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[110] Please refer to paragraph 3.12.1(d) below with respect to the enforceability of full title transfer arrangements under German law.

[111] Where an account is held in the name of the account holder but for the account of another person, for example a fiduciary account (*Treuhandkonto*), the pledgee should verify whether the account holder may dispose of such account and validly create a security interest over such account or, as the case may be, the relevant beneficiary under such account has approved the creation of the security interest. If the pledgee is aware that the account is a trust account (*offenes Treuhandkonto*), the pledgee cannot in good faith acquire a security interest in the assets booked into the account. If the pledgee is not aware that the account is a trust account (*verdecktes Treuhandkonto*), the pledgee may acquire a security interest in the account. However, when a pledgee later becomes aware the relevant account is a trust account, it must not enforce a security interest acquired in such account or exercise any set-off rights (BGH WM 1990, 1954, 1955; BGH WM 96, 249, 251; *Hadding/Häuser*, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, 4th ed. (2011), § 37 nos. 43 *et seq.*).

or payment of cash by the security provider to an account of the secured party should neither qualify as a pledge nor as an assignment for security purposes but as an "full title transfer" in the cash.

(c) Security over securities

Under German conflict of laws provisions, the validity of the transfer of title in securities is generally determined by the laws of the jurisdiction in which the securities are located (*lex cartae sitae*) in accordance with Article 43 EGBGB[112] (*Wertpapiersachstatut*).[113] The following principles apply in respect of the *in rem* title to any physical certificate of a security. The rights represented by the securities (*Wertpapierrechtsstatut*) (e.g. the acquisition of voting, dividend or interest rights) are determined by the laws governing such right, for example in relation to shares the jurisdiction in which the issuer is located or established and in relation to bonds the jurisdiction the issuer has chosen to govern the bonds.

Subject to the rules on collectively held securities set out below, if the law governing the transfer of title in securities provides that the transfer of title in the securities requires the delivery of a certificate (such as bearer securities under German law, *Inhaberpapiere*), the transfer of title in such securities is governed by the laws of the jurisdiction in which the certificate is physically located.[114]

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[112] An English translation of Article 43 EGBGB reads as follows:

"(1) Rights to an object are governed by the laws of the jurisdiction where the object is situated.

(2) If an object in respect of which rights have been established is brought to another jurisdiction, such rights must not be exercised contrary to the laws of such country.

(3) If a right to an object which is brought to Germany has not been established yet, events relevant to the creation of a right in another jurisdiction are taken into account in the same manner as events relevant to the creation in Germany for purposes of the creation."

[113] *Welter*, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, 4th ed. (2011), § 26 nos. 172 *et seq.*; *Wendehorst*, in: Münchener Kommentar zum BGB, 5th ed. (2010), Article 43 EGBGB nos. 194 *et seq.*; *Stoll,* in: Staudinger, Int SachenR (1996), no. 413.

[114] *Wendehorst*, in: Münchener Kommentar zum BGB, 5th ed. (2010), Article 43 EGBGB no. 196.

In respect of negotiable registered securities (*Orderpapiere*), on the other hand, the analysis under German conflict of laws is different.[115] The law governing the rights represented by the securities (*Wertpapierrechtsstatut*) determines whether the transfer of the title in the negotiable registered securities requires an endorsement, delivery of the certificate or both. If negotiable registered securities bear a blank endorsement (*Blankoindossament*) and the law which governs the securities provides that the transfer of title in the securities may be transferred by delivery of the certificate, the transfer of title in such negotiable registered securities is governed by the laws of the jurisdiction in which the certificates are physically located.

If an instrument under its governing law qualifies as a claim transferable by assignment rather than as a bearer instrument or negotiable registered security (for example, Schuldschein loans or non-negotiable registered bonds governed by German law (*Namensschuldverschreibung*)), the instrument may only be transferred by assignment of such claim.

Where section 17a DepotG[116] applies the aforementioned conflict of laws provisions are modified (*lex rei sitae*). Section 17a DepotG provides that in respect of "collectively held securities" which are transferable by booking into an account with constitutive legal effect for the benefit of the transferee, the law governing the dispositions (*Verfügungen*, e.g. the transfer of, or creation of a security interest over, securities)) of such securities is determined by reference to the location of the principal or branch office of the custodian bank (or, as the case may be, the central securities depository) making the account entry in favour of the transferee. "Collectively held securities" are (i) securities which are kept in collective safe custody (*Sammelverwahrung*) by a central securities depository, (ii) securities represented by a global certificate, or (iii) securities represented by a

[115] *Wendehorst*, in: Münchener Kommentar zum BGB, 5th ed. (2010), Article 43 EGBGB no. 197 *et seq.*

[116] Section 17a DepotG serves the implementation of Article 9 para 2 SFD and in an English translation reads as follows: "Any disposition (*Verfügung*) of securities or interests in securities held in a central securities depository system, which are, with constitutive legal effect, entered into a register or booked in an account are governed by the laws of the country under whose supervision the register is kept in which such entry for the direct benefit of the transferee is made or in which the main or branch office of the custodian is located which makes the account entry with constitutive legal effect for the benefit of the transferee."

book entry for a central securities depository (for example, certain German government bonds).

With respect to "dematerialised securities" which are transferable by book entry in a register with constitutive legal effect for the benefit of the transferee, section 17a DepotG provides that the law governing the transfer of such securities is determined by reference to the jurisdiction of the country under whose supervision the register is maintained making the account entry in favour of the transferee. "Dematerialised securities" are securities which are represented by a book entry in a register (*Buchrechte*). However, up to date, certain questions relating to section 17a DepotG remain unresolved, and no court precedents exist in respect of the interpretation of such rule, in particular with respect to the meaning of "constitutive legal effect".[117]

(d) Full title transfers

In our view, a full title transfer to collateralise obligations can be validly made under German law. Parties are entitled to agree expressly that the secured party shall become the unrestricted title holder in respect of assets which are transferred for security purposes. Such a full title transfer arrangement does in our view not violate general principles of property laws. In particular, the requirement that property rights must be established in accordance with the enumerative list of eligible property rights or in rem rights under German law (*numerus clausus*) is not affected because full title transfers can be made in accordance with the laws governing transfers of assets in general. Furthermore, the concept of full title transfers in order to collateralise obligations has been established under German law in section 1 para 17 KWG which refers to full title transfers[118] as one form of

[117] See also *Einsele*, WM 2001, 2415, 2421 *et seq.*; *Reuschle*, RabelsZ 68 (2004), 687, 720; *Dittrich*, in: Scherer, DepotG (2012), § 17a nos. 51 *et seq.*

[118] The FCD uses the term "title transfer financial collateral arrangement". Pursuant to Article 1 lit (b) FCD "title transfer financial collateral arrangement" means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations.

