CLIFFORD
CHANCE

CLIFFORD CHANCE
DEUTSCHLAND LLP
PO BOX 11 14 42
60049 FRANKFURT AM MAIN
MAINZER LANDSTRASSE 46
60325 FRANKFURT AM MAIN
TEL +49 69 71 99-01
FAX +49 69 71 99-4000
www.cliffordchance.com

Our ref: 70-40556546
Direct Dial: +49 697199 3304
E-mail: marc.benzler@cliffordchance.com

LCH.Clearnet Limited
Aldgate House
33 Aldgate High Street
London EC3N IEA

12 June 2014

Dear Sirs

Responses to Instructions to Counsel – Membership, Insolvency, Security, Set-off & Netting and Client Clearing

You have asked us to provide this opinion in respect of the laws of Germany ("**this jurisdiction**") in response to certain specific questions raised by LCH.Clearnet Limited ("**LCH**") in relation to membership, insolvency, security, set-off and netting and client clearing with respect to entities incorporated in Germany (the "**Relevant Jurisdiction**") becoming clearing members of LCH (each a "**Relevant Clearing Member**") and entering into the Clearing Membership Agreement, the Deed of Charge and LCH's Rulebook (all as defined in paragraph 1.3 below) which becomes a contractual arrangement between each clearing member and LCH through entry into the Clearing Membership Agreement.

The relevant questions are set out in full in paragraph 3 of this opinion together with the corresponding responses.

1. INTRODUCTION, TERMS OF REFERENCE

1.1 Formal statement

This opinion letter (the "**Opinion Letter**") is a formal statement of opinion as to German law on the matters set out in paragraph 3 (Opinion) below. It is based on our understanding of LCH's clearing services as they are described in the Service Description and the Opinion Documents listed in paragraph 1.3 below, and is subject to assumptions set out in paragraph 2 (Assumptions) and to the additional qualifications set out in paragraph 4 (Qualifications). The opinions given in this Opinion Letter are strictly limited to the specific questions raised by you as set out in

Opinion Letter are strictly limited to the specific questions raised by you as set out in paragraph 3 (Opinion) hereafter and do not extend to any other matters. We have assumed that all matters which are or could be material in the context of our delivery of this Opinion Letter have been disclosed to us.

1.2 No advice

We have not been responsible for advising any party to the Opinion Documents. We have been instructed to issue this Opinion Letter and the delivery of this Opinion Letter to any other person to whom a copy of this Opinion Letter may be communicated does not evidence the existence of any relationship of client and lawyer between us and such person.

1.3 Documents reviewed

For the purposes of preparing our opinion we have reviewed electronic versions of the following documents:

1.3.1 the General Regulations, Procedures, Default Rules, Settlement Finality Regulations and the Product Specific Contract Terms and Eligibility Criteria Manual published on LCH's website as at the date of this opinion ("**Rulebook**"),

1.3.2 the Clearing Membership Agreement (as defined in the Rulebook) which is substantially in the form appended as Appendix 1 of this opinion letter ("**Clearing Membership Agreement**"), and

1.3.3 a deed of charge entered into between a Clearing Member and LCH in respect of all Charged Property transferred to LCH by that Clearing Member which is substantially in the form of the Deed of Charge set out in Appendix 2 and which contains no material modifications to the wording set out in Clause 2 of that annexed form (for the avoidance of doubt, a change to the numbering of the clause or other provision in which the relevant wording appears in a particular deed of charge would not (in either such case) of itself constitute a "material modification" for these purposes) (the "**Deed of Charge**" and together with the Clearing Membership Agreement, the "**Agreements**").

The documents referred to in paragraphs 1.3.1 to 1.3.3 are referred to as the "**Opinion Documents**". We have reviewed the Opinion Documents in connection with the instructions to counsel dated 21 October 2013 (the "**Instructions**") and the Service Description (as set out and defined in the Instructions).

1.4 Defined terms

Unless otherwise defined herein, terms defined under the Opinion Documents shall have the meaning ascribed to such terms in the Opinion Documents.

1.5 Scope of examination and investigation

1.5.1 The opinions given in paragraph 3 are in respect of the Opinion Documents as at the date of this Opinion Letter. We express no opinion as any provisions of the Opinion Documents other than those on which we expressly opine.

1.5.2 We do not express any opinion as to any matters of fact including, for the avoidance of doubt, factual matters of law (*Rechtstatsachen*), except to the extent that we expressly opine on such matters.

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

1.5.4 We do not opine on the suitability or appropriateness of the Opinion Documents or any Contract for the purposes intended by the parties or related issues including any advisory obligations and related duties of care.

1.5.5 We do not opine on tax and accounting matters.

1.6 Our opinion is given solely in respect of Relevant Clearing Members, i.e. Clearing Members which are

1.6.1 Unregulated Companies,

1.6.2 Companies licensed as Credit Institutions, and

1.6.3 Companies licensed as Financial Services Institutions,

each incorporated in, and acting through their offices in, Germany.

1.7 For purposes of this Opinion Letter,[1]

1.7.1 "**Company**" means a stock corporation (*Aktiengesellschaft*, "**AG**") established under the German Stock Corporation Act (*Aktiengesetz*, "**AktG**"), 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**");[2]

1.7.2 "**Credit Institution**" means a Company in the form of an AG or GmbH or established under public law as separate legal entity (*juristische Person des öffentlichen Rechts*), in the form of a corporation (*Körperschaft des öffentlichen Rechts*) or an agency (*Anstalt des öffentlichen Rechts*), licensed as a credit institution (*Kreditinstitut*) within the meaning of section 1 para 1 KWG;[3] and

1.7.3 "**Financial Services Institution**" means a Company in the form of an AG or GmbH or established under public law licensed as a financial services institution (*Finanzdienstleistungsinstitut*) within the meaning of section 1 para 1a KWG (Credit Institutions and Financial Services Institutions collectively referred to as "**Institutions**").

1.8 Enforceability

In this Opinion Letter, 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 and without risk of successful challenge. We do not opine on the

---

[1] We do not give an opinion on general regulatory restrictions, including investment guidelines, under regulatory laws or regulations regarding entities subject to further regulatory restrictions other than those generally applicable to all Credit Institutions or Financial Services Institutions under the German Banking Act (*Kreditwesengesetz*; "**KWG**").

[2] We do not give an opinion on German corporate law where, in specific cases, statutory restrictions on set-off apply (section 66 AktG and section 19 GmbHG) which restrict the right of a shareholder to set-off against its obligation to provide equity contributions. Pursuant to sections 392 *et seq.* of the German Civil Code (*Bürgerliches Gesetzbuch*, "**BGB**"), set-off is generally subject to restrictions in specific circumstances, i.e. in case of confiscated claims, claims which arise due to an intentionally committed tort and claims which are not subject to attachment.

[3] We do not express any opinion on 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*).

availability of any judicial remedy or on the factual or commercial success of any enforcement measures.

1.9 Language

The opinions given in this Opinion Letter 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, foreign law would be applicable. This Opinion Letter expresses and describes German legal concepts in the English language rather than in their original form and such expressions and/or descriptions may not be fully reflective in their meaning of the underlying German law concepts. Any issues of interpretation arising in respect of this Opinion Letter will be determined by the German courts in accordance with German law and we express no opinion on the interpretation that the German courts may give to any such expressions or descriptions. Please note in the general context of the aforesaid that German courts have held that, under German law, documents which are governed by German law may, if they have been executed in the English language, be interpreted with a view to the meaning of such English terms in an English law environment.

1.10 No updating

We assume no duty to update this Opinion Letter or inform LCH or any other person to whom a copy of this Opinion Letter may be communicated of any change in German law (including, in particular, applicable court decisions), or the legal status of any party to the Opinion Documents, or any other circumstance that occurs, or is disclosed to us, after the date on which this Opinion Letter is given, which might have an impact on the opinions given in this Opinion Letter.

1.11 Date

This Opinion Letter is given as of 12 June 2014.

1.12 Reliance

This opinion letter is given for the exclusive benefit of the addressee. In this opinion we do not assume any obligation to notify or inform you of any developments subsequent to its date that might render its content untrue or inaccurate in whole or in part at such time. It may not, without prior written consent, be relied on by any other person. We consent to a copy of this opinion letter being made publically available on the addressee's website and being shown to: (i) actual and prospective clearing members and clearing clients; (ii) relevant regulators; and/or (iii) legal counsel appointed by the addressee or any person listed in (i) above to advise on matters of the

laws of other jurisdictions, in each case for information purposes only and solely on the basis that we assume no responsibility to any such parties as a result or otherwise.

2. ASSUMPTIONS

We assume the following:

2.1 LCH is validly authorised under English law as a central counterparty within the meaning of Article 2 point 1 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**")[4] ("**CCP**").

2.2 The Opinion Documents and Contracts have been validly agreed between all parties and incorporated and form part of the legal relationship between LCH and its Clearing Members.

2.3 The Opinion Documents (including all Contracts entered into thereunder) are governed by English law.

2.4 That under the laws of England (including its insolvency laws) and under all other relevant laws (other than the laws of Germany) the Opinion Documents constitute and will at all times constitute valid and legally binding obligations of the Parties thereto, enforceable in accordance with their terms and (under all relevant laws other than the laws of Germany) the choice of the laws of England as the governing law of each Opinion Document is a valid and binding selection.

2.5 Each party has the capacity, power and authority under all applicable law(s) to enter into the Opinion Documents and Contracts, to perform its obligations under the Opinion Documents and Contracts, and that each party has taken all necessary steps to execute and deliver and perform the Opinion Documents and Contracts.

2.6 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 Opinion Documents and Contracts and to ensure the legality, validity, enforceability or admissibility in evidence of the Opinion Documents in Germany.

2.7 None of the parties is subject to any regulatory, provisional insolvency, reorganisation, insolvency or winding-up proceedings under the laws of any jurisdiction.

---

[4] Official Journal ("**OJ**") of the European Union No L 201 of 27 July 2012, p. 37.

2.8 The Opinion Documents are entered into prior to the formal commencement of any insolvency, bankruptcy, reorganisation or similar proceedings or any provisional insolvency or regulatory measures by competent authorities of any relevant jurisdiction.

2.9 The Opinion Documents have been entered into, and each of the Contracts referred to therein is carried out, by each of the parties thereto in good faith, for the benefit of each of them respectively, on arm's length commercial terms and for the purpose of carrying on, any by way of, their respective business and that none of the parties has entered into or will enter into the same if entering into the same would prejudice any of its creditors.

2.10 The Opinion Documents accurately reflect the intentions of the parties thereto.

2.11 None of the parties is entitled to claim in relation to itself or its assets immunity from suit, attachment, execution or other legal process. To the extent any entity established under German public law enters into the Opinion Documents or Contracts, the execution of such agreement constitutes, and the exercise of that party's rights and performance of its obligations thereunder will constitute, private and commercial acts done and performed for private and commercial purposes.

2.12 None of the parties is or would (as a consequence of entering into any Contract under the Opinion Documents or performing any obligation or allowing or doing any act or thing which the Opinion Documents contemplates, permits or requires such party to do) be in a situation of illiquidity, impending illiquidity or over-indebtedness (see paragraph 3.2.3(b) below) or in any analogous situation justifying an application for the opening of insolvency, bankruptcy or other proceedings under the laws of any jurisdiction.

2.13 That any cash provided as collateral is in a currency that is freely transferable internationally under the laws of all relevant jurisdictions.

2.14 To the extent any transfers of cash or securities or the creation of security interests over, cash or securities, are subject to mandatory property laws (*Sachenrecht*), such property laws are complied with.

2.15 The pledges granted and the outright title transfers made by Clearing Members under the Opinion Documents to LCH are made over accounts held in England and/or assets booked on accounts held in England, are valid, and the requirements of the relevant applicable law governing the creation, transfer and/or enforcement of these pledges

and title transfers are complied with, under all applicable laws (other than this jurisdiction).

2.16 That none of the parties qualifies as a consumer (*Verbraucher*) within the meaning of section 13 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.

2.17 There is no other agreement, instrument, arrangement or dealing between any of the parties to the Opinion Documents and Contracts which modifies, supersedes or affects the Opinion Documents and Contracts.

2.18 The obligations assumed under the Opinion Documents and Contracts are mutual between the parties, in the sense that the parties are each individually and solely liable as regards obligations owing by each other and are solely entitled to the benefit of obligations owed to each other, respectively. "**Mutuality**" (*Gegenseitigkeit*) generally exists where each party is individually 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.

3. OPINION

On the basis of the foregoing terms of reference and assumptions and subject to the qualifications set out under paragraph 4 below we are of the following opinions in response to specific questions which are set out in italics:

3.1 Membership

3.1.1 *Are there any statutory limitations on the capacity of, or specific regulatory requirements associated with, any Relevant Clearing Member entering into the LCH Agreements (including for the purpose of granting of security under the Deed of Charge)?*

As to the relevance of any limitations imposed by the constitutional documents of a Relevant Clearing Member, see paragraph 3.1.3 below.

There are no specific statutory limitations or regulatory requirements which would limit the capacity of an appropriately authorised Relevant Clearing Member to enter into the Agreements.

The activities of the Relevant Clearing Member may, however, be subject to licence requirements under section 32 para 1 KWG. To the extent a Relevant Clearing Member purchases or sells financial instruments (such as OTC derivatives) in its own name for the account of Clients, it may conduct principal broking services (*Finanzkommissionsgeschäft*) (section 1 para 1 sentence 2 no 4 KWG). Furthermore, to the extent it either keeps securities in safe custody or administers securities for Clients, its activities constitute licensable safe custody business (*Depotgeschäft*) (section 1 para 1 sentence 2 no 5 KWG), which is subject to a licence requirement. Since the Opinion Documents exclusively deal with clearing, performance by a Relevant Clearing Member of the obligations under the Opinion Documents alone and in itself does not trigger licence requirements in connection with investment brokering (*Anlagevermittlung*) under section 1 para 1a sentence 2 no 1 KWG or other financial services under the KWG.[5] For the avoidance of doubt, we do not express any opinion in respect of activities Relevant Clearing Members may perform in addition to strictly providing clearing services under the Opinion Documents.

In this context, please note that agreements violating statutory law are generally null and void under German law only if they are in breach of prohibition provisions which apply to both parties (mutual prohibitions, *beiderseitige Verbotsgesetze*).[6] The provisions of the KWG prohibiting the conduct of banking business for unregulated entities are generally not seen as such mutual prohibitions within the meaning of section 134 BGB. However, as a general principle, courts could find an agreement to be invalid if both of

---

[5] Licenseable financial services are, among others, investment advice (section 1 para 1a sentence 2 no 1a KWG, *Anlageberatung*), contract broking (section 1 para 1a sentence 2 no 2 KWG, *Abschlussvermittlung*), portfolio management (section 1 para 1a sentence 2 no 3 KWG, *Finanzportfolioverwaltung*) and own account trading (section 1 para 1a sentence 2 no 4 KWG, *Eigenhandel*).

[6] German Federal Court of Justice (*Bundesgerichtshof*, "**BGH**") NJW 2000, 1186, 1187; Higher Administrative Court (*Verwaltungsgerichtshof*, "**VGH**") Kassel WM 2009, 1889, 1893; *Körner*, ZHR 131, 127, 135; *K.P. Berger*, in: Münchener Kommentar BGB, 6th ed. (2012), § 488 no. 96; *Ellenberger*, in: Palandt, BGB, 73rd ed. (2014), § 134 no. 20). Except for section 3 para 1 no 1 KWG.

the parties knew about the licence requirements and acted together willingly breaching the law.[7]

Where one or both of the parties violate a licence requirement under the KWG by entering into an agreement, the respective agreements may either have to be terminated in accordance with their terms upon instruction of the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "**BaFin**") or may be unwound by administrative order of the BaFin if it takes action against an entity for breach of German licensing requirements.[8] An agreement must usually be unwound so that the parties are put into the position they were in when they initially entered into the agreement. If both of the parties acted together willingly breaching the law, the counterparty would likely not be able to claim damages from the entity which breached the licence requirements.

3.1.2 *Would LCH be deemed to be domiciled, resident or carrying on business in the Relevant Jurisdiction by virtue of providing clearing services to a Relevant Clearing Member? If so, would LCH be required to obtain a licence or be registered before providing clearing services to a Relevant Clearing Member or are there any special local arrangements for the recognition of overseas clearing houses in these circumstances?*

Section 32 para 1 KWG in connection with section 1 para 1 sentence 2 no. 12 and para 31 KWG implements Article 14 EMIR and provides that any person which intends to act as a CCP in Germany must obtain a licence from BaFin. Article 14 para 1 EMIR provides that where a legal person established in the European Union ("**EU**") intends to provide clearing services as a CCP, it must apply for authorisation to the competent authority of the member state of the EU ("**Member State**") where it is established. Article 14 para 2 EMIR provides that once authorisation has been granted in accordance with Article 17 EMIR, it will be effective for the entire territory of the EU. Any additional or further licences from other authorities where the CCP performs its activities are therefore not required. This is expressly confirmed in BaFin's note – information on the activity of a central counterparty (*Merkblatt - Hinweise*

---

[7] BGH MDR 1990, 416.

[8] The legal basis for such an administrative order would be section 37 KWG. See further VGH Kassel WM 2009 1889, 1893 and German Federal Administrative Court *(Bundesverwaltungsgericht,* "**BVerwG**") BKR 2011, 208, 211.

zum Tatbestand der Tätigkeit als zentrale Gegenpartei).[9] Based on our assumption that LCH will be validly authorised as a CCP in accordance with EMIR (by the competent UK authorities) it may therefore act as a CCP in Germany without obtaining a licence from BaFin.

3.1.3 *What type of documents should be obtained by LCH to evidence that a Relevant Clearing Member and its officers have the capacity and authority to enter into the LCH Agreements? Is LCH required to verify such evidence?*

An AG validly established under German private law has its own legal personality (section 1 para 1 AktG). The same applies to a GmbH (section 13 para 1 GmbHG). Each such Company generally has full capacity to enter into all types of contracts and agreements. The concept of *ultra vires*, under which the power and capacity of an entity to validly enter into an agreement is restricted to its area of competence which is defined by the relevant law or constitutional documents establishing such entity (i.e. the statutes (*Satzung*) of an AG or the articles of association (*Gesellschaftsvertrag*) of a GmbH) and by the statutory tasks and functions attributed to it) only applies to entities established under public law, not to Companies (subject to paragraph 3.1.3(c) below).[10]

With respect to a Relevant Clearing Member established under private law, LCH should obtain at least the following documents:

- a commercial register extract (*Handelsregisterauszug*) which has been obtained less than fifteen (15) calendar days before (and including) the date on which reliance is sought and,

- where power of attorney of a representative is not evidenced by such commercial register extract, a written power of attorney evidencing authority of the representative that allows the authority of a signatory to be tracked back to a person properly authorised and named in the commercial register. This can also be in the form of a signatory list.

---

[9] Published as of 19 September 2013 (http://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Merkblatt/mb_050401_grenzueberschreitend.html).

[10] Fleischer, NZG 2005, p. 529 *et seq.*, 529.

It is not necessary to review constitutional documents of a Relevant Clearing Member established under private law. Where a Relevant Clearing Member is established under public law, capacity needs to be checked individually. We also refer to our qualifications on the concept of *ultra vires* and other restrictions that may apply to public law entities in paragraph 4.13.

(a) Commercial register information evidencing corporate existence

In order to verify the corporate existence and capacity of a Relevant Clearing Member, LCH should obtain a commercial register extract of the Relevant Clearing Member.

As the commercial register is a public register, good faith of third parties in the correctness of the content of the commercial register is protected by section 15 of the German Commercial Code (*Handelsgesetzbuch*, "**HGB**"). Pursuant to section 15 para 2 HGB it is possible to rely (absent positive knowledge of contrary facts or negligent failure not to be aware of such contrary facts) for a period of fifteen (15) calendar days after inspection on the commercial register to be correct. Following the expiry of such time period, a commercial register extract no longer provides for a statutory protection against failure to know of any changes which have been entered into the commercial register. Upon request, the commercial register excerpt can be certified by the relevant local court which is, however, not a requirement for reliance and it should also be noted that some courts exclusively provide uncertified electronic commercial register extracts that, however, have a reduced evidential value.

(b) Power of representation and the function of the commercial register

The excerpt from the commercial register may also identify the persons entitled to duly represent the Company and the manner in which they are entitled to represent it (by acting alone or jointly with one or more other individuals).

(i) A Company is legally represented by those corporate bodies that have the statutory power to represent the relevant Company, i.e. the executive board (*Vorstand*) of an AG or the managing directors (*Geschäftsführer*) of a GmbH. In the absence of any other provisions in the constitutional documents, all members of the executive board of an AG or all managing

directors of a GmbH must act jointly (*Gesamtvertretungsmacht*, sections 35 para 2 sentence 1 GmbH, 77 para 1 sentence 1 AktG) to represent the Company. Usually, the constitutional documents would provide that (i) one member of the executive board or managing directors may represent the Company acting alone (*Einzelvertretungsmacht*), (ii) acting jointly with another member, or (iii) acting jointly with a holder of a *Prokura* (see below) to validly represent the Company. A limitation of scope of authority of the executive board or managing directors by internal restrictions is generally invalid vis-à-vis third parties (sections 82 para 1 AktG, 37 para 2 GmbHG).

(ii) Business transactions on behalf of the Company can also be concluded by persons who have been granted a power of attorney covering the relevant transaction(s). The HGB provides for specific types of powers of attorney related to transactions on behalf of a Company (commercial powers of attorney), the most important type being the *Prokura* which confers the authority to represent the Company in all kinds of transactions or legal acts in and out of court that are related to the operation of any commercial business. Thus, it is not limited to the scope of the particular business carried out by the Company. However, transactions that affect the operation of the business as such (*Grundlagengeschäfte*, e.g., sale or closure of the business, change of the business name, application for opening of insolvency proceedings, application for registration of the business with the commercial register) or transfer or encumbrance of real property are not covered by the *Prokura*. The *Prokura* can be conferred either in such way that the *Prokurist* represents the Company acting alone (*Einzelprokura*), or in such way that the *Prokurist* represents the Company acting jointly with a statutory representative or a further *Prokurist* (*Gesamtprokura*). The *Prokura* can also be limited to the business of one of several branches of a business, provided that the branches operate under different business names. Any other limitation of the scope of authority covered by the *Prokura* is invalid vis-à-vis third parties.

As the statutory representative (i.e. members of the executive board of an AG, managing directors of a GmbH) and the

Prokuristen are identified in the commercial register, LCH may also rely on the authority of the persons named in the commercial register to be members of the board or having *Prokura* if the contract is entered by two authorised persons provided, however, that the counterparty acts in the context of commercial operations under private law (*Geschäftsverkehr*).[11] Where, however, one of the cases described in paragraph 3.1.3(c) below applies, a contract would not be validly concluded.

(iii) Where the person representing the Company is not named in the commercial register, such person can give evidence of its authorisation by providing the relevant document under which a power of attorney is granted.

Pursuant to section 172 BGB a document under which a power of attorney is granted to a representative by the Company generally evidences its right to represent the Company. The authority remains effective until the power of attorney is either returned to the Company or declared invalid by the Company. The Company may declare the power of attorney invalid by public notice. Public notices are given to and published by the local court (section 186 para 2 of the German Code of Civil Procedure (*Zivilprozessordnung*, "**ZPO**")).

As a result, a counterparty of a Company may rely on its capacity and the authorisation of the representatives if it has verified the existence of that Company and the authority of its representatives on the basis of a current commercial register excerpt and power of attorney (where applicable), where German law is relevant (see paragraph 3.1.3(e)). A breach of internal restrictions would not lead to the invalidity of the contract concluded in breach of such restrictions if the representative is duly authorised to act vis-à-vis third parties. Where, however, one of the cases described in paragraph 3.1.3(c) below applies, a contract would not be validly concluded.

---

[11] BFH NJW 1978, 1944.

(c) Exceptions

However, there are certain instances under German law in which an agreement cannot be validly concluded by a Relevant Clearing Member even if the representative of a Company is, in principle, authorised.

(i) If the breach of internal restrictions on the authorisation or power of the representative was unquestionably obvious (*offensichtlich*) for the counterparty, then an agreement is rendered invalid. Under the concept of misuse of authority (*Mißbrauch der Vertretungsmacht*), contracts entered into by a representative are not binding on the Company if the representative or apparent representative misused its authority to represent the Company and if such misuse was known or obvious to the counterparty.[12] Such a misuse may only occur where the power of a representative to bind a Company with regard to third parties exceeds the internal limits of the representative's authority as agreed between the representative and the Company or stipulated in the Company's internal documents which are binding on the representative.

(ii) Furthermore, in the case of collusive and abusive interaction (*Kollusion*), agreements are void or the claims thereunder are considered unenforceable. Collusion means that the respective person acting in the name and on behalf of the relevant Company and its counterparty are both aware of the lack of authorisation or power of (the person acting for) the respective Company, but, notwithstanding such explicit knowledge, enter into the agreement. However, collusion requires an understanding between the parties to jointly conclude the relevant agreement despite their knowledge of a lack of power or authority.

(iii) As a general matter of law, pursuant to section 181 BGB a representative may not without permission enter into a legal

---

[12] *Hopt,* in: Baumbach/Hopt, Handelsgesetzbuch 36th ed. (2014), § 50 no. 5; *von Westphalen*, DStR 1993, 1186, 1188; BGH NJW 1984, 1461, 1462; BGH NJW 1988, 2241; BGH NJW 1999, 2883; BGH NJW 2011, 66, 69.

transaction in the name of the principal with itself in its own name or as an agent of a third party, unless the legal transaction solely consists in the fulfilment of an obligation. These particular restrictions deriving from section 181 BGB can be excluded by private contract, subject to certain formal requirements.

The legal consequence in each case to be determined by the underlying factual situation, would be that the counterparty may not rely on the binding effect of the legal acts of the representative.

(d) Constitutional and corporate documents (including powers of attorney)

Internal restrictions on the permitted activities of a Company or a representative's authorisation may be contained in the internal documents of a Company. A counterparty of a Company is, however, not obliged to review internal documents of a Company[13] in order to research restrictions on a representative's authorisation.[14] Rather it may rely on the excerpts from the commercial register. However, if it does review the relevant documents, any limitation therein will be considered as obvious (*offensichtlich*) for the counterparty.

(e) Representation under conflict of laws considerations

The statements above, and in particular the principles of good faith in the commercial register (section 15 HGB) or power of attorney (section 172 BGB) apply under German law.

There is no explicit provision under the Regulation (EU) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the

---

[13] In case of an AG the relevant internal documents consist of the articles of association, the by-laws (*Geschäftsordnung*) of the supervisory board (*Aufsichtsrat*) and the by-laws (*Geschäftsordnung*) of the executive board (*Vorstand*). In case of a GmbH, the relevant internal documents consist of the articles of association of a GmbH , the by-laws (*Geschäftsordnung*) of the supervisory board (*Aufsichtsrat*), if any, the by-laws (*Geschäftsordnung*) of the advisory board (*Beirat*), if any, and the by-laws (*Geschäftsordnung*) of the managing directors (*Geschäftsführer*). The relevant documents may provide that a resolution by the executive board managing director or supervisory board may be required.

[14] BGH NJW 1984, 1461 (in case of a GmbH).

law applicable to contractual obligations ("**Rome I**")[15] as to the law governing the grant or use of a power of attorney. Pursuant to Article 1 para 2 lit. (g) Rome I the question of whether an agent is able to bind a principal, or a statutory representative to bind a company or other body corporate or unincorporated, in relation to a third party, is excluded from its scope. Also there is no statutory German conflict of laws provision as to this matter. However, German courts have developed the following principles where a contract is entered into which is governed by a law different from German law (here the laws of England).

