BAHR

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Oslo, 12 June 2014

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LCH.Clearnet Limited - Membership, Insolvency, Security, Set-off & Netting and Client Clearing - Norwegian law advice

We have been asked to provide advice in respect of the laws of Norway in response to certain specific questions raised in by LCH.Clearnet Limited ("**LCH**") in relation to membership, insolvency, security, set-off and netting and client clearing. The relevant questions are set out in full in Section 3 of this advice together with the corresponding responses. Terms not otherwise defined in this advice shall have the meaning ascribed to such terms in the LCH Rulebook (as defined below).

We confirm that our advice is applicable to each of the LME Service, the SwapClear Service, the RepoClear Service, the EquityClear Service, the LCH Enclear OTC Service, the Turquoise Derivatives Service, the Nodal Service, the ForexClear Service, the NLX Service and the FEX Service.

1. Documents

For the purposes of giving this opinion, we have reviewed only copies of the following documents, in the form provided to us by Clifford Chance LLP on 9 June 2014 (the "**Opinion Documents**" or the "**LCH Agreements**"):

(a) The General Regulations, Procedures, Default Rules, Settlement Finality Regulations and the Product Specific Contract Terms and Eligibility Criteria Manual of LCH (the "**LCH Rulebook**");

(b) The standard form template version of the Relevant Clearing Membership agreement to be entered into between LCH and each Relevant Clearing Member, which incorporates LCH's Rulebook (the "**Clearing Membership Agreement**"); and

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(c) The standard form template version of the agreement entitled "Charge by Clearing Member - Charge Securing Own Obligations" (related to companies incorporated England or Wales or an overseas company, version 8.0 dated 14 April 2014) (the "**Deed of Charge**").

We have also reviewed the Services Description and the Instructions as provided to us in electronic form by Clifford Chance LLP on 22 October 2013. LCH and its legal advisors as to the laws of England and Wales have also reviewed and commented on this opinion.

For the purposes of our advice, we have made the assumptions set out in Schedule 1 to this opinion. Our advice is subject to the reservations set out in Schedule 2 to this opinion.

2. Definitions

In this opinion:

(a) "**1863 Bankruptcy Act**" means the Norwegian Act on Bankruptcy and the Treatment of Bankruptcy Estates of 6 June 1863 (repealed).

(b) "**Administration Board**" means a board appointed by the FSAN in connection with Public Administration.

(c) "**Bankruptcy Act**" means the Norwegian Act on Debt Settlement Proceedings and Bankruptcy Proceedings of 8 June 1984.

(d) "**Bankruptcy Proceedings**" means the proceedings referred to in paragraph 3.2.1(c) below.

(e) "**Civil Procedure Act**" means the Norwegian Civil Procedure Act of 17 June 2005.

(f) "**Contracts Act**" means the Norwegian Contracts Act of 31 May 1918.

(g) "**CR Act**" means the Norwegian Creditors Recovery Act of 8 June 1984 no 59.

(h) "**Date of Filing**" means:

(i) in relation to Bankruptcy Proceedings, the date when a successful petition for the opening of Bankruptcy Proceedings was received by the relevant court;

(ii) in relation Debt Settlement Proceedings, the date when the petition for the opening of Debt Settlement Proceedings was received by the relevant court; and

(iii) in relation to Public Administration, the date when the Norwegian Ministry of Finances resolves that the Guaranteed Institution shall be placed under Public Administration.

(i) "**Debt Settlement Proceedings**" means the proceedings referred to under the heading "Debt Settlement Proceedings" in paragraph 3.2.1(c) below.

(j) "**Derivatives**" means the Financial Instruments referred to in Subsection 5 of Section 2-2 of the ST Act and Section 2-1 of the ST Regulation, cf. item 5 of Subsection 5 of Section 2-2 of

the ST Act, corresponding with the financial instruments listed in items 3 to 10 of Section C of Annex I to Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 as supplemented by articles 38 and 39 of Commission Regulation (EC) No 1287/2006 of 10 August 2006.

(k) "**FC Act**" means the Norwegian Financial Collateral Act of 26 March 2004 no 17.

(l) "**Financial Collateral**" means cash deposits, Financial Instruments and claims for the repayment of money arising out of a credit institution granting credit to a debtor not being a consumer, cf. Section 2(1)(c) of the FC Act.

(m) "**Financial Instruments**" means the instruments defined as financial instruments (Norwegian: *finansielle instrumenter*) pursuant to Section 2-2 of the ST Act.

(n) "**FSAN**" means the Financial Supervisory Authority of Norway (Norwegian: *Finanstilsynet*)

(o) "**Guaranteed Institution**" means a Relevant Clearing Member which is a (i) licensed bank either incorporated as a Norwegian private limited liability company (Norwegian: *aksjeselskap*), Norwegian public limited liability company (Norwegian: *allmennaksjeselskap*), (ii) licensed insurance company either incorporated as a Norwegian private limited liability company (Norwegian: *aksjeselskap*), Norwegian private limited liability company (Norwegian: *allmennaksjeselskap*) or a mutual insurance company (Norwegian: *gjensidig forsikringselskap*), (iii) parent company of either a financial conglomerate or a credit institution (other than banks) which is a member of the Norwegian Banks' Guarantee Fund (Norwegian: *Bankenes sikringsfond*) or (iv) pension fund (Norwegian: *pensjonskasse*).

(p) "**Guarantee Schemes Act**" means the Norwegian Act on Guarantee Schemes for Banks and Public Administration etc. of Finance Institutions of 6 December 1996 no. 75.

(q) "**Insolvency Proceedings**" means Bankruptcy Proceedings and Public Administration.

(r) "**Lugano Convention**" means the Lugano Convention on jurisdiction and the recognition and "enforcement of judgements in civil and commercial matters of 30 October 2007.