Financial Collateral.[119] Whilst there are no German court decisions confirming the validity of a full title transfer to collateralise an obligation, we take the view that a full title transfer is valid under German law. In particular, in our view, an agreement on a full title transfer to collateralise an obligation should not be regarded as a loan agreement, as in case of such a full title transfer agreement the secured party is not obliged to return the collateral assets following a default of the security provider. Such agreement does therefore not provide for an obligation which is characteristic (*vertragstypische Leistungspflicht*) for a loan agreement, such as the repayment of the loan amount upon maturity.

(e) Right of re-use

Generally, where a security interest is created under German law the secured party is not entitled to dispose of collateral assets prior to the occurrence of an enforcement event.[120] Assuming German law applies, and title has been transferred under a title transfer arrangement, the relevant title holder may dispose of such collateral subject to any agreement between the parties to the contrary.[121] If a security interest in the form of a pledge under German law has been created, the secured party may generally not dispose of the pledged assets prior to the occurrence of an enforcement event.[122] Under an assignment for security purposes the secured party is bound by an underlying fiduciary

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[119] *Bliesener*, in: Lwowski/Fischer/Langenbucher, Das Recht der Kreditsicherung, 9th ed. (2011), § 17 no. 4; *Behrends*, in: Zerey, Finanzderivate, 3rd ed. (2013), § 6 nos. 65 *et seq.*

[120] In particular, under a German law security transfer (*Sicherungsübereignung*) or security assignment (*Sicherungsabtretung*) such obligation of the secured party not to dispose of the security assets prior to the occurrence of an enforcement event derives from a fiduciary relationship (although such fiduciary relationship and the contractual duties resulting therefrom do not remove a person's ability to dispose of the relevant security assets in contravention of such duties). See generally *Kindl*, in: Beck'scher Online-Kommentar BGB, 24th ed. (1 August 2012), § 930 no. 13.

[121] If the parties to a contract agree on a prohibition of the disposal over assets (*rechtsgeschäftliches Verfügungsverbot*), such prohibition will not restrict any *in rem* transfer to, or the creation of any *in rem* right in favour of, a third party, even if such third party was aware of the prohibition (section 137 BGB).

[122] Generally, only the owner of the assets may grant a pledge (section 1205 para 1 BGB). A third party may, however, grant a pledge, if the owner of the pledged assets has given its consent (section 185 para 1 BGB). Furthermore, a pledgor could, under section 185 para 1 BGB give its consent to the pledgee's disposal of the pledged assets.

relationship to dispose of the assigned claim only in accordance with the security purpose agreement which is made in connection with such assignment for security purposes. However, we understand that it is generally accepted that the parties may waive such a fiduciary duty.

(f) Recharacterisation

The BGB uses the term "re-characterisation" (*Umdeutung*) only in the context of the re-characterisation of a void legal transaction (*Rechtsgeschäft*) into another type of legal transaction, if the requirements for such other type of legal transaction are met and the entry into such other legal transaction reflects the intentions of the parties (section 140 BGB). However, where a transaction is valid, German courts seek to give effect to the true economic intentions of the parties as a matter of interpretation (*Auslegung*). As a result, under German law, a German court may construe a purported full title transfer as a security interest e.g. in the form of a security assignment, if it finds that the security assignment reflects the true economic intentions of the parties. If German law applies, German courts therefore generally recognise the validity of the agreement between the parties on a full title transfer of collateral unless they find that a full title transfer does not reflect the true economic intentions of the parties. Where a German court construes a purported full title transfer as a security interest, the right of re-use or re-hypothecation may be restricted.

3.12.2 Cash Collateral

Payments made by a Member to the Clearing House as by means of a full title transfer constitute an absolute transfer of cash, so that, in the event of Insolvency Proceedings relating to the Clearing House, such cash would be treated as the property of the Clearing House available to its creditors generally. The creation of a pledge or the security assignment of payment claims by a Member for the benefit of the Clearing House, on the other hand, do not constitute an absolute transfer of cash, so that, in the event of Insolvency Proceedings relating to the Clearing House, such cash would not be treated as the property of the Clearing House available to its creditors generally. Based on our reasoning above, we take the view that Collateral provided by means of a full title transfer can be validly made and would not be re-characterised as a loan.

(a) Full title transfers

(i) Treatment of Collateral following the Clearing House's insolvency

(A) Upon a full title transfer of Cash Collateral, the Cash Collateral would form part of the Clearing House's assets and hence be liquidated upon the opening of Insolvency Proceedings (section 35 InsO). As mentioned above (paragraph 3.12.1(a)), it is not entirely clear whether the Clearing Conditions provide for a full title transfer of cash.

(B) Depending on the facts of each individual case, the Member may have a claim for repayment of an amount equivalent to all or part of the collateral granted to the Clearing House. Such claim would, however, rank *pari passu* with all other claims of unsecured creditors of the Clearing House in its insolvency.

(b) Pledges

(i) Creation of pledges

Under the Collateral Agreement securities are pledged by a relevant Member to the Clearing House.

(A) In order to create and perfect a pledge over contractual claims, the parties have to agree to pledge the relevant claim and to notify the debtor of the claim of the pledge (section 1205 and 1280 BGB). Under a pledge, the obligor and the creditor in respect of the pledged claim remain the same upon the creation of the pledge. The secured party is vested with certain rights in relation to the pledged claim which, in particular, facilitate enforcement following the pledgor's default. German law pledges are of an accessory nature which means that the existence of the pledge depends on the existence of the secured obligation and that the transfer of the pledge is legally effected by transferring the secured obligation (upon which the pledge "follows" by

operation of mandatory law (section 1250 para 1 BGB)). In order to create and perfect a pledge over contractual claims, the parties have to agree to pledge the relevant claim and to notify the debtor of the claim of the pledge (section 1205 and 1280 BGB). Under a pledge the pledgee must be identical with the creditor of the secured obligation.