(i) Where the Company is represented by its statutory representatives, i.e. the executive board (*Vorstand*) of an AG or the managing directors (*Geschäftsführer*) of a GmbH, the question whether the statutory representatives are capable of validly representing the Company is a matter of the law governing the legal establishment and existence of a company (*Gesellschaftsstatut*) rather than of contract law. [16] Under German conflict of law rules generally the governing law has to be determined with regard to the effective place of administration of a company (*Sitztheorie*).[17]

(ii) Where a power of attorney is granted by contractual arrangement, different rules apply. Pursuant to German conflict of laws principles the law applicable to the granted power of attorney is the law of the jurisdiction where the power of

---

[15] OJ No. L 177 of 4 July 2008. Rome I applies to contracts concluded on or after 17 December 2009 (Article 28 of Rome I as revised by the corrigendum published in OJ No. L 309 of 24 November 2009, p. 87).

[16] BGH NJW 1992, 618; Regional Court (*Landgericht*, "**LG**") Karlsruhe RIW 2002, 153; *Kegel/Schurig*, IPR, 9th ed. (2004), p. 620; *Schotten/Schmellenkamp*, IPR in der notariellen Praxis, 2nd ed. (2007), § 5, nos 91,102; *Kindler*, in: Münchener Kommentar BGB, 5th ed. (2010), IntGesR, no. 582 *et seq.*

[17] European Court of Justice ("**ECJ**"), judgment of 9 March 1999, case C-217/99, Centros Ltd. ./. Erhvervs-og Selskabsstyrelsen, NJW 1999, 2027; ECJ, judgment of 5 November 2002, case C-208/00, Überseering BV ./. Erhvervs-og Selskabsstyrelsen, NJW 2002, 3614; ECJ, judgment of 30 September 2003, case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam ./. Inspire Art Ltd, NJW 2003, 3331.

attorney, according to the intention of the principal, is supposed to take effect.[18]

(iii) In principle, also a *Prokura* is granted contractually and does not constitute a statutory representation. However, with respect to certain commercial powers of attorney, in particular a *Prokura*, specific conflicts of laws provisions have been developed by German courts.[19] The scope of the *Prokura*, remains in principle subject to German law. Under German conflict of law rules, foreign law may not impose additional requirements on the granting of the *Prokura*.

Foreign conflict of law rules might be inconsistent with the German conflicts of laws approach. Our recommendation on documents to be reviewed does not take foreign conflict of laws rules into account.

3.1.4 *Are there any formalities to be complied with upon entry into of any of the LCH Agreements and, if so, what is the effect of a failure to comply with these?*

There are no regulatory filings which need to be made by a Relevant Clearing Member upon the entry into of the Clearing Membership Agreement.[20]

To the extent German conflict of law provisions refer to English law, only applicable requirements under English law would need to be complied with as under German law there are no further filings, notifications or recordings or other formalities required in order for the Relevant Clearing Member to validly create a first priority perfected security interest under the Deed of Charge. Please see, however, paragraph 3.2.2 as to the effectiveness of the Deed of Charge in the context of Insolvency Proceedings below.

---

[18] *Schotten/Schmellenkamp,* Das Internationale Privatrecht in der notariellen Praxis, 2nd ed. (2007), § 5 no. 90; BGHZ 64, 183, 192; dissenting view: *Spellenberg* in: Münchener Kommentar BGB, 5th ed. (2010), Vor Art. 11 no. 145 et seq., who reports the majority view under no. 107 *et seq.*

[19] *Schotten/Schmellenkamp*, Das Internationale Privatrecht in der notariellen Praxis, 2nd ed. (2007), § 5 no. 91; *Thorn*, in: Palandt, BGB, 73rd ed. (2014), Anh. zu Art. 10 EGBGB, no. 2.

[20] Section 24b KWG only provides for an obligation of an Institution to notify BaFin and Bundesbank of its intention to operate a System. Implementing Article 10 para 1 sub-para 4 SFD, section 24b KWG provides that each Institution participating in a System is obliged to inform anyone with a legitimate interest of the Systems in which it participates and to provide information about the main rules governing the functioning of those Systems.

3.1.5 *Would the courts of the Relevant Jurisdiction uphold the contractual choice of law and jurisdiction set out in Regulation 51?*

(a) Choice of law

In court proceedings taken in Germany for the enforcement of the obligations of an obligor under any Opinion Document, the choice of English law under Regulation 51(a) of the General Regulations would be recognised, subject in each case to the provisions of Rome I and, where it concerns non-contractual obligations arising out of such Opinion Document, subject in each case to the provisions of the Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations ("**Rome II**").[21]

(b) Choice of jurisdiction

According to Regulation 51(c) of the General Regulations, LCH and every Relevant Clearing Member irrevocably agrees for the benefit of LCH that the courts of England shall have exclusive jurisdiction to hear and determine any claim or matter arising from or in relation to any Contract or in relation to the Regulations which does not fall to be referred to arbitration under Regulation 51(b) of the General Regulations, or to be dealt with under the ATS Rules (as defined in the Regulations), save that the submission to the exclusive jurisdiction of the English courts shall not limit the right of LCH to take proceedings in any other court of competent jurisdiction.

In general, and subject to Regulation (EC) No 44/2001 of the Council of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("**Brussels I Regulation**") [22] (or, from 10 January 2015, the recast Brussels I Regulation (Regulation (EC) No 1215/2012) [23]), the submission to the jurisdiction of the courts in England contained in

---

[21] OJ No L 199 of 31 July 2007, p. 40.

[22] OJ No L 12 of 16 January 2001, p. 1.

[23] OJ No L 351 of 20 December 2012, p. 1.

Regulation 51(c) of the General Regulations would be recognised by the German courts.

However, the choice of jurisdiction contained in Regulation 51(c) of the General Regulations will not be recognised by German courts to the extent a dispute is effectively referred to arbitration under Regulation 51(b) of the General Regulations if such Regulation prevails.

In addition, the choice of jurisdiction contained in Regulation 51(c) of the General Regulations qualifies as a unilateral jurisdiction clause (*einseitig begünstigende Gerichtsstandsklausel*) as only the Clearing Member but not LCH irrevocably submits to the exclusive jurisdiction of the courts of England. Such a unilateral jurisdiction clause may not be upheld by German courts even if the arbitration agreement under Regulation 51(b) of the General Regulations were not applicable: In decision no 11-26.022 (26 September 2012)[24], the French Cour de Cassation decided that a unilateral jurisdiction clause in a form similar to that in Regulation 51(c) was ineffective because it did not comply with the requirements of Article 23 Brussels I Regulation and, as a result, that the clause did not confer jurisdiction on the court identified in it. The decision of the Cour de Cassation is not binding on other courts in the EU, and we believe that there are strong arguments why this decision should not be followed. However, there is a risk that courts within the EU, including ultimately the ECJ (whose decisions are binding on all courts within the EU, including German courts), will reach the same conclusion as the Cour de Cassation. Similar concerns arise where the jurisdiction is determined on the basis of the Agreement between the European Community and the Kingdom of Denmark on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters[25] or on the basis of the 2007 Lugano Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters.[26] If so, Regulation 51(c) of the General Regulations would not confer jurisdiction on the courts specified therein, in which case the jurisdiction of the German and

---

[24] Cour de Cassation ZEuP 2013, 890 *et seq.*

[25] OJ No L 79 of 21 March 2013, p. 4.

[26] OJ No L 339 of 21 December 2007, p. 3.

other courts would be determined by reference to the general law applicable in those courts, including, in the case of Germany, the ZPO.

(c) Recognition of arbitration agreement

The arbitration agreement contained in Regulation 51(b) of the General Regulations would be recognised by the German courts – and a civil law action before a German court would be considered inadmissible due to the arbitration agreement – subject to the preconditions of sections 1025 *et seq.* ZPO having been met. In line with those provisions, it is permissible to arrange for arbitration in a contract which is signed by the parties (or concluded in letters, telefax copies, telegrams, or other forms of transmitting messages exchanged by the parties that ensure proof of the agreement) by referring in this contract to another (unsigned) document like the Rulebook that contains an arbitration clause if the reference is made such that this arbitration clause is incorporated into the contract. We do not opine on whether or not the Contracts contain effective references to the Rulebook.

It is not entirely clear whether the arbitration agreement contained in the Rulebook applies to the Clearing Membership Agreement. It is unclear if "Contract" in the meaning of Regulation 51(b) of the General Regulations includes the basic contract "Clearing Membership Agreement" or only the contracts closed on the basis of the Rulebook. Additionally, the Clearing Membership Agreement contains a special choice of jurisdiction (see section 13.1) which may prevail over the general rules under Regulation 51 of the General Regulations.

3.1.6 *Will the courts uphold the judgement of the English courts or an English arbitration award*?

(a) English court judgements

An English court judgement would be recognised by a German court in accordance with the Brussels I Regulation (or, from 10 January 2015, the recast Brussels I Regulation (Regulation EU No 1215/2012)).

(b) English arbitral award

An English arbitral award will be recognised by a German court in accordance with sections 1059 *et seq.* ZPO. Recognition and enforcement of the award may be refused in Germany, if any grounds

for refusal of recognition and enforcement under the United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards[27] apply.

An order for the enforcement of an English arbitral award on a civil matter will be issued by a German court provided that the requirements for recognition are met and provided further that the party interested in the enforcement has filed for enforcement of the arbitral award with the competent court in Germany in compliance with applicable legal requirements for such filings, including but not limited to, the submission of the relevant documentation.

3.1.7 *Are there any "public policy" considerations that the courts may take into account in determining matters related to choice of law and/or the enforcement of foreign judgements*?

Yes, "public policy" considerations are taken into account by German courts in determining matters related to choice of law and/or the enforcement of foreign judgements. For details see paragraph 4.1 to 4.3 below.

3.2 Insolvency, Security, Set-off and Netting

3.2.1 *Please opine on insolvency proceedings and pre-insolvency reorganisation, restructuring and/or resolution measures under the laws of Germany. Would any of these not be covered by those events entitling LCH to liquidate, transfer or otherwise deal with Contracts as provided for in Rule 3 of the Default Rules? Are any other events or procedures not envisaged in Rule 3 of the Default Rules relevant*?

Under paragraph 3.2.1(a) to, and including, 3.2.1(d) we provide an overview of mandatory insolvency, reorganisation and related proceedings under German and in each case their international scope of application. Our specific answers are given in paragraph 3.2.1(h).

(a) Insolvency Proceedings under German law

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which a Relevant Clearing Member

---

[27] Germany adhered to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1 June 1958 on 30 June 1961 (BGBl. II 1961 p. 122).

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**"). The main insolvency procedures (*Hauptinsolvenzverfahren*) under the InsO are referred to as "**Insolvency Proceedings**". A Party who is subject to Insolvency Proceedings is called an "**Insolvent Party**" and its counterparty is called the "**Solvent Party**". When using the term Insolvency Proceedings we do not refer to opening proceedings (*Eröffnungsverfahren*), in particular not to any provisional insolvency measures (*vorläufige Maßnahmen*) taken under sections 21 *et seq.* InsO ("**Provisional Insolvency Measures**") (in respect of which see paragraph 3.2.1(c)).

Generally, Insolvency Proceedings may be opened by 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 is existing. The InsO enumerates the following reasons for the opening of Insolvency Proceedings:

(1) 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 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.[28]

---

[28] 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

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

(3) 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 more likely (*überwiegend wahrscheinlich*) under the given circumstances (section 19 para 2 InsO). Over-indebtedness applies to legal entities (*juristische Personen*) (section 19 para 1 InsO)[29] 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).

With respect to Credit Institutions and Financial Services Institutions only the BaFin may file an application for the opening of Insolvency Proceedings (section 46b para 1 sentence 4 KWG). In respect of Institutions, BaFin may file an application for the opening of Insolvency Proceedings by reason of impending illiquidity only upon the Institution's approval (section 46b para 1 sentence 5 KWG).

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 administrator (*Insolvenzverwalter*, "**Insolvency Administrator**"). Upon the opening of Insolvency Proceedings the insolvent Relevant

---

10% threshold is, however, not a fixed limit which would automatically allow the conclusion that a debtor is illiquid if it is exceeded or that it is not illiquid where the threshold is not reached.

[29] Over-indebtedness would also apply to companies without legal personality but only if none of the general partners of such company is a natural person (section 19 para 3 InsO).

Clearing Member's right to manage and transfer assets belonging to the insolvency estate is vested in the Insolvency Administrator (section 80 InsO). Any dispositions of the insolvent Relevant Clearing Member over its property made after the opening of Insolvency Proceedings are void unless the relevant insolvency court otherwise orders (section 81 para 1 InsO).[30] 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).

Where an insolvency court has, upon application of the insolvent Relevant Clearing Member, ordered the management of the insolvent Relevant Clearing Member to continue its activities in accordance with section 270 InsO (*Eigenverwaltung*, "**Self Administration Proceedings**"), numerous rights of the Insolvency Administrator are exercised by the creditors' trustee (*Sachwalter*) (including any challenge in insolvency rights under sections 129 *et seq.* InsO as referred to in paragraph 3.2.4(a) below, see section 280 InsO). The insolvent Relevant Clearing Member may also exercise certain rights itself but in consultation with the creditors' trustee (including the Selection Right as defined in paragraph 3.2.3(c) 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 Institutions. An insolvency court may order Self Administration Proceedings when it releases an order for the opening of Insolvency Proceedings provided the insolvent Relevant Clearing Member 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 Relevant Clearing Member's creditors (section 270 para 2 InsO).

Legal entities which are established under public law and subject to the supervision of a German Federal State (*Bundesland*) may be exempt from Insolvency Proceedings in Germany under the law of such Federal State (section 12 para 1 no 2 InsO). Instead, special rules may

---

[30] Please refer to paragraph 3.2.1(e) with respect to exemptions for "Financial Collateral" (as defined herein).

apply or be enacted under public law to the winding-up of such entities and such special rules may have an impact on the enforceability of the Opinion Documents and the enforcement of any security interest or title transfer arrangements.[31] Where a legal entity established under public law is not exempt from Insolvency Proceedings, it will generally be treated similar to entities established under private law. Legal entities incorporated under private law which are publicly owned are not exempt from Insolvency Proceedings.[32]

Insolvency Proceedings under German law apply universally to all assets of the insolvent Relevant Clearing Member, irrespective of the location of such assets (*Universalitätsprinzip*), subject to recognition under applicable foreign laws where such assets are from a German law perspective deemed to be located outside Germany.

(b) Territorial scope of application of Insolvency Proceedings

Whether or not German insolvency courts have jurisdiction for opening Insolvency Proceedings over the assets of a Relevant Clearing Member 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**"), 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**").

(i) Jurisdiction of German insolvency courts within the scope of application of the EUIR

---

[31] Certain German public law entities such as *Deutsche Bundesbank*, the German central bank and KfW may only be dissolved by an act of the German Federal Parliament (*Bundestag*), see section 44 sentence 1 of the Act on Deutsche Bundesbank (*Gesetz über die Deutsche Bundesbank*) and section 13 para 1 of the Act on KfW (*KfW-Gesetz*), respectively. As a result, they may not be subject to Insolvency Proceedings (as this would result in their liquidation). *Ott/Vuia*, in: Münchener Kommentar InsO, 3rd ed. (2013), § 12 no. 13; *Ehricke*; in: Jaeger, InsO (2004), § 12 no. 14.

[32] *Kirchhof*, in: Heidelberger Kommentar InsO, 6th ed. (2012), § 12 no. 7; *Gundlach/Frenzel/Schmidt*, NZI 2000, 561, 565.

The EUIR applies to insolvency proceedings as specified in Article 1 para 1, Annex A EUIR. The EUIR is not applicable to insolvency proceedings concerning insurance companies, credit institutions [33], investment undertakings (*Wertpapierfirmen*) [34] which provide services involving the holding of funds or securities for third parties, and collective investment undertakings (*Organismen für gemeinsame Anlagen*)[35] (Article

---

[33] 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 under Article 4 para 1 point 1 of 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**"), i.e. an undertaking whose business is to take deposits or other repayable funds from the public and to grant credits for its own account. Under German law, such credit institutions are defined in section 1 para 3d KWG as "**CRR Credit Institutions**" (*CRR-Kreditinstitute*).

[34] No definition of "investment undertaking" is provided in the EUIR but Article 4 para 1 no. 1 of 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 as amended (OJ No L 145 of 30 April 2004, p. 1 "**MiFID**") defines the term "investment firm" to include any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis (see also *Virgos/Schmit*, Report on the Convention on Insolvency Proceedings (1996), no. 59 and *Brinkmann*, in: K. Schmidt, InsO, 18th ed. (2013), Article 1 EUInsVO no. 7). The German language versions of both the EUIR and the MiFID use the term "*Wertpapierfirma*" which confirms this interpretation.

[35] The term "collective investment undertaking" means, in accordance with Article 1 para 2 of the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) (OJ No L 302 of 17 November 2009, p. 34, "**UCITS Directive**") undertakings (i) the sole object of which is the collective investment in transferable securities of capital raised from the public and which operate on the principle of risk-spreading, and (ii) the units of which are, at the request of the holders, re-purchased or redeemed, directly or indirectly, out of those undertakings' assets ("**UCITS**"). This interpretation is based on the assumption made by *Virgos/Schmit* (Report on the Convention on Insolvency Proceedings (1996), no. 56 *et seq.*) according to which the rationale behind the exceptions provided in Article 1 para 2 EUIR is to exclude such entities, which are subject to specific EU regulations and supervision by regulators in their respective Member States. Investment Companies which qualify as UCITS are regulated and supervised in accordance with the UCITS Directive and, hence, they are excluded from the scope of application of the EUIR. From our point of view, this general analysis should prevail despite the wording under the EUIR which might lead to the conclusion that the term "collective investment undertaking" within the meaning of the EUIR corresponds to the equivalent term in Article 3 UCITS Directive pursuant to which it is used for certain collective investment undertakings which do not qualify as UCITS as defined in the UCITS Directive. *Brinkmann*, in: K. Schmidt, InsO, 18th ed. (2013), Article 1 EUInsVO no. 7 also takes the view that the reference to collective investment undertakings in the EUIR is a

1 para 2 EUIR). The ECJ takes the view that the application of provisions of the EUIR does not generally depend on the existence of a cross-border link (*grenzüberschreitenden Bezug*) to another EU member state (other than Denmark) unless a relevant provision of the EUIR expressly requires such link.[36]

Within this scope of application, the courts of the Member States (other than Denmark[37]) where the "centre of main interests" of a debtor is situated may open main insolvency proceedings (as specified in Annex A to the EUIR). In case of a legal entity, the place of the registered office is presumed to be the centre of its main interests in the absence of proof to the contrary (Article 3 para 1 EUIR). Insolvency proceedings are generally governed by the law of the Member State where such proceedings are opened. They are, with regard to other Member States, international in scope being effective in all Member States unless secondary proceedings are opened in another Member State. The only main insolvency proceedings permitted under Annex A of the EUIR under the laws of Germany would be Insolvency Proceedings.

---

reference to the definition in Article 1 point 2 UCITS Directive. It must be noted, however, that due to the lack of court precedents dealing with this issue a certain degree of uncertainty remains.

[36] Judgment of 16 January 2014, Case C-328/12, *Ralph Schmid v Lilly Hertel*, NJW 2014, 610, 611 *et seq.* Several legal commentators have taken the view that the application of the EUIR does generally require a cross-border link. See *Liersch*, in: Braun, Insolvenzordnung, 5th ed. (2012), before §§ 335-358 no. 13; *Kindler*, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch, 5th ed. (2010), VO (EG) 1346/2000 Article 1 no. 23; *Virgos/Schmit*, Report on the Convention on Insolvency Proceedings, no. 11. See also the overview given by *Reinhart*, in: Münchener Kommentar InsO, 2nd ed. (2008), Art. 1 EUInsVO nos. 15 *et seq.*

[37] See *Liersch,* in: Braun, InsO, 5th ed. (2012), before §§ 335-358 no. 13; *Kindler*, in: Münchener Kommentar BGB, 5th ed. (2010), VO (EG) 1346/2000 Article 1 no. 23; *Virgos/Schmit*, Report on the Convention on Insolvency Proceedings (1996), no. 11. However, the EUIR does not define as to when a cross-border effect in another EU member state (other than Denmark) is given. Moreover, it is also disputed in German legal literature as to whether Article 3 para 1 EUIR is still applicable if the Insolvent Party's "centre of main interest" is located in a member state (other than Denmark) but the cross-border effect of the Insolvency Proceeding is merely confined to a non-member state (or Denmark). The BGH has referred this question to the ECJ (WM 2012, 1449). See also the overview given by *Reinhart*, in: Münchener Kommentar InsO, 2nd ed. (2008), Article 1 EUInsVO nos. 15 *et seq.*

If the "centre of main interests" of a debtor is in an Member State (other than Denmark), under Article 3 para 2 EUIR, the courts of another Member State (other than Denmark) may open "territorial proceedings" or, after the opening of main proceedings, "secondary proceedings" in the event that such debtor possesses an establishment within the territory of such other Member State. The applicable law of such territorial or secondary insolvency proceedings is the law of that other Member State. However, territorial or secondary insolvency proceedings are limited in scope to the debtor's assets located in that Member State and will, thus, not extend beyond the Member State where they are opened. Furthermore, under Article 3 para 3 EUIR, secondary proceedings are limited to winding-up proceedings.

As a result of the implementation of Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions ("**WUD**")[38], the opening of secondary or territorial Insolvency Proceedings is excluded in respect of such CRR Credit Institutions (section 46e para 2 KWG). Insolvency Proceedings may only be opened by the competent authorities of the home state (*Herkunftsmitgliedsstaat*) of such CRR Credit Institution.

Within the scope of application of the EUIR, if the centre of main interests of an insolvent Relevant Clearing Member is in Germany, Insolvency Proceedings are opened in Germany with respect to the insolvent Relevant Clearing Member irrespective of whether or not the relevant authorities in any other jurisdiction have initiated proceedings in respect of a branch office or any other assets of the insolvent Relevant Clearing Member in such jurisdiction.

Where the centre of main interests of an insolvent Relevant Clearing Member is in a Member State other than Germany or Denmark and the insolvent Relevant Clearing Member has an establishment (within the meaning of the EUIR) in Germany,

---

[38] OJ No L 125 of 5 May 2011, p. 15.

the German insolvency courts will have jurisdiction in respect of such assets of the insolvent Relevant Clearing Member which are located in Germany. An establishment is defined in Article 2 lit (h) EUIR as any place of operations where the debtor carries out a non transitory economic activity with human means and goods (such term including branch offices). As mentioned above, no secondary or territorial proceedings may be opened in respect of CRR Credit Institutions.

Where the centre of main interests of the insolvent Relevant Clearing Member is in a Member State other than Germany or Denmark and the insolvent Relevant Clearing Member has no establishment (within the meaning of the EUIR) in Germany, the German insolvency courts will have no jurisdiction in respect of such insolvent Relevant Clearing Member.[39]

(ii) Jurisdiction of German insolvency courts outside the scope of application of the EUIR

Outside the scope of application of the EUIR, if an insolvent Relevant Clearing Member has its place of general jurisdiction in Germany, Insolvency Proceedings are opened in Germany with respect to the insolvent Relevant Clearing Member irrespective of whether or not the relevant authorities in any other jurisdiction have initiated proceedings in respect of a branch of the insolvent Relevant Clearing Member in such jurisdiction. In case of a legal entity, the place of general jurisdiction is the registered seat. If the centre of that legal entity's independent business activity is located elsewhere (e.g. if the management is located at a place other than the registered seat) such place determines the competent insolvency court (section 3 para 1 sentence 2 InsO). If the centre of an independent business activity of the insolvent Relevant Clearing Member is located outside Germany, German

---

[39] Pursuant to Article 3 para 2 EUIR, a secondary insolvency proceeding can be opened only for an establishment; the EUIR does not provide for jurisdiction solely based on the situation of assets. However, where applicable, section 354 para 2 InsO recognises that a secondary Insolvency Proceeding may be opened in Germany based on the location of assets in Germany (*Paulus*, DStR 2005, 334, 339; see also *Wenner*, in: Mohrbutter/Ringstmeier, Handbuch der Insolvenzordnung, 8th ed. (2007), § 20 no. 71.

insolvency courts have no jurisdiction except for the opening of (separate) territorial or secondary Insolvency Proceedings (which are limited in their scope to the assets of the insolvent Relevant Clearing Member located in Germany).

Territorial Insolvency Proceedings can be commenced in Germany under section 354 para 1 InsO if the debtor has an establishment in Germany. Where an insolvent Clearing Member has no establishment[40] in Germany, a sufficient basis for separate proceedings in Germany under the InsO is also provided in respect of assets located or deemed to be located in Germany upon request of a creditor, if such creditor provides evidence for its "special interest" in the opening of German territorial proceedings due to the fact that it would have worse prospects (*erheblich schlechter stehen*) for the settlement of its debt in the non-German proceedings (section 354 para 2 InsO). [41] The recognition of foreign main insolvency proceedings under section 343 InsO does not exclude secondary proceedings. If territorial or secondary insolvency proceedings are opened in Germany, they take precedence over the non-German insolvency proceedings in relation to those assets of the insolvent Clearing Member which are situated in Germany. Such territorial or secondary insolvency proceedings and, thus, the applicability of German insolvency law are, however, limited in scope to the debtor's assets in Germany.

In case the insolvent Clearing Member is a CRR Credit Institution, Insolvency Proceedings may be opened in Germany only if Germany is considered to be the home member state.

---

[40] There is no definition of the term "establishment" (*Niederlassung*) in the InsO. Some legal authors (*Kindler*; in: Münchener Kommentar BGB, 5th ed. (2010) § 354 InsO no. 3; *Lüer*, in: Uhlenbruck, InsO, 13th ed. (2010), § 354 no.9) suggest to refer to the definition given in Article 2 lit (h) EUIR while LG Frankfurt am Main in its decision of 30 October 2012 (2-9 T 418/12) and others (*Reinhart*, in: Münchener Kommentar InsO, 2nd ed. (2008), § 354 no. 7) apply the definition which has been developed for purposes of section 21 ZPO, i.e. any branch office which is separate from the owner's seat and acts for a certain time in the owner's name and for its account independently, i.e. the branch office acts and enters into agreements upon its own decision (*Heinrich*, in: Musielak, ZPO, 10th ed. (2013), § 21 no. 2).

[41] *Wenner*, in: Mohrbutter/Ringstmeier, Handbuch der Insolvenzverwaltung, 8th ed. (2007), § 20 no. 71, suggests that this provision should be construed narrowly.

This is the case if the main office (*Hauptniederlassung*) of the CRR Credit Institution is located in Germany (section 1 para 4 KWG); the opening of secondary or territorial insolvency proceedings in other Member States is excluded (section 46e para 2 KWG).

(iii) Situation of payment claims

Under the EUIR, payment claims are deemed to be situated in the Member State in which the debtor of such claim has the centre of its main interests (Article 2 lit (g) EUIR). Therefore, if the centre of main interests of the Solvent Party is in another Member State (other than Denmark), and there are secondary proceedings under the EUIR in respect of the insolvent Relevant Clearing Member in that Member State, then under the EUIR the claims of such Insolvent Relevant Clearing Member against the Solvent Party would be deemed to be situated outside of Germany. The Insolvency Administrator would be required to defer to the jurisdiction of the Insolvency Administrator appointed in such other Member State in relation to such claims. Under the InsO, payment obligations are assets deemed to be situated in Germany if the debtor has its seat in Germany. Therefore, only such payment obligations are assets deemed to be situated in Germany which are payable by the Solvent Party out of Germany.

As for special conflict of laws provisions governing close-out netting and set-off, please refer to paragraph 3.2.3(a) below.

(c) Provisional Insolvency Measures

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 administrator (*vorläufiger Insolvenzverwalter*) and issue Provisional Insolvency Measures to protect the insolvent Relevant Clearing Member's assets in accordance with section 21 InsO.