(s) "**Part VII**" means Part VII of the Companies Act 1989;

(t) "**Parties**" means the parties to any of the Opinion Documents, and "**Party**" means either of them.

(u) "**Perfected Contract**" means a Contract which has been entered into the relevant Securities Settlement System prior to the opening of Insolvency Proceedings or Reorganisation Measures of a Relevant Clearing Member.

(v) "**Pledge Act**" means the Norwegian Pledge Act of 8 February 1980.

(w) "**PS Act**" means the Norwegian Act on Payment Systems etc. of 17 December 1999.

(x) "**Public Administration**" means the proceedings referred to in paragraph 3.2.1(b) below.

(y) "**Relevant Clearing Member**" means a clearing member of LCH incorporated in Norway.

(z) "**Relevant Jurisdiction**" means Norway.

(aa) "**Reorganisation Measures**" means Debt Settlement Proceedings.

(bb) "**Securities Settlement System**" means a system based on common rules for netting, settlement or transfers of Financial Instruments.

(cc) "**ST Act**" means the Norwegian Securities Trading Act of 29 June 2007.

(dd) "**ST Regulation**" means the Norwegian Regulation on Securities Trading of 29 June 2007.

(ee) "**Transfer Orders**" has the meaning given to the term "transfer order" in article 2(i) of Directive 98/26/EC (as amended).

(ff) Debt Settlement Proceedings are "**opened**", "**commenced**" or "**initiated**" (and synonymous or derivative expressions) at the time at which the decision to open Debt Settlement Proceedings was received by the district court.

(gg) Bankruptcy Proceedings are "**opened**", "**commenced**" or "**initiated**" (and synonymous or derivative expressions) at the time at which the decision to open Bankruptcy Proceedings was passed by the competent court.

(hh) Public Administration is "**opened**", "**commenced**" or "**initiated**" (and synonymous or derivative expressions) at the time at which the decision to open Public Administration has been passed by the Norwegian Ministry of Finance.

(ii) Financial Collateral is deemed to have been "**granted**" or "**provided**" (and synonymous or derivative expressions) when all perfection requirements applicable to that Financial Collateral have been duly fulfilled.

3. 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)?***

Generally speaking, there are no relevant statutory limitations on the capacity of, or specific regulatory requirements associated with, any Relevant Clearing Member entering into the LCH Agreements. However, Norwegian commercial banks (i.e. all banks other than savings banks) have to notify the FSAN before granting any security, i.e. pursuant to the Deed of Charge. Failure to notify the FSAN has no bearing on the validity or perfection of the security.

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?***

LCH will not, as a consequence of the execution of the LCH Agreements with a Relevant Clearing Member or performance or enforcement of the LCH Agreements and contracts be deemed to be domiciled or resident in Norway.

Clearing houses established outside Norway offering services to Relevant Clearing Members are deemed to be carrying on business in Norway and will be subject to a requirement of prior authorisation under the relevant provisions of the Norwegian Securities Trading Act 2007 if

(i) the clearing house markets its services in Norway; or

(ii) the clearing activity is directed towards the Norwegian market.

With regard to the criterion in (i), we have assumed that LCH does not market its services in the Norwegian market specifically (general marketing not directed specifically at individual clearing members or potential clearing members in or into Norway will not trigger authorisation requirements).

The criterion in (ii) must be assessed on a case by case basis. If services are provided after LCH has been solicited or approached by the Relevant Clearing Member, no authorisation requirements will be triggered. If clearing services are provided following solicitation or approach of clearing members or potential of clearing members in Norway by LCH, LCH will as a rule be seen as carrying on business in Norway.

As a consequence, LCH would be prevented from doing general marketing of its services or solicitation of individual customers directed towards the Norwegian market. Any marketing would be considered solicitation for these purposes, and would be prohibited.

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?***

LCH should obtain the certificate of incorporation (Norwegian: *firmaattest*), articles of association (Norwegian: *vedtekter*) and a board resolution from the Relevant Clearing Member approving the entry into of the Opinion Documents. Furthermore, LCH should obtain certified copies of specimen signatures for the signatories of the LCH Agreements, e.g. passport copies or similar.

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?***

The only formality which needs to be complied with is the notification to the FSAN mentioned in 3.1.1 above, which applies to Norwegian commercial banks. However, failure

by a Relevant Clearing Member commercial bank to comply with this requirement has no bearing on the validity or perfection of the security created under the Deed of Charge.

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

Norwegian courts would uphold the contractual choice of law and jurisdiction set out in Regulation 51.

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

Norwegian courts would uphold the judgement of the English courts in accordance with the terms of the Civil Procedure Act and the Lugano Convention. Norwegian courts would uphold an English arbitration judgement in accordance with the terms of the Civil Procedure Act and the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Norwegian courts will also give effect to the choice of the jurisdiction in the Opinion Documents. Save as set out at 3.1.7, and for failure to comply with procedural requirements, there are no circumstances where a Norwegian court will not uphold an English judgement or arbitration award.

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?*

Section 36 of the Contracts Act allows Norwegian courts to revise or not give effect to "unfair" contract terms. Amongst other things, this provision entails that when a party to an agreement is vested with a discretion or may determine a matter in its opinion, Norwegian law may require that such discretion is exercised reasonably or that such opinion is based on reasonable grounds and a provision that a certain determination is conclusive and binding will not prevent judicial inquiry into the merits of any claim by an aggrieved party.