(B) The Parties may agree to create a pledge over future claims (section 1204 para 2 BGB), if such future claim is already identifiable (*bestimmbar*) at the date of the creation of the pledge.[123] The secured obligations may be future obligations and are also subject to the requirement of identifiability.[124]

(c) Treatment of Members' pledges in the insolvency of the Clearing House

(i) Where assets have been pledged to the Insolvent Party, the pledgee does not acquire the pledged assets. The pledged assets do therefore not form part of the Insolvent Party's assets under section 35 InsO.[125]

(ii) Whilst the pledge would continue to exist as an encumbrance over the pledged assets as it did before the opening of Insolvency Proceedings, the Insolvency Representative would not be entitled to dispose over the pledged assets in absence of an enforcement event, if Insolvency Proceedings were opened over the assets of the Clearing House.

(iii) Once the security purpose of the pledge ceases to exist, the pledgor is entitled to demand segregation of the pledged assets under section 47 InsO (i.e. the Insolvency Representative would have to return the pledged assets to the pledgor).

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[123] BGH, NJW 1985, 863, 864.

[124] *Damrau*, in: Münchener Kommentar zum BGB, 6th ed. (2013), § 1204 no. 23.

[125] *Hirte*, in: Uhlenbruck, Insolvenzordnung; 13th ed (2010), § 35 no. 146

3.12.3 Treatment of creditors in Insolvency Proceedings

The general rule is that in Insolvency Proceedings all creditors rank *pari passu* except where they are entitled to preferential treatment or are subject to subordination. Generally, claims against the insolvent Clearing House have to be registered with the insolvency court. Claims which are eligible for registration are satisfied *pari passu* from the proceeds (if any) of the liquidation of the insolvent Clearing House's assets after deduction of the procedural costs and satisfaction of creditors which benefit from preferential treatment. To be eligible for registration with the insolvency court, the payment claim has to be converted into EURO (section 45 sentence 2 InsO).

(a) Rights to segregation and to separate satisfaction

A relevant Member as creditor is entitled to enforce its rights if it may avail itself of a right to segregation (*Aussonderungsrecht*) from the insolvency estate or separate satisfaction (*Absonderungsrecht*) within Insolvency Proceedings. If a pledge was validly created under a jurisdiction other than Germany and such security interest allows for segregation under German insolvency laws, it could be enforced without being affected by the opening of Insolvency Proceedings. If such security allowed for separate satisfaction, a Member as secured party would benefit from preferential treatment within Insolvency Proceedings but if such security interest further constituted Financial Collateral or secured claims under a System, the situation would be comparable to a right to segregation.

Only in exceptional cases would contractual claims entitle the creditor to a right of segregation. A relevant Member which has any repayment claims for security provided or full title transfers made to the Clearing House would therefore generally rank *pari passu* with all other unsecured creditors.

It is disputed in German legal literature which law applies when determining the effects of Insolvency Proceedings on security over assets located outside Germany (i.e. to determine whether such secured party would be entitled to a right to segregation). Both Article 5 para 1 EUIR and section 351 para 1 InsO provide that in the event a creditor has a right to segregation under German law for assets that are located in Germany at the opening of foreign insolvency proceedings, such segregation right will not be affected. Neither Article 5 EUIR nor

section 351 InsO or any other provision of German insolvency law does, however, address the reverse scenario, i.e. that (German) Insolvency Proceedings are opened but third party rights exist with respect to non-German assets.

Generally, the *lex fori concursus* (i.e. German insolvency law) determines which assets form part of the insolvency estate. As a consequence, certain legal commentators take the view that the *lex fori concursus* would also have to decide which consequences a certain right *in rem* would have in Insolvency Proceedings, e.g. whether it would entitle a third party to claim segregation of certain assets from the insolvency estate.[126] Other authors take the view that this should be subject to the *lex causae* (contract law) or *lex rei sitae* (property law), depending on the nature of the relevant asset.[127] If a court followed this view it would have to apply the *lex causae* or *lex rei sitae* either of the Clearing Documentation or of the relevant security interest. As the *lex causae* or *lex rei sitae* on the one side and the respective national insolvency laws on the other side could possibly lead to different results a court would have to decide on this query. A third group of legal commentators is of the view that the *lex fori concursus* and the *lex causae* should be combined so that with respect to an asset that is located in a country other than Germany, German insolvency law should be applicable but only to the extent that it does not restrict the creditor's right in a more restrictive way than it would be restricted by the insolvency law identified by way of the process according to the first view.[128]

We take the view that the treatment of assets located outside Germany upon the opening of Insolvency Proceedings should be determined in accordance with the rules of the InsO but the characterisation of any rights in relation to such assets should be determined in accordance with the governing law of these rights. A court would therefore have to

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126 *Kindler*, in: Kindler/Nachmann: Handbuch Insolvenzrecht in: Europa, (2010), § 4 no. 51; *Ehret*, in: Braun, InsO, 5th ed. (2012), § 351 no. 1.

127 *Gottwald/Kolman*, in: Insolvenzrechtshandbuch, 4th ed. (2010), § 132 no. 20; *Geimer*, Internationales Zivilprozessrecht, 6th ed. (2009), no. 3553.

128 See *Reinhart*, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. (2008), § 335 no. 58 for an overview.

determine, on the basis of the specific characteristics of the relevant security interest under its governing law (as determined under German conflict of laws principles), whether for purposes of the InsO a security interest or a full title transfer benefits from preferential treatment in the form of segregation or preferred satisfaction or whether it would rank *pari passu* with all other unsecured creditors.

(b) Enforcement of rights to separate satisfaction

Where a security interest provides the secured party with a right to separate satisfaction rather than with a right for segregation, a distinction generally has to be drawn between such security interests which may be enforced by the secured party and security interests which are enforced by the Insolvency Representative. Where section 166 para 1 and 2 InsO applies, a security interest would be enforced by the Insolvency Representative (e.g. pledges over moveables such as bearer securities). The Insolvency Representative would in such case be obliged to transfer any proceeds realised after deduction of a lump sum fee for the determination of the existence of the security interest amounting to 4 per cent (*Feststellungskosten*) plus up to 5 per cent (in certain cases even more than 5 per cent) for any cost incurred in the context of the realisation of the security interest (*Verwertungskosten*) (plus applicable VAT on the proceeds of realisation) to the relevant secured party.