Provisional Insolvency Measures are limited to attachments (freezing injunctions) that prevent the insolvent Relevant Clearing Member from disposing of its assets and creditors from seizing them and, thus,

jeopardise the purpose of Insolvency Proceedings. Such freezing injunction may cover all assets of the insolvent Relevant Clearing Member or parts thereof. The insolvency court may impose a general prohibition of dispositions (*Verfügungen*) on the insolvent Relevant Clearing Member (section 21 para 2 sentence 1 no 2 InsO), order that the insolvent Relevant Clearing Member's dispositions of property require the consent of the provisional insolvency administrator (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 Relevant Clearing Member (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 ability of a party to set claims off since the provisions concerning insolvency set-off pursuant to sections 94 through 96 InsO (see paragraph 3.2.3(d) below) are deemed as both comprehensive and exclusive.[42] Nor is a provisional insolvency administrator 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 3.2.3(c) 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 Administrator's Selection Right (please refer to paragraph 3.2.3(c)) 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 rechnen ist*).[43] This means that an early termination may still be invalid even if it occurred prior to the opening of Insolvency Proceedings (please refer, however, to paragraph 3.2.1(e) for exemptions for Financial Collateral (as defined in that paragraph), paragraph 3.2.1(f) for exemptions for Systems (as defined in that paragraph) and

---

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

[43] BGH WM 2013, 274, 276.

paragraph 3.2.1(g) for an exemption for necessary measures under Article 48 EMIR).

(d) Regulatory Proceedings

Additional regulatory proceedings may be instituted and measures may be taken by BaFin with respect to Relevant Clearing Members that qualify as Institutions under the KWG (sections 45 to 48t KWG) and the KredReorgG, in order to avoid an insolvency of an Institution. If the Relevant Clearing Member is a Credit Institution, BaFin has more far-reaching powers than in respect of Institutions generally. For purposes hereof, the procedures described in this paragraph 3.2.1(d) are collectively referred to as "**Regulatory Proceedings**".

(i) 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 jeopardised, 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**").

(ii) Regulatory measures by BaFin

BaFin may take various measures in respect of Institutions:

Under section 45 KWG BaFin may take measures for the reinforcement of an 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 products or the use of certain systems or order that the Institution implement measures laid down in its recovery plan (*Sanierungsplan*).

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

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 and 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 "**Moratorium**") (see for legal effects of those prohibitions on set-off further paragraph 3.2.3(g)(i);

(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.[44]

(iii) 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 Credit Institution itself by notifying BaFin and are 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 orders the implementation of restructuring proceedings and appoints a restructuring advisor (*Sanierungsberater*) to implement the restructuring plan (sections 3 para 1 and 6 para 1 KredReorgG). Restructuring

---

[44] 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 possibility to liquidate all Credit Institutions (section 47d KWG) and is empowered to remove obstacles to the liquidation 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. Further provisions of the Ring Fencing Act 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. Since 1 January 2014 BaFin is further empowered under the KWG as amended by the German Act to Implement CRD IV (*CRD IV-Umsetzungsgesetz*) to require Institutions to draw up and update recovery plans, if (i) disruptions to their business (*Störung des Geschäftsbetriebs*) (ii) threats to their continued existence (*Bestandsgefährdung*) or (iii) their insolvency may jeopardise the stability of the financial system.

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 (*Reorganisations-verfahren*) may be opened (section 7 KredReorgG). Reorganisation proceedings are 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 there is a threat to the Credit Institution's continued existence (*Bestandsgefährdung*) and this in turn may jeopardise 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 (please refer, however, to paragraph 3.2.1(e) for exemptions for Financial Collateral (as defined in that paragraph) and paragraph 3.2.1(f) for exemptions for Systems (as defined in that paragraph) based on section 23 KreditReorgG).

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.[45] 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.[46]

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 upon 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 the half of the

---

[45] 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.

[46] Please refer to paragraph 3.2.1(d)(v) with respect to the effects of such provision on agreements not governed by German law.

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 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 are deemed to exist if the necessary majorities within the respective groups of creditors 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 jeopardised and on the stability of the financial system.

If the votes have been positive, the reorganisation plan must be approved by the OLG Frankfurt prior to becoming effective in accordance with section 20 KredReorgG. The reorganisation plan becomes effective upon the OLG Frankfurt's 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 is 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.[47]

(iv) Transfer Order

Where the BaFin determines that the ongoing existence of a Credit Institution under the KWG is jeopardised (*Bestandsgefährdung*) and this in turn may jeopardise the

---

[47] 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.

stability of the financial markets (*Systemgefährdung*)[48], BaFin is entitled to issue a transfer order (*Übertragungsanordnung*) pursuant to sections 48a *et seq.* KWG ("**Transfer Order**")[49]. By issuing a Transfer Order BaFin may transfer all or parts of the Credit Institution's property to another entity ("**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 are 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

---

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

[49] The Transfer Order 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.

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. 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 an order by BaFin from the Bridge Bank to the Credit Institution under section 48j KWG ("**Re-Transfer Order**") within 4 months after the Transfer Order having become effective 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 is transferred, section 48k para 2 KWG provides that Financial Collateral (as defined below, paragraph 3.2.1(e)) must be transferred together with the business parts it relates to. Where assets are part of a System (as defined below, paragraph 3.2.1(f)) 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 Articles 195, 196 and 295 CRR[50] 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 upon exercise of any netting rights are 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 Articles 195, 196 and 295 CRR 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.[51]

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).

---

[50] Article 295 CRR refers to Article 296 CRR which provides further guidance on the term eligible netting agreement (Article 296 para 1 lit (a) CRR refers to "...a contractual netting agreement ... which creates a single legal obligation, covering all included transactions, such that, in the event of default by the counterparty ... [the institution] would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;...").

[51] *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.

Transfer Orders and Re-Transfer Orders may be challenged by the Credit Institution before the VGH Kassel within one month upon their publication (section 48r KWG). Section 48r KWG excludes ordinary appeals against the VGH Kassel's judgment but 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.

(v) International scope of application of regulatory measures under the KWG and the KredReorgG

Pursuant to section 46d para 3 sentence 3 KWG, section 340 paras 2 and 3 InsO (paragraph 3.2.3(b)) applies analogously to reorganisation measures (*Sanierungsmaßnahmen*). Among such reorganisation measures are, in particular, measures taken under section 46 KWG which are intended to preserve or restore the financial status of a Credit Institution and which may affect existing rights of third parties in a host member state of the European Economic Area ("**EEA**") (section 46d para 3 sentence 1 KWG). The view of the German legislator appears to be that such reorganisation measures also qualify as reorganisation measures as this term is defined in Article 2 point 7 WUD because section 46d para 1 sentence 1 KWG requires BaFin to inform the competent authorities of host EEA member states when taking reorganisation measures under the KWG.[52] The requirement to inform the competent authorities of the host EEA member state is established by Article 4 WUD in respect of reorganisation measures within the meaning of the WUD. However, the scope of section 46d para 3 KWG is not clear as the term reorganisation measure is not used elsewhere in the KWG.

The same issue arises under section 7 para 5 sentence 2 KredReorgG as it provides that section 46d paras 1 to 4 KWG shall apply analogously to reorganisation proceedings under the KredReorgG. Whether restructuring proceedings

---

[52] BT-Drucksache 17/3024, p. 49.

(*Sanierungsverfahren*), reorganisation proceedings (*Reorganisationsverfahren*) under the KredReorgG and the Transfer Order pursuant to sections 48a *et seq.* KWG are covered by the reference is therefore not clear although, given the purpose of the KredReorgG to stabilise Credit Institutions and to allow them to operate as going concerns, there are good reasons to assume that measures under the KredReorgG qualify as reorganisation measures for purposes of the WUD and section 46d para 3 sentence 3 KWG whereas the qualification of Transfer Orders for these purposes raises various questions.

To the extent the term "reorganisation measures" (*Sanierungsmaßnahmen*) as used in section 46d para 3 sentence 3 KWG and section 7 para 5 sentence 2 KredReorgG covers regulatory measures taken by BaFin and, as a consequence, sections 338 and 340 InsO apply (as provided in section 46d para 3 sentence 3 KWG) and if a court followed our interpretation of sections 338 and 340 InsO (see paragraph 3.2.3(b)), and subject to the application of Article 9 para 2 Rome I (see paragraph 3.2.1(d)(v)), the effects of reorganisation proceedings on the Opinion Documents would have to be decided on the basis of English law as the law governing the Opinion Documents. We are, however, not aware of any court decisions on this issue.

However, legislative reasoning[53] also shows that the German legislator considers the Termination Restrictions to constitute overriding mandatory provisions as defined under Article 9 para 1 Rome I.[54] Notwithstanding a recognition of the choice of English law under the Opinion Documents (above, paragraph 3.1.5) a German court would therefore apply, in particular, the Termination Restrictions, if proceedings were brought in Germany and the German court followed the German

---

[53] BT-Drucksache 17/3024, p. 67.

[54] In accordance with Article 9 para 1 Rome I, mandatory provisions are provisions which are regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under Rome I.

legislator's reasoning (Article 9 para 2 Rome I). The idea that the Termination Restrictions constitute overriding mandatory provisions on an international level has not been expressly enacted and would therefore depend on the courts' interpretation. It is not entirely clear whether the WUD will prevail over Rome I or *vice versa*.

Please note that as the KredReorgG has only recently been implemented and entered into force, there have neither been any restructuring proceedings, reorganisation proceedings nor have any Transfer Orders been initiated under the new provisions. Accordingly, we are not aware of any guidance from BaFin or court decisions on any of these provisions and a detailed analysis in legal literature has started only recently.

(e) Exemptions for Financial Collateral

Specific exemptions from certain mandatory restrictions under the InsO apply to financial collateral as defined in section 1 para 17 KWG ("**Financial Collateral**"). Section 1 para 17 sentence 1 and 2 KWG reads in an English convenience translation 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) [(Financial Collateral Directive, "**FCD**")] and monetary claims which arise from an agreement based on which an insurance company as defined in section 1 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 outright 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 Directive 2002/47/EC as 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 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."

We understand that Relevant Clearing Members are normally Institutions licensed in accordance with MiFID or Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ No L 176 of 27 June 2013, p. 338, "**CRD IV**"). Therefore, Relevant Clearing Members 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. Even where a Relevant Clearing Member falls within the scope of Article 1 para 2 lit (e) FCD, collateral posted in connection with the Opinion Documents can still constitute Financial Collateral if such Relevant Clearing 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 LCH's Rulebook involves the sale of financial instruments in the form of derivatives the security created in favour of LCH (which falls within the scope of Article 1 para 2 lit (d) FCD) to secure obligations thereunder therefore qualifies as Financial Collateral as in all likelihood Relevant Clearing 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 3.2.4), 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 (below, paragraph 3.2.3(e)(vi)), enforcement of security (below, paragraph 3.2.2(c)) and challenge in insolvency (below, paragraph 3.2.4(a)). 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 Administrator's Selection Right (see the detailed analysis of section 104 InsO below at paragraph 3.2.3(c)).

(f) Exemptions for Systems

Further specific exemptions from certain mandatory restrictions under the InsO apply to systems (*Systeme*) as defined under section 1 para 16 KWG ("**Systems**").

An English convenience 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) as amended by Directive 2009/44/EC (OJ No L 146 of 10 June 2009, p. 37) [(Settlement Finality Directive, "**SFD**")], 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 states are treated in the same manner as 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 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 execution 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."

Under German law it is not entirely clear what constitutes a System. We note, however, that LCH is included in the list of Security Settlement Systems maintained by the European Commission with respect to its services as "central counterparty/clearing house for equities, futures and options".[55] Given the general reference to LCH in the list we understand that the specification as a system applies to all of the Services, i.e. consists of LCH's Rulebook (including the Procedures) together with the further Opinion Documents, i.e. the Clearing Membership Agreement and the Deed of Charge.

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.[56] Such view would appear to be based on the idea that an entry into the list does have constitutive effect under the laws of the Member States implementing the SFD. 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 entry into the list is one of several requirements that must be met for an arrangement to qualify as a System. The legal effects of notification and entry into the list of Designated Payment and Security Settlement Systems are therefore not entirely clear. We understand that it is not possible to register a Clearing System as such. Therefore, even if the list had constitutive legal effect, it would be unclear whether the clearing services operated by LCH fall within the scope of the list. We will therefore analyse the clearing services operated by LCH 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 Opinion

---

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

[56] 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.

Documents establish a System since it consists of standardised terms, is intended to be used with various Clearing Members and, amongst other things, provides for the clearing through a central counterparty[57] and for the execution of transfer orders of participating Clearing Members in course of the settlement. The Opinion Documents are, however, not entered into between Clearing Members but between LCH and each of its Clearing Members separately.[58] 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 multilateral agreements but rather that three or more participants are bound by the same formal arrangements, such as the Opinion Documents. 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[59] 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, it is our opinion that, despite the risk that the courts may not follow our view, LCH's securities settlement systems should be considered as a System on the basis that the Opinion Documents should be sufficient to allow the conclusion of establishing a System. Given that often no clear distinction is made between payment, settlement and clearing systems, LCH's clearing services might be treated similarly. This view is

---

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

[58] 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".

[59] 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..."

supported by Article 17 para 4 EMIR as we would 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 transfer orders. We are not aware of any court decisions and a court may not follow our analysis. The following analysis is carried out on the basis that a court would (despite the risk referred to above) conclude that the Opinion Documents establish a System. Should this not hold true and the courts not follow this view, then the exemptions available for Systems are not applicable.

In Insolvency Proceedings specific conflict of laws provisions apply with respect to rights and obligations of participants in Systems (Article 9 EUIR, see paragraph 3.2.3(a), and section 340 para 3 InsO, see paragraph 3.2.3(b)). Within the scope of application of the InsO, exemptions for Systems apply with respect to insolvency related set-off (paragraph 3.2.3(d) below) and the enforcement of security (paragraph 3.2.2(c) below). 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).

(g) Exemptions for necessary measures under Article 48 EMIR

Where German insolvency laws apply, 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.

Pursuant to Article 102b section 1 para 1 EGInsO the opening of Insolvency Proceedings does 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 are not subject to challenge in insolvency (see paragraph 3.2.1(a) below). Article 102b EGInsO will also apply 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[60], we construe Article 102b EGInsO as a provision of substantive law rather than as a conflict of laws provision.[61] 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 serve also the interests of clearing clients but this will not necessarily result in a legal relationship between CCP and 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 clearing member and clearing client and thus also protect the positions of a clearing client from the application of mandatory insolvency laws, if such mandatory insolvency laws 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.

---

[60] BT-Drucksache 17/11289, p. 28.

[61] 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. The term "necessary" should in our view refer to any appropriate measures that are suitable to implement the measures described in Article 48 EMIR.

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", in our view the reference to "necessary measures" is intended to ensure that both relationships in the clearing cascade, CCP with clearing member and clearing member with clearing client, will be covered. A different treatment of those relationships producing different results will 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 do either not apply at all or to a limited extent only. As a result, the provisions of the Opinion Documents will prevail over mandatory provisions under the InsO, however, only to the extent the measures under the Opinion Documents 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 will refer to Article 102b EGInsO.

Please note that the aforementioned interpretation of Article 102b EGInsO has not been confirmed in 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 is interpreted differently in court decisions.

(h) Proceedings covered by Rule 3 of the Default Rules

Rule 3 of the Default Rules provides that LCH may take steps as defined in Rule 6 of the Default Rules (among others, terminating all or part of the relevant Contracts) "... in the event of a Relevant Clearing Member appearing to the Clearing House to be unable, or to be likely to become unable, to meet its obligations in respect of one or more Contracts." Whilst this provision is governed by English law under which its preconditions (for example the term "likely") and effects have to be construed (and on which we do not opine), it appears that any steps may already be taken by LCH at an early stage, i.e. in the case of a likely payment default as regards one single Contract.

In any event, we understand that Rule 3 of the Default Rules generally enables LCH to take steps prior to the opening of Insolvency Proceedings (as defined below). If applicable, upon the opening of Insolvency Proceedings, section 104 InsO provides for a mandatory automatic early termination of those Contracts 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 prevail and govern the close-out netting of those Contracts which fall within its scope (see paragraph 3.2.3(b)). Please also refer to paragraph 3.2.3 below whether there is a risk of any "cherry-picking right" being exercised.

LCH's right to take steps under Rule 3 of the Default Rules covers situations of financial difficulties of a Relevant Clearing Member at a very early stage, and therefore could generally arise in situations already preceding the actual opening of Insolvency Proceedings, Provisional Insolvency Measures or Regulatory Proceedings under the laws of Germany. Subject to the interpretation of the Default Rules under English law, we cannot exclude that Regulatory Proceedings (as defined in paragraph 3.2.1(d)) may be taken for reasons that do not (yet) affect the Relevant Clearing Member's ability to meet its obligations under a Contract (which would enable LCH to take steps in accordance with Rule 3 of the Default Rules). However, a general termination event preceding a situation in which a Clearing Member

"... is likely to become unable, to meet its obligations in respect of one or more Contracts ..." may be difficult to define and prove.

The opening of Regulatory Proceedings themselves would also be covered by Rule 5(e): " ... a Regulatory Body [as defined in the General Regulations] takes or threatens to take action against or in respect of the Clearing Member under any statutory provision or process of law ..." as we would construe that provision (which is, however, a matter of English law, on which we do not opine).

However, the Termination Restriction pursuant to section 13 of the KreditReorgG may already apply prior to the BaFin as "Regulatory Body" taking any upon the initiation of reorganisation proceedings (*Reorganisationsverfahren*) within the meaning of section 7 KredReorgG by the Credit Institution itself and would, therefore apply to a termination covered by Rule 5(e) of the Default Rules, but only if a court considered the provision applicable on a termination pursuant to the Default Rules under conflict of law aspects (see paragraph 3.2.1(d)(v).

3.2.2 *Would the Deed of Charge be effective in the context of Insolvency Proceedings or Reorganisation Measures in respect of a Relevant Clearing Member? Is there anything that would prevent LCH from enforcing its rights under the Deed of Charge? Would LCH be required to take any particular steps or abide by any particular procedures for the purposes of enforcing against Collateral provided to it by a Relevant Clearing Member under the Deed of Charge?*

We understand that under the Deed of Charge collateral is provided by the Relevant Clearing Member in favour of LCH in order to secure all obligations of that Relevant Clearing Member arising under and in connection with the Clearing Membership Agreement and the Clearing House's Rulebook. Collateral consists of securities and rights relating thereto and held by the Relevant Clearing Member with LCH as custodian in designated securities accounts. We understand that these accounts are established in England and the relevant account relationship is governed by English law. These accounts are subject to a security interest in favour of LCH under the Deed of Charge.

The Deed of Charge provides that all cash forming part of the collateral shall be paid to and retained by LCH in a cash account and any such monies which

may be received by the Relevant Clearing Member shall pending such payment be held in trust for LCH.

We further understand that the Deed of Charge does not permit LCH as the secured party to dispose of any of the Charged Property prior to a Default (as defined in the Deed of Charge) and that LCH does not become unrestricted title holder in the Charged Property. LCH does not acquire a right of reuse or comparable rights with respect to the Charged Property.

We first describe in the following paragraphs relevant German conflict of laws provisions and then analyse the application of these provisions to the security to be provided by Clearing Members to LCH under the Deed of Charge thereby mentioning steps to be taken by LCH to realise collateral.

(a) Security under German conflict of laws provisions

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 English law to govern such obligation is recognised by the German courts under Article 3 para 1 Rome I. This holds true for the general obligation to enter into a Deed of Charge under LCH's Rulebook as a preconditions for becoming a Clearing Member but also for the contractual obligations under the Deed of Charge which do not have an *in rem* aspect.

The law applicable to the creation of the security interest itself (i.e. the property law or *in rem* aspect of the Deed of Charge) 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 collateral 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. In respect of the security interest itself and depending on the type of security interest it should be noted that different legal and factual requirements must be fulfilled to ensure the validity of such security interest and, as a separate matter, its enforceability and the possibilities to enforce it.

(b) Conflict of laws provisions governing creation of a security

(i) Security over cash

Any cash forming part of the Charged Property as defined in the Deed of Charge must be paid by the Relevant Clearing Member to LCH. LCH will hold that cash in an account maintained in the United Kingdom and opened in its own name.

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 transfers of cash made into such account *prima facie* constitute assets 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 "outright title transfer" arrangement (*Vollrechtsübertragung*), rather than as a security interest (*Sicherheit* or *beschränkt dingliches Recht*). 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.[62]

---

[62] 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.*).

(ii) 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 of Rome I clarifies 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 for 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 an outright 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*) (please refer to paragraph 3.2.2(c)(i) as to mandatory rules of enforcement of security in Insolvency Proceedings as defined in paragraph 3.2.1(a)). As mentioned above, transfer 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 "outright title transfer" in the cash.

(iii) 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 of the German Introductory Act to the Civil Code (*Einführungsgesetz zum Bürgerlichen*

Gesetzbuch, "**EGBGB**" [63]) (*Wertpapiersachstatut*). [64] 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.[65]

In respect of negotiable registered securities (*Orderpapiere*), on the other hand, the analysis under German conflict of laws is different.[66] 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

---

[63] Article 43 EGBGB reads in an English convenience translation 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 jurisdiction.

(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."

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

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

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

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 of the German Safe Custody Act (*Depotgesetz*, "**DepotG**")[67] 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 legal acts (*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 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

---

[67] Section 17a DepotG serves the implementation of Article 9 para 2 SFD. An English convenience translation of section 17a DepotG 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."

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".[68]

(iv) Recharacterisation

The BGB uses the term "recharacterisation" (*Umdeutung*) only in the context of the recharacterisation 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 outright title transfer as a security interest e.g. in the form of a pledge or a security assignment, if it finds that a pledge or 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 unless they find that the form of security as agreed does not reflect the true economic intentions of the parties.

(v) Renvoi

Under Article 20 Rome I, the application of the law of any country specified by Rome I generally means the application of

---

[68] 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.*

the rules of law in force in that country other than its rules of conflict of laws (exclusion of *renvoi*).

Conversely, where the EGBGB applies, Article 4 para 1 sentence 1 EGBGB provides that any references of German law to the laws of another jurisdiction include the conflict of laws provisions of the other jurisdiction. If these conflict of laws provisions refer back to German law, German courts will accept such reference (*renvoi*) and apply German substantive law (Article 4 para 1 sentence 2 EGBGB). It is unclear whether the general rule of Article 4 para 1 EGBGB also applies to the more specific conflict of laws provision stipulated by section 17a DepotG.

To summarise, as matter of contract law, the choice of English law concerning the obligation to create security under the Opinion Documents will generally be recognised by the German courts.

Further, the choice of English law to govern the Deed of Charge is also generally recognised by the German courts if the Deed of Charge is granted over claims governed by English law and securities held in safe custody with LCH in England.

As German conflict of laws provisions refer to English law with respect to the creation of a security interest, no filing or registration requirements apply under German law in addition to any English law requirements to ensure that German law recognises the validity of the security interest as the recognition of the English law as the law governing the security interest will also extend to any filing or registration requirements. Further, there are no filing or registration requirements under German law which are merely based on the status of the Relevant Clearing Member having its place of establishment, incorporation or registration Germany.

(c) Enforcement of collateral in Insolvency Proceedings

Whilst as a general matter, collateral can be enforced in accordance with its contractual terms and with the provisions of the relevant laws governing creation of the security (which may prevail over the contractual terms), mandatory restrictions which may affect the

enforceability of security upon the opening of Insolvency Proceedings have to be observed.

(i) Rights to segregation and to separate satisfaction

LCH as creditor of a Relevant Clearing Member is entitled to enforce its rights in case of Insolvency Proceedings being commenced if it has a right to segregation (*Aussonderungsrecht*) from the insolvency estate with respect to an asset or if it has a right for separate satisfaction (*Absonderungsrecht*) within Insolvency Proceedings. If a security interest 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 interest allowed for separate satisfaction, LCH as secured party may 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 even be comparable to a right to segregation.

We are not aware of any court decisions which provide guidance as to how German courts would determine whether and under which circumstances rights created under foreign law such as an English law charge would grant a right to segregation under section 47 InsO. Section 47 InsO not only refers to rights *in rem* but also to contractual claims that can give rise to a segregation right. However, the BGH held that in general only "absolute" rights *in rem* which can be asserted against any third party would be covered by section 47 InsO.[69] Only in exceptional cases would contractual claims entitle the creditor to a right of segregation. In any event, a creditor secured under an outright title transfer arrangement is entitled to a right of segregation if the title in the relevant collateral asset has been validly acquired and is not re-characterised.

---

[69] BGH VIZ 2004, 196, 197 *et seq.*

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 is not affected. Neither Article 5 para 1 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.[70]

Generally, it is determined pursuant to the *lex fori concursus* (i.e. German insolvency law) which assets form part of the insolvency estate. As a consequence, certain legal commentators take the view that the *lex fori concursus* would also determine the question 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.[71] 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.[72] If a court followed this view it would have to apply the *lex causae* or *lex rei sitae* either of the Deed of Charge 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

---

[70] *Lüer*, in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010), § 351 no. 2, *Reinhart*, in: Münchener Kommentar InsO, 2nd ed. (2008), § 351 no. 3.

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

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

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.[73]

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 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 benefits from preferential treatment in the form of segregation or preferred satisfaction or whether it would rank *pari passu* with all other unsecured creditors as its specific characteristics were not comparable to a security interest benefiting from preferential treatment in the form of segregation or preferred satisfaction.

(ii) 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 Administrator. Where section 166 para 1 and 2 InsO applies, a security interest would be enforced by the Insolvency Administrator (e.g. pledges over moveables).[74] Pledges over

---

[73] See *Reinhart*, in: Münchener Kommentar InsO, 2nd ed. (2008), § 335 no. 58 for an overview.

[74] Generally pledges over German bearer securities are pledges over moveables. However, it is controversially discussed in legal literature whether the indirect possession (*mittelbarer Besitz*) of the Insolvency Administrator in collectively held securities is sufficient to give the Insolvency Administrator the right pursuant to section 166 para 1 InsO to realise the security interest (*Hirte*, WM 2008, 48, 52 *et seq.*, describing the discussion in legal literature; *Berger*, WM 2009, 577 *et seq.*). Securities which are represented by a global certificate which is kept in collective safe custody by a German central securities

contractual claims would neither fall under section 166 para 1 InsO nor under section 166 para 2 InsO which only covers assignment of claims.[75]

The Insolvency Administrator 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). If the preconditions for these exemptions are met, they apply irrespective of the specific type of the foreign security interest. Please refer to 3.2.1(f) with respect to the exemptions relating to Systems and with respect to Financial Collateral please refer to paragraph 3.2.1(e).

Furthermore, a secured party may enforce (German law) pledges over contractual claims itself (section 173 para 1 InsO).

As a result, in our view, the enforcement of the security interest granted under the Deed of Charge would be subject to restrictions under the InsO applicable to the realisation of collateral. Whether the

---

depository and owned by the security provider are only indirectly possessed by the Insolvency Administrator. Indirect possession is based on the custody chain (*Verwahrkette*) established by the account relationships with its custodian banks who intermediate the access to the German central securities depository and possession in those securities.

In cases where such custodian bank of the security provider is the secured party, it has to be considered whether the Insolvency Administrator's indirect possession would entitle him to enforce the security interest pursuant to section 166 para 1 InsO even though the custodian bank as secured party has indirect possession. Whilst there are no specific court decisions on this particular case, we are of the view that the custodian bank's indirect possession should entitle it to realise the security interest rather than the Insolvency Administrator. This view is supported by *Tetzlaff* in: Münchener Kommentar InsO, 3rd ed. (2013), section 166 no. 15 who refers to the "better" possession.

[75] BGH WM 2012, 549, 552.

security interest could be seen as a right to segregation (*Aussonderungsrecht*) from the insolvency estate with respect to an asset or a right for separate satisfaction (*Absonderungsrecht*) would be determined in accordance with the law governing the security interest.

However, if the Opinion Documents establish a System, effects of Insolvency Proceedings on the rights and obligations of participants in a System within the meaning of section 1 para 16 KWG would be governed by the laws of the state which applies to that System rather than being subject to the provisions of the InsO, please see as to the effects and scope of application of section 340 para 3 InsO paragraph 3.2.3(b).

3.2.3 *Would LCH have the right to take the actions provided for the Default Rules (including exercising rights to deal with Contracts under Rule 6 and rights of set-off under Rule 8 but not at this stage considering those actions specifically provided for in the Client Clearing Annex to the Default Rules) in the event that a Relevant Clearing Member was subject to Insolvency Proceedings or Reorganisation Measures? Is it necessary or recommended that LCH should specify that certain Insolvency Proceedings and/or Reorganisation Measures will constitute an Automatic Early Termination Event in accordance with Rule 3 of the Default Rules?*

To answer this question, we first summarise our understanding of the actions provided in Rules 6 and 8 of the Default Rules followed by an analysis of the respective restrictions on such actions in Insolvency Proceedings.