Another provision of interest is Section 8 of the FC Act, which requires the realisation and valuation of Financial Collateral, as well as the calculation of financial obligations, to be carried out on "*commercially reasonable terms*". The provision is founded upon Article 4 paragraph 6 of Directive 2002/47/EC. We understand that under the Deed of Charge, LCH may, if a Default has occurred, sell or otherwise dispose of the Financial Collateral at any consideration. Norwegian law does not prevent LCH and a Relevant Clearing Member from entering into such an agreement. However, the concrete realisation, valuation and calculation carried out by LCH must - regardless of the terms in the Opinion Documents - be carried out on "*commercially reasonable terms*". There is no entirely certain way of knowing beforehand whether the terms pursuant to which the realisation, valuation and calculation are carried out are commercially reasonable or not. This depends on a concrete assessment of the particular circumstances surrounding the realisation. Relevant criteria in this assessment are, inter alia, trade practice and the balance between the obligations arising from the Agreement. However, it is assumed that the realization, valuation and calculation of financial collateral normally will have to reflect market value in order to satisfy Section 8 of the FC Act.

There is no precedent setting out the extent to which a Norwegian judgement debtor would be able to invoke these two specific provisions. Accordingly, there is some uncertainty as to the possibility of the Norwegian courts refusing to give effect to a foreign judgement or arbitration award which would in effect contravene these provisions. However, we consider it unlikely that a judgement or arbitration award based on the LCH Agreements, entered into by professional parties who have been advised by legal counsel, will not be upheld or enforced in Norway due to public policy considerations.

3.2 Insolvency, Security, Set-off and Netting

3.2.1 Please identify the different types of Insolvency Proceedings and Reorganisation Measures. 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?

We confirm that all Norwegian Insolvency Proceedings, namely Bankruptcy Proceedings and Public Administration, are envisaged in Rule 3 of the Default Rules.

As regards Reorganisation Measures, the only reorganisation measure under Norwegian law is Debt Settlement Proceedings, which is described in greater detail under (c) below. LCH could consider implementing language in Rule 3 of the Default Rules which covers these. However, it is our view that the benefit of this would be limited, given that the effects of Debt Settlement Proceedings take effect from the time the petition for such proceedings is received by the relevant Norwegian district court. Moreover, Debt Settlement Proceedings are of limited practical significance, because a Relevant Clearing Member is likely to be a Guaranteed Institution, and therefore Debt Settlement Proceedings will not be applicable.

(a) *Introduction*

General Norwegian insolvency law recognises two main types of proceedings/measures: Debt Settlement Proceedings (Norwegian: *gjeldsforhandling*) and Bankruptcy Proceedings (Norwegian: *konkurs*). The main legislation governing such proceedings is found in the Bankruptcy Act and the CR Act.

A fundamental difference between Debt Settlement Proceedings and Bankruptcy Proceedings lies in the ultimate goal of the respective proceedings: while Debt Settlement Proceedings aim at reducing and/or restructuring the debtor's liabilities so that it can continue its business going forward, Bankruptcy Proceedings are a pure liquidation process where the goal is to maximise the value of the debtor's estate, liquidate it and distribute the proceeds thereof to the debtor's creditors. Both natural persons and legal entities can be subject to Debt Settlement Proceedings and Bankruptcy Proceedings. Legal entities in Bankruptcy Proceedings will be liquidated and cease to exist when the Bankruptcy Proceedings end.

Although large parts of Norwegian insolvency legislation apply to both Debt Settlement Proceedings and Bankruptcy Proceedings, there are many special rules which only apply to either type of proceeding. As a starting point, the requirements for invoking either type of proceeding are different: Debt Settlement Proceedings can be requested when the debtor

is unable to pay its bills as they fall due (illiquidity), whereas in Bankruptcy Proceedings there is an additional requirement that the debtor's liabilities exceed the value of its assets (insufficiency). In Debt Settlement Proceedings, the debtor retains control of its assets and can continue its business subject to a number of restrictions and the scrutiny of a specially appointed restructuring board (Norwegian: *gjeldsnemnd*). Conversely, in Bankruptcy Proceedings all of the debtor's assets are seized by the bankruptcy estate (Norwegian: *konkursbo*), which is a separate legal entity established by the court to oversee the liquidation and distribution of the debtor's assets to the creditors. This characteristic difference between Debt Settlement Proceedings and Bankruptcy Proceedings has an impact on the rules relating to the treatment of the debtor's contracts.

Pursuant to Section 7-3 of the CR Act, a bankruptcy estate is (subject to certain exceptions not discussed herein) entitled to assume (or "step into") a bankrupt debtor's mutually obligating (Norwegian: *gjensidig bebyrdende*) contracts, i.e. contracts where the parties have rights and obligations towards each other. The bankruptcy administrator has a discretionary right to "cherry pick", and cause the estate to only step into contracts deemed beneficial for the purposes of the Bankruptcy Proceedings. However, when the estate has assumed a contract, it becomes bound by it and must fulfil the debtor's contractual obligations towards the other contract party(-ies) in accordance with the contract's terms (subject to a statutory early termination right which is not discussed herein).

Conversely, in Debt Settlement Proceedings, the debtor's contracts continue uninterrupted without any step-in or "cherry picking" rights, cf. Section 7-3a of the CR Act. This is a natural consequence of the fact that a debtor in Debt Settlement Proceedings, unlike in Bankruptcy Proceedings, retains control over its assets. However, the commencement of Debt Settlement Proceedings triggers a statutory early termination right (which is not discussed herein).

(b) *Relevant Clearing Members which are Guaranteed Institutions*

Guaranteed Institutions cannot be subject to Debt Settlement Proceedings or Bankruptcy Proceedings. The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which a Guaranteed Institution could be subject under the laws of Norway, is Public Administration pursuant to the Guarantee Schemes Act.