A secured party entitled to separate satisfaction may in any event realise security interests which collateralise claims under a System as well as security interests which qualify as Financial Collateral itself even within Insolvency Proceedings (section 166 para 3 nos. 1 and 3 InsO). Both these exemptions apply irrespective of the type of security interest. Furthermore, a secured party may enforce (German law) pledges over contractual claims itself (section 173 para 1 InsO). Please refer to 3.4.2(h) with respect to the exemptions relating to Systems and with respect to Financial Collateral please refer to paragraph 3.4.2(g).

3.13 Non-cash Collateral in the insolvency estate

The principles discussed above (paragraph 3.12) also apply in respect of Non-Cash Collateral. In the Clearing House's insolvency any Non-Cash Collateral forms therefore part of the assests of the insolvent Clearing House if its has been provided to the Clearing House on a full title transfer basis. Non-cash Collateral is, however, not

provided by means of full title transfer where Cash Collateral is provided under German law (and we do not opine on any Collateral which is provided in accordance with any other laws than German law). Where Non-Cash Collateral is provided by means of pledges the Insolvency Representative managing the assets of the Clearing House would exercise any rights of a pledgor under German law and a relevant Member would only have a claim for segregation once the security purpose of the pledge ceases to exist and provided it can show that it is the owner of the assets over which the pledge has been created.

3.14 Members' Assessment Liabilities

The following summarises the obligations of a relevant Member in connection with its contributions to the Clearing House's default funds under the Clearing Conditions.

3.14.1 Overview of the Member's Assessment Liability:

(a) Section 3.8 of the Clearing Conditions deals with the clearing fund (*Clearing-Fonds*, "**Clearing Fund**")) maintained by the Clearing House in accordance with the Clearing Conditions. Under section 3.8.1 para 2 of the Clearing Conditions each Member is obliged to make contributions to the Clearing Fund. The amount of the Member's contributions will be determined by the Clearing House in accordance with its published calculation method and adjusted if necessary. Acceptable collateral may consist of cash or securities (section 3.8.1 (3) of the Clearing Conditions which refers to section 3.5 of the Clearing Conditions) and, in exceptional case upon a risk analysis performed by the Clearing House, bank guarantees (section 3.8.1 para 3 of the Clearing Conditions).

(b) Section 3.8.2 para 1 of the Clearing Conditions provides that the Clearing House shall be entitled to use Clearing Fund contributions to deal with the default (*Verzug*) (as set out under section 3.9 of the Clearing Conditions) of any member.

(c) Under section 3.8.3 of the Clearing Conditions Members are, upon the use of any of its contributions to the Clearing Fund by the Clearing House, obliged to make new contributions in an amount necessary for its overall contribution to reach the initial amount within 10 business

days[129] after the use unless the Member has returned its clearing licence within 5 business days upon the use.

3.14.2 Validity and enforceability of a Members obligations to contribute to the Clearing Fund

(a) Section 3.8 of the Clearing Conditions generally creates valid and enforceable obligations as it it does not breach a statutory prohibition (*gesetzliches Verbot*) within the meaning of Section 134 BGB or a principle of German public policy (*gute Sitten*) within the meaning of Section 138 BGB. As regards German law governing general business conditions (*Allgemeine Geschäftsbedingungen*), reference is made to paragraph 4.3 below.

(b) The actual transfer of securities has to be made in accordance with German property law. Any money transfers to, or direct debits by, the Clearing House have to be made in accordance with all applicable statutory provisions on the transfer of moneys (*Überweisungsrecht*) and in accordance with all provisions applicable to direct debits (*Lastschriften*).

(c) The requirement set out by section 286 para 1 BGB that the default of an obligee (*Verzug*) (as a requirement for the utilisation of contributions) generally only occurs upon prior warning, may be waived by the parties and the waiver of the warning requirement (section 3.9.1 para 1 of the Clearing Conditions) is valid.[130]

(d) To the extent the obligations of a Member depend on the calculation and determination of the Clearing House, the obligations are valid only if the Clearing House exercises fair and reasonable discretion (*billiges Ermessen*) (section 315 BGB).[131]

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[129] Business day is defined under section 1 of the Clearing Conditions as any day from Monday until Friday on which Trades are "financially cleared" (*finanziell abgewickelt*) by the Clearing House with the exception of TARGET closing days.

[130] *Ernst*, in: Münchener Kommentar zum BGB, 6th ed. (2012), § 286 no. 15; *Schmidt-Kessel*, in: Prütting/Wegen/Weinreich, BGB, 4th ed. (2009), § 286 no. 15.

[131] The application of section 315 BGB may, however, be waived by the parties to any agreement.

3.14.3 Actions against a Member who fails to pay its contributions

(a) Section 3.9.1 (3) sentence 1 of the Clearing Conditions, under which the Clearing House may claim damages for losses incurred as a result of the Member' s default corresponds to German statutory law (section 280 para 1 and para 2 and section 286 BGB) and hence can be validly agreed.

(b) The obligation of a defaulting Member to pay liquidated damages in the amount of 0.5 per cent of the outstanding sum but at least EUR 500 per calendar day (section 3.9.1 para 3 sentence 2 of the Clearing Conditions) can in principle be validly agreed in accordance with section 339 BGB.[132]

(c) Section 3.9.3 of the Clearing Conditions provides for the closing out or the transfer to another Member of all transactions of a Member as well as for the utilisation of all collateral posted by such Member but subject to restrictions as regards collateral posted a Member's non clearing member (which shall from a collateral group of ist own).[133]

(d) If German insolvency laws apply and the Clearing House has claims against an insolvent Member to make contributions to cover excess losses to the Clearing Fund or the Credit Clearing Fund and no security exists in respect of such claims, the Clearing House's claim ranks *pari passu* with the claims of all other unsecured creditors and it must register such claims for consideration in the distribution of the liquidation proceeds in accordance with the mandatory rules of the InsO.