Pursuant to Rule 3 of the Default Rules, any steps taken under Rule 6 shall serve the purpose (i) to discharge all the Clearing Member's rights and liabilities under or in respect of all Contracts to which it is party or upon which it is or may be liable and (ii) to complete the process set out in Rule 8.

Accordingly, Rule 6 entitles LCH to terminate Contracts entered into with the Relevant Clearing Member, and we understand that Contracts which are dealt with in Rule 6 may or may not be automatically terminated in accordance with Rule 5 of the Default Rules (stipulating certain events which give LCH the right to take the actions as contemplated by Rule 6).

Furthermore, under Rule 6 LCH may also take other steps, in summary including incurring new and additional obligations of such defaulting Relevant Clearing Member for the purpose of settling or liquidating any open Contracts

(for example by way of entering into opposite Contracts or by exercising any options on behalf of the defaulting Relevant Clearing Member).

Rule 6 also enables LCH to realise security granted to LCH by the defaulting Relevant Clearing Member.

In a second step, Rule 8 as we understand, provides for a process to be completed by LCH to determine net amounts remaining payable between LCH and the defaulting Relevant Clearing Member, i.e. LCH is permitted to aggregate, i.e. set-off, any sums payable by and to a defaulting Relevant Clearing Member with respect to each "kind of account" (as such term is defined in Rule 11 (b) of the Default Rules, i.e. each separated client account and the Relevant Clearing Member's own account) including any cash collateral.

In our view, the termination right under Rule 6 and the set-off under Rule 8 constitute close-out netting provisions and therefore, where we refer in the following to the German law treatment of netting, our reasoning is applicable to these provisions. 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 netting (*Liquidations-Netting*). In the context of documentation providing for the central clearing of derivative transactions, 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. Netting upon termination of Contracts in accordance with Rules 6 and 8 of the Default Rules qualifies in our view as such close-out netting.

Whether or not relevant restrictions under the InsO apply is a matter of conflict of insolvency laws provisions.

(a) Conflict of laws provisions as regards netting and set-off under EUIR

Where the EUIR applies, Article 4 provides that the law applicable to Insolvency Proceedings and their effects is the law of the Member State in which the proceedings are opened. Secondary proceedings are

governed by the law of the Member State (other than Denmark) in which they are opened (Articles 3 para 2, 28 EUIR).

Cases where rights may be immunised from the effects of insolvency law of the Member State in which the relevant proceedings are brought are, for example, "rights *in rem*" over assets outside the jurisdiction where the insolvency proceedings are conducted (Article 5 EUIR), rights of set-off permitted by the law applicable to the insolvent debtor's claim (Article 6 EUIR) and rights and obligations of the parties to a payment or settlement system or to a financial market which are governed solely by the law of the Member State applicable to that system or market (Article 9 EUIR).

Under the EUIR, any set-off is permitted if permitted under the insolvency laws of the jurisdiction in which insolvency proceedings have been opened in relation to the insolvent debtor (Article 4 para 2 lit (d) EUIR) or if permitted by the law applicable to the insolvent debtor's claim (Article 6 para 1 EUIR).[76] In our view, close-out netting arrangements do not fall within the scope of application of Article 6 para 1 EUIR. The wording of Article 6 para 1 EUIR supports this as the term "set-off" only covers one element of close-out netting but does not refer to other integral parts such as the early termination (closing out) of transactions or the valuation and conversion of the terminated transactions into claims which are eligible for set-off.

Whilst it has been argued that Article 6 para 1 EUIR should be construed broadly to include close-out netting arrangements to enable financial market participants to choose the insolvency law applicable to close-out netting[77], Recital 27 EUIR in connection with Article 9 EUIR clarifies that the European legislator distinguishes between set-off and netting agreements. Moreover, the European legislator uses the terms set-off and netting agreements differently in other relevant

---

[76] Where Article 6 para 1 EUIR refers to German insolvency law, sections 94 *et seq.* InsO will apply; see *Kindler*, in: Münchener Kommentar BGB, 5th ed. (2010), § 340 no.8, *Gruber*, in: Haß *et al.*, EU-Insolvenzverordnung (2005), Article 6 no. 9; *Reinhart*, in: Münchener Kommentar InsO, 2nd ed. (2008), Article 6 EuInsVO no. 9.

[77] See European Financial Markets Lawyers Group, Protection for Bilateral Insolvency Set-off and Netting Agreements under EC Law, A report by the European Financial Market Lawyers Group (EFMLG), October 2004, nos. 72 *et seq.*

European legal acts as well.[78] Therefore, we take the view that Article 6 para 1 EUIR does not include close-out netting arrangements and will therefore not apply to Rule 8 because it cannot be considered on an isolated basis but forms part of a netting agreement.

Under Article 9 para 1 EUIR, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market are governed solely by the law of the Member State applicable to that system or market. Whether the reference to "payment or settlement systems" would include CCP clearing is not entirely clear. In our view, the definition of "System" as set out Article 2 lit (a) SFD may generally be referred to when construing Article 9 EUIR. [79] The uncertainties referred to above (paragraph 3.2.1(f)) are therefore also relevant in the context of Article 9 EUIR. If the Default Rules form part of a System and if the same definition of the term System is also relevant for construing Article 9 EUIR, then Article 9 EUIR refers to the substantive law governing the relevant System (see further below, paragraph 3.2.3(b) on the meaning and consequences of such reference).

Separately, the term "financial market" is not defined in the EUIR but is understood to be a market in a Member State (other than Denmark) where financial instruments, other financial assets or commodity futures and options are traded and which is subject to supervision by the Member State's competent authorities.[80] Even if LCH is supervised as a CCP under EMIR, we do not believe that the Opinion Documents qualify as a financial market because Article 9 para 1 EUIR requires the financial market as such to be regulated (as regulated markets under Article 4 para 1 point 14 MiFID). In our view, the Opinion

---

[78] The WUD contains, in addition to the general rule on set-off (Article 23 para 1), a specific rule for "netting agreements" (Article 25). On 12 December 2012, the European Commission published a proposal for a regulation amending the EUIR (COM(2012) 744 final) by, among others, adding a new Article 6a, the wording of which is identical with that of Article 25 WUD.

[79] *Stephan*, in: Heidelberger Kommentar InsO, 6th ed. (2008), Article 9 EuInsVO no. 4, *Huber*, in: Haß *et al.*, EU-Insolvenzverordnung (2005), Article 9 no. 2.

[80] *Virgos/Schmit*, Report on the Convention on Insolvency Proceedings (1996), no. 120.

Documents do not constitute a financial market for purposes of Article 9 para 1 EUIR.[81]

To summarise, within the scope of application of the EUIR, neither Article 6 para 1 EUIR on set-off nor Article 9 para 1 EUIR on financial markets would provide that the effects of Insolvency Proceedings on the close-out netting provisions contained in Rule 8 have to be considered under the substantive insolvency laws of a jurisdiction other than Germany (see in detail paragraph 3.2.3(a) for the applicable rules under the InsO and for available exemptions for close-out netting in the context of OTC derivatives clearing, see paragraph 3.2.3(f)).

However, if the Opinion Documents establish a System, Article 9 EUIR would refer to the substantive law governing the System, i.e. English law.

(b) Conflict of laws provisions as regards netting and set-off under the InsO

Outside the scope of the EUIR, under German international insolvency laws, section 335 InsO provides that insolvency proceedings and their effects are, in general, governed by the laws of the jurisdiction in which the proceedings have been opened. However, the InsO provides for some exceptions to this principle.

Section 338 InsO provides that any right to declare a set-off will not be affected by the opening of Insolvency Proceedings, provided that such right exists in accordance with the law governing the relevant claim of the insolvent Relevant Clearing Member at the time the Insolvency Proceedings are opened.

Section 340 para 2 InsO provides for an insolvency conflict of laws rule for "netting agreements". In more detail, section 340 para 2 InsO provides for the effects of Insolvency Proceedings on netting agreements (*Schuldumwandlungsverträge und Aufrechnungs-vereinbarungen*) to be governed by the law applicable to that

---

[81] If Article 9 para 1 EUIR applies to Contracts by reason of the fact that Contracts are traded on exchanges or other financial markets, it will provide for a separate treatment of those Contracts which are traded on the financial market and those which are not.

agreement. Even though section 340 para 2 InsO does not provide any guidance on the interpretation of the term "netting agreement", the legislative history reveals that master agreements within the meaning of section 104 para 2 sentence 3 InsO (please refer to paragraph 3.2.3(c)(iv)) fall within the scope of section 340 para 2 InsO.[82] On that basis, we are of the view that agreements qualify as "netting agreements" for purposes of section 340 para 2 InsO, if they are entered into as bilateral agreements providing a legal framework for an undefined number of transactions and provide for the early termination of all transactions entered into under such agreements upon the occurrence of agreed events of default, including upon an insolvency.[83] Such early termination must result in the calculation of a net settlement claim with respect to all claims which are outstanding under any transactions covered by the agreement. We note, however, that there are no court decisions available on the interpretation of section 340 para 2 InsO and the term "netting agreement". On this basis it is not clear whether section 340 para 2 InsO applies to rules of CCPs in a clearing context and it is therefore unclear whether it would apply to LCH's Rulebook, in particular rules 6 and 8 of the Default Rules.

Section 340 para 3 InsO provides that the effects of Insolvency Proceedings on the rights and obligations of participants in a System within the meaning of section 1 para 16 KWG are governed by the laws of the state which applies to that System. If the Opinion Documents qualify as a System (see also paragraph 3.2.1(f) above), section 340 para 3 InsO applies and the effects of a Relevant Clearing Member's insolvency are, under section 340 para 3 InsO as we would construe such provision, governed by the laws governing the System. With respect to the legal consequences, where section 340 para 3 InsO applies, it is not entirely clear to which set of rules the wording "law of

---

[82] BT-Drucksache 15/16, p. 20; see also *Gottwald/Kolman*, in: Insolvenzrechtshandbuch, 4th ed. (2010), § 132 no. 71.

[83] We are not aware of any court decisions on the interpretation of the term master agreement, however, a court may when construing such provisions refer to other legal provisions such as Articles 195, 196 and 296 CRR. Article 296 para 1 lit (a) CRR does not use the term "master agreements" but provides for a definition of contractual netting agreements (A "...a contractual netting agreement ... which creates a single legal obligation, covering all included transactions, such that, in the event of default by the counterparty ... [the institution] would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;...").

the state which applies to that System" refers. Basically, section 340 para 3 InsO could refer to (i) the substantive insolvency laws of the jurisdiction that has been chosen by the parties to govern the relevant System[84], (ii) the substantive contract law of the jurisdiction that has been chosen by the parties to govern the relevant System[85] or (iii) directly to the terms of the relevant System without any regard to the substantive insolvency or contract laws.[86]

While the wording of section 340 para 3 InsO does not provide any clear guidance as to its interpretation, both the legal history and the context of this provision can be used as guidance in its interpretation. Section 340 para 3 InsO implements the SFD into German law. When implementing the SFD into German law, the German legislator expressly referred to this intention behind the SFD and emphasised the necessity to ensure predictability regarding the applicable laws.[87] It is, however, not necessary in order to achieve this purpose to give effect to the parties without having regard to the principles of insolvency law. Moreover, the wording of section 340 para 3 InsO refers to the laws of the state instead of merely referring to the terms of the System. According to our interpretation of section 340 para 3 InsO, the netting would therefore take effect in accordance with the substantive insolvency laws of the jurisdiction the laws of which have been chosen by the parties to govern the System. Therefore, the effectiveness of the contractual terms of a System would not only be a matter of the terms of the System (without any reference to substantive insolvency laws) pursuant to section 340 para 3 InsO but a matter of the laws of the jurisdiction by which such System is governed. An interpretation within which section 340 para 3 InsO would refer to the contract law of the jurisdiction that has been chosen to govern the relevant System is not convincing as section 340 para 3 InsO is an insolvency conflict of laws provision. However, we note that, as far as we are aware, the

---

[84] See (in the context of section 340 para 2 InsO) *Liersch/Tashiro*, in: Braun, 5th ed. (2012) § 340 nos. 3 and 4; *Jahn*, in: Münchener Kommentar InsO, 2nd ed. (2008) § 340 no. 6.

[85] See (in the context of section 340 para 2 InsO) *Kindler*, in: Münchener Kommentar BGB, 5th ed. (2010), § 340 no. 5 (*lex causae*); *Stephan*, in: Heidelberger Kommentar InsO, 6th ed. (2008), § 340 nos. 6, 7.

[86] See (in the context of section 340 para 2 InsO) *Schneider*, in: Kohler/Obermüller/Wittig, Kapitalmarkt – Recht und Praxis, Gedächtnisschrift für Ulrich Bosch (2006), p. 211.

[87] BT-Drucksache 15/16, p. 20.

interpretation of section 340 para 3 InsO has not been the subject of any court decision yet.

To summarise, also outside the scope of application of the EUIR special conflict of law provisions referring to English substantive law (under the EUIR as well as under the InsO as we construe these laws) apply to the Opinion Documents if the Opinion Documents establish a System. In addition, section 340 para 2 InsO also provides for the application of English substantive law to "netting agreements", but should section 340 para 3 InsO apply we believe that section 340 para 3 InsO should prevail over section 340 para 2 as section 340 para 3 InsO is even more specific than section 340 para 2 InsO. This is, however, not decisive as both, section 340 para 2 and section 340 para 3 InsO, would in our view refer to English law.

(c) Close-out netting under the InsO

However, should the Opinion Documents not establish a System and if also no other conflict of laws provisions provide for the application of English substantive insolvency law with respect to the effects of the opening of Insolvency Proceedings over the assets of a Relevant Clearing Member, the following principles of substantive German law apply.

Following the opening of Insolvency Proceedings, executory contracts[88] which have not been effectively terminated prior to such opening of Insolvency Proceedings are, pursuant to section 103 InsO, subject to the Insolvency Administrator's right to decide whether to assume or reject such contracts;[89] i.e. to refuse performance of unprofitable contracts and to enforce profitable ones ("**Selection Right**" - such selection right by the Insolvency Administrator often

---

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

[89] 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). Therefore, neither the opening of Insolvency Proceedings nor the decision of the Insolvency Administrator results directly in a termination of the contractual agreement.

being referred to as "cherry-picking" right) pursuant to section 103 InsO.

Section 103 InsO reads in an English convenience translation as follows:

"Section 103

Option to be Exercised by the Insolvency Administrator

(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 administrator may perform such contract in place of the debtor and claim performance by the other party.

(2) If the insolvency administrator 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 administrator to decide whether it chooses performance or non-performance the insolvency administrator shall state his intention to claim performance without undue delay. If the insolvency administrator does not give his statement he may no longer insist on performance."

Under section 103 InsO, the Insolvency Administrator 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 Administrator 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 Administrator's Selection Right (see further below). As an early termination restricts the Selection Right LCH's early termination right under Rules 3 and 6 of the Default Rules 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 Default Rules and any potential exceptions.

Section 104 InsO provides for two major exceptions to the Insolvency Administrator's Selection Right. 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. To the extent that section 104 InsO applies, it overrides the Insolvency Administrator'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 Opinion Documents 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 Administrator'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. As the early termination (indirectly) prevents the Insolvency Administrator from exercising its Selection Right under section 103 InsO to disclaim or enforce outstanding contracts and may be regarded as a circumvention of mandatory insolvency provisions regarding executory contracts. The majority of German insolvency law commentators[90] have advocated 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

---

[90] See: *Wilmowsky*, ZIP 2007, 553, 554 *et seq.*; *Jahn/Fried* in: Münchener Kommentar InsO, 3rd ed. (2013), § 104 nos. 163 *et seq.*; *Huber* in: Münchener Kommentar InsO, 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.*

existence of any serious cause for such an application.[91] A termination right directly based on an actual opening of Insolvency Proceedings is, however, considered to be legally ineffective. This dispute has now been solved by the BGH.[92]

In its judgment of 15 November 2012[93] the BGH held that an insolvency related termination provision in a contract is invalid, because it would exclude the Selection Right of the Insolvency

---

[91] 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 section 119 InsO in which the parties agreed on a "right of termination for serious cause" (*Kündigungsrecht bei Vorliegen eines wichtigen Grundes*). The parties in that case, however, did not specify in detail the events that would constitute serious cause 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. The proponents of the restrictive interpretation conclude that this means that the legislator had a corresponding intention which, in turn, requires a restrictive interpretation of section 119 InsO (see *Huber*, in: Münchener Kommentar InsO, 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*, 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/Bork, InsO, 55th ed. (October 2013), § 119 nos. 15 *et seq.*).

[92] BGH WM 2013, 274.

[93] BGH WM 2013, 274.

Administrator under section 103 InsO and therefore violate section 119 InsO. Whilst the 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 will result in the exclusion of an Insolvency Administrator'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*).[94] 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*) (above, paragraph 3.2.1(c)).

According to the BGH insolvency related termination provisions are only upheld if the contractual insolvency related termination right 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 are generally not covered by section 119 InsO.

We understand that termination rights and automatic termination events under Rule 5 of the Default Rules 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 Administrator under section 103

---

[94] BGH WM 2013, 274.

InsO.[95] 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.

(i) Exceptions under section 104 InsO

Upon the opening of Insolvency Proceedings, 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 3.2.3(c) would apply.

Section 104 InsO[96] reads in an English convenience translation 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

---

[95] *Obermüller*, ZInsO 2013, 476; *Jacoby*, ZIP 2014, 649, 655.

[96] 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).

market or exchange 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,

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 Contract 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 which have been entered into under a master agreement (see below, paragraph (iv)). Section 104 para 3 InsO 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 is expressed in Euro and may be subject to set-off.[97]

(ii) Fixed date transactions (*Fixgeschäfte*)

Section 104 para 1 InsO applies to fixed date transactions (*Fixgeschäfte*) on tangible goods with a market or exchange

---

[97] Please note that section 104 para 3 InsO does not provide for a set-off according to views in legal literature (Ehricke, ZIP 2003, p. 273, 280) but, by transforming the former payment and delivery claims into a Euro denominated payment claim, forms a basis for set-off. However, *von Hall*, Insolvenzverrechnung in bilateralen Clearingsystemen, 2010, p. 152, 156 *et seq.* takes the view that section 104 para 2 sentence 3 InsO contains in itself a statutory close-out netting provision. Following the argument that section 104 para 2 sentence 3 InsO does not provide for a set-off itself, the general set-off restrictions under contract and insolvency law, as applicable, have to be considered.

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. A market or exchange price is (at least also) given if the price can be determined by an expert.[98]

(iii) Financial transactions within the meaning of section 104 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 88 above). However, an exception from this rule applies to transactions which have been entered into under a master agreement (paragraph 3.2.3(c)(iv) below). To qualify as a financial transaction, the relevant contracts must provide for a specific time at which or period of time in which the performance has to be made.[99] Furthermore, the transaction needs to have a market or exchange price.[100] 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.[101] Where a transaction falls within

---

98 *Von Hall*, WM 2011, 2161.

99 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. 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.

100 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 is to be construed broadly.

101 *Jahn/Fried*, in: Münchener Kommentar InsO, 3rd ed. (2013), § 104 no. 57.

the scope of section 104 para 1 InsO, section 104 para 2 InsO does not apply.[102]

According to the majority of German legal authors section 104 para 2 InsO may also apply to spot transactions which are usually settled in two days (*Kassageschäfte*).[103] 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 days).[104] 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.

---

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

[103] 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. Section 104 InsO does not, however, 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 InsO, 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*, Kölner Schrift zur Insolvenzordnung, 2nd ed. (2009), p. 1027 no. 72; different view: *Meyer*, in: Smid, Insolvenzordnung, 2nd ed. (2001), § 104 no. 11.

[104] BGH NJW 2002, 892, 892; *Bosch*, Kölner Schrift zur Insolvenzordnung, 2nd ed. (2009), p. 1027 no. 72. We also note that the term "spot contract" is defined in Article 38 para 2 of the Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive (OJ No L 241 of 2 September 2006, p. 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; or (b) the period generally accepted in the market for that commodity, asset or right as the standard delivery period

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"). [105] 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. [106] 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 forward, 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 future developments with respect to financial transactions.[107] Furthermore, based on the purpose of section 104 InsO to limit the Insolvency Administrator'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, [108] 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

---

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

[106] 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.

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

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

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.[109] However, a German court will likely balance the impact of any such decision on the Selection Right and the ability of the Insolvency Administrator to administer the estate.

(iv) 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. [110] 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 also not clear 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 from the Selection Right but it does not create an exemption for the 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

---

[109] *Jahn/Fried,* in: Münchener Kommentar InsO, 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.

[110] BT-Drucksache 15/1853, p. 11 *et seq.*

definition of "close-out netting" under the FCD[111] 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 are therefore not be subject to, if any, Selection Right.[112] 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.

(v) Section 104 para 2 sentence 3 InsO and the Opinion Documents

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, when reasons for the opening of Insolvency Proceedings exist, it can only be terminated in its entirety, then such contracts are together deemed to form one single mutual agreement within the meaning of sections 103, 104 InsO.

The InsO does not provide for a more detailed definition of the term "master agreement" but assumes this is entered into on a bilateral basis. An additional express precondition of section

---

[111] 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.

[112] See also *Jahn/Fried*, in: Münchener Kommentar InsO, 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.

104 para 2 sentence 3 InsO is 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 Opinion Documents are intended to be used by several parties they mostly create bilateral relationships. Still, this would in our view not suffice for the Opinion Documents to qualify as a master agreement. (however, see paragraph 3.2.1(f) above with respect to Systems). Section 104 para 2 sentence 3 InsO has been enacted to address bilateral master agreements. It was not intended to apply to documentation which provides for the central clearing of derivative or other transactions or to multilateral netting arrangements (including multilateral netting involving a central counterparty). [113] In addition, LCH's Rulebook does not provide for the termination of all Contracts following the insolvency of a Relevant Clearing Member. Rather, Rule 6(b) of the Default Rules entitles LCH "to effect a closing-out in respect of an open contract of the Defaulter (whether by the entering into of a closing-out contract or otherwise) and at the option of the Clearing House to settle such contracts or to effect the transfer or termination, close-out and cash-settlement of an open contract of the Defaulter by applying a price determined by the Clearing House in its discretion". LCH has therefore the right to select whether or not to terminate an open Contract. However, in the legislative process, the parties' agreement on the termination of the whole master agreement (and not only part thereof) has been considered a decisive condition for an agreement to constitute a master agreement.[114]

While LCH's Rulebook and the further Opinion Documents should therefore not qualify as a master agreement within the meaning of section 104 para 2 sentence 3 InsO, the Contracts would nonetheless terminate by virtue of law under the precondition that (i) they are considered executory contracts

---

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

[114] BT-Drucksache 12/7302 p. 168.

and (ii) they qualify either as fixed date transactions on tangible goods or as financial transactions within the meaning of section 104 InsO.[115]

Given that the contractual termination right arises prior to the statutory termination achieved by section 104 InsO, it has to be considered to what extent the termination rights of LCH under Rule 6 are affected by the Selection Right under section 103 InsO as LCH and the Clearing Member may have entered into Contracts within the scope of section 104 InsO but might also have entered into Contracts not falling within its scope. Upon the occurrence of an Automatic Early Termination Event or in the case LCH terminates not only part but all of the Contracts with a defaulting Relevant Clearing Member, the exercise of the insolvency-related termination provision involved in Rules 3, 5 and 6 of the Default Rules may at least be invalid for those Contracts which fall not within the scope of section 104 InsO.

It has therefore to be considered, whether or not such partial invalidity of the insolvency-related termination provision under Rules 3, 5 and 6 of the Default Rules would render these provisions invalid in their entirety, leading to a "contamination" of the insolvency-related termination right also for those Contracts, for which such termination right is enforceable as they fall within the scope of section 104 InsO. In our view, this would be a matter of applicable contract law. Sections 119, 103 InsO only have an effect on those Contracts falling within their scope of application, i.e. not within the scope of section 104 InsO. However, for master agreements within the meaning of section 104 para 2 sentence 3 InsO it is discussed in legal literature whether sections 119, 103 InsO would also have an effect on those Contracts falling within the scope of section 104 if such master agreement is a "mixed master agreement" (master agreements also covering "non-qualifying transactions", i.e. transactions not falling within section 104

---

[115] *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.

para 2 InsO).[116] However, according to Rules 3, 5 and 6 of the Default Rules, LCH is entitled to terminate only part but not all of the Contracts. Accordingly, in our view the Opinion Documents and all Contracts do not constitute a master agreement within the meaning of section 104 para 2 sentence 3 InsO.

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

---

[116] If LCH's Rulebook and the Clearing Membership Agreement were together considered a master agreement, the effects of a partial termination would have to be considered taking also into account section 104 para 2 sentence 3 InsO. Contracts involving financial transactions are combined in a master agreement within section 104 para 2 sentence 3 InsO they shall together be deemed to form one single mutual agreement. Accordingly, these contracts (which all fall within section 104 InsO) can be terminated based on an insolvency-related termination provision. The effects of an insolvency-related termination provision with respect to a master agreement which also covers contracts not falling within the scope of section 104 InsO (i.e. those contracts for which no exception from the application of section 119 Inso applies) are unclear and disputed in legal literature. There are three potential legal consequences described in legal literature for a "mixed master agreement" within the meaning of section 104 para 2 sentence 3 InsO: (1) According to the first interpretation, section 104 para 2 InsO does not apply at all, i.e. one non-qualifying transaction would also prevent the application of section 104 para 2 InsO for such transactions which would qualify as financial transactions. (2) According to the second interpretation, the master agreement is split into two parts where those transactions which qualify as financial transactions (including those transactions under which one of the parties has already fully discharged its obligations) are covered by section 104 para 2 InsO, whereby those transactions which do not qualify as financial transactions remain outside the scope of section 104 para 2 InsO and therefore each of them will be individually subject to the Selection Right. (3) According to the third interpretation, section 104 para 2 InsO applies to all transactions, even if only one ore some of the transactions qualify as financial transactions. See *Jahn/Fried,* in: Münchener Kommentar InsO, 3rd ed. (2013), § 104 no. 176 *et seq.*; *Obermüller*, Insolvenzrecht in der Bankpraxis, 8th. ed. (2011), no. 8.402 *et seq.* In our view, the second interpretation is more in line with the wording than the other interpretations, because section 104 para 2 sentence 3 InsO refers to "financial transactions" only and does in our view not intend to exempt all transactions under a master agreement. Rather, the provision's purpose is to exclude financial transactions from the Insolvency Administrator's Selection Right generally and 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, 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. 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; *von Hall,* Insolvenzverrechnung in bilateralen Clearingsystemen (2010), p. 152 *et seq.*

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 related termination would be permissible for those transactions which fall within the scope of application of section 104 InsO.[117]

This means, whether or not the partial invalidity of under Rules 3, 5 and 6 of the Default Rules would render them as a whole, leading to a "contamination" of a contractual termination right would be a matter of English contractual law only rather than of German insolvency law. Since the Opinion Documents are governed by English law, outside Insolvency Proceedings, a German court would have to consider section 119 InsO an "overriding mandatory provision of German law" in accordance with Article 9 para 2 Rome I. Mandatory provisions within this meaning are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to the extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under Rome I. If a court considered section 119 InsO an overriding mandatory provision of German law, it would, in a second step, have to consider whether the partial invalidity of the insolvency related termination clause would extend to the insolvency related termination clause as a whole. Again, this would be a matter of the interpretation of LCH's Rulebook by

---

[117] According to a view expressed in legal literature (*Andres*, in: Andres/Leithaus, Insolvenzordnung, 2nd ed. (2011), § 119 no. 3), section 119 InsO is a statutory prohibition (*Verbotsgesetz*) within the meaning of section 134 BGB (see paragraph 3.1.1). 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 arguments are therefore that section 119 InsO should be treated as procedural insolvency provision.

such court under English law as the law governing the Contracts (Article 12 para 1 Rome I).