Section 4-6(1)(e) of the Guarantee Schemes Act states that the provisions of the CR Act "*apply accordingly*" in Public Administration, but the provision does not specify the exact Sections of the CR Act that apply. As the CR Act contains several provisions which are only applicable to Debt Settlement Proceedings or Bankruptcy Proceedings respectively, the scope of the CR Act's application in Public Administration is of interest in order to determine the effects of Public Administration. Neither the Guarantee Schemes Act nor its preparatory works give any firm answer with respect to this issue. However, before the CR Act and the Guarantee Schemes Act were enacted, public administration of commercial banks was regulated in the Commercial Banks Act 1961. The Commercial Banks Act stated that public administration of a bank would be subject to chapter 4 and Sections 119-122 of the 1863 Bankruptcy Act (which was succeeded by the current Bankruptcy Act and CR Act

in 1984). Chapter 4 of the 1863 Bankruptcy Act regulated to what extent assets could be seized by a bankruptcy estate (including claw-back rules), and Sections 119-122 contained certain provisions relating to rights of set-off, recognition of interest on claims and the rights of guarantors and other parties who were jointly liable with the debtor, in the event of bankruptcy proceedings. When the CR Act was enacted in 1984, the specific reference in the Commercial Banks Act to the above-mentioned Sections in the 1863 Bankruptcy Act was replaced with a statement to the effect that "the CR Act should apply accordingly" to public administration proceedings. This wording has been preserved in Section 4-6(1)(e) of the Guarantee Schemes Act. It is not clear whether the legislator upon implementing this change intended to expand the scope of bankruptcy-related rules applicable to public administration of banks, although some statements in the preparatory works seem to imply that this was indeed the case.[1]

Looking beyond the plain wording of the current statutes, it is evident from the preparatory works to the Guarantee Schemes Act and the legislation preceding that act that the purpose of Public Administration is not primarily liquidation, but rather finding a basis for continued operations of the distressed Guaranteed Institution. If continued operation is not feasible, the Administration Board should try to facilitate a merger between the distressed Guaranteed Institution and a solvent financial institution, or alternatively sell all or parts of the Guaranteed Institution's operations. While under Public Administration, all payments by the Guaranteed Institution to its creditors are subject to approval by the FSAN. The same goes for any decisions of material significance to the Guaranteed Institution under Public Administration. If, following twelve months of Public Administration, the Guaranteed Institution has no realistic prospects of being able to resume its operations on a commercially viable basis, the Administration Board should proceed to liquidate it.

Section 4-6 of the Guarantee Schemes Act describes the legal consequences of a Guaranteed Institution being placed under Public Administration. Apart from having its governing bodies replaced by the Administration Board, a Guaranteed Institution under Public Administration cannot, among other things, accept or repay deposits, grant new credit or expand current credits without the FSAN's approval. This is similar to the legal effects of Debt Settlement Proceedings as described in Section 14 of the Bankruptcy Act, and distinctly different from the consequences of the commencement of Bankruptcy Proceedings as described in Section 100 of the same act. In the bankruptcy setting, it does not make sense to talk about what the debtor can or cannot do with its assets, because the debtor has no right to use or dispose of most of its assets once Bankruptcy Proceedings have commenced and the debtor's assets have been seized by the bankruptcy estate.

There is no precedent available to shed light on how the courts consider Public Administration in light of the traditional insolvency legislation discussed above. The only known case of public administration of a bank in Norway in recent years is the public administration of the Norwegian branch of Icelandic bank Kaupthing Banki Hf in 2008. Based on conversations with the former chairman of Kaupthing's administration board, our

[1] See Ot.prp.nr.50 (1980-1981) pp. 227

understanding is that the administration board found it difficult to draw an exact line between applicable and non-applicable rules in the CR Act. However, in relation to Kaupthing's contracts, we understand that the administration board did not consider itself legally entitled to "cherry-pick" contracts pursuant to Section 7-3 of the CR Act

When a Guaranteed Institution is placed under Public Administration, no "estate" or other separate legal entity is created as a result. Although the bank's Administration Board will have many tasks similar to those of a bankruptcy administrator, the Administration Board will not be regarded as a separate legal entity, rather it is a special body appointed to handle the Guaranteed Institution's business. It is therefore difficult to reconcile the legal status of an Administration Board with a right to "step into" or "cherry pick" the bank's contracts.

Accordingly, when considering whether to apply Section 7-3 (which applies in Bankruptcy Proceedings) or Section 7-3a (which applies in Debt Settlement Proceedings) of the CR Act to the Public Administration of a Guaranteed Institution, the better view is that Section 7-3a should apply and that the Guaranteed Institution's contracts continue uninterrupted while the Guaranteed Institution is under Public Administration.

Public Administration will be initiated against a Guaranteed Institution if it is no longer able to pay its debts as they fall due, or if it can no longer meet the capital adequacy requirements set by the FSAN.

Once Public Administration has been initiated against a Guaranteed Institution, all former bodies of the Guaranteed Institution will be removed. The Administration Board appointed by the FSAN will replace the Guaranteed Institution's former board. All assets and liabilities of the Guaranteed Institution will form part of an estate similar to a traditional bankruptcy estate. This estate is not a separate legal entity from the Guaranteed Institution. The purpose of the Public Administration is to determine whether (i) the Guaranteed Institution's business can be carried on in an economically sound way, or (ii) the business can be transferred to other banks, or (iii) the Guaranteed Institution should be wound up and its assets liquidated.

Other than Public Administration, there are rules which apply if a Guaranteed Institution is experiencing financial difficulties. A Guaranteed Institution shall inform the FSAN of a situation where liquidity or balance sheet problems may arise. Accordingly, the duty to inform may arise prior to the possible financial issues becoming manifest. Once informed, the FSAN can initiate several measures, including decreasing the Guaranteed Institution's subordinated debt capital. The FSAN can also, amongst other things, call for general meetings of the Guaranteed Institution, demand that the composition of the managing organs of the Guaranteed Institution be changed, or impose conditions or guidelines which are deemed required in order to ensure that the Guaranteed Institution's continued business is carried out in a sound way. Such pre-insolvency measures do not in general affect agreements entered into by a Guaranteed Institution.