[132] Liquidated damages may be reduced to an appropriate amount by a court upon the debtor's application, if the amount which has been agreed on is disproportionately high (*unverhältnismäßig hoch*) (section 343 BGB). Section 343 BGB, is, however inapplicable, if the Member qualifies as a merchant for purposessection 348 HGB. Even so, an agreement providing for the payment of liquidated damages upon the occurrence of a certain event, may be void, if it is contained in general business condition (section 307 para 1 BGB). According to the settled case law of the German courts, general business conditions providing for the payment of liquidated damages are valid only if the payment of liquidated damages is dependant on the scope of the obligation it is intended to secure and capped in accordance with this scope (BGH NJW 1999, 2662, 2663 *et seq.*).

[133] Section 3.9.3 no. 5 of the Clearing Conditions provides that any surplus which arises from the utilisation of Collateral has to be returned to the defaulting Member.

4. QUALIFICATIONS

The opinions in this opinion letter are subject to the following qualifications:

4.1 General

4.1.1 The German law principle of *Treu und Glauben* (section 242 BGB) requires that contracts are performed and rights exercised in good faith. Actions *contra bonos mores* may provide certain rights in favour of a contracting party or may render contracts or commitments void or voidable. In addition, public policy may lead to "equitable" rights being upheld in German courts or may render contracts or commitments void or voidable or may lead to the recharacterising of such contracts or commitments and German courts may declare provisions providing for strict liability invalid. In this respect a German court might take the view that the termination of all Trades under the Clearing House Documentation as a result of a default under a Trade which does not materially affect the interests of the non-defaulting party infringes the principle of *Treu und Glauben* and, therefore, set aside such early termination as void. This will hold true in particular if the default is temporary and the early termination would apply to numerous Trades.

4.1.2 A determination, designation, calculation or certificate by any Party to the Clearing House Documentation as to any matter provided for therein may in certain circumstances be held by a German court not to be final, conclusive and binding (for example, if it could be shown to have been incorrect or to have any other reasonable or arbitrary basis or not to have been made in good faith) notwithstanding the provisions of the relevant document.

4.1.3 Where, depending on the facts of the case, specific performance of an obligation is impossible, either generally or for the debtor, or unduly disproportionate to the obligee's interest in performance, the debtor will be relieved from his obligation to perform or he may refuse performance, respectively. The debtor may however be held liable for damages (sections 275, 280, 282 and 283 BGB).

4.1.4 In some circumstances, a German court will not give effect to any provision of the Clearing House Documentation which provides that, in the event of any invalidity, illegality or unenforceability of any provision of such Clearing House Documentation or omission therein the remaining provisions thereof shall not be affected or impaired or the omission shall be corrected, particularly if to do so would not accord with public policy or would require

that the court make a new contract for the Parties or would contravene the intention of the Parties to such Clearing House Documentation (i.e. the relevant court establishes that the Parties would not have entered into the Clearing House Documentation without the illegal provision being agreed between them which may be found to be the case by the court under circumstances where the invalid, illegal or unenforceable provision is a material provision).

4.1.5 Claims may become time-barred under the BGB or may be or become subject to the defence of set-off or to counterclaim. For example, any prohibition of set-off may not be up-held to the extent that the relevant obligor's counterclaim has been upheld in a final judgement or is undisputed.

4.1.6 Any provision in the Clearing House Documentation providing that certain certifications or determinations will be conclusive, binding and authoritative will not necessarily prevent judicial enquiry into the merits of any claim by any aggrieved party.

4.1.7 Any provision in the Clearing House Documentation stating that a notice or other expression of an intention or instruction is irrevocable may be open to challenge in circumstances where there have been material changes in the underlying situation.

4.1.8 Where any person is vested with a discretion or may determine a matter in its opinion, German law may require that such discretion is exercised reasonably or that such opinion is based on reasonable grounds.

4.1.9 Generally, a claim cannot be validly assigned under German law if the creditor and the debtor of the claim have contractually restricted the assignment of the claim. Any assignment of a claim contrary to a contractually agreed restriction on assignment will be invalid. However, under an exception contained in section 354a HGB, the assignment of monetary claims (i.e. claims for the payment of money) governed by German law cannot effectively be contractually excluded if the underlying agreement constitutes a commercial transaction (*Handelsgeschäft*) for both contracting parties or if the debtor is a public law entity (*juristische Person des öffentlichen Rechts*) or public law fund (*öffentlich rechtliches Sondervermögen*). Such monetary claims can be validly assigned notwithstanding a contractual restriction on assignment in the

underlying contract.[134] The debtor of the claim may discharge his or her obligation by paying the assignor unless the assignment was notified to him.

4.1.10 Under Article 20 Rome I, the application of the law of any country specified by Rome I generally means the application of the rules of law in force in that country other than its rules of private international law (exclusion of *renvoi*). By way of contrast, where the Introductory Code applies, Article 4 para 1 sentence 1 EGBGB provides that any references of German law to the laws of another country include the conflict of laws provisions of the other country. If these conflict of laws provisions re-refer to German law, German courts will accept the re-referral and apply German substantive law (Article 4 para 1 sentence 2 EGBGB). It is unclear whether Article 4 para 1 EGBGB also applies in respect of the conflict of laws provisions of the InsO[135] or the DepotG.

4.1.11 If a party is substantially over-collateralised, a security interest governed by German law can be void in case of an initial over-collateralisation for being contrary to public policy (section 138 para 1 BGB).[136] If a subsequent over-collateralisation occurs, the secured party is required to release part of the security it has provided. Whether or not a party is substantially over-collateralised generally depends on the relation of the value of the secured obligation towards the realisable value of the collateral.[137]

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[134] Section 354a HGB not only applies to prohibitions of an assignment but also to clauses which have a similar effect, such as contractual provisions requiring the debtor's consent for any assignment to be validly made (BGH, NJW-RR 2005, 624, 626; BGH, NJW 2009, 438, 439 *et seq.*).

[135] See the overview given by *Reinhardt*, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. 2008, Vorbemerkungen §§ 335 ff. InsO no. 38, who advocates the application of Article 4 para 1 EGBGB.

[136] BGH NJW 1998, 2047. The BGH has not yet given any guidance as to when initial over-collateralisation would be considered as "substantial" and therefore void under section 138 para 1 BGB.