(vi) 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 Contracts 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 15 November 2012[118] may also affect the results of such early termination and, accordingly, the determination of any close-out or the calculation of any termination amounts under LCH's Rulebook. Section 104 InsO para 3 InsO which provides for a calculation method following the early termination of transactions by section 104 InsO is equally protected by section 119 InsO. Accordingly, it could be considered a mandatory provision which must not be contracted out. If such interpretation holds true, the results of a contractual 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

---

[118] BGH WM 2013, 274.

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 judgement of 15 November 2012 excluding the Insolvency Administrator's right to "cherry pick".[119] 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 contracts 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.

(vii) Summary of the effects of sections 103 and 104 InsO

Pursuant to section 340 para 3 InsO, if the Opinion Documents establish a System for purposes of section 1 para 16 KWG the consequences of the opening of Insolvency Proceedings over the assets of a participant in such System should be determined in accordance with English law, so that sections 103 and 104 InsO should not apply. However, there are no authoritative court precedents to confirm this view and various legal issues have to be addressed in determining what constitutes a System. The impact of sections 103 and 104 InsO on the Opinion Documents (if German insolvency law applies) can be summarised as follows:

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

---

[119] BGH WM 2013, 274.

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

(C) However, if according to the contractual termination provision the contract 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.

(D) 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 Opinion Documents, however, should not qualify as a master agreement.

(E) Contracts which do not fall within the scope of section 104 InsO may be subject to the Insolvency Administrator's Selection Right pursuant to section 103 InsO, even if LCH's Rulebook provides for a termination of such Contracts upon the filing for Insolvency Proceedings.

(F) In our view, the calculation of termination values can be contractually agreed between LCH and its Clearing Members. However, if the relevant Contract 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.

(G) Article 102b section 1 para 1 no. 1 EGInsO provides that the performance of necessary measures by a central counterparty 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.

(d) Other acts taken by LCH in accordance with Rule 6 of the Default Rules

In addition to or alternatively to terminating Contracts, under Rule 6 LCH may incur new and additional obligations on behalf of a defaulting Clearing Member for the purpose of settling or liquidating open Contracts (for example by way of entering into opposite transactions or by exercising any options on behalf of the defaulting Clearing Member).

According to section 80 para 1 InsO upon the opening of Insolvency Proceedings an Insolvent Party's right to manage and transfer the insolvency estate shall be vested in the Insolvency Administrator. Furthermore, pursuant to section 81 InsO, any dispositions of the Insolvent Party over its property made after the opening of Insolvency Proceedings are void unless the relevant court otherwise orders. Only dispositions over Financial Collateral effected after the actual opening of Insolvency Proceedings are valid, 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. A "disposition" within the meaning of section 81 InsO is any act that has a direct and immediate effect on the Insolvent Party's assets.[120]

A contractual authorisation of a third party (such as the CCP) to represent the Insolvent Party would, in accordance with section 115 *et seq.* InsO expire upon the opening of Insolvency Proceedings. If the exercise of LCH's rights under Rule 6 were therefore based on a

---

[120] *Lüke* in: Kübler/Prütting/Bork, InsO, 55th ed. (October 2013), section 81 no. 5

contractual authorisation, such authorisation could not be upheld in Insolvency Proceedings.

If the Opinion Documents establish a System, section 340 para 3 InsO may refer to substantial English insolvency laws also with respect to these further measures taken by LCH under Rule 6 instead of applying the provisions of the InsO. Section 340 para 3 InsO refers not only to specific types of agreements (unlike section 340 para 2 InsO) but constitutes a conflicts of laws provision for "rights and obligations of participants in the System". The scope of this provision has to be construed in the light of the EU directives it implements.[121] However, the precise scope of application of section 340 para 3 InsO has not been subject to any court decision and there is, in particular, no guidance as to what extent section 340 para 3 InsO prevails over conflicting insolvency conflict of laws provisions as for example section 339 InsO governing challenge in insolvency or section 351 InsO governing rights *in rem* as regards assets that are located in Germany at the opening of foreign insolvency proceedings.

To the extent section 340 para 3 InsO does not refer to substantial English insolvency laws and, instead, the above-described restrictions under the InsO would apply, we refer to the exemption under Article 102b EGInsO as described in paragraph 3.2.3(f) below.

(e) Insolvency-related set-off

In addition, if substantive German insolvency law applies (please see for its scope of application the conflict of laws analysis in paragraphs 3.2.3(a) and 3.2.3(b) above) insolvency-related restrictions on set-off may be relevant because the netting provisions under LCH's Rulebook, in particular Rule 8 of the Default Rules, involve elements of set-off and, as mentioned above, section 104 InsO provides for the termination

---

[121] Section 340 para 3 InsO implements the SFD. Section 340 para 1 InsO, to which section 340 para 3 InsO refers, implements the WUD and Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings (OJ No L 110 of 20 April 2001, p. 28, "**IWUD**" (Insurance Winding Up Directive)). According to *Ehricke,* WM 2006, p. 2111, both provisions have to be construed equally broad. Based on the wording of Article 23 IWUD and taking into account Recital 24 thereof, which refer to challenge in insolvency, a German Court may construe section 340 para 1 InsO as also containing a conflict of laws provision as regards challenge in insolvency and construe section 340 para 3 InsO equally broad.

of Contracts to form a basis for set-off and provides for the calculation of compensation claims which may serve as a basis for set-off (above, footnote 97) but, in particular absent a master agreement, does not effect the aggregation of compensation claims by set-off.

The following provisions govern set-off upon the opening of Insolvency Proceedings over the assets of the Relevant Clearing Member and are therefore relevant to any set-off agreements (such as settlement and general set-off arrangements irrespective of an early termination and aggregation) if German substantial insolvency law applies.

(i) 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.[122] The extent to which a set-off after the opening of

---

[122] Sections 94 through 96 InsO read in an English convenience 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 unmatured 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 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. The claims are 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 s prohibited if

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

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

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 is in our view to be determined in accordance with the applicable contract law as determined in accordance with applicable conflict of laws provisions.

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.

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 has been 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. [123] The validity of contractual agreements concerning set-off is therefore called into question in German

---

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

4. a debtor 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 s determined in accordance with the definition of business day as stipulated by section 1 para 16b KWG."

[123] *Lüke*, in: Kübler/Prütting, InsO, 55th ed. (October 2013), § 94 no. 7.

legal literature and a restrictive interpretation of section 94 InsO pursuant to which agreements concerning set-off may not override prohibitions of set-off that aim at protecting third parties' rights is proposed.[124] According to this view, such agreements also have to comply with sections 95 and 96 InsO.

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.

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

Pursuant 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*).[125] The BGH took 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.

(iii) 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

---

[124] *Kroth*, in: Braun, Insolvenzordnung, 5th ed. (2012), § 95 no. 20; *K. Schmidt*, NZI 2005, 138, 140 *et seq.*; see also *Brandes/Lohmann*, in: Münchener Kommentar BGB, 3rd ed. (2013), § 94 nos. 44 *et seq.*

[125] BGH NJW 2004, 3185.

conditions are met (section 95 para 1 sentence 1 InsO). Pursuant to section 95 para 1 sentence 2 InsO, section 41 InsO [126] concerning claims not yet due at the date when Insolvency Proceedings are opened and section 45 InsO [127] 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 can 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.[128]

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 effected.[129] 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.

---

[126] Section 41 InsO reads in an English convenience translation as follows: "(1) Unmatured claims are deemed to be mature. (2) If such claims do not bear interest they are discounted at the statutory rate of interest. Thereby they are 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."

[127] Section 45 InsO reads in an English convenience translation as follows: "Non-liquidated claims filed at the value estimated for the date when the Insolvency Proceedings were opened. Claims expressed in foreign currency or in a mathematical unit are 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."

[128] Moreover, section 95 para 1 sentence 3 InsO has been construed restrictively by the BGH in 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.

[129] This is considered as a general principle of German law which also applies under section 94 InsO even though it is not mentioned therein (*Höhn/Kaufmann*, JuS 2003, 751, 753).

(iv) Set-off and challenge in insolvency

In the event an insolvency creditor acquired the right to set off his claim by a transaction which may be challenged, set-off is prohibited pursuant to section 96 para 1 no 3 InsO. This prohibition applies irrespective of whether or not the Insolvency Administrator has actually challenged the transaction. The BGH has decided that a legal act will not be prevented from becoming subject to challenge in insolvency 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.[130] 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 (see paragraph 3.2.4(a)(ii))). Therefore, if a German court took the view that German law on insolvency-related set-off apply to the Default Rules (see, however, paragraphs 3.2.3(a) with respect to the conflict of laws analysis), it could reach the conclusion that the exercise of powers of LCH to bring claims into existence under Rule 6 of the Default Rules as a result of a Relevant Clearing Member's default constitute legal acts which are potentially 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.

(v) 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

---

[130] BGH WM 2013, 1132, 1133.

opportunity to set off his claim by a legal act subject to challenge in insolvency (below, paragraph 3.2.4(a) 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).

(vi) 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).

(f) Effects of Article 102b EGInsO on restrictions under the InsO as regards further measures taken by LCH upon default of a Clearing Member

To the extent sections 103, 104 and 94 to 96 InsO restrict measures taken by LCH, a general exemption applies in our view under Article 102b section 1 EGInsO if such measures by LCH constitute "necessary measures" (*gebotene Maßnahmen*) under Article 102b EGInsO (see generally above, paragraph 3.2.1(g)). Article 102b section 1 EGInsO also protects further measures involving dispositions over the assets of an Insolvent Party which are restricted according to sections 80 *et seq.* InsO or the transfer of its assets (subject to a prohibition to acquire rights in assets of the insolvency estate according to section 91 InsO). In our view, Article 102b EGInsO does not apply to measures taken upon default of a CCP.

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 must not be affected by the opening of Insolvency Proceedings. LCH's various rights to settle Contracts in accordance with Rule 6 other than by way of termination (in particular by entering into offsetting transactions) may therefore fall under the

description of measures within the meaning of Article 48 paras 2 and 3, 5 sentence 3 and 6 sentence 3 EMIR.

As mentioned previously, in the absence of any authoritative court precedents or administrative practice, we construe Article 102b section 1 para 1 no. 1 EGInsO as a provision of substantive law rather than as a conflict of laws provision (paragraph 3.2.1(g)).

Based on our assumption that LCH qualifies as a CCP for purposes of Article 2 point 1 EMIR and provided that the close out of Contracts is a necessary measure in accordance with Article 48 EMIR, Article 102b section 1 para 1 no. 1 EGInsO would in our view prevent the application of restrictions under the InsO and Article 102b section 2 EGInsO would also exclude challenge in insolvency under German law. The application of Article 102b EGInsO is not limited to certain types of Contracts as it is applicable on the performance of necessary measures, i.e. it would apply in respect of all Contracts which are cleared in accordance with the Opinion Documents.

Whilst the validity of the close-out under contract law is a matter of English law and whilst we do not express any opinion as to any matters of English law, if the close-out process complies with Article 48 EMIR, Article 102b EGInsO will prevent the application of, amongst other provisions, sections 80, 94 to 96, 103 and 104 and 129 *et seq.* InsO as far as the legal relationship between the Relevant Clearing Member and LCH is concerned. As set out under paragraph 3.2.1(g) above, we also believe that Article 102b EGInsO applies to the legal relationship between a Relevant Clearing Member and a Client if any necessary measures under Article 48 EMIR will also affect such relationship. The effects of Article 102b section 1 para 1 no. 1 EGInsO are limited to the exclusion of restrictions under the InsO; other legal restriction under German or foreign laws (as the case may be) would apply (see above, paragraph 3.2.1(g)).

(g) Regulatory Proceedings

(i) BaFin may - prior to the filing of an application for the opening of Insolvency Proceedings - issue certain measures under section 46 KWG (see above, paragraph 3.2.1(d)(ii)) including a Moratorium.

It has been suggested that a Moratorium by BaFin has the effect of a deferral (*Stundung*), i.e. extension of the due date.[131] Accordingly, a set-off of obligations would not be permissible in such circumstances (as set-off may not be effected where the claim against which it is to be effected is not due).

In its decision of 12 March 2013, the BGH has held that a Moratorium would not result in a deferral.[132] Instead, the Moratorium creates a temporary obstacle to specific performance and entitles a Relevant Clearing Member to refuse specific performance for as long as the Moratorium continues to exist (based on an analogous application of section 275 para 1 BGB[133]).[134] As an administrative act (*Verwaltungsakt*) directed against a Clearing Member it would have to be published *vis-à-vis* a Clearing Member 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.[135] 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.[136]

---

[131] 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.

[132] BGH WM 2013, 742, 748.

[133] Section 275 para 1 BGB reads in an English convenience translation as follows: "The claim for specific performance is excluded, if performance is impossible for every person or for the debtor."

[134] As a consequence, the creditor of the Relevant Clearing Member would in our view generally be entitled to refuse performance of any counterclaims for as long as the ban continues to exist under section 326 para 1 sentence 1 BGB (applied analogously) which reads in an English convenience translation as follows: "If the debtor is not required to perform in accordance with section 275 paras 1 to 3, the counterclaim shall cease to exist; ..."

[135] BGH WM 2013, 742, 747.

[136] BGH WM 2013, 742, 744.

Whilst the BGH has left this question open, it has made *obiter* remarks indicating that a Moratorium does not prevent set-off. The BGH points out that the purpose of section 46 para 1 sentence 2 no. 4 KWG, i.e. to secure the assets of the Institution concerned and to prevent its insolvency would not prevent set-off. Even Provisional Insolvency Measures and the opening of Insolvency Proceedings would not generally prevent set-off (see above, paragraphs 3.2.1(c) and 3.2.3(e)) and section 46 para 1 sentence 2 no. 4 KWG is not intended to impose restrictions beyond the restrictions Insolvency Proceedings entail.[137] From a German law perspective 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 civil law allows for set-off only, if the claim against which set-off is to be effected can be performed (*Erfüllbarkeit der Hauptforderung*) (section 387 BGB[138]). Whether and under which circumstances set-off in accordance with non-German law against claims of a Relevant Clearing Member which is subject to the Moratorium can be effected is an open question.[139]

The protection afforded to Systems and Financial Collateral under the InsO applies to every Moratorium by way of analogy (section 46 para 2 sentence 6 KWG). Where measures under section 46 KWG are taken in respect of set-off or netting agreements sections 338 and 340 InsO (above, paragraph 3.2.3(b)) apply analogously (section 46d para 3 sentence 2 KWG).

---

[137] BGH WM 2013, 742, 747.

[138] Section 387 BGB reads in an English convenience translation as follows: "If two persons owe each other the performance of claims which are of the same kind, then each part may set off its claim against the claim of the other party as soon as it may demand the performance owed to it and perform the claim it owes."

[139] Prior to the BGH's decision, some authors argued that a ban of sales and payments would not exclude the possibility of set-off to the extent such possibility of set-off comes into existence upon or prior to the coming into force of the ban on payment and sales (*Binder*, Bankeninsolvenzen im Spannungsfeld zwischen Bankenaufsichts- und Insolvenzrecht, 2005, p. 313; *Lindemann*, in: Boos/Fischer/Schulte-Mattler, KWG, 4th ed. (2012), § 46 no. 92).

(ii) BaFin may further issue a Transfer Order where the existence of a Relevant Clearing Member is jeopardised and this in turn jeopardises the stability of the Financial System. As mentioned a Transfer Order (or a Re-Transfer Order) must transfer eligible netting agreements in their entirety (above, paragraph 3.2.1(d)(iv)) but it is not clear whether the Opinion Documents 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.

(iii) The Termination Restrictions may further affect netting and notwithstanding the choice of English law to govern the Opinion Documents (paragraph 3.2.1(d)(iv)) but an exemption will be available if the Opinion Documents qualify as a System from the application of section 13 KredReorgG and in respect of any Financial Collateral. As mentioned above, under section 7 para 5 sentence 2 KredReorgG in connection with section 46d para 3 KWG, section 340 InsO also applies to reorganisation proceedings.

Based on our interpretation of section 340 para 3 InsO (paragraph 3.2.3(b)), if the Opinion Documents constitute a System, one might argue that a German court which would have to consider whether or not the Opinion Documents are effective or whether its effectiveness will be affected by the Termination Restrictions, would be a question of the substantive laws (including insolvency- or reorganisation laws) of the state the laws of which have been chosen by the parties to govern the System, rather than applying German law. Irrespective thereof, absent any authoritative precedents from courts and a detailed analysis in legal literature, it is unclear in which way a German court would resolve the conflict between section 340 InsO particularly for reorganisation measures on the one hand and the direct application of provisions which the German legislator considers to be overriding mandatory provisions of German law under Article 9 para 1 Rome I on the other hand.

The provisions of the KWG on the Transfer Order do not contain a reference to section 46d para 3 KWG, which provides for an application of section 340 InsO. Thus, this conflict of law provision is not applicable. A German court may, thus, consider the Termination Restriction of section 48g para 7 KWG as an overriding mandatory provision within the meaning of Article 9 para 1 Rome I.

(h) Provisional Insolvency Measures

As mentioned previously, Provisional Insolvency Measures do not prevent set-off (above, paragraph 3.2.1(c)). A prohibition to make any dispositions (section 21 para 2 no 2 InsO) will, however prevent the exercise of termination rights by a Relevant Clearing Member which is subject to Provisional Insolvency Measures. If, however, LCH exercises a termination right following the imposition of Provisional Insolvency Measures on a Relevant Clearing Member or an automatic termination event occurs termination would in our view not be prevented by the imposition of Provisional Insolvency Measures. Section 103 InsO does not apply where Provisional Insolvency Measures have been taken (paragraph 3.2.1(c)). This should, in our view, also extend to section 104 InsO which relates to and is a special provision in respect of, section 103 InsO and therefore the imposition of Provisional Insolvency Measures will not generally affect netting. Since Article 102b EGInsO applies to Provisional Insolvency Measures these restrictions under the InsO will particularly not affect netting where netting constitutes a necessary measure under Article 48 EMIR.

(i) Application to LCH's Default Rules

(i) If the Opinion Documents qualify as a System governed by English substantive law, the effects of the opening of Insolvency Proceedings or Regulatory Proceedings (with the exception of the Transfer Order) and Provisional Insolvency Measures on the netting provisions under the Opinion Documents will have to be determined in accordance with English substantive law (i.e. contract and insolvency laws).

(ii) If German insolvency laws apply, then netting would not be enforceable to the extent Contracts fall outside the scope of section 104 InsO.

(iii) It is not entirely clear whether Contracts which fall within the scope of section 104 InsO can be enforced in accordance with their terms or whether section 104 InsO provides for a mandatory calculation method. The aggregation of claims under Rule 8 of the Default Rules to a compensation claim would be subject to restrictions on insolvency set-off.

(iv) Where any close-out netting by LCH qualifies as a necessary measure by a CCP under Article 48 EMIR, there is good reason to conclude that section 104 InsO and the restrictions on set-off would not apply. This, however, only applies to an insolvent Relevant Clearing Member and not to the reverse scenario where LCH is in default.

(v) Measures taken by LCH under Rule 6 of the Default Rules other than terminating and closing-out Contracts may be subject to restrictions under the InsO. However, taking the view that the Opinion Documents qualify as a System governed by English substantive law, the effects of the opening of Insolvency Proceedings or Regulatory Proceedings (with the exception of the Transfer Order) and Provisional Insolvency Measures on such measures would be determined in accordance with English substantive law (i.e. contract and insolvency laws) pursuant to section 340 para 3 InsO. There is no precise guidance as to the scope of section 340 para 3 InsO, in particular other conflicting insolvency conflict of laws provisions.

3.2.4 *Is there a "suspect period" prior to Insolvency Proceedings and/or Reorganisation Measures where Contracts with a Relevant Clearing Member could be avoided or challenged and, if so, what are the grounds? What are the risks for LCH in entering into Contracts and in taking Collateral in respect of those Contracts during such a period? Are any special protections or exemptions from the relevant arrangements for avoidance or challenge available under the law of the Relevant Jurisdiction in respect of contracts in financial markets?*

(a) Challenge in insolvency

Any legal acts performed in accordance with the Opinion Documents may be subject to challenge in insolvency. The applicable German conflict of laws provisions as regards these rules are determined either by the EUIR or the InsO.

(i) Conflict of laws analysis

Where the EUIR applies, Article 13 EUIR provides that German provisions on challenges in insolvency do not apply, if the beneficiary of the relevant act proves that the act as a whole is subject to the laws of a member state other than Germany and that such law does not allow any means of challenge in insolvency the act at the case in point.[140]

Where the InsO applies, section 339 InsO provides that German provisions on challenge in insolvency will not apply, if the beneficiary of the relevant act proves that the act as a whole is subject to the laws of a state other than Germany and that such law does not allow any means of challenge in insolvency in such circumstances.[141]

(ii) German challenge in insolvency in general

Assuming German provisions on challenges in insolvency apply, then 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 challenge periods (*Anfechtungsfristen*) prior to the opening of Insolvency

---

[140] Article 13 EUIR reads as follows:

"Article 4 (2) (m) shall not apply where the person who benefited from an act detrimental to all the creditors provides proof that: the said act is subject to the law of a Member State other than that of the State of the opening of proceedings, and that law does not allow any means of challenge in insolvency that act in the relevant case."

[141] In an English convenience translation, section 339 InsO reads as follows: "A legal act may be subject to challenge, if the requirements for challenge are satisified in accordance with the laws of the jurisdiction in which the insolvency proceedings have been opened, unless the party against which the challenge is instituted (*Anfechtungsgegner*) provides proof that the said act is subject to the laws of another jurisdiction which does not allow the challenge of the relevant legal act in the relevant case."

Proceedings may be subject to challenge by an Insolvency Administrator 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.

Challenge periods are ascertained separately in respect of each legal act. For example, if margin is delivered, substituted or returned under the terms of LCH's Rulebook, the delivery, substitution or return may qualify as new legal acts. The entry into the Clearing Membership Agreement and the termination of the Clearing Membership 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.[142] 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.

---

[142] The condition precedent must not refer to an "insolvency event" (*Insolvenzfall*) which we understand is the case if it refers to the formal opening of Insolvency Proceedings; see *Huhn/Bayer*, ZIP 2003, 1965 *et seq.*; *Kirchhof*, in: Münchener Kommentar InsO, 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 3.2.3(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.

If BaFin has, prior to a Relevant Clearing Member's insolvency, taken measures under section 46 para 1 KWG such as a Moratorium to prevent the Relevant Clearing Member from becoming illiquid (see paragraph 3.2.1(d)(ii)) and Insolvency Proceedings are subsequently opened, challenge 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. Furthermore, where legal acts have been made between the imposition of regulatory 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 deemed not to be detrimental to creditors as a whole (section 46c para 2 sentence 1 KWG).

(iii) Challenge provisions relevant to legal acts made in connection with a Clearing Member's clearing through LCH

Legal acts made in connection with the Opinion Documents 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, 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 Relevant Clearing Member 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 Relevant Clearing Member's inability to make payments or the petition for opening of Insolvency Proceedings at the

time of the legal act ("congruent coverage" (*kongruente Deckung*)).

Knowledge of circumstances which necessarily lead to the conclusion that the Relevant Clearing Member was unable to make payments is regarded as equivalent to actual knowledge of the insolvent Relevant Clearing Member's pending inability to make payments or of the filing for opening of Insolvency Proceedings (section 130 para 2 InsO).

(B) Pursuant to section 131 InsO, a challenge period of one to three months applies where a legal act gives or makes available to a creditor, security or satisfaction to which it has no right or no right to claim in such manner or at such time, and the corresponding legal act is subject to challenge if either, (i) the legal act is effected during the last month prior to filing for the opening of Insolvency Proceedings or following such filing; or, (ii) the legal act is effected during the second or third month prior to filing for the opening of Insolvency Proceedings and the insolvent Relevant Clearing Member 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 Relevant Clearing Member. In relation to (iii), knowledge of circumstances that necessarily lead to the conclusion that a legal act is detrimental to the insolvent Relevant Clearing Member is equivalent to actual knowledge of such detriment (section 131 para 2 InsO ("incongruent coverage" (*inkongruente Deckung*))).

A legal transaction (*Rechtsgeschäft*) by the insolvent Relevant Clearing Member that is directly detrimental to the creditors is subject to challenge action, (i) if it was effected in the last three months prior to the filing for the opening of Insolvency Proceedings, if the insolvent Relevant Clearing Member 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 Relevant Clearing Member to make payments or of the petition for opening of Insolvency Proceedings at the time of the legal transaction (section 132 para 1 InsO).

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

(D) A legal act made by the insolvent Relevant Clearing Member 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 action, if the other party was aware of the debtor's intention on the date of such legal act (section 133 para 1 sentence 1 InsO). Such awareness is presumed if the Solvent Party knew of the imminent inability of the insolvent Relevant Clearing Member to make payment when due including circumstances which compel this conclusion), and that the transaction constituted a disadvantage for the creditors (section 133 para 1 sentence 2 InsO).

(E) Under section 133 para 2 InsO, a contract for a consideration entered into by the insolvent Relevant Clearing Member and a person with whom the insolvent Relevant Clearing Member has a close relationship which is directly detrimental to the creditors is 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 Relevant Clearing Member 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 in insolvency provisions is presumed (sections 130 para 3, 131 para 2 sentence 2 and 132 para 2 InsO).[143]

(F) Under section 147 sentence 1 InsO legal acts which are performed after the opening of the Insolvency Proceedings but are legally effective in accordance with section 81 para 3 sentence 2 InsO (above, paragraph 3.2.1(e)) may be subject to challenge in insolvency. The provisions governing a challenge in insolvency in respect of legal acts performed before the Insolvency Proceedings were opened (as set out in this paragraph) apply under section 147 sentence 1 InsO as if the relevant legal acts had been made before Insolvency Proceedings were opened. In respect of legal acts relating to claims and performances which fall within the scope of section 96 para 2 InsO (below, paragraph 3.2.3(e)(vi)) the application of section 147 sentence 1 InsO shall, however, not reverse the set-off of account balances or affect the validity of the payment orders, orders of payment services providers or intermediate

---

[143] If the Insolvent Party is a legal person, the term "person with whom the insolvency debtor has a close relationship" shall, in accordance with section 138 para 2 InsO in an English convenience translation, mean:

"1. the members of the management or supervisory board and personally liable shareholders of the insolvent party as well as person which hold more than one quarter of the insolvent party's share capital;

2. a natural or legal person which due to a comparable connection with the insolvent party established under the articles of association, partnership agreement or under a service contract is able to obtain information on the insolvent party's economic situation;

3. a person as described under nos. 1 and 2 which has a personal relationship as set out under paragraph 1 (i.e. in particular near relatives and persons which under contractual arrangements are able obtain information on the insolvent party's economic status) unless the person described under nos. 1 and 2 is under a statutory obligation to maintain confidentiality in matters of the insolvent party."

providers or orders for the transfer of securities (section 147 sentence 2 InsO).

(b) Defences 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 English law pledge (or any security interest under the laws of another state) or full title transfer qualifying as Financial Collateral and made to secure obligations under the Opinion Documents 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. Initial margin is calculated to cover LCH's potential future exposures to counterparties in the interval between the last margin requirement and the close-out of Contracts and liquidation of collateral following a Counterparty's default. Variation margin may therefore qualify as margin collateral whereas initial margin should not qualify as such.[144]

Section 142 InsO provides that payments on the part of a insolvent Relevant Clearing Member in return for which the insolvent Relevant Clearing Member's estate benefited immediately and directly (*unmittelbar*) from an equivalent (*gleichwertig*) consideration (i.e. there was an exchange of services or goods of the same value within a narrow time frame[145]) would only be subject to challenge in insolvency,

---

[144] Section 130 para 1 sentence 1 InsO refers to the adjustment of the relation between the values 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.

[145] BGH NJW 2002, 1722, 1724.

if the payment was made with the intention to prejudice the creditors as set out under section 133 para 1 InsO (above, paragraph 3.2.4(a)(iii)(D)).

As mentioned before (paragraph 3.2.1(g)), 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.