(c) Relevant Clearing Members which are not Guaranteed Institutions

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which a Relevant Clearing Member which is not a Guaranteed Institution could be subject in Norway, are Debt Settlement Proceedings or Bankruptcy Proceedings.

Debt Settlement Proceedings can be requested by debtors who are unable to meet their obligations as they fall due, but who are not necessarily insolvent. Debt Settlement Proceedings consist in negotiations between the debtor and its creditors over either a voluntary settlement or a compulsory composition (although based on our experience, a Relevant Clearing Member is likely to be a Guaranteed Institution).

During Debt Settlement Proceedings, the company will continue to operate under its management subject to certain restrictions and the supervision of a creditor committee. The debtor retains its assets and remains authorised to contract with third parties, but must obtain the consent of the restructuring board in order to sell assets, grant security, acquire property or lend certain important assets. The debtor's mutually obligating contracts which were concluded prior to the opening of the Debt Settlement Proceedings continue to remain in force.

After a petition for Debt Settlement Proceedings has been submitted, Section 16 of the Insolvency Act states that a petition for bankruptcy submitted by creditors of claims arising prior to the opening of Debt Settlement Proceedings cannot be granted until after the petition for Debt Settlement Proceedings has been revoked, denied or cancelled, or after the Debt Settlement Proceedings have been completed. There are however exceptions to this rule, e.g. that the petitions for bankruptcy may be granted three months after the opening of Debt Settlement Proceedings.

The Debt Settlement Proceedings may result in a voluntary settlement (consisting of a payment extension, pro rata reduction of debt, liquidation of all or parts of the debtors assets or a combination of these measures) or a compulsory composition (consisting of a payment extension, pro rata reduction of debt, liquidation of all or parts of the debtors assets or a combination of these measures). In voluntary settlement proceedings, the adoption of a voluntary settlement requires the consent of all creditors comprised by the proposed settlement. The adoption of a compulsory composition requires the consent of 60% of the creditors if the proposed composition will cover at least 50% of the debtor's debt or 75% of the creditors if the proposed composition will cover less than 50% of the debt. A compulsory composition may however not be adopted unless it will cover at least 25% of the debtor's debt.

Bankruptcy Proceedings may be opened where a debtor, following a petition to the courts from either the debtor or its creditors, is found to be insolvent. Bankruptcy Proceedings may also in certain cases be instigated following failed Debt Settlement Proceedings. The purpose of Bankruptcy Proceedings is to liquidate the debtor's assets for the benefit of its creditors and to distribute the proceeds in accordance with the distribution rules set out in Chapter 9 of the CR Act.

The instigation of Bankruptcy Proceedings results in the insolvency estate of the debtor being established. The insolvency estate is a legal person separate from the debtor. The

insolvency estate is, subject to certain exceptions, entitled to seize the assets of the debtor and to step into and "cherry pick" the mutually obligating contracts of the debtor pursuant to Section 2-2 and 7-3 of the CR Act.

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?***

In order for the Deed of Charge to be effective in the context of Insolvency Proceedings and Reorganisation Measures in respect of a Relevant Clearing Member, two general conditions would in our view have to be fulfilled: (i) LCH would have to be able to net the obligations of the Relevant Clearing Member, turning these obligations into a net claim; and (ii) LCH would have to be able to enforce this resulting net claim against the Relevant Clearing Member pursuant to the Deed of Charge.

Section 4-2 (1) of the PS Act states that agreements regarding netting and settlement may be enforced in accordance with their terms even where Insolvency Proceedings or Reorganisation Measures have been initiated against a Relevant Clearing Member, provided that the Contract has been entered into the Securities Settlement System prior to the opening of Insolvency Proceedings, cf. Section 4-2 (2) of the PS Act. Only Perfected Contracts, i.e. Contracts which have been entered into the relevant Securities Settlement System prior to the opening of Insolvency Proceedings of the Relevant Clearing Member, enjoy the protection of these provisions of the PS Act.

We are of the opinion that items (b), (h)(v) and (k) of Rule 6 of the Default Rules of the LCH Rulebook constitute an agreement regarding netting (Norwegian: *avtale om avregning*) for the purposes of Section 4-2 of the PS Act, cf. the discussion in paragraph 3.2.3(a) below. This means that even if Insolvency Proceedings have been initiated against a Relevant Clearing Member, LCH would be entitled to net all sums under the Perfected Contracts in accordance with the Default Rules.

Following the netting of the Perfected Contracts, the Parties would be left with a net claim and a net obligation. This net claim or obligation would then constitute a "financial obligation" (Norwegian: *finansiell forpliktelse*) for the purposes of the FC Act. Section 7 of the FC Act permits enforcing Financial Collateral for financial obligations on the terms and conditions set out in the agreement between the parties, also after Insolvency Proceedings have been initiated against a Relevant Clearing Member. Given that the net claim or obligation following the above-described netting is a financial obligation and that the Collateral granted under the Deed of Charge is Financial Collateral, it is our opinion that the Deed of Charge would be effective in the context of Insolvency Proceedings or Reorganisation Measures in respect of a Relevant Clearing Member.

It is further our opinion that Section 14-3 cf. Section 14-1 of the ST Act would protect the Deed of Charge against avoidance pursuant to Section 5-7 of the CR Act, even where the

relevant Financial Collateral has been granted after the obligations have been incurred under the Perfected Contracts. Please also refer to our response to question 3.2.4 below.