[137] The BGH (NJW 1998, 671, 674) provided the following guidance in respect of subsequent over-collateralisation: the claim for release of security is triggered once the realisable value of the collateral not only temporarily exceeds the value of the secured obligation by 10 per cent. The BGH further stated that even if an agreement whereby a security transfer is effected does not provide for provisions on the release of the collateral, the debtor has an inherent claim for release if a (subsequent) over-collateralisation has occurred. Therefore, such security interest should not be void due to a substantial over-collateralisation (however, this does not apply in case of an initial over-collateralisation); the secured party would only be obliged to return the excess collateral. The same applies to the release of a pledge. We are not aware of any judgment according to which this also applies in case collateral is provided by way of a outright title transfer. In case of a pledge under German law, an over-collateralisation should not occur because due to

However, if a security interest is governed by non-German law, German courts would only in exceptional cases not recognise the security interest by reason of over-collateralisation. Even if the granting of collateral results in a substantial over-collateralisation of the secured party by German standards, this does not necessarily lead a German court to conclude that the security interest is in breach of German public policy and that such security interest can therefore not be recognised under Article 21 Rome I or Article 6 EGBGB, as the case may be (i.e. the standards for assessing any infringement of German public policy are not the same under section 138 para 1 BGB as under Article 21 Rome I or Article 6 EGBGB[138]). We are not aware of any court precedents supporting the application of the *ordre public* in such case.

4.1.12 On the basis of section 2 lit (b) of Article VIII of the International Monetary Fund Agreement, as applicable in Germany and applied by German courts, an obligation which is contrary to the exchange control regulations of another member state of the International Monetary Fund may not be enforceable in Germany.

4.1.13 Any transfer of rights or payment in respect, or other performance, of an obligation under the Clearing Agreement involving the government of any country which is currently the subject of United Nations or European Union sanctions, any person or body resident in, incorporated in or constituted under the laws of any such country or exercising public functions in any such country or any person or body controlled by any foregoing or by any person acting on behalf of any of the foregoing may be subject to restrictions pursuant to such sanctions as implemented in German law.

4.1.14 We do not opine on regulatory consequences the enforcement of a security interest may have (e.g. notification requirements under German large shareholding provisions where enforcement results in the acquisition of voting rights in German issuers).

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the accessory nature of a pledge, the pledge only exists in the amount of the secured obligation (including any future obligation). However, in case pledge assets have been transferred to the pledgee or a third party (for example, a depository), the pledgor may request the return of such assets which are not subject to the pledge anymore.

[138] *Sonnenberger*, in: Münchener Kommentar BGB, 5th ed. (2010), Article 6 EGBGB no. 62; *Mülbert/Bruinier*, in: WM 2005, 105, 100. The BGH has not yet given any guidance as to when initial over-collateralisation would be considered as "substantial" and therefore void under section 138 para 1 BGB.

4.1.15 In respect of cross-border cash payments the notification requirements under the German Foreign Trade Act (*Außenwirtschaftsgesetz*) and the German Foreign Trade Regulation (*Außenwirtschaftsverordnung*) need to be observed. The reports have to be submitted to the *Deutsche Bundesbank* using the applicable notification forms. A failure to do so would, however, by no means endanger the validity of the respective transaction.

4.1.16 We express no opinion as to whether any Party has complied with any applicable provisions of Title II of EMIR, any delegated or implementing acts adopted under EMIR, the provisions of the KWG, the German Securities Trading Act (*Wertpapierhandelsgesetz*) or the BörsG which were amended or enacted to implement EMIR, or any regulations adopted thereunder in respect of anything done by such Party in relation to or in connection with any of the Clearing Conditions other than provisions on which we expressly opine.

4.2 Challenge in insolvency

Any legal acts performed in accordance with the Clearing Conditions may be subject to challenge in insolvency under German law.

4.2.1 German challenge in insolvency in general

(a) In accordance with section 129 para 1 InsO any legal act (*Rechtshandlung*) which is detrimental to the creditors of the insolvent debtor and was made during hardening periods (*Anfechtungsfristen*) prior to the opening of Insolvency Proceedings may be subject to challenge by an Insolvency Representative under sections 130 to 146 InsO. The term "legal act" refers to acts within the scope of contractual agreements, in particular the execution of a declaration of intention, such as a declaration to terminate, but also to other acts having a legal effect, as well as to factual acts in the context of *in rem* transfers and assignments.

(b) Challenge periods are ascertained separately in respect of each legal act. For example, if margin is delivered, substituted or returned under the Clearing Documentation the delivery, substitution or return may qualify as new legal acts. The entry into the Clearing Agreement, and the termination of the Clearing Agreement also each qualify as separate legal acts. In case of a legal act that is subject to a condition precedent, which is for example the case if an agreement automatically terminates when certain circumstances occur, the satisfaction of such

condition precedent is not regarded as a legal act (section 140 para 3 InsO). This means that in such case the (earlier) agreement on the condition precedent rather than the (later) occurrence of the event which triggers the condition precedent is the relevant legal act for purposes of challenge in insolvency. However, our understanding of relevant court precedents and statements in legal literature is that the formal opening of Insolvency Proceedings may not be agreed as a condition precedent for purposes of section 140 para 3 InsO.[139] The filing of an application for the opening of Insolvency Proceedings, on the other hand, should in our view be an event which can be agreed on as a condition precedent.

(c) Whether or not a specific legal act is voidable by way of a challenge in insolvency therefore depends on the individual circumstances of the respective transaction.

(d) If BaFin has, prior to a Party's insolvency, issued pre-insolvency measures under section 46 para 1 KWG such as a Moratorium to prevent the Party from becoming illiquid (see paragraph 3.1.2(a)) and Insolvency Proceedings are subsequently opened, hardening periods begin to run (counting backwards) on the day on which such an order has been issued (section 46c para 1 KWG) rather than on the later day of the filing for insolvency proceedings which is usually relevant (as stated in more detail below, paragraph 4.1.15). Furthermore, where legal acts have been made between the release of pre-insolvency measures by BaFin in accordance with section 46 para 1 sentence 2 nos. 4 to 6 KWG and an application for the opening of Insolvency Proceedings, such legal acts are presumed not to have been detrimental to creditors as a whole (section 46c para 2 sentence 1 KWG).