3.2.5 *Is there relevant netting legislation in the Relevant Jurisdiction that, in the context of Insolvency Proceedings or Reorganisation Measures in respect of a Relevant Clearing Member, might apply as an alternative to the relevant arrangements set out in the Default Rules*?

Yes, within the scope of application of the InsO, section 104 InsO provides for a mandatory automatic termination of those transactions which fall within the scope of section 104 InsO upon the opening of Insolvency Proceedings (see above paragraph 3.2.3(c)).

3.2.6 *Can a claim for a close-out amount be proved for in Insolvency Proceedings without conversion into the local currency*?

In order to receive payment of claims in Insolvency Proceedings, the creditor of an Insolvent Party should register its claims with the Insolvency Administrator within a certain period of time supporting the registration with the relevant documents and state the basis and amount of the claim (section 174 para 1 InsO).[146]

After the opening of Insolvency Proceedings, for the purposes of such registration cash payment claims against an Insolvent Party in a currency other than Euro must be converted into Euro at an exchange rate applicable at the place of performance at the time of the opening of the Insolvency Proceedings (section 45 sentence 2 InsO).

According to the BGH, the official exchange rate applicable on the date of the opening of Insolvency Proceedings at the place of payment applies and the place of payment is the place where the Insolvency Proceedings have been

[146] This does not apply to claims of a creditor having a right to segregation (*Aussonderungsrecht*) or creditors of the estate, *Riedel* in: Münchener Kommentar InsO, 3rd ed. (2013), § 174 no. 6.

opened.[147] With respect to enforcement proceedings, however, it is proposed that cash payment claims in a currency other than Euro are converted at the official conversion rate on the date and at the place of payment.[148]

3.3 Client Clearing

3.3.1 *Please opine on the availability and effectiveness of any law, regulation or statutory provision (having the force of law) in the Relevant Jurisdiction which (if so designated by LCH) would be expected to qualify as an Exempting Client Clearing Rule. Please clarify whether the relevant Exempting Client Clearing Rule would be expected to apply to Relevant Clearing Members of all entity types or to only certain entity types.*

If, and to the extent that, you consider such an Exempting Client Clearing Rule to be available, please (i) assume for the purposes of answering the following Questions that LCH will rely upon the existence of the relevant Exempting Client Clearing Rule and will not require those Relevant Clearing Members to which that Exempting Client Clearing Rule applies to enter into a Security Deed; and (ii) ignore Questions 3.3.7 to 3.3.9.

In cases where you do not consider an Exempting Client Clearing Rule to be available, please: (i) assume for the purposes of answering the following Questions that LCH will require Relevant Clearing Members to enter into a Security Deed; (ii) assume that the Security Deed is legal, valid, binding and enforceable under English law (as its governing law) and complies with all relevant perfection requirements under the law of any jurisdiction(s) other than the Relevant Jurisdiction which you consider to be relevant to that matter; and (iii) provide a response to Questions 3.3.7 to 3.3.9.

We understand that an "Exempting Client Clearing Rule" would be any law or regulation protecting the validity of actions taken under the Client Clearing Annex of the Default Rules (in particular the porting of client assets and positions to a backup clearing member) from challenge under the insolvency laws applicable to the Relevant Clearing Member.

---

[147] BGH NJW 1989, 3155 (on the KO); *Andres*, in: Nehrlich/Römermann, Insolvenzordnung, 24th update (2012), § 45 no. 4; see, however, *Bitter*, in: Münchener Kommentar InsO, 3rd ed. (2013), § 45 no. 20).

[148] *Bach*, in: Beck'scher Onlinekommentar ZPO, (2013), § 722 Rn. 27).

As already outlined in paragraph 3.2.1, the InsO and EGInsO provide for different exemptions from application of its restrictions, in particular the challenging rights thereunder.

(a) Article 102b EGInsO

Where German insolvency laws apply, Article 102b EGInsO provides for a general rule under which certain mandatory provisions in Insolvency Proceedings and Provisional Insolvency Measures do not apply if they would affect measures considered necessary in accordance with Article 48 EMIR (see paragraph 3.2.1(f)). In particular, 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, these measures shall not be subject to insolvency avoidance and challenge.

With respect the scope of application of Article 102b EGInsO and its effects in general, see paragraph 3.2.1(g) above and with respect to its effect on measures taken by LCH under Rule 6 and 8 of the Default Rules, please see also paragraph 3.2.3(f) above.

In particular, there are two limitations of the scope of application of Article 102b EGInsO: (i) It protects necessary (*gebotene*) measures taken by a CCP in accordance with Article 48 EMIR only and (ii) it is an insolvency law provision therefore not addressing any property or contractual law aspects in connection with Article 48 EMIR and any necessary measures thereunder. It is not entirely clear how the term "necessary" should be construed in this context and whether CCPs have discretion in determining the measures which are necessary under specific circumstances.

Accordingly, we cannot confirm that Article 102b EGInsO provides for the required level of protection from insolvency laws and other laws affecting measures to be taken by a CCP as would be expected to be granted under an Exempting Client Clearing Rule.

(b) Rules applicable to Systems

Further specific exemptions from certain mandatory restrictions under the InsO apply to Systems, please see also paragraph 3.2.1(f) above.

In Insolvency Proceedings specific conflict of laws provisions apply with respect to rights and obligations of participants in Systems (Article 9 EUIR, see paragraph 3.2.3(a), and section 340 para 3 InsO, see paragraph 3.2.3(b)). Within the scope of application of the InsO, exemptions for Systems apply with respect to insolvency related set-off (paragraph 3.2.3(d) below) and the enforcement of security (paragraph 3.2.2(c) below).

Whilst we take the view that the Opinion Documents establish a System, absent any court decisions on the definition of the term "System" and on the scope of application of section 340 para 3 InsO, a German court may also take a different view.

(c) Relationship between section 340 para 3 InsO and Article 102b EGInsO

Special conflict of law provisions referring to English substantive law (section 340 para 3 InsO) would apply to the Opinion Documents if they qualify as a System. In such case, Article 102b EGInsO would not be applicable because Article 102b EGInsO is a provision of substantive law rather than as a conflict of laws provision. Therefore, Article 102b EGInsO only applies if German insolvency law applies.

However, if the Opinion Documents do not constitute a System or section 340 para 3 InsO cannot be construed that English substantive insolvency law applies with respect to the effects of the opening of Insolvency Proceedings over the assets of a Relevant Clearing Member, then substantive German law applies. In such case, Article 102b EGInsO would apply to the Opinion Documents.

The legal risk resulting from the uncertainties described in paragraphs 3.3.1(a) and 3.3.1(b) above can be mitigated by entering into a Security Deed, thereby creating a security interest in favour of the Relevant Clearing Member's clients (see also paragraphs 3.3.8 *et seq.* below).

3.3.2 *If LCH were to: (i) declare a Relevant Clearing Member to be in Default in circumstances other than the commencement of Insolvency Proceedings or*

Reorganisation Measures in respect of that clearing member and (ii) seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could the Relevant Clearing Member or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?

(a) Porting under the Rulebook

Prior to analysing the rights of a Relevant Clearing Member or other person to successfully challenge the actions of LCH, we summarise our understanding of the term "porting" as used herein as follows:

"Porting" includes the transfer of Client Contracts of a Relevant Clearing Member (by way of novation) to a Backup Clearing Member, together with the Account Balances pursuant to the Default Rules, including the Client Clearing Annex.[149] In such case, the Relevant Clearing Member is "deprived" of any entitlement to the collateral posted by it (in the form of either the Account Balance or the Client Clearing Entitlement) as it is transferred to the Backup Clearing Member.

The term "Account Balance" as defined in the General Regulations means such part of the collateral granted by the Relevant Clearing Member which is attributable to the relevant client account held by the Relevant Clearing Member on behalf of such client and which is attributed by LCH to the relevant client.

Collateral granted in this context means either security over cash which is granted by way of outright title transfer or, with respect to non-cash collateral granted under the Deed of Charge, any cash amounts after realisation of the relevant security interest that exceed the Relevant Clearing Member's obligations to LCH.

(b) Contractual law analysis

If Insolvency Proceedings have not been opened over the assets of a Relevant Clearing Member, the choice of English law to govern the

---

[149] The relevant rules are General Regulation 11 and Rules 6 to 9 of the Client Clearing Annex (set out in Schedule 1 to the Default Rules).

transfer or termination and re-establishment of Contracts as a contractual matter and the agreement on the scope and preconditions for release of collateral as a contractual matter would, from a German conflict of laws perspective generally be recognised unless it involved the transfer of property rights, in which case mandatory conflict of laws rules must be observed (see paragraph 3.2.2(b) above).

(c) Insolvency laws affecting porting

If Insolvency Proceedings are opened, German mandatory insolvency laws including provisions on challenge in insolvency may apply to the transfer (see generally paragraph 3.2.4(a) above).

However, special conflict of law provisions would apply to the Opinion Documents if they qualify as a System and refer to English substantive law (Article 9 EUIR, section 340 para 3 InsO).

If the Opinion Documents do not qualify as a System and German insolvency law applies, section 102b EGInsO provides for exemptions from mandatory insolvency provisions under the following circumstances: Based on our assumption that LCH qualifies as a CCP for purposes of EMIR and provided that the transfer of the Contracts and collateral are necessary measures in accordance with Article 48 EMIR, an exemption from German insolvency laws would potentially apply although its scope is unclear as such exemption only recently been enacted. Please also refer to paragraph 3.2.1(g) above. We also note that no specific amendments have been made to other laws such as property laws to fully implement this provision.

3.3.3 *If LCH were to: (i) declare a Relevant Clearing Member to be in Default in circumstances other than the commencement of Insolvency Proceedings or Reorganisation Measures in respect of that clearing member; and (ii) seek to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client, could the Relevant Clearing Member or any other person successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement*?

If Insolvency Proceedings have not been opened over the assets of a Relevant Clearing Member, the choice of English law to govern the scope of the

Relevant Clearing Member's claim for return of the Client Clearing Entitlement[150] as a contractual matter would, from a German conflict of laws perspective generally be recognised unless it involved the transfer of property rights, in which case different conflict of laws rules apply (see paragraph 3.2.2(b) above).

With respect to Insolvency Proceedings being subsequently opened, please see paragraph 3.3.2(c) above and paragraph 3.3.6 below.

3.3.4 *If (i) following the commencement of Insolvency Proceedings, a Relevant Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could an insolvency officer appointed to the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?*

(a) Effects of the opening of Insolvency Proceedings

If the Opinion Documents qualify as a System both, Article 9 EUIR and section 340 para 3 InsO would refer to English substantive law with respect to effects of Insolvency Proceedings (see paragraphs 3.2.3(a), 3.2.3(b) and 3.2.4(a)(i) above) given that the Opinion Documents (including the account relationships of all collateral accounts) are governed by English law. On this basis, provided the arrangements of the Opinion Documents are effective and allow the distinction of a Client's assets from any other assets as a matter of English law (as to which we express no opinion) neither porting of assets related to Accounts which are segregated under the Opinion Documents nor the porting of Client Contracts and the Account Balance of a Clearing Client to a Backup Clearing Member would be affected by the opening of Insolvency Proceedings if the arrangements providing for segregation and portability as between LCH, the defaulting Relevant Clearing Member, its Client and the backup

---

[150] Such term defined in Clause 9.1 of the Client Clearing Annex as "the entitlement to Collateral (and any close-out amounts referred to in (a) of this paragraph 9.1) (the "**Client Clearing Entitlement**") of the Defaulter in respect of each such Clearing Client [...]".

Clearing Member are valid and all transfers are validly made as a matter of English law.

As mentioned previously, the precise scope of application of section 340 para 3 InsO has not been subject to any court decision and there is, in particular, no guidance as to what extent section 340 para 3 InsO prevails over conflicting insolvency conflict of laws provisions as for example section 339 InsO governing challenge in insolvency or section 351 InsO governing rights *in rem* as regards assets that are located in Germany at the opening of foreign insolvency proceedings. Furthermore, section 340 para 3 InsO does not address property law aspects and it is therefore necessary to ensure that all transfers comply with applicable property law.

However, if German insolvency laws apply, the restrictions set out under paragraph 3.2.1(a) above in particular the prohibitions on the Insolvent Party to dispose of its assets apply and have to be observed. To the extent the porting of Client Contracts is not effected in accordance with Article 48 EMIR and Article 102b EGInsO is not applicable, the transfer would potentially be subject to all the restrictions the opening of Insolvency Proceedings entails (see paragraph 3.2.1(a) and 3.2.3(b) above), including challenge in insolvency (see paragraph 3.2.4) but partial exemptions may apply. Such partial exemptions are available if Financial Collateral is granted (see paragraph 3.2.1(e)). Furthermore, where "porting" is effected by means of close-out and re-establishment, the analysis given in respect of close-out netting at paragraph 3.2.3(c) above applies. Upon the opening of Insolvency Proceedings security interests generally must be enforced in accordance with the InsO, i.e. it would have to be determined whether a security interest grants a right for segregation or separate satisfaction (paragraph 3.2.2(c)).

In addition to restrictions under insolvency laws (and even if an exemption applied), any transfer would have to be made in accordance with applicable civil and property law requirements. If applicable, German law, for example, would not allow for the transfer of pledged assets unless the pledgor, the legal owner of the assets, has given its consent. Where Insolvency Proceedings are opened over the assets of a pledgee this would under German law not result in the pledge ceasing

to exist. Rather, the pledge would continue to exist until the security purpose ceased to exist.

According to the legislative materials, the German legislator wrote the exemption to ensure that measures taken by a CCP in accordance with EMIR upon a default of one of its Relevant Clearing Members are valid as a matter of German insolvency law.[151] We note that no specific amendments have been made to other laws such as property laws to fully implement this provision.

(b) Provisional Insolvency Measures

Where applicable, Article 102b section 1 para 2 EGInsO exempts necessary measures taken in accordance with Article 48 of EMIR from the effects of Provisional Insolvency Measures and therefore our reasoning given at the preceding paragraph applies analogously to Provisional Insolvency Measures.

3.3.5 *If (i) following the commencement of Insolvency Proceedings, a Relevant Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client, could an insolvency officer appointed to the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement?*

Please refer to our comments made in paragraph 3.3.4.

3.3.6 *If (i) following the implementation of Reorganisation Measures, a Relevant Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could the representative appointed to reorganise/manage the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?*

---

[151] BT-Drucksache 17/11289, p. 27.

Please see paragraph 3.2.1 for an overview of Insolvency Proceedings, Provisional Insolvency Proceedings and Regulatory Proceedings under the laws of Germany.

Certain measures under Regulatory Proceedings such as the closure of a Relevant Clearing Member for ordinary business with clients (section 46 para 2 sentence 2 no. 5 KWG), the imposition of a Moratorium and, in particular, the Transfer Order may affect portability (see further paragraph 3.2.1(d) above). Taking the view that the Opinion Documents qualify as a System or that ported positions qualify as Financial Collateral, however, exemptions are available (above, paragraphs 3.2.1(f)).

Since Article 102b EGInsO only refers to Insolvency Proceedings and Provisional Insolvency Measures, it would not apply to prevent the application of any restriction under other laws, i.e. porting would have to be made in accordance with applicable substantive civil law (including property law) and may be affected by the opening of Regulatory Proceedings.

To summarise, our reasoning is that German law generally refers to English law as far as contract aspects of actions taken in connection with the Default Rules are concerned, while restrictions under Insolvency and Regulatory Proceedings as well as Provisional Insolvency Measures may affect porting. A general exemption from Insolvency Proceedings and Provisional Insolvency Measures apply if porting constitutes a necessary measure under Article 48 EMIR. Further (albeit less comprehensive) exemptions would be available if the Opinion Documents constitute a System or if porting involves Financial Collateral; such partial exemptions are also available in Regulatory Proceedings.

With respect to Insolvency Proceedings and Provisional Insolvency Proceedings, please refer to paragraph 3.3.4.

3.3.7 *If (i) following the commencement of Reorganisation Measures, a Relevant Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client, could the representative appointed to reorganise/manage the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement*?

Please see paragraph 3.3.6 above.

3.3.8 *Would the Security Deed provide an effective security interest under the laws of the Relevant Jurisdiction over the Account Balance or Client Clearing Entitlement in favour of the relevant Clearing Client*?

We understand from the fact pattern that German conflict of laws provisions on the creation of a security interest refer to English law because no assets located in Germany are the subject of the security interest to be created under the Security Deed.

Please see above in paragraph 3.2.2 for an analysis with respect to a security interest governed by English law including an analysis of applicable mandatory conflict of laws provisions as regards the valid creation of a security interest.

3.3.9 *Are there any perfection steps which would need to be taken under the laws of the Relevant Jurisdiction in order for the Security Deed to be effective*?

To the extent German conflict of laws provisions refer to English law with respect to the creation of a security interest, no filing or registration is required under German law in addition to any English law requirements to ensure that German law recognises the validity of the security interest as the recognition of the English law as the law governing the security interest also extends to any filing, registration or perfection requirements.

Further, there are no filing or registration requirements under German law which are merely based on the status of the Relevant Clearing Member having its place of establishment, incorporation or registration Germany.

3.3.10 *Is there any risk of a stay on the enforcement of the Security Deed in the event of Insolvency Proceedings or Reorganisation Measures being commenced in respect of a Relevant Clearing Member*?

Please see above in paragraph 3.2.2 applicable provisions of German law as regards the enforcement of a security interest governed by English law in particular in Insolvency Proceedings.

3.4 *Please provide brief details of any other significant legal or regulatory issues which might be expected to arise in connection with the provision by a Relevant Clearing Member of Client Clearing Services and which are not covered by the Questions above.*

We are not aware of any such issues but we are happy to look into this again upon further guidance on the issues you are looking for.

4. QUALIFICATIONS

4.1 Even where a German court would normally have to recognise the choice of the laws of England to govern the contractual obligations under the Opinion Documents, it may,

4.1.1 give effect to mandatory provisions of the law of the country where the obligations arising out of the Opinion Documents have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the contract unlawful (Article 9 para 3 Rome I);

4.1.2 apply overriding mandatory provisions of German law (Article 9 para 2 Rome I) irrespective of the choice of the laws of England for the Opinion Documents;

4.1.3 refuse to apply the laws of England to the Opinion Documents, to the extent the application of the laws of England is manifestly incompatible with German public policy (Article 21 Rome I);

4.1.4 have regard to the law of the country in which performance takes place in relation to the manner of performance and the steps to be taken in the event of defective performance (Article 12 para 2 Rome I); and

4.1.5 apply the provisions of the law of another Member State which cannot be derogated from by agreement, if all elements relevant to the situation at the time that the Opinion Documents were entered into were located in a Member State other than England (Article 3 para 3 Rome I).

4.2 Pursuant to Article 34 Brussels I Regulation German courts do generally not recognise a judgment under the Brussels I Regulation

4.2.1 if such recognition would be manifestly contrary to public policy in the Member State in which recognition is sought;

4.2.2 where it was given in default of appearance, if the defendant was not served with the document which instituted the proceedings or with an equivalent document in sufficient time and in such a way as to enable him to arrange for his defence, unless the defendant failed to commence proceedings to challenge the judgment when it was possible for him to do so;

4.2.3 if it is irreconcilable with a judgment given in a dispute between the same parties in the Member State in which recognition is sought; and

4.2.4 if it is irreconcilable with an earlier judgment given in another Member State or in a third State involving the same cause of action and between the same parties, provided that the earlier judgment fulfils the conditions necessary for its recognition in the Member State addressed.

4.3 Where German law applies, the German law principle of *Treu und Glauben* (section 242 BGB) requires that agreements are performed in good faith. Actions violating such principle by one party may result in certain "equitable" rights in favour of its counterparty being upheld by the German courts or may make agreements or commitments unenforceable or void.

4.4 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).[152] If over-collateralisation occurs subsequently, 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.[153]

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

---

[152] 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.

[153] Pursuant to the BGH (NJW 1998, 671, 674) 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 where 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 the accessory nature of a pledge, the pledge only exists in the amount of the secured obligation (including any future obligation). However, if pledged 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.

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[154]). We are not aware of any court precedents supporting the application of the *ordre public* in such case.

4.5 The general terms and conditions of German banks as published by the relevant German bankers' associations are frequently used by Credit Institutions. Where these general terms and conditions govern a business relationship with a Credit Institution, any account maintained with the Credit Institution are usually subject to a first ranking account pledge created in favour of the Credit Institution. Even where no such standardised terms and conditions are used, similar general terms and conditions are most likely to be in place when dealing with a Credit Institution. For purposes of this Opinion Letter, we have only reviewed the Opinion Documents and only expressed an opinion on the Opinion Documents without taking into consideration further documents which may have an impact on our analysis.

4.6 On the basis of section 2 lit (b) of Article VIII of the International Monetary Fund Agreement, as implemented 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.

4.7 Any transfer of rights or payment in respect, or other performance, of an obligation under the Opinion Documents involving the government of any country which is currently the subject of United Nations or EU 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.

4.8 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

---

[154] *Sonnenberger*, in: Münchener Kommentar BGB, 5th ed. (2010), Article 6 EGBGB no. 62; *Mülbert/Bruinier*, 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.

submitted to the Deutsche Bundesbank using the applicable notification forms. Any failure to comply would, however, not affect the validity of the respective transaction.

4.9 We do not express any opinion on the German Federal Data Protection Act (*Bundesdatenschutzgesetz*) or on German law principles governing bank secrecy.

4.10 We express no opinion as to whether any party has complied with any applicable provisions of Title II EMIR, any delegated or implementing acts adopted under EMIR, the provisions 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 it in relation to or in connection with the Opinion Documents other than provisions on which we expressly opine. However, Article 12 para 3 EMIR provides that any infringement of the rules under Title II EMIR "shall not affect the validity of an OTC derivative contract or the possibility for the parties to enforce the provisions of an OTC derivative contract", consequently any failure by a party to so comply should not make the Opinion Documents invalid or unenforceable.

4.11 Any set-off against a claim of a Credit Institution which is established as a public law entity is only permissible if payment is to be attributed to the same fund (*Kasse*) (i.e. where the entity has an administrative sub-division administering its own budget) of such German public law entity from which the claim of the party intending to effect the set-off is to be paid (section 395 BGB).

4.12 Credit Institutions which are established as public law entities may enter into contracts under private law where this is not expressly prohibited. However, where they engage in commercial acts under private law they are bound by the general restrictions applicable to German public law entities. In particular, they are bound by the fundamental rights (*Grundrechte*) of the German Constitution and the rule of law (*Rechtsstaatsprinzip*). On the facts of each individual case, the German courts may therefore reach the conclusion that general restrictions of Credit Institutions under public law prevent them from entering into certain types of transactions or oblige to refrain from exercising certain rights or to exercise their rights in a certain manner.

4.13 Under the German public law doctrine of *ultra vires*, the power and capacity of a legal entity established under public law to validly enter into a legally binding agreement under private law is limited. Public law entities may principally only enter into transactions that fall within their scope of competence (*Verbandskompetenz*) and functions (*Wirkungskreis*) as defined by the laws establishing or applicable laws

conferring its powers and capacities upon such public law entity.[155] If a public law entity purports to enter into a contract under private law that is beyond or exceeding its functions, such a contract might be considered *ultra vires* and therefore void.[156] Provided that the *ultra vires* doctrine is applicable, it applies regardless of the good faith of the counterparty or any representation by the public law entity to the contrary. As a rule, *ultra vires* measures are unenforceable. They may not be ratified.

4.14 It is often argued that public sector entities are subject to a prohibition on speculation even though the legal basis of such prohibition is very unclear.[157] The prohibition on speculation would prevent public sector entities from entering into transactions for speculative purposes. In the absence of a clear legal basis or this principle the position of German courts has been that the prohibition on speculation – irrespective of the question whether and to what extent it constitutes a rule of law – would not lead to the voidness of contracts under section 134 BGB.[158]

Yours faithfully,

Dr. Marc Benzler

CLIFFORD CHANCE DEUTSCHLAND LLP

---

[155] BGH NJW 1956, 746, 747; BGH NJW 1969, 2198, 2199; Higher Administrative Court (*Oberverwaltungsgericht*) Lüneburg NVwZ-RR 2010, 639, 641.

[156] BGH NJW 1956, 746, 747 *et seq.*; *Gurlit*, in: Erichsen/Ehlers, Allgemeines Verwaltungsrecht, 14th ed. (2010), § 31 no. 5.

[157] OLG Bamberg BKR 2009, 288, 292.

[158] OLG Naumburg NJOZ 2005, 3420, 3425; LG Düsseldorf, judgment of 11 May 2012 – 8 O 77/11.

Appendix 1 – Clearing Membership Agreement

CLEARING MEMBERSHIP AGREEMENT

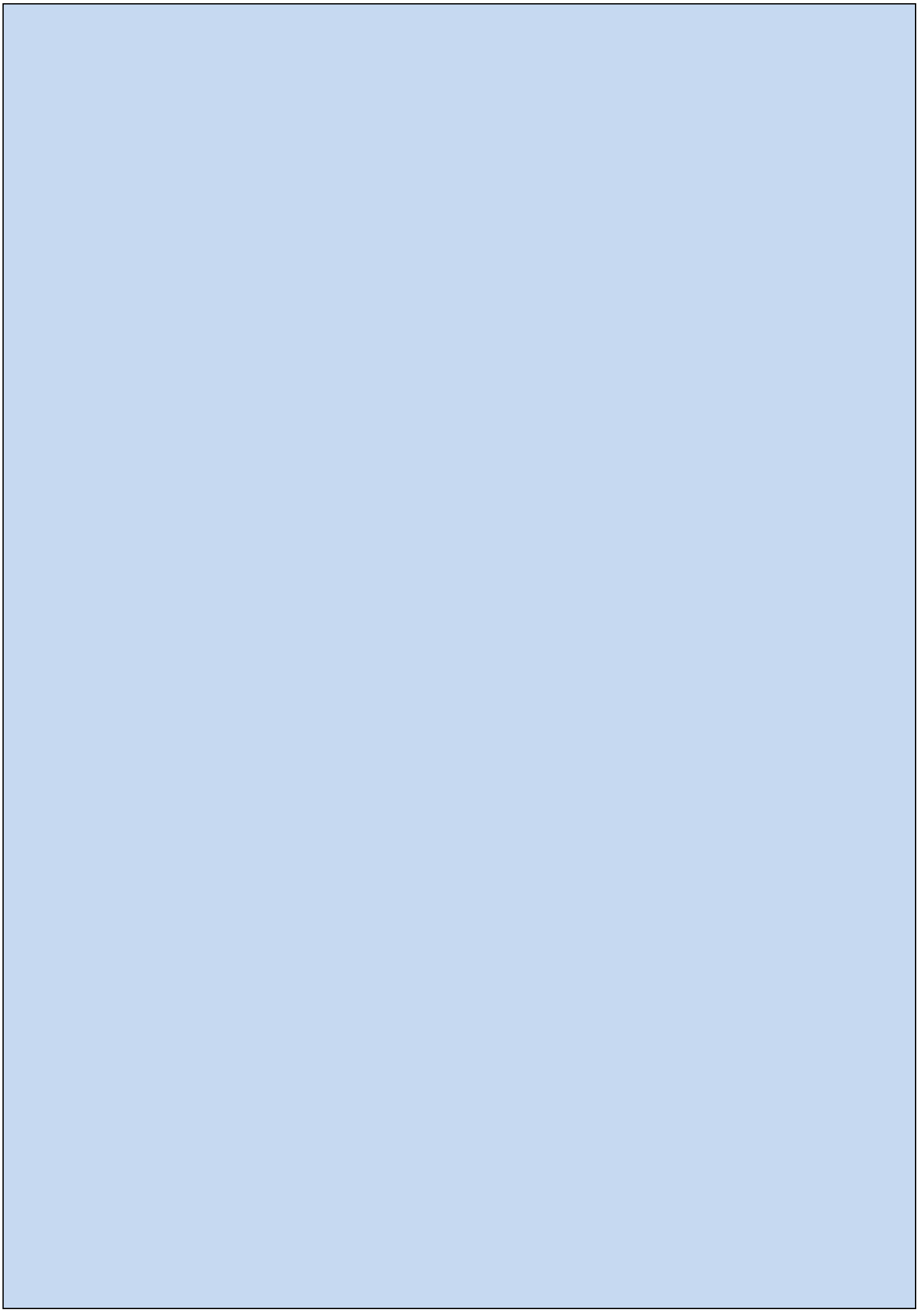
DATED

LCH.CLEARNET LIMITED

and

("the Firm")

Address of the Firm



THIS AGREEMENT is made on the date stated above

BETWEEN the Firm and LCH.CLEARNET LIMITED ("the Clearing House"), whose registered office is at Aldgate House, 33 Aldgate High Street, London, EC3N 1EA.