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 will constitute an Automatic Early Termination Event in accordance with Rule 3 of the Default Rules and/or Reorganisation Measures? If the answer is affirmative, please identify those specific Insolvency Proceedings to which the answer applies and briefly explain your reasoning***

As discussed in more detail in section 3.4.3 below, we believe that in the event of Insolvency Proceedings being commenced against a Relevant Clearing Member, the participation of that Relevant Clearing Member within the System would be determined by the application of English insolvency law, being the law governing that System. Accordingly, Part VII of the Companies Act 1989 would apply to any Relevant Clearing Member subject to Insolvency Proceedings (other than Debt Settlement Proceedings).

Based on the assumption that under the laws of England and Wales, Part VII will protect the actions listed in Rule 6 of the Default Rules from invalidation/challenge in the administration of an insolvent estate upon default of a clearing member incorporated in England and Wales, we are of the opinion that Part VII would also protect the actions listed in Rule 6 from invalidation/challenge in respect of a Relevant Clearing Member subject to Insolvency Proceedings (other than Debt Settlement Proceedings).

If, however, Norwegian courts were to hold the view that Part VII were not to apply to a Relevant Clearing Member and as further set out in the remainder of this section 3.2.3, our view is that (without the consent of the FSAN), LCH would be able to take the actions described in (b), sub-item (v) of (h) and (k) of Rule 6 of the Default Rules against a Guaranteed Institution once Insolvency Proceedings have been commenced.

As regards whether or not LCH will have the right to take the actions provided for in the Default Rules in the event that a Relevant Clearing Member is subject to Insolvency Proceedings, a distinction must be made between actions which result in the Defaulter being given new obligations (see (a) below) and the actions which result in the termination of Contracts (see (b) below).

(a) *Actions resulting in new disposals post opening of Insolvency Proceedings or Reorganisation Measures*

Pursuant to Section 100 of the Bankruptcy Act, the debtor is not entitled to make any disposals on behalf of the insolvency estate after the opening of Bankruptcy Proceedings, hereunder incurring new obligations. Following Section 23 of the Contracts Act, actions made by an agent in the name of the debtor are not binding on the insolvency estate to any further extent than if the action was made by the debtor himself. Therefore, actions

taken under the Default Rules which consitute disposals either over the assets of the insolvency estate (Norwegian: *forføye over boets eiendeler*) or otherwise on behalf of the insolvency estate after the opening of Insolvency Proceedings ("**New Disposals**") are not binding upon the insolvency estate. In our opinion, the following actions in the Default Rules would, if taken following the opening of Insolvency Proceedings, result in such New Disposals:

(i) registering an original contract or an FCM Transaction in the name of the Defaulter under Rule 6(a);

(ii) to effect a closing-out in respect of an open contract of the Defaulter by entering into a closing-out contract under Rule 6(b);

(iii) to invoice a contract back under Rule 6(d);

(iv) to exercise an option of the Defaulter on its behalf under Rule 6(f);

(v) to transfer an open contract from the account of another Clearing Member to the account of the Defaulter under Rule 6(g);

(vi) to tender (or submit a Delivery Notice) or to receive a tender (or a Delivery Notice) in the Defaulter's name under Rule 6(i);

(vii) to perform on an open contract subject to tender (or an FCM Exchange Contract Subject to Delivery Notice) or a delivery contract (or Physically-Settled FCM Exchange Contract) by either delivery of or by accepting delivery of the commodity which is the subject of such contract to or from, as the case may be, the Defaulter, its agent or a third party in any manner permitted by the terms of the Contract and the Exchange Rules (if any) under Rule 6(j);

(viii) to make or to procure the making of one or more contracts, including (without limitation) original contracts for the purpose of hedging market risk to which the Defaulter is exposed, and to register the same in the Defaulter's name under the Regulations or the FCM Regulations (as the case may be) under Rule 6(l);

(ix) to make or to procure the making of one or more contracts, whether or not in the terms of exchange contracts (or FCM Exchange Transactions), for the sale, purchase or other disposition of a commodity, and to register the same in the Defaulter's name under the Regulations under Rule 6(m); and/or

(x) to take such action as the Clearing House may deem necessary for its protection in the name and at the expense of the Defaulter with regard to any open contract standing in its name under Rule 6(p).

The above-mentioned actions would therefore not be binding upon the insolvency estate if executed following the opening of Bankruptcy Proceedings. There are no applicable exemptions.

As regards Public Administration, Section 4-6 of the Guarantee Schemes Act states that the effect of Public Administration is *inter alia* that the prior consent of the FSAN is required for (i) a bank to accept deposits, assume new engagements or increase existing engagements or (ii) a Guaranteed Institutions to make payments to depositors or other creditors. These restrictions are not commented on in the preparatory works of the act, and there are no court precedents available. In particular, it is unclear what is meant by a bank assuming new engagements (Nw: *påta seg nye engasjementer*). A litteral interpretation of this expression suggests that this only concerns the lending out of money or assumption of a commitment to lend out money. There is however a risk that the expression could be given a wider interpretation, and therefore cover the assumption of new obligations. This is supported by Subsection 2 of the Section 4-6 stating that new obligations incurred while the Guaranteed Institution is subject to Public Administration is considered as preferred debt, which could suggest that new obligations may only be incurred by the administration board and, conversely, not by the counterparties of the Guaranteed Institution exercising contractual rights established prior to the opening of Public Administration. If the expression "assuming new engagements" is given the latter interpretation, this would jeopardise the effectiveness of the actions mentioned in (i) - (x) above.

There are no applicable exemptions.