4.2.2 Challenge provisions relevant to legal acts made in connection with the Clearing House's clearing services

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[139] The condition precedent must not refer to an "insolvency event" (*Insolvenzfall*) which we understand is the case if it refers the formal opening of Insolvency Proceedings; see *Huhn/Bayer*, ZIP 2003, p. 1965 *et seq.*; *Kirchhof*, in: Münchener Kommentar zur Insolvenzordnung, 3rd ed. (2013), § 140 no. 52c; German Federal Employment Court (*Bundesarbeitsgericht*, "**BAG**") NZI 2007, 58 *et seq.* (while the BAG does not define the insolvency event, we understand from its reasoning that it refers to the opening of Insolvency Proceedings), p. 61; however, see also *v. Wilmowsky*, ZIP 2007, 553, 562; *Rogge*, in: Hamburger Kommentar InsO, 3rd ed (2009), § 140 no. 34. See further paragraph 3.6.1(b).

Legal acts made in connection with the Clearing House Documentation may, in particular, be subject to challenge in insolvency under the following circumstances:

(a) Under section 130 para 1 sentence 1 InsO, a legal act may be subject to challenge in insolvency, if it gives or makes available to a creditor security or satisfaction and (i) it was effected during the last three months prior to the filing for the opening of Insolvency Proceedings, if the Insolvent Party was unable to pay its debts when due at the time of the legal act and if the creditor had knowledge of such inability to make payments at such time; or (ii) it was effected after the filing for the opening of Insolvency Proceedings and the creditor had knowledge of the Insolvent Party's inability to make payments or the petition for opening of Insolvency Proceedings at the time of the legal act ("congruent coverage" (*kongruente Deckung*)).

(b) Knowledge of circumstances which necessarily lead to the conclusion that the Clearing House was unable to make payments will be regarded as equivalent to actual knowledge of the Insolvent Party's inability to make payments or of the filing for opening of Insolvency Proceedings (section 130 para 2 InsO).

(c) Where a legal act gives or makes possible to a creditor, security or satisfaction to which it has no right or no right to claim in such manner or at such time, the legal act will be subject to challenge in insolvency, (i) if the legal act is effected during the last month prior to filing for the opening of Insolvency Proceedings or following such filing; or, (ii) if the legal act is effected during the second or third month prior to filing for the opening of insolvency proceedings and the Insolvent Party was unable to make payments at the time of the legal act; or, (iii) if the legal act is effected during the second or third month prior to filing for the opening of Insolvency Proceedings and the creditor has knowledge at the time of the legal act that it is detrimental to the Insolvent Party. In relation to (iii), knowledge of circumstances that necessarily lead to the conclusion that a legal act is detrimental to the Insolvent Party is equivalent to actual knowledge of such detriment (section 131 2 InsO ("incongruent coverage" (*inkongruente Deckung*))).

(d) A legal transaction (*Rechtsgeschäft*) by the Insolvent Party that is directly detrimental to the creditors is subject to challenge in

insolvency, (i) if it was effected in the last three months prior to the filing for the opening of Insolvency Proceedings, if the Insolvent Party was unable to pay its debts when due at the time of the legal transaction and if the other party had knowledge of such inability to make payments at such time; or, (ii) where it was effected after filing for the opening of Insolvency Proceedings and the other party had knowledge of the inability of the Insolvent Party to make payments or of the petition for opening of Insolvency Proceedings at the time of the legal transaction (section 132 para 1 InsO).

(e) A legal act which involves the Insolvent Party losing a right, or pursuant to which the Insolvent Party is no longer able to assert such a right, or which results in a property claim against the Insolvent Party being maintained or becoming enforceable is equivalent to a legal act that is directly detrimental to the creditors (section 132 para 2 InsO).

(f) A legal act made by the Insolvent Party during the last ten years prior to the filing for the opening of Insolvency Proceedings, or subsequent to such request, with the intention to disadvantage his creditors may be subject to challenge in insolvency, if the other party is aware of the debtor's intention on the date of such legal act (section 133 para 1 sentence 1 InsO). Such awareness will be presumed if the Solvent Party knew of the imminent inability of the Insolvent Party to make payment when due, and that the transaction constituted a disadvantage for the creditors (section 133 para 1 sentence 2 InsO).

(g) Under section 133 para 2 of InsO, a contract for a consideration entered into by the Insolvent Party and a person with whom the Insolvent Party has a close relationship which is directly detrimental to the creditors will be subject to challenge in insolvency action unless it was entered into more than two years prior to the filing for the opening of insolvency proceedings or the other party was unaware of an intention of the Insolvent Party to prejudice the creditors. In respect of person with whom the insolvency debtor has a close relationship, the requisite knowledge or awareness of the relevant circumstance under the different challenge provisions will be presumed (sections 130 para 3, 131 para 2 sentence 2 and 132 para 2 InsO).

(h) Under section 147 sentence 1 InsO legal acts performed after the opening of the Insolvency Proceedings but being legally effective in

accordance with section 81 para 3 sentence 2 InsO (above, paragraph 3.1.1) may be subject to challenge in insolvency. The provisions governing the challenge in respect of legal acts performed before the Insolvency Proceedings were opened (as set out in this paragraph 3.7) apply under section 147 sentence 1 InsO as if the relevant legal acts had been made before Insolvency Proceedings were opened. The application of section 147 sentence 1 InsO shall, however, in respect of legal acts relating to claims and performances which fall within the scope of section 96 para 2 InsO (above, paragraph 3.7.2(f)) not reverse the set-off of account balances or affect the validity of the payment orders, orders of payment services providers or intermediate providers or orders for the transfer of securities (section 147 sentence 2 InsO).