WHEREAS:

A The Clearing House is experienced in carrying on the business of a clearing house and undertakes with each Clearing Member the performance of contracts registered in its name in accordance with the Rulebook;

B The Clearing House has been appointed by certain Exchanges to provide central counterparty and other services in accordance with the terms and conditions of the Rulebook and certain agreements entered into between the Clearing House and such Exchanges;

C The Clearing House also provides central counterparty and other services to participants in certain over-the-counter ("OTC") markets in accordance with the terms of this Agreement and the Rulebook;

D The Firm desires to be admitted as a Clearing Member of the Clearing House to clear certain categories of Contract agreed by The Clearing House with the Firm and, the Clearing House having determined on the basis inter alia of the information supplied to it by the Firm that the Firm satisfies for the time being the relevant Criteria for Admission, the Clearing House agrees to admit the Firm as a Clearing Member subject to the terms and conditions of this Agreement.

NOW IT IS HEREBY AGREED as follows:-

1 INTERPRETATION AND SCOPE OF AGREEMENT

1.1. Unless otherwise expressly stated, in this Agreement:

(a) "Cash Cover" means cover for margin (within the meaning of that term in the "Definitions" section of the Rulebook) provided in the form of a cash deposit with the Clearing House;

(b) "Clearing Member" means a Person who has been admitted to membership of the Clearing House and whose membership has not terminated;

(c) "Contract" means a contract or transaction eligible for registration in the Firm's name by the Clearing House in accordance with the Rulebook;

(d) "Contribution" and "Contribution to the Default Fund" mean the sums of cash deposited by the Firm as cover in respect of the Firm's obligation to indemnify the Clearing House as provided by clause 9 of this Agreement and the Default Rules;

(e) "Criteria for Admission" means criteria set out in one or more documents published from time to time by the Clearing House, being criteria to be satisfied by an applicant for admission as a Clearing Member in respect of the Designated Contracts which the applicant wishes to clear with the Clearing House;

(f) "Default Fund" means the fund established under the Default Rules of the Clearing House to which the Clearing Member is required to contribute by virtue of clause 9 of this Agreement;

(g) [DELETED]

(h) "Default Notice" means a notice issued by the Clearing House in accordance with the Default Rules in respect of a Clearing Member who is or is likely to become unable to meet its obligations in respect of one or more Contracts;

(i) "Default Rules" means that part of the Rulebook having effect in accordance with Part IV of the Financial Services and Market Act 2000 (Recognition Requirements for Investment Exchange and Clearing Houses) Regulations 2001 to provide for action to be taken in respect of a Clearing Member subject to a Default Notice;

(j) "Designated Contract" has the meaning given to it in clause 2.1;

(k) "Exchange" means an organisation responsible for administering a market with which the Clearing House has an agreement for the provision of central counterparty and other services to Clearing Members;

(l) "Exchange Contract" means any contract which an Exchange has adopted and authorised Exchange Members to trade in under its Exchange Rules and in respect of which the Clearing House has agreed to provide central counterparty and other services;

(m) "Exchange Member" means any person (by whatever name called) being a member of, or participant in, a Market pursuant to Exchange Rules;

(n) "Exchange Rules" means any of the regulations, rules and administrative procedures or contractual arrangements for the time being and from time to time governing the operation of a Market administered by an Exchange and includes, without prejudice to the generality of the foregoing, any regulations made by the directors of an Exchange or by any committee established under the Rules, and, save where the context otherwise requires, includes Exchange Contracts, and the Rulebook;

(o) "Rulebook" means the Clearing House's General Regulations, Default Rules, Settlement Finality Regulations and Procedures and such other rules of the Clearing House as published and amended from time to time;

(p) "Market" means a futures, options, forward, stock or other market, administered by an Exchange, or an OTC market, in respect of which the Clearing House has agreed with such Exchange or, in respect of an OTC market, with one or more participants in that market, to provide central counterparty and related services on the terms of the Rulebook and in the case of an Exchange, pursuant to the terms of any agreement entered into with the Exchange;

(q) "Person" includes any firm, company, corporation, body, association or partnership (whether or not having separate legal personality) or any combination of the foregoing;

(r) "Procedures" means that part of the Rulebook by that name;

(s) "Registered Contract" means a contract registered in the Firm's name by the Clearing House in accordance with the Rulebook;

1.2. (a) References to "the parties" are references to the parties hereto, and "party" shall be construed accordingly;

(b) References herein to a clause are to a clause hereof and clause headings are for ease of reference only;

(c) Unless the context otherwise requires, words (including defined terms) denoting the singular shall include the plural and vice versa;

(d) References to writing include typing, printing, lithography, photography, facsimile transmission and other modes of representing or reproducing words in a visible form; and

(e) References herein to statutes, statutory instruments, the Rulebook, or provisions thereof are to those statutes, statutory instruments, Rulebook or provisions thereof as amended, modified or replaced from time to time.

1.3 This Agreement, the terms of any other agreement to which the Clearing House and the Clearing Member are party which relates to the provision of central counterparty and other services by the Clearing House, the terms of, and applicable to, each and every Registered Contract, the Rulebook and all amendments to any of the foregoing shall together constitute a single agreement between the Clearing House and the Clearing Member and both parties acknowledge that all Registered Contracts are entered into in reliance upon the fact that all such items constitute a single agreement between the parties.

1.4 A person who is not a party to this Agreement shall have no rights under or in respect of this Agreement.

2 CLEARING MEMBERSHIP

2.1. The Firm is hereby admitted as a Clearing Member on the terms set out in this Agreement. The Firm shall be eligible to clear such categories of Contract (each a "Designated Contract") as the Clearing House shall from time to time notify to the Firm.

2.2. The Firm warrants that the information supplied by the Firm to the Clearing House in connection with the enquiry conducted by the Clearing House to determine whether the Firm satisfies for the time being the Criteria for Admission was and is at the date of this Agreement true and accurate in all material respects.

2.3. The Firm will ensure that it will at all times satisfy the Criteria for Admission. If at any time it has reason to believe that it no longer satisfies or may cease to satisfy any of such criteria the Firm shall immediately notify the Clearing House of the circumstances.

2.4. The Firm shall give written notice forthwith to the Clearing House of the occurrence of any of the following of which it is aware:-

(a) the presentation of a petition or passing of any resolution for the bankruptcy or winding-up of, or for an administration order in respect of, the Firm or of a subsidiary or holding company of the Firm;

(b) the appointment of a receiver, administrative receiver, administrator or trustee of the estate of the Firm;

(c) the making of a composition or arrangement with creditors of the Firm or any order or proposal in connection therewith;

(d) where the Firm is a partnership, an application to dissolve the partnership, the presentation of a petition to wind up the partnership, or any other event which has the effect of dissolving the partnership;

(e) where the Firm is a registered company, the dissolution of the Firm or the striking-off of the Firm's name from the register of companies;

(f) any step analogous to those mentioned in paragraphs (a) to (e) of this clause 2.4 is taken in respect of such persons as are referred to in those respective paragraphs in any jurisdiction;

(g) the granting, withdrawal or refusal of an application for, or the revocation of any licence or authorisation to carry on investment, banking or insurance business in any country;

(h) the granting, withdrawal or refusal of an application for, or the revocation of, a license or authorisation by the Financial Conduct Authority, the Prudential Regulation Authority or membership of any self-regulating organisation, recognised or overseas investment exchange or clearing house (other than the Clearing House) under the Financial Services and Markets Act 2000 or any other body or authority which exercises a regulatory or supervisory function under the laws of the United Kingdom or any other state;

(i) the appointment of inspectors by a statutory or other regulatory authority to investigate the affairs of the Firm(other than an inspection of a purely routine and regular nature);

(j) the imposition of any disciplinary measures or sanctions (or similar measures) on the Firm in relation to its investment or other business by any Exchange, regulatory or supervisory authority;

(k) the entering of any judgment against the Firm under Section 150 of the Financial Services and Markets Act 2000;

(l) the conviction of the Firm for any offence under legislation relating to banking or other financial services, building societies, companies, credit unions, consumer credit, friendly societies, insolvency, insurance and industrial and provident societies or for any offence involving fraud or other dishonesty;

(m) the conviction of the Firm, or any subsidiary or holding company of the Firm for any offence relating to money laundering, or the entering of judgment or the making of any order against the Firm in any civil action or matter relating to money laundering;

(n) any enforcement proceedings taken or order made in connection with any judgement (other than an arbitration award or judgement in respect of the same) against the Firm; and

(o) any arrangement entered into by the Firm with any other Clearing Member relating to the provision of central counterparty and associated services by the Clearing House of Contracts or transactions entered into by the Firm after the effective date of termination of this Agreement.

2.5. The Firm shall give written notice forthwith to the Clearing House of any person becoming or ceasing to be a director of or a partner in the Firm or of the occurrence of any of the following in relation to a director of or a partner in the Firm, if aware of the same:-

(a) the occurrence of any event specified in clause 2.4 (insofar as it is capable of materially affecting him); or

(b) any disqualification order under the Company Directors Disqualification Act 1986 or equivalent order in overseas jurisdictions.

2.6. The Firm shall give written notice forthwith to the Clearing House of any change in its name, the address of its principal place of business, registered office or UK office.

2.7. The Firm shall give written notice to the Clearing House forthwith upon its becoming aware that any person is to become or cease to be, or has become or ceased to be, a controller of the Firm, and shall in relation to any person becoming a controller of the Firm state:-

(a) the controller's name, principal business and address;

(b) the date of the change or proposed change.

In this clause and in clause 2.9 "controller" means a person entitled to exercise or control the exercise of 20 per cent or more of the voting power in the Firm.

2.8. The Firm shall give written notice forthwith to the Clearing House of any change in its business which affects the Firm's ability to perform its obligations under this Agreement.

2.9. Where the Clearing House receives notification pursuant to any of clauses 2.3 to 2.8, or the Clearing House reasonably suspects that the Firm may no longer satisfy some or all of the Criteria for Admission or the criteria for clearing a Designated Contract, the Clearing House shall be entitled in its absolute discretion to call for information of whatsoever nature in order to determine whether the Firm continues to satisfy the Criteria for Admission or the criteria for clearing a Designated Contract. Without prejudice to the foregoing, the Clearing House may at any time call for information relating to the affairs (including the ownership) of any controller of the Firm or any person who is to become a controller of the Firm. The Firm shall forthwith on demand supply to the Clearing House information called for under this clause and shall ensure that such information is true and accurate in all respects.

2.10. The Firm undertakes to abide by the Rulebook and undertakes at all times to comply with other provisions of Exchange Rules so far as they apply to the Firm.

2.11. The Firm undertakes that at all times, to the extent the Firm is required under any applicable law to be authorised, licensed or approved in relation to activities undertaken by it, it shall be so authorised, licensed or approved.

2.12. The Firm agrees that in respect of any Contract for which central counterparty services are to be provided to the Firm by the Clearing House in accordance with the Rulebook, including, but not limited to, any contract made by the Firm under Exchange Rules on the floor of a Market (or through a Market's automated trading system) or otherwise, whether with a member of that Market or with a client or with any other person, and including any Contract entered into in an OTC market, the Firm shall contract as principal and not as agent.

2.13. The Firm shall furnish financial information to the Clearing House in accordance with the requirements of the Rulebook or such other requirements as the Clearing House may from time to time prescribe.

2.14. The Firm undertakes that, in its terms of business with its clients (being clients in respect of whom the Firm is subject to any regulations made pursuant to rules and/or legislation applicable to the Firm with respect to the safeguarding or segregation of clients' money):

(a) where it is subject to Exchange Rules, it will at all times include a stipulation that contracts made under Exchange Rules with or for them shall be subject to Exchange Rules (including the Rulebook); and

(b) that money of such clients in the possession of the Clearing House may be dealt with by the Clearing House in accordance with the Rulebook without exception.

2.15. Without prejudice to clause 2.14 the Firm undertakes that its dealings with all its clients or counterparties shall be arranged so as to comply with the requirement that the Firm deals with the Clearing House as principal, and that all sums deposited

with the Clearing House by way of Cash Cover (including the Firm's Contribution to the Default Fund) shall be deposited unencumbered and by the Firm acting as sole principal and as legal and beneficial owner.

2.16. The Firm undertakes not to assign, charge or subject to any other form of security, whether purporting to rank in priority over, pari passu with or subsequent to the rights of the Clearing House, any Cash Cover provided to the Clearing House, including its entitlement to repayment of its Contribution to the Default Fund or any part of it. Any purported charge, assignment or encumbrance (whether by way of security or otherwise) of Cash Cover provided to the Clearing House shall be void. The Firm shall not otherwise encumber (or seek to encumber) any Cash Cover provided to the Clearing House.

3 REMUNERATION

3.1. The Clearing House shall be entitled to charge the Firm such fees, charges, levies and other dues, on such events, and calculated in accordance with such scales and methods, as are for the time prescribed by the Clearing House and, where relevant, for Exchange Contracts, after consultation with the relevant Exchange.

3.2. The Clearing House shall give the Firm not less than fourteen days' notice of any increase in such fees, charges, levies or other dues.

4 FACILITIES PROVIDED BY THE CLEARING HOUSE

4.1. Provision of Central Counterparty Services

(a) Details of all Contracts to be registered by the Clearing House in the name of the Firm and in respect of which central counterparty services are to be provided shall be provided to the Clearing House in accordance with the Rulebook and any other agreement entered into between the Clearing House and the Firm.

(b) Provided that a Contract meets the criteria for registration of that Contract in the name of the Firm and is a Designated Contract, and subject to the Rulebook, the Clearing House shall enter into a Registered Contract with the Firm in respect thereof. Each such Contract shall be registered in accordance with the Rulebook and the Clearing House shall perform its obligations in respect of all Registered Contracts in accordance with this Agreement and the Rulebook.

4.2. Maintenance of Records

The Clearing House agrees that for a period of ten years after termination of a Registered Contract it shall maintain records thereof. The Clearing House may make a reasonable charge to the Firm for the production of any such records more than three months after registration.

4.3. Information

The Clearing House will provide to the Firm such information at such times as is provided for by the Rulebook.

4.4. Accounts

The Clearing House agrees to establish and maintain one or more accounts for the Firm in accordance with the Rulebook. Accounts will be opened and kept by the Clearing House in such manner as will not prevent the Firm from complying with requirements of any regulations made pursuant to rules and/or legislation applicable to the Firm with

respect to the safeguarding or segregation of clients' money and the rules of such regulatory organisation as the Firm may be subject to in respect of their cleared business.

5 DEFAULT

In the event of the Firm appearing to the Clearing House to be unable, or to be likely to become unable, to meet any obligation in respect of one or more Registered Contracts, or failing to observe any other financial or contractual obligation under the Rulebook, the Clearing House shall be entitled to take all or any of the steps set out in that regard in the Rulebook, including (but not limited to) the liquidation of all or any of the Registered Contracts.

6 DISCLOSURE OF INFORMATION

The Firm agrees that the Clearing House shall have authority to disclose any information of whatsoever nature concerning the Firm to such persons as is provided for by the Rulebook.

7 PARTNERSHIP

If the Firm is a partnership, the liability of each partner in the Firm hereunder and under any Registered Contract shall be joint and several and, notwithstanding an event which would by operation of law give rise to the dissolution of the partnership, or entitle a partner to seek an order to dissolve the partnership, including, but not limited to, the event of the death, bankruptcy, winding-up or dissolution of any such partner, the respective obligations of the Clearing House and all other partners shall remain in full force and effect. If the Firm is a partnership, the Firm undertakes that if any new partner joins the Firm, the Firm shall procure that such new partner becomes jointly and severally liable alongside existing partners in respect of obligations of the Firm to the Clearing House outstanding at the date of such new partner's accession to the Firm.

8 TERM

8.1. Subject to clause 8.3 either party (provided, in the case of the Firm, that the Clearing House has not issued a Default Notice in respect of the Firm) may terminate this Agreement by giving to the other party notice in writing, such notice to specify the effective date of termination ("the termination date") which shall be a business day not less than three months after the date of the notice, and this Agreement shall, subject to clause 8.2(b), terminate on the termination date. By the close of business on the termination date the Firm shall ensure that all Registered Contracts in the Firm's name have been closed-out or transferred so that there are no open Registered Contracts to which the firm is party at the end of the termination date.

8.2. If, under clause 8.1, the Firm has not closed out or transferred all Registered Contracts by the set termination date the Clearing House shall, at its sole discretion, be entitled to:

(a) liquidate any such Registered Contracts in accordance with the Rulebook; and

(b) require that the Firm remains a member of the Clearing House until such time as there are no Registered Contracts in existence to which the Firm is a party and the effective date of termination of this Agreement shall be postponed until such time.

8.3. If the Firm is in breach of or in default under any term of this Agreement or the Rulebook, or if the Clearing House has issued a Default Notice in respect of the Firm, or if the Clearing House reasonably determines that the Firm no longer satisfies the Criteria for Admission as a Clearing Member, the Clearing House may in its absolute discretion terminate this Agreement in writing either summarily or by notice as follows.

Any termination by notice under this clause 8.3 may take effect (subject as follows) on the expiry of 30 days or such longer period as may be specified in the notice. A notice given by the Clearing House under this clause may at the Clearing House's discretion allow the Firm a specified period in which to remedy the breach or default or to satisfy the Criteria for Admission as the case may be, and may specify what is to be done to that end, and may provide that if the same is done to the satisfaction of the Clearing House within that period the termination of this Agreement shall not take effect; and if this Agreement has terminated after the Clearing House has allowed the Firm such a period for remedy or satisfaction, the Clearing House shall then notify the Firm of the fact of termination. The Clearing House may, if the Clearing House has issued a Default Notice in respect of the Firm immediately, and in any other case after the effective date of termination, take such other action as it deems expedient in its absolute discretion to protect itself or any other Clearing Member including, without limitation, the liquidation of Registered Contracts but without prejudice to its own rights in respect of such contracts.

8.4. Upon the termination of this Agreement for whatever reason the Firm shall unless otherwise agreed cease to be a Clearing Member.

9 DEFAULT FUND

9.1. In this clause the term "Excess Loss" bears the meaning ascribed to it in the Rulebook.

9.2. The Firm, as primary obligor and not surety, hereby indemnifies the Clearing House in respect of any Excess Loss, and undertakes to deposit cash with the Clearing House as collateral for its obligations in respect of such indemnity, in accordance in each case with the Default Rules.

9.3. The Firm shall, in accordance with the Default Rules, continue to be liable to indemnify the Clearing House in respect of any Excess Loss arising upon any default occurring before the effective date of termination of this Agreement. Subject thereto, the indemnity hereby given shall cease to have effect on the effective date of termination of this Agreement, unless a Default Notice is issued by the Clearing House in respect of the Firm, in which case the indemnity hereby given shall cease to have effect after the date three months after the date of issue of such Default Notice.

9.4. Save as provided expressly by the Default Rules, the Firm shall not be entitled to exercise any right of subrogation in respect of any sum applied in satisfaction of its obligations to the Clearing House under this clause 9.

10 FORCE MAJEURE

Neither party shall be liable for any failure in performance of this Agreement if such failure arises out of causes beyond its control. Such causes may include, but are not limited to, acts of God or the public enemy, acts of civil or military authority, fire, flood, labour dispute (but excluding strikes, lock-outs and labour disputes involving the employees of the party intending to rely on this clause or its sub-contractors), unavailability or restriction of computer or data processing facilities or of energy supplies, communications systems failure, failure of a common depository, clearing system or settlement system, riot or war.

11 THE RULEBOOK

In the event of conflict between the Rulebook and the provisions of this Agreement the Rulebook shall prevail.

12 NOTICES

12.1. Any notice or communication to be made under or in connection with this Agreement shall be made in writing addressed to the party to whom such notice or communication is to be given; save that a notice or communication of an urgent nature shall be given or made orally and as soon as reasonably practicable thereafter confirmed in writing in conformity hereto. A notice may be delivered personally or sent by post to the address of that party stated in this Agreement, or to such other address as may have been notified by that party in accordance herewith.

12.2. Where a notice is sent by the Clearing House by post it shall be deemed delivered 24 hours after being deposited in the post first-class postage prepaid in an envelope addressed to the party to whom it is to be given in conformity to clause 12.1, or in the case of international mail, on the fourth business day thereafter. In all other cases notices shall be deemed delivered when actually received.

13 LAW

13.1. This Agreement shall be governed by and construed in accordance with the laws of England and Wales. The parties irrevocably agree that the courts of England and Wales shall have exclusive jurisdiction to hear and determine any action or dispute which may arise herefrom. The Clearing House and the Firm each irrevocably submits to such jurisdiction and to waive any objection which it might otherwise have to such courts being a convenient and appropriate forum.

13.2. The Firm irrevocably waives, with respect to itself and its revenues and assets all immunity on the grounds of sovereignty or other similar grounds from suit, jurisdiction of any court, relief by way of injunction, order for specific performance or for recovery of property, attachment of its assets (whether before or after judgement) and execution or enforcement of any judgement to which it or its revenues or assets might otherwise be entitled in any proceedings in the courts of any jurisdiction and irrevocably agrees that it will not claim any such immunity in any proceedings.

14 SERVICE OF PROCESS

Without prejudice to any other mode of service, and subject to its right to change its agent for the purposes of this Clause on 30 days' written notice to the Clearing House, the Firm (other than where it is incorporated in England and Wales or otherwise has an office in England and Wales) appoints, as its agent for service of process relating to any proceedings before the courts of England and Wales in connection with the Firm the person in London as notified to the Clearing House in writing with the application for admission.

IN WITNESS whereof the parties hereto have caused this Agreement to be signed by their duly authorised representatives the day and year first before written.

(Signature)

(Print Name and Title)

for THE FIRM

(Signature)

(Print Name and Title)

for THE FIRM

(Signature)

(Print Name and Title)

for **LCH.CLEARNET LIMITED**

(Signature)

(Print Name and Title)

for **LCH.CLEARNET LIMITED**

LCH.CLEARNET LIMITED

Aldgate House 33 Aldgate High Street London EC3N 1EA

Tel: +44 (0)20 7426 7000 Fax: +44 (0)20 7426 7001

Internet: http://www.lchclearnet.com

LCLTD/TRAIN/CMA-05/05(0.1)

Appendix 2 – Deed of Charge

A company whether incorporated in England and Wales or an overseas company.

CHARGE BY CLEARING MEMBER

CHARGE SECURING OWN OBLIGATIONS

Date of Execution: _____

Date of Delivery:
(to be completed by LCH.Clearnet Limited) _____

Name and Address of Chargor: _____

_____

_____

Clearing Membership Agreement Date: _____

Chargor's Account: _____

THIS DEED made on the date above-stated **BETWEEN THE ABOVE-NAMED CHARGOR** ("**the Chargor**") and **LCH.CLEARNET LIMITED** ("**the Clearing House**")

WITNESSES as follows :

1. **Interpretation**

(1) Any reference herein to any statute or to any provisions of any statute shall be construed as a reference to any statutory modification or re-enactment thereof and to any regulations or orders made thereunder and from time to time in force.

(2) The clause headings shall not affect the construction hereof.

(3) A person who is not a party to this Deed has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce or to enjoy the benefit of any term of this Deed.

2. **The Secured Obligations**

(1) The Chargor shall pay to the Clearing House all monies (including settlement costs, interest and other charges) which now are or at any time hereafter may be or become due or owing by the Chargor to the Clearing House on the account identified above (or, but only if no account is identified, on all accounts of the Chargor with the Clearing House) and discharge all other liabilities of the Chargor (whether actual or contingent, now existing or hereafter incurred) to the Clearing House on the said account (or, if no account is identified, on all accounts of the Chargor with the Clearing House) in each case when due in accordance with the Clearing Membership Agreement and the Clearing House's Rulebook referred to therein (the Clearing Membership Agreement and the Clearing House's Rulebook as from time to time amended, renewed or supplemented being hereinafter referred to as "**the Agreement**") or, if the Agreement does not specify a time for such payment or discharge, promptly following demand by the Clearing House.

(2) In the event that the Chargor fails to comply with sub-paragraph (1), the Chargor shall pay interest accruing from the date of demand on the monies so demanded and on the amount of other liabilities at the rate provided for in the Agreement or, in the event of no such rate having been agreed, at a rate determined by the Clearing House (the rate so agreed or determined to apply after as well as before any judgment), such interest to be paid upon demand of the Clearing House in accordance with its usual practice and to be compounded with rests in the event of its not being duly and punctually paid.

(3) The monies, other liabilities, interest and other charges referred to in paragraph (1) of this clause, the interest referred to in sub-paragraph (2) of this clause and all other monies and liabilities payable or to be discharged by the Chargor under

or pursuant to any other provision of this Deed are hereinafter collectively referred to as "**the Secured Obligations**".

2A. **Custody of Collateral**

(1) The Chargor shall, in accordance with the Procedures, transfer collateral to the Clearing House. Where such collateral takes the form of Securities, the Clearing House shall hold such Securities as custodian for the Chargor, subject to the terms of this Deed.

(2) From time to time, in accordance with the Procedures and in the context of a transfer of one or more contracts and related cover from one member of the Clearing House to the Chargor at the request of a client of that other member or the Chargor, the Clearing House shall designate that certain Securities which it previously held as custodian for a third party are instead held by the Clearing House as custodian for the Chargor and form part of the collateral provided by the Chargor in satisfaction of its requirements under the Procedures. Upon such designation, the Clearing House shall hold such Securities as custodian for the Chargor, subject to the terms of this Deed.

(3) Where any Securities referred to in sub-paragraphs (1) or (2) are held by or for the account of the Clearing House in any Clearance System or with any Custodian Bank, the Clearing House will identify in its books that such Securities are held by it as custodian for the Chargor.

(4) All Distributions received by the Clearing House on any Securities which are held by the Clearing House as custodian for the Chargor in accordance with sub-paragraphs (1) or (2) shall be deposited by the Clearing House in a Cash Account and held by the Clearing House as custodian for the Chargor.

(5) For the avoidance of doubt, the Clearing House may hold any Securities and Distributions pursuant to this Clause 2A (*Custody of Collateral*) in one or more omnibus accounts together with other Securities and cash amounts which it holds as custodian for other third parties which have granted a charge over such Securities in favour of the Clearing House in a form substantially the same as this Deed (each a "**Relevant Charge**"). The Clearing House shall ensure that any such account with a Clearance System or Custodian Bank is clearly identified as a custody account relating to Relevant Charges.

(6) The Clearing House undertakes to the Chargor that it will at all times ensure that, pursuant to the terms governing any account with any Clearance System or Custodian Bank in which any Securities or cash (including any Distributions) are held for the Chargor, any claim or security interest which that Clearance System or Custodian Bank may have against or over such Securities or cash (including any Distributions) shall be limited to any unpaid fees owed by the Clearing House to such Clearance System or Custodian Bank in respect of such account.

3. **Charge**

(1) The Chargor acting in due capacity (as defined in sub-paragraph (3) below) (and to the intent that the security so constituted shall be a security in favour of the Clearing House extending to all beneficial interests in the assets hereby charged and to any proceeds of sale or other realisation thereof or of any part thereof including any redemption monies paid or payable in respect thereof) hereby assigns, charges and pledges by way of first fixed security and by way of continuing security to the Clearing House, until discharged by the Clearing House in accordance with this Deed, for the payment to the Clearing House and the discharge of all the Secured Obligations, the Charged Property (as defined in paragraph (3) below).

(2) It shall be implied in respect of Clause 3(1) that the Chargor is charging the Charged Property free from all charges and encumbrances (whether monetary or not) and from all other rights exercisable by third parties (including liabilities imposed and rights conferred by or under any enactment) except for any charge or lien arising in favour of a Custodian Bank or Clearance System and for any third party's beneficial interest in the Charged Property which ranks behind the rights of the Clearing House in respect of the Charged Property.