As regards the effects of Debt Settlement Proceedings, the debtor is as a rule entitled to dispose of its assets. However, Subsection 2 of Section 14 of the Bankruptcy Act states that the consent of the restructuring board is required for the debtor to incur or refinance debts, grant as security, sell or lease its immovable property, offices or any other assets of material importance. Firstly, it should be noted that the expression "to incur ... debts" in light of the preparatory works of the Bankruptcy Act covers only the incurrence of obligations to pay monies in the future and not other obligations which are to be performed in the future.[2] Therefore new obligations require the consent of the restructuring board if the obligation is performed by the future payment of monies. This would in our opinion cover the actions referred to in subparagraphs (i), (ii) (iii), (v), (viii), (ix) and (x) in paragraph 3.2.3(a) above where the debtor is to perform by cash payment. Secondly, the same actions, as well as exercising a put option pursuant to the action referred to in paragraph 3.2.3(a)(iv) above, would require the consent of the restructuring board where the debtor's performance concerns the transfer of ownership of an asset of material importance to the business of the debtor. If any actions under the Default Rules are taken in breach of Subsection 2 of Section 14 of the Bankruptcy Act, the actions will be binding if LCH in good faith was not aware that the consent of the restructuring board was required due to the opening of Debt Settlement Proceedings.

(b) Actions resulting in the termination of LCH's obligations

Under Norwegian insolvency law, the insolvency estate of the debtor will, as a general rule, following the opening of Bankruptcy Proceedings be entitled to step into the mutually

[2] NOU 1972:20 pp. 69.

obligating agreements which the debtor has concluded, cf. Section 7-3 of the CR Act. Where the debtor is subject to Debt Settlement Proceedings, the agreements of the debtor continue in full force and effect as prior to the opening of such proceedings, cf. Section 7-3a of the CR Act. Section 7-3(2)(2) of the CR Act states that contractual provisions which give the counterparty a more extensive right to terminate the agreement following the insolvency of the debtor are not binding on the insolvency estate. This provision applies *mutatis mutandis* following the opening of Debt Settlement Proceedings, cf. Section 7-3a(1)(3) of the CR Act.

In both Insolvency Proceedings and Debt Settlement Proceedings, a consequence of the statutory provisions referred above is that the counterparties of the debtor may not terminate Contracts on grounds of the opening of the applicable Insolvency Proceedings or Debt Settlement Proceedings in the absence of an applicable exemption. In our opinion, the following actions would constitute a termination for the purposes of Sections 7-3 and 7-3a of the CR Act:

(i) to effect the transfer or termination, close-out and cash-settlement of an open contract of the Defaulter under Rule 6(b);

(ii) to settle an open contract under Rule 6(c);

(iii) to transfer an open contract of the Defaulter to the account of another Clearing Member under Rule 6(g)(i) and (ii);

(iv) to close-out and terminate an open contract under Rule 6(g)(iii);

(v) to transfer or terminate and close-out contracts under Rule 6(h);

(vi) to declare the Defaulter's right and obligations respect of an open contract subject to tender (or an FCM Exchange Contract Subject to Delivery Notice) discharged under Rule 6(k); and

(vii) to transfer an open contract of the Defaulter under Rule 6(o).

Whether or not LCH will have the right to take such actions in the event that a Relevant Clearing Member is subject to Insolvency Proceedings therefore depends on whether applicable exemptions are available. Possible exemptions are discussed at (i) - (iii) below.

(i) The right to terminate due to the nature of the contract

Section 7-3(2)(1) of the CR Act states that the step-in right of the insolvency estate does not affect the counterparty's right to invoke the insolvency as a termination event due to the nature of the agreement (Norwegian: *avtalens art*). The same applies *mutatis mutandis* to Debt Settlement Proceedings and Public Administration, cf. Section 7-3a(1)(2) of the CR Act and the discussion in 3.2.1(b) above. When considering whether this exemption is applicable, a first question is whether Derivatives *per se* is of a nature that entitles LCH to terminate outstanding Contracts. If answered in the negative, a second question is whether LCH's role as a CCP affects this position. These two questions are discussed below.

The question of whether Derivatives *per se* are of a nature that entitles a solvent counterparty to terminate outstanding contracts in the event of the insolvency of its counterparty is not directly touched upon by the CR Act or its preparatory works. The preparatory works of the CR Act do however provide general guidance on the application of the exception in Section 7-3(2)(1) by stating that it firstly applies where the contract is of a type where the solvency of the counterparty was a relevant premise for the solvent party's entry into of the agreement.[3] Secondly, the exception may apply where the contract presupposes the personal performance of the insolvent party.[4] Based upon this, Norwegian legal scholars have argued that neither interest rate swaps nor currency swaps are contracts which can be terminated due to the nature of the agreement. The reason for this point of view is that the element of credit in interest rate or currency swaps is not the dominating element of the contract. Accordingly, such swaps are not comparable with the granting of a loan, which the preparatory works refers to as an example of a contract that may be terminated due to the borrower's insolvency.[5] However, the terms of Derivatives other than interest rate or currency swaps contain a greater element of credit, and the case could be made for recognising Section 7-3(2)(1) of the CR Act as applicable to those. In any event, due to the vague wording of Section 7-3(2)(1) and its preparatory works, it is not possible to conclude with absolute certainty whether the solvent party in relation to certain Derivatives will be entitled to terminate the contracts due to the opening of Insolvency Proceedings in its counterparty, and, if so, which Derivatives.

The question of whether LCH's role as a CCP affects the above position has not to our knowledge been addressed in any preparatory works or legal literature. It could be argued that the CCP's role as an intermediary makes the solvency of its counterparties a more essential premise for the entry into of contracts, as when a CCP does not receive payments under a contract with one Clearing Member, this will expose the CCP to market risk under the corresponding contract with another Clearing Member. However, due to vague wording of Section 7-3(2)(1) of the CR Act and the lack of other sources addressing this specific question, we are also here unable to give the opinion that 7-3(2)(1) will entitle LCH to terminate its contracts with Clearing Members who have become Defaulters due to being subject to Insolvency Proceedings.