(i) Defence to challenge in insolvency

Section 130 para 1 sentence 1 InsO is not applicable where the relevant legal act is based on a security agreement which contains the obligation to provide Financial Collateral, to replace Financial Collateral by other Financial Collateral or to provide additional Financial Collateral in order to readjust the relation between the value of the obligation and the value of the collateral as set forth in the security agreement (*Margensicherheit*; margin collateral (section 130 para 1 sentence 2 InsO). Any security interest or full title transfer qualifying as Financial Collateral and made to secure obligations under the Clearing Conditions would therefore not be subject to challenge in insolvency pursuant to section 130 para 1 sentence 1 InsO to the extent any legal assets serve the provision or replacement of (additional) Financial Collateral in order to readjust the relation between the value of the obligation and the value of the collateral as set forth in the security agreement. We understand that initial margin is calculated under the Clearing Conditions to cover the Clearing House's potential future exposures to Members in the interval between the last margin requirement and the close-out of Trades and liquidation of collateral following a Member's default. Variation margin may therefore qualify

as margin collateral whereas initial margin should not qualify as such.[140]

Section 142 InsO provides that payments on the part of a Insolvent Party in return for which the Insolvent Party's estate benefited directly from an equivalent consideration (i.e. there was an exchange of services or goods of the same value within a narrow time frame[141]) would only be subject to challenge in insolvency, if the payment was made with the intention to prejudice the creditors as set out under section 133 para 1 InsO (above, paragraph 4.1.11 (f)).

As mentioned before (paragraph 3.4.2(i), under Article 102b section 2 EGInsO all necessary measures which are permissible in accordance with Article 102b section 1 para 1 EGInsO are not subject to challenge in insolvency.

4.3 General Business Conditions

4.3.1 The provisions of the Clearing Conditions qualify as general business conditions within the meaning of section 305 BGB. General business conditions are standardised contract terms which are pre-formulated for use under a number of agreements and are imposed by one party on its counterparty without negotiation (section 305 para 1 BGB).

4.3.2 Contractual provisions which qualify as general business conditions are subject to the specific rules laid down in sections 305 to 310 BGB. We specifically would like to draw your attention to the following:

(a) The protection provided by these provisions for the benefit of the counterparty of the user of standard forms ("**Counterparty**") applies not only if the Counterparty qualifies as a consumer, but also if such counterparty qualifies as an entrepreneur (*Unternehmer*); [142] however,

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[140] Section 130 para 1 sentence 1 InsO refers to the adjustment of the relation between the value of the secured obligations and the value of the collateral. While initial margin may be adjusted as well this is not normally due to a change in the values of secured obligations and security provided but rather constitutes a measure based on the generally perceived volatility in the market; see *Kirchhof*, in: Münchener Kommentar InsO, 3rd ed (2013), § 130 nos 5d and 5e; *de Bra*, in: Braun, InsO, 5th ed. (2012), § 130 no 41.

[141] BGH NJW 2002, 1722, 1724.

[142] For purposes of the BGB, "entrepreneur" means any natural or legal person who enters into an agreement in pursuit of its economic or independent professional activity (section 14 para 1 BGB).

the standard of protection for entrepreneurs is not as high as the standard of protection provided to consumers.

(b) If the Counterparty qualifies as an entrepreneur, then provisions contained in general business conditions may be set aside by a court as invalid without a possibility to reduce its content to a valid provision pursuant to sections 305b to 307 BGB, if they are (a) surprising to the Counterparty (section 305c BGB), (b) conflicting with a provision specifically negotiated with the Counterparty (section 305b BGB), (c) intended to circumvent any of the provisions on general business conditions under sections 305 to 310 BGB (section 306a BGB) or (d) contrary to good faith, inappropriately disadvantageous to the detriment of the Counterparty; in this respect section 310 BGB provides for an assumption that a clause in general business conditions is (in particular without limitation) inappropriately disadvantageous to the detriment of the Counterparty if such provision contravenes the fundamental principles of a statutory provision from which it derogates or constrains fundamental rights and obligations which arise out of the specific nature of the respective contract in such a way that the achievement of the purpose of such contract is at danger) (section 307 BGB);

(c) However, although the main provisions on general business conditions in section 308 and 309 BGB do not apply directly with respect to entrepreneurs, most infringements of the provisions contained therein count as an infringement of section 307 BGB. Please note that German courts will subject contractual provisions to a higher level of scrutiny under the standard of good faith set out in section 307 BGB than under the standard of good faith referred to in Paragraph 4.1 above. For example, the German courts take the view that that any clause in general business conditions which purports to exclude the right of the user's (the Clearing House's) counterparty (the Member) to set-off claims which are undisputed (*unbestritten*) or have been confirmed in a judgment which is final (*rechtskräftig festgestellt*) is ineffective as between entrepreneurs on the basis of section 307 BGB.[143] This would follow directly from section 309 no. 3 BGB where an entrepreneur uses general business conditions *vis-à-vis* a consumer.

[143] BGH NJW 2007, 3421, 3422.

(d) If a provision contained in general business conditions is unclear, then such lack of clarity will be detrimental to the user of the standard business general business conditions and to the Counterparty (section 305 para 2 BGB);

(e) General business conditions may be subject to challenge by individual Counterparties or by way of class actions before the German courts;

(f) Any provision in the Clearing Conditions stating that a representation or communication shall be deemed to have been made or delivered or which reverses the burden of proof may be void, if it is contained in general business conditions (section 308 nos. 5, 6 BGB); and

(g) where general business conditions are non-transparent, German courts will set aside provisions which favour the party using such general business conditions.

There are no other material issues relevant to the issues addressed in this opinion which we wish to draw to your attention.

This opinion is given for the sole benefit of the Futures and Options Association (the "**FOA**"). This opinion may not, without our prior written consent, be relied upon for any other purpose or be disclosed to or relied upon by any other person save that it may be disclosed without such consent to:

(a) such of the FOA's members (excluding associate members) as subscribe to the FOA's opinions library and whose terms of subscription give them access to this opinion (each a "subscribing member") and the officers, employees, and professional advisors of such subscribing member;

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(c) any competent authority supervising a subscribing member or an affiliate of such subscribing member in connection with their compliance with their obligations under prudential regulation; and

(d) the officers, employees and professional advisors of the FOA,

on the basis that (i) such disclosure is made solely to enable any such person to be informed that an opinion has been given and to be made aware of its terms but not for the purposes of

reliance, and (ii) we do not assume any duty or liability to any person to whom such disclosure is made.

We accept responsibility to the FOA in relation to the matters opined on in this opinion. However, the provision of this opinion is not to be taken as implying that we assume any other duty or liability to the FOA's members or their affiliates. The provision of this opinion does not create or give rise to any client relationship between this firm and the FOA's members or their affiliates.

Yours faithfully

Dr. Marc Benzler

CLIFFORD CHANCE PARTNERSCHAFTSGESELLSCHAFT