(3) In this Deed:

"**acting in due capacity**" in relation to the Chargor means that each of the dispositions of property hereby effected by the Chargor is made with full title guarantee subject to any other charge or lien arising in favour of a Custodian Bank or Clearance System;

"**Cash Account**" means an account with a Custodian Bank in which the Clearing House will deposit and hold all monies forming part of the Charged Property from time to time;

"**Charged Property**" means at any time all present and future right, title and interest of the Chargor in and to:

(i) all Securities held by the Clearing House as custodian for the Chargor pursuant to Clauses 2A(1) and (2) which are for the time being held by, or by any Clearance System on behalf of, for the account of, to the order of or under the control or direction of the Clearing House; and

(ii) all Securities held by the Clearing House as custodian for the Chargor pursuant to Clauses 2A(1) and (2) which are for the time being held by, or by any Clearance System on behalf of, for the account of or to the order of or under the control or direction of a Custodian Bank, for the account of the Clearing House.

"**Clearance System**" shall be construed as a reference to any system from time to time used or constituted for the clearing, collective safe custody or central deposit of securities, and any depository for any of the foregoing;

"**Clearing Membership Agreement**" means in relation to the Chargor the "Clearing Membership Agreement" between the Chargor and the Clearing House having the date specified on the first page of this Deed, as such agreement may be amended and or replaced from time to time;

"**Custodian Bank**" means a bank or custodian with which the Clearing House maintains any Cash Account or any securities account in which it holds any Securities belonging to the Chargor or any nominee company or trust company which is a subsidiary of such a bank or custodian;

"**Deed**" means this charge made between the Chargor and the Clearing House on the date above-stated, as the same may be amended, supplemented or restated from time to time;

"Distributions" means all rights, benefits and proceeds including, without limitation, any dividends or interest, annual payments or other distributions attaching to or arising from or in respect of any Securities forming part of the Charged Property;

"**Procedures**" means the one or more documents containing the working practices and administrative requirements of the Clearing House for the purposes of implementing the Clearing House's Rulebook and Default Rules from time to time in force, or procedures for application for and regulation of clearing membership of the Clearing House;

"**Receiver**" means a receiver or manager or an administrative receiver as the the Clearing House may specify at any time in the relevant appointment made under this Deed, which term will include any appointee made under a joint and/or several appointment by the Clearing House; and

"**Securities**" shall be construed as a reference to bonds, debentures, notes, stock, shares, bills, certificates of deposit and other securities and instruments and all monies, rights or property which may at any time accrue or be offered (whether by way of bonus, redemption, preference, option, substitution, compensation or otherwise) in respect of any of the foregoing (and without limitation, shall include any of the foregoing not constituted, evidenced or represented by a certificate or other document but by any entry in the books or other records of the issuer, a trustee or other fiduciary thereof, or a Clearance System).

4. **Release**

(1) Upon the Clearing House being satisfied (acting in good faith) that the Secured

Obligations have been irrevocably paid or discharged in full, the Clearing House shall, at the request and cost of the Chargor, release or discharge (as appropriate) all the Charged Property from the security created by this Deed provided that, without prejudice to any remedy which the Chargor may have if the Clearing House fails to comply with its obligations under this Clause, such actions shall be without recourse to, and without any representations or warranties by, the Clearing House or any of its nominees.

(2) The Chargor may, in the circumstances specified in Sections 4.1.2 and 4.1.3 of the Procedures, request that part or all of the Charged Property, or the proceeds thereof, be returned or repaid to, or to the order of, the Chargor. Where, pursuant to such a request, any of the Charged Property, or the proceeds thereof, is actually returned or repaid pursuant to Sections 4.1.2 or 4.1.3 of the Procedures, such Charged Property shall be released or discharged (as appropriate) from the security interest created over such Charged Property and the proceeds thereof pursuant to Clause 3(1) with effect from the time such Charged Property, or the proceeds thereof, are transferred by the Clearing House to, or to the order of, the Chargor in accordance with the Procedures.

5. **Income**

Prior to the enforcement of the security created by this Deed, all Distributions received by the Clearing House in respect of any Charged Property shall be paid by the Clearing House to the Chargor

6. **Reinstatement**

If any discharge, release or arrangement is made by the Clearing House in whole or in part on the basis of any payment, security or other disposition which is avoided or must be restored in insolvency, liquidation, administration or otherwise, without limitation, then the liability of the Chargor and the security created by this Deed will continue or be reinstated as if the discharge, release or arrangement had not occurred.

7. **Warranties and Undertakings**

The Chargor hereby represents and warrants to the Clearing House and undertakes that:

(i) the Chargor is duly incorporated or organised and validly existing under the laws of its jurisdiction of organisation or incorporation;

(ii) the Chargor and each of its subsidiaries has the power to own its assets and carry on it business as it is being conducted;

(iii) subject to any legal or equitable interest which any common depository, Clearance System or Custodian Bank may have in any Securities and to any

third party's beneficial interest in the Charged Property which ranks behind the rights of the Clearing House in respect of the Charged Property, the Chargor is and will at all times during the subsistence of the security and security interest hereby constituted, be the sole and lawful owner of, and be entitled to the entire beneficial interest in, the Charged Property free from mortgages or charges (other than as a result of the security created under this Deed, any charge or lien arising in favour of any Clearance System or Custodian Bank and any charge in favour of the Chargor) or other encumbrances and no other person (save as aforesaid) has any rights or interests therein;

(iv) save as contemplated by Clause 5(2), the Chargor has not sold or agreed to sell or otherwise disposed of or agreed to dispose of, and will not at any time during the subsistence of the security hereby constituted sell or agree to sell or otherwise dispose of or agree to dispose of, the benefit of all or any rights, titles and interest in and to the Charged Property or any part thereof;

(v) the Chargor has and will at all material times have the necessary power to enable the Chargor to enter into and perform the obligations expressed to be assumed by the Chargor under this Deed;

(vi) this Deed constitutes a legal, valid, binding and enforceable obligation of the Chargor and is a security over, and confers a first security interest in, the Charged Property and every part thereof effective in accordance with its terms (subject to applicable bankruptcy, reorganisation, insolvency, moratorium or similar laws affecting creditors' rights generally and subject, as to enforceability, to equitable principles of general application (regardless of whether enforcement is sought in a proceeding in equity or at law));

(vii) all necessary authorisations to enable or entitle the Chargor to enter into this Deed have been obtained and are in full force and effect and will remain in such force and effect at all times during the subsistence of the security hereby constituted;

(viii) the execution of this Deed does not violate any agreement to which the Chargor is a party or breach any obligation to which the Chargor is subject;

(ix) it has been and shall at all times remain expressly agreed between the Chargor and each of the Chargor's clients or other persons who are for the time being (or would be, but for the provisions of this Deed) entitled to the entire beneficial interest in all or any parts of the Charged Property that, in relation to any assets from time to time held by the Chargor or delivered to the Chargor for the account of any such client or other person which at any time form part of the Charged Property, the Chargor may, free of any interest of any such client or other person therein which is adverse to the Clearing House, charge or otherwise constitute security over such assets with the result that the Chargor may charge or otherwise constitute security over such assets in favour of the Clearing House on such terms as the Clearing House may from time to time

prescribe and, in particular but without limitation, on terms that the Clearing House may enforce and retain such charge or other security in satisfaction of or pending discharge of all or any obligations of the Chargor to the Clearing House;

(x) in no case is the Chargor or the Chargor's client or other person who is for the time being the lawful owner of or person entitled to the entire beneficial interest in any part of the Charged Property, nor will the Chargor, client or other such person be, in breach of any trust or other fiduciary duty in placing or authorising the placing of any Charged Property (or rights, benefits or proceeds forming part of the Charged Property) under this Deed;

(xi) no corporate actions, legal proceedings or other procedure or steps have been taken in relation to, or notice given in respect of, a composition, compromise, assignment or arrangement with any creditor of the Chargor or in relation to the suspension of payments or moratorium of any indebtedness, winding-up, dissolution, administration or reorganisation (by way of voluntary arrangement, scheme of arrangement or otherwise) of, or the appointment of an administrator to, the Chargor (other than any which will be dismissed, discharged, stayed or restrained within 15 days of their instigation) and no such step is intended by the Chargor (save for the purposes of any solvent re-organisation or reconstruction which has previously been approved by the Clearing House);

(xii) the Chargor undertakes to abide by the Procedures as in effect from time to time.

8. **Negative Pledge**

(1) The Chargor hereby undertakes with the Clearing House that at no time during the subsistence of the security hereby constituted will the Chargor, otherwise than:

(i) in favour of the Clearing House; or

(ii) with the prior written consent of the Clearing House and in accordance with and subject to any conditions which the Clearing House may attach to such consent,

create, grant, extend or, except in relation to any charge or lien in favour of any Clearance System or Custodian Bank, permit to subsist any mortgage or other fixed security or any floating charge or other security interest on, over or in the Charged Property or any part thereof. The foregoing prohibition shall apply not only to mortgages, other fixed securities, floating charges and security interests which rank or purport to rank in point of security in priority to the security hereby constituted but also to any mortgages, securities, floating charges or security interests which rank or purport to rank pari passu therewith or thereafter.

(2) Sub-paragraph (1) above does not, during the subsistence of the security hereby constituted, operate to prevent the Chargor from continuing to hold a security interest in the Charged Property previously created in favour of the Chargor, *provided always* that the interest in favour of the Chargor shall rank after the security created by this Deed.

9. **Preservation of Charged Property**

Until the security hereby constituted shall have been discharged:

(a) the Chargor shall ensure, so far as the Chargor is able, that all of the Charged Property is and at all times remains free from any restriction on transfer; and

(b) the Chargor shall pay all payments due in respect of any part of the Charged Property, and in any case of default by the Chargor in this respect the Clearing House may if it thinks fit make any such payments on behalf of the Chargor in which event any sums so paid shall be reimbursed on demand by the Chargor to the Clearing House and until reimbursed shall bear interest in accordance with Clause 2(2) above.

10. **Rights Attaching to the Charged Property**

(1) The Chargor shall not, to the extent that the same is within the control of the Chargor, permit or agree to any variation of the rights attaching to or conferred by the Charged Property or any part thereof without the prior consent of the Clearing House in writing.

(2) Subject to sub-paragraph (3), the Clearing House and its nominees may at the Clearing House's discretion (in the name of the Chargor or otherwise whether before or after any demand for payment hereunder and without any consent or authority on the part of the Chargor) exercise in respect of any Securities which form part of the Charged Property the powers and rights conferred on or exercisable by the bearer or holder thereof.

(3) The Clearing House shall not have any right of use or re-hypothecation right, in respect of the Charged Property, whether under Regulation 16 of the Financial Collateral Arrangements (No.2) Regulations 2003, the New York Uniform Commercial Code or any applicable Federal law of the United States or otherwise, *provided that* this provision shall not affect the powers of the Clearing House under Clauses 13 (*Power of Sale*) and 14 (*Right of Appropriation*) or any other rights to enforce the security interest herein created against the Charged Property.

11. **Further Assurance**

(1) In the case of any part of the Charged Property situated in the United States of America, it is acknowledged and agreed by the Chargor that this Deed shall

also constitute a security agreement for the purpose of creating a security interest in the Charged Property under applicable provisions of the Uniform Commercial Code or other applicable laws or regulations of the State of New York. For purposes hereof, "**Charged Property situated in the United States of America**" means (i) in the case of any securities account and/or securities entitlements or other rights or assets or investment property credited to a securities account as financial assets, a securities account maintained with a securities intermediary whose jurisdiction is New York or any other State of the United States for purposes of the NY UCC; (ii) in the case of any deposit account and/or any amounts credited to a deposit account, a deposit account maintained with a bank whose jurisdiction is New York or any other State of the United States for purposes of the NY UCC; and (iii) in the case of any commodity account or any commodity contract credited to a commodity account such commodity account is maintained with a commodity intermediary whose jurisdiction is New York or any other State of the United States for purposes of the NY UCC . In furtherance of the foregoing and without limiting the generality of Clause 3 above, in order to secure the payment, performance and observance of the Secured Obligations, the Chargor hereby grants to the Clearing House a continuing security interest in, right of setoff against, and an assignment to the Clearing House of all of the Charged Property situated in the United States of America and all rights thereto, in each case whether now owned or existing or hereafter acquired or arising and which shall include, without limitation, all of the Chargor's interests in any deposit accounts, investment property and securities entitlements (as such terms are defined in the Uniform Commercial Code of the State of New York; the "**NY UCC**"), together with all Proceeds (as defined in the NY UCC) and products of all or any of the property described above.

(2) The Chargor undertakes promptly to execute and do (at the cost and expense of the Chargor) all such deeds, documents, acts and things as may be necessary or desirable in order for the Clearing House to enjoy a fully perfected security interest in the whole of the Charged Property, including without limitation the deposit of the Charged Property with a Custodian Bank and the perfection of pledges or transfers under such laws, of whatever nation or territory, as may govern the pledging or transfer of the Charged Property or part thereof or other mode of perfection of this Deed and the security interest expressed to be created hereby. Without limiting the foregoing, the Chargor agrees with and covenants to the Clearing House that with respect to all Charged Property situated in the United States of America consisting of investment property, money, instruments, securities, securities entitlements, other financial assets and commodity contracts (as defined in the NY UCC), such Charged Property shall be held, maintained or deposited, as applicable, in a securities account or commodity account (in the case of commodity contracts) (such that, in each case, the Clearing House shall become the entitlement holder thereof, as defined in the NY UCC) or a deposit account (as defined in the NY UCC), in the case of Charged Property that may be credited to a Deposit Account, in the name of the Clearing House, or, if permitted by the

Procedures, may be maintained and held in the Chargor's name at a Custodian Bank (whose jurisdiction is New York or any other State of the United States for purposes of the NY UCC) which shall have executed and delivered to the Clearing House an agreement whereby such Custodian Bank agrees that it will comply with entitlement orders of the Clearing House without further consent by the Chargor. Notwithstanding anything to the contrary herein, in respect of any Charged Property situated in the United States of America, the Clearing House shall comply with all non-waivable requirements of the NY UCC with respect to how the secured party must deal with Collateral under its control or in its possession.

12. **Enforcement of Security**

On and at any time:

(i) if a Default Notice is served on the Chargor in accordance with Rule 3 of the Default Rules; or

(ii) if the Chargor requests the Clearing House to exercise any of its powers under this Deed,

(each such event a "**Default**"), the security created by or pursuant to this Deed is immediately enforceable and the Clearing House may, without notice to the Chargor or prior authorisation from any court, in its absolute discretion:

(a) enforce all or any part of the security created by this Deed (at the times, in the manner and on the terms it thinks fit) and take possession of and hold, sell, or otherwise dispose of all or any part of the Charged Property (at the time, in the manner and on the terms it thinks fit); and

(b) whether or not it has appointed a Receiver, exercise all or any of the powers, authorisations and discretions conferred by the Law of Property Act 1925 (as varied or extended by this Deed) on chargees and by this Deed on any Receiver or otherwise conferred by law on chargees or Receivers.

13. **Power of Sale**

(1) If a Default has occurred, the Clearing House shall have and be entitled without prior notice to the Chargor to exercise the power to sell or otherwise dispose of, for any consideration (whether payable immediately or by instalments) as the Clearing House shall think fit, the whole or any part of the Charged Property and may (without prejudice to any right which it may have under any other provision hereof) treat such part of the Charged Property as consists of money as if it were the proceeds of such a sale or other disposal. The Clearing House shall be entitled to apply the proceeds of such sale or other disposal in paying the costs of such sale or other disposal and (subject to the rights or claims of

any person entitled in priority to the Clearing House) in or towards the discharge of the Secured Obligations, the balance (if any) to be paid to the Chargor or other persons entitled thereto. Such power of sale or other disposal shall operate as a variation and extension of the statutory power of sale under section 101 of the Law of Property Act 1925.

(2) The restriction contained in section 103 of the Law of Property Act 1925 on the exercise of the statutory power of sale shall not apply to any exercise by the Clearing House of its power of sale or other disposal which shall arise, as shall the statutory power under the said section 101 of appointing a receiver of the Charged Property or the income thereof, immediately upon any such default by the Chargor as is referred to in sub-paragraph (1) of this clause. In favour of a purchaser a certificate in writing by an officer or agent of the Clearing House that either or both of such powers has arisen and is exercisable shall be conclusive evidence of that fact.

(3) Upon any such default or failure as aforesaid the Clearing House shall also have with respect to any part of the Charged Property situated in the United States of America all of the rights and remedies of a secured party under the NY UCC or any other applicable law of the State of New York and all rights provided herein or in any other applicable security, loan or other agreement, all of which rights and remedies shall to the full extent permitted by law be cumulative.

14. **Right of Appropriation**

To the extent that any of the Charged Property constitutes "financial collateral" and this Deed and the obligations of the Chargor hereunder constitute a "security financial collateral arrangement" (in each case as defined in, and for the purposes of, the Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003 No. 3226), as amended, (the "**Regulations**") the Clearing House shall have the right (at any time following the occurrence of a Default) to appropriate all or any part of such financial collateral in or towards discharge of the Secured Obligations and may exercise such right to appropriate upon giving written notice to the Chargor. For this purpose, the parties agree that the value of such financial collateral so appropriated shall be the market price of the Charged Property determined by the Clearing House by reference to a public index or by such other process as the Clearing House may select (acting in a commercially reasonable manner), including independent valuation. The parties agree that the method of valuation provided for in this Deed shall constitute a commercially reasonable method of valuation for the purposes of the Regulations.

15. **Immediate Recourse**

The Chargor waives any right it may have of first requiring the Clearing House to proceed against or enforce any other rights or security or claim payment from any person before claiming from the Chargor under this Deed. This waiver applies irrespective of any law or any provision of this Deed to the contrary.

16. **Consolidation of Securities**

Subsection (1) of section 93 of the Law of Property Act 1925 shall not apply to this Deed.

17. **Effectiveness of Security**

(1) This Deed shall be in addition to and shall be independent of every other security which the Clearing House may at any time hold for any of the Secured Obligations. No prior security held by the Clearing House over the whole or any part of the Charged Property shall merge into the security hereby constituted.

(2) This Deed shall remain in full force and effect as a continuing security unless and until the Clearing House discharges it.

(3) Nothing contained in this Deed is intended to, or shall operate so as to, prejudice or affect any bill, note, guarantee, mortgage, pledge, charge or other security of any kind whatsoever which the Clearing House may have for the Secured Obligations of any of them or any right, remedy or privilege of the Clearing House thereunder.

18. **Avoidance of Payments**

If the Clearing House considers (acting in good faith) that any payment or discharge of the Secured Obligations is capable of being avoided or reduced by virtue of any bankruptcy, insolvency, liquidation or similar laws then such payment or discharge shall not be considered to have been made for the purposes of determining whether the Secured Obligations have been irrevocably paid or discharged in full.

19. **Power of Attorney**

The Chargor hereby irrevocably appoints the Clearing House to be the Chargor's attorney and in the Chargor's name and on the Chargor's behalf and as the act and deed of the Chargor to sign, seal, execute, deliver, perfect and do all deeds, instruments, mortgages, acts and things as may be, or as the Clearing House may consider to be, requisite for carrying out any obligation imposed on the Chargor under Clause 11 above, or for enabling the Clearing House to exercise its power of sale or other disposal referred to in Clause 13 above or for carrying any such sale or other disposal made under such power into effect, or exercising any of the rights and powers referred to in Clause 10 above, including without limitation the appointment of any person as a proxy of the Chargor. The Chargor hereby undertakes to ratify and confirm all things done and documents executed by the Clearing House in the exercise of the power of attorney conferred by this clause.

20. **Receivers and Administrators**

(1) At any time after having been requested to do so by the Chargor or after this Deed becomes enforceable in accordance with Clause 12 the Clearing House may by deed or otherwise (acting through an authorised officer of the Clearing House), without prior notice to the Chargor:

(a) appoint one or more persons to be a Receiver of the whole or any part of the Charged Property;

(b) appoint one or more Receivers of separate parts of the Charged Property respectively;

(c) remove (so far as it is lawfully able) any Receiver so appointed; and

(d) appoint another person(s) as an additional or replacement Receiver(s).

(2) Each person appointed to be a Receiver pursuant to Clause 20(1) will be:

(a) entitled to act individually or together with any other person appointed or substituted as Receiver;

(b) for all purposes deemed to be the agent of the Chargor which shall be solely responsible for his acts, defaults and liabilities and for the payment of his remuneration and no Receiver shall at any time act as agent for the Clearing House; and

(c) entitled to remuneration for his services at a rate to be fixed by the Clearing House from time to time (without being limited to the maximum rate specified by the Law of Property Act 1925).

(3) The powers of appointment of a Receiver shall be in addition to all statutory and other powers of appointment of the Clearing House under the Law of Property Act 1925 (as extended by this Deed) or otherwise and such powers shall remain exercisable from time to time by the Clearing House in respect of any part of the Charged Property.

(4) Every Receiver shall (subject to any restrictions in the instrument appointing him but notwithstanding any winding-up or dissolution of the Chargor) have and be entitled to exercise, in relation to the Charged Property in respect of which he was appointed, and as varied and extended by the provisions of this Deed (in the name of or on behalf of the Chargor or in his own name and, in each case, at the cost of the Chargor):

(a) all the powers conferred by the Law of Property Act 1925 on mortgagors and on mortgagees in possession and on receivers appointed under that Act;

(b) all the powers of an administrative receiver set out in Schedule 1 to the Insolvency Act 1986 (whether or not the Receiver is an administrative receiver);

(c) all the powers and rights of an absolute owner and power to do or omit to do anything which the Chargor itself could do or omit to do;

(d) the power to delegate (either generally or specifically) the powers, authorities and discretions conferred on it by this Deed (including the power of attorney) on such terms and conditions as it shall see fit which delegation shall not preclude either the subsequent exercise any subsequent delegation or any revocation of such power, authority or discretion by the Receiver itself; and

(e) the power to do all things (including bringing or defending proceedings in the name or on behalf of the Chargor) which seem to the Receiver to be incidental or conducive to:

(i) any of the functions, powers, authorities or discretions conferred on or vested in him;

(ii) the exercise of any rights, powers and remedies of the Clearing House provided by or pursuant to this Deed or by law (including realisation of all or any part of the Charged Property); or

(iii) bringing to his hands any assets of the Chargor forming part of, or which when got in would be, Charged Property.

(5) The receipt of the Clearing House or any Receiver shall be a conclusive discharge to a purchaser and, in making any sale or disposal of any of the Charged Property or making any acquisition, the Clearing House or any Receiver may do so for such consideration, in such manner and on such terms as it thinks fit.

(6) No purchaser or other person dealing with the Clearing House or any Receiver shall be bound to inquire whether the right of the Clearing House or such Receiver to exercise any of its powers has arisen or become exercisable or be concerned with any propriety or regularity on the part of the Clearing House or such Receiver in such dealings.

(7) Any liberty or power which may be exercised or any determination which may be made under this Deed by the Clearing House or any Receiver may be exercised or made in its absolute and unfettered discretion without any obligation to give reasons.

21. **No liability**

Neither the Clearing House nor any receiver appointed pursuant to this Deed shall be liable by reason of (a) taking any action permitted by this Deed or (b) any neglect or default in connection with the Charged Property or (c) the taking possession or realisation of all or any part of the Charged Property, except in the case of gross negligence or wilful default upon its part.

22. **Remedies, Time or Indulgence**

(1) The rights, powers and remedies provided by this Deed are cumulative and are not, nor are they to be construed as, exclusive of any right of set-off or other rights, powers and remedies provided by law.

(2) No failure on the part of the Clearing House to exercise, or delay on its part in exercising, any of the rights, powers and remedies provided by this Deed or by law (collectively "**the Clearing House's Rights**") shall operate as a waiver thereof, nor shall any single or partial waiver of any of the Clearing House's Rights preclude any further or other exercise of that or any other of the Clearing House's Rights.

(3) The Clearing House may in its discretion grant time or other indulgence or make any other arrangement, variation or release with any person not party hereto (irrespective of whether such person is liable with the Chargor) in respect of the Secured Obligations or in any way affecting or concerning them or any of them or in respect of any security for the Secured Obligations or any of them, without in any such case prejudicing, affecting or impairing the security hereby constituted, or any of the Clearing House's Rights or the exercise of the same, or any indebtedness or other liability of the Chargor to the Clearing House.

23. **Costs, Charges and Expenses**

All costs, charges and expenses of the Clearing House incurred in the exercise of any of the Clearing House's Rights, or in connection with the execution of or otherwise in relation to this Deed or in connection with the perfection or enforcement of all security hereby constituted shall be reimbursed to the Clearing House by the Chargor on demand on a full indemnity basis together with interest from the date of the same having been incurred to the date of payment at the rate referred to in Clause 2(2) above.

24. **Accounts**

All monies received, recovered or realised by the Clearing House under this Deed (including the proceeds of any conversion of currency) may in the discretion of the Clearing House be credited to any suspense or impersonal account and may be held in such account for so long as the Clearing House shall think fit (with interest accruing thereon at such rate, if any, as the Clearing House may deem fit) pending their

application from time to time (as the Clearing House shall be entitled to do in its discretion) in or towards the discharge of any of the Secured Obligations.

25. **Currency**

(1) For the purpose of or pending the discharge of any of the Secured Obligations the Clearing House may convert any monies received, recovered or realised or subject to application by the Clearing House under this Deed (including the proceeds of any previous conversion under this clause) from their existing currency of denomination into such other currency of denomination as the Clearing House may think fit, and any such conversion shall be effected at such commercial spot selling rate of exchange then prevailing for such other currency against the existing currency as the Clearing House may in its discretion determine.

(2) References herein to any currency extend to any funds of that currency and for the avoidance of doubt funds of one currency may be converted into different funds of the same currency.

26. **Notices**

(1) Any notice or demand (including any Default Notice) requiring to be served on the Chargor by the Clearing House hereunder may be served on any of the officers of the Chargor personally, or by letter addressed to the Chargor or to any of its officers and left at its registered office or any one of its principal places of business, or by posting the same by letter addressed in any such manner as aforesaid to such registered office or any such principal place of business.

(2) Any notice or demand (including any Default Notice) sent by post in accordance with paragraph (1) of this clause shall be deemed to have been served on the Chargor at 10 a.m. Greenwich Mean Time on the business day next following the date of posting. In proving such service by post it shall be sufficient to show that the letter containing the notice or demand (including any Default Notice) was properly addressed and posted and such proof of service shall be effective notwithstanding that the letter was in fact not delivered or was returned undelivered.

27. **Provisions Severable**

Each of the provisions contained in this Deed shall be severable and distinct from one another and if at any time any one or more of such provisions is or becomes invalid, illegal or unenforceable, the validity, legality and enforceability of each of the remaining provisions of this Deed shall not in any way be affected, prejudiced or impaired thereby.

28. **Clearing House's Discretions**

Any liberty or power which may be exercised or any determination which may be made hereunder by the Clearing House may (save where stated to the contrary) be exercised or made in the absolute and unfettered discretion of the Clearing House which shall not be under any obligation to give reasons thereof.

29. **Law and Jurisdiction**

This Deed, and any non-contractual obligations arising herefrom, shall be governed by and construed in accordance with English law, and the Chargor hereby irrevocably submits to the non-exclusive jurisdiction of the English courts; provided that with respect to issues arising as a result of the provisions of Clause 11(1) above or the use of this Deed as a security agreement as provided therein, this Deed shall be governed by and construed in accordance with applicable laws of the State of New York.

The Chargor
Executed as a **DEED** by

The Chargor
[CHARGOR NAME]

.....
Signature of Director

.....
Name of Director

.....
Date

.....
Signature of Director/Secretary

.....
Name of Director/Secretary

.....
Date

The Clearing House
LCH. Clearnet Limited

.....
Signature of Director

.....
Name of Director

.....
Title of Director

.....
Date

Dated 2014

_____

and

LCH.CLEARNET LIMITED

CHARGE BY CLEARING MEMBER SECURING OWN OBLIGATIONS