(ii) The PS Act

Following Section 4-2(1) of the PS Act, agreements regarding netting are enforceable against a Norwegian participant in Securities Settlement Systems regardless of whether Insolvency Proceedings or Reorganisation Measures are opened in such participant, provided that the Contract is entered into the system prior to the opening of insolvency proceedings. Netting is defined as the conversion of transfer orders between two or more participants to one net claim or one net obligation, cf. Section 1-3 of the PS Act.

One question that arises in this context is which contractual provisions that are considered as regarding netting for the purposes of Section 4-2(1) of the PS Act and therefore

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[3] NOU 1972:20 pp. 313
[4] Loc.cit.
[5] Tjaum *Valuta- og renteswaper.* (Universitetsforlaget, 1996) pp. 357-364.

enforceable regardless of the opening of Insolvency Proceedings of a Clearing Member. The definition of "*netting*"' contained in Section 1-3, as referred above, can be taken to imply that the PS Act refers to a procedure whereby the Contracts are terminated and the net sum of the gains and losses of the parties thereafter are calculated. In our opinion, neither the definition of "*netting*" in Directive 98/26/EC (as amended) nor the preparatory works of the PS Act suggest a narrower interpretation. Our opinion is therefore that Rule 8 will be enforceable pursuant to Section 4-2(1) of the PS Act only to the extent it operates to the effect of terminating outstanding Transfer Orders and producing a net sum on the basis of the value of the Parties' obligations under the Contracts. Conversely, due to the lack of legal basis for an exemption from Sections 7-3 and 7-3a of the CR Act, the termination of outstanding Contracts without a subsequent settlement based on the netting of the value of the Contracts would not be enforceable. Our understanding is that where Rule 6 of the Default Rules provides for the termination, close-out and re-establishment of contracts, this implies that the contracts are terminated and the gains/losses of LCH resulting from the re-establishment of contracts are taken into account for the purposes of Rule 8 of the Default Rules.

Based on this understanding, it is our opinion that termination and close-out of contracts pursuant to item (b) and sub-item (v) of item (h) of Rule 6 of the Default Rules will be effective despite the opening of Insolvency Proceedings. This also applies to the action referred to in item (k) of Rule 6 of the Default Rules. On balance therefore, of the actions in Rule 6 that result in the termination of Contracts, only the actions in (b), sub-item (v) of (h) and (k) of Rule 6 are likely to be available to LCH once Insolvency Proceedings have been commenced.

To the extent the provisions in the Default Rules providing for the termination and netting of Contracts are enforceable pursuant to Section 4-2(1) of the PS Act, the net sum will be a financial obligation which may be subject to a financial collateral arrangement as described in paragraph 3.2.2 above. Financial Collateral transferred in order to secure the net obligation of the Clearing Member may therefore be set-off against the net amount due from the Clearing Member to LCH.

(iii) The right to set-off other amounts than those due under Transfer Orders

As stated above, it is only the netting of Transfer Orders which is enforceable pursuant to Section 4-2(1) of the PS Act. Rule 8(a) however appears to go further than this, by providing that amounts other than those owing under transfer orders, such as amounts due under the Regulations, any sum due in respect of any breach of the Regulation and any amount due from the Defaulter to the Clearing House in respect of any Treasury Contract (**"Other Amounts"**) will also be taken into account when netting the obligations of the Clearing House and the Defaulter. Section 4-2(1) of the PS Act does not guarantee that exercising the right of set-off will be effective in relation to Other Amounts. To what extent Other Amounts may be off-set against the claim of the Defaulter in the event that a net amount is due to the Defaulter following the close-out of the Contracts will therefore be regulated by Section 8-1 of the CR Act.

Section 8-1 of the CR Act provides (office translation):

"A party which at the time of commencement of the insolvency proceedings holds a claim against the debtor that may be filed with the insolvency estate, may off-set the claim with its full amount against a claim which at that time is held by the debtor, but forms part of the insolvency estate.

Set-off may not take place if set-off due to the nature of the claims would have been prevented if the debtor was still solvent. The fact that the counterclaim relates to other means than monies, or becomes due after the claim is due, does nevertheless not exclude set-off. Set-off may however not be effected if the debtor's claim fell due prior to the commencement of insolvency proceedings and the counterclaim falls due after this point of time."

In the discussions below, the claim against which the Non-Defaulting Party intends to exercise set-off is referred to as the "claim" or "claims", while the Non-Defaulting Party's claim is referred to as the "counterclaim" or "counterclaims".

As it will appear from the wording of Section 8-1 of the CR Act, set-off is firstly conditional upon whether the claims fulfil the condition of being "*a claim which at [the time of commencement of the Insolvency Proceedings] is held by the debtor*", thus allowing the Non-Defaulting Party to off-set its counterclaims against such claims. Secondly, the counterclaim(s) must be claims held at the time of commencement of the insolvency proceedings that may be filed with the insolvency estate. Thirdly, set-off must not have been prevented if the debtor was still solvent.

As regards the requirement that the claim was held by the debtor at the opening of Insolvency Proceedings, the main implication is that claims arising due to the Insolvency Estate exercising its step-in right and performing contracts may not be settled by set-off. To the extent contracts are closed-out pursuant to Section 4-2(1) of the PS Act, this will not be the case, and therefore exercising set-off against a net amount owed by LCH under Contracts to the Defaulter will satisfy this condition.

As regards the requirement that the counterclaims must be claims held at the time of commencement of the insolvency proceedings that may be filed with the insolvency estate, this covers claims against the debtor which were due and payable at the opening of the proceedings, as well as unmatured and contingent (Nw: *dividendeberettiget krav*), as well as claims that at the opening of Bankruptcy Proceedings have not yet matured or are contingent on events that have not occurred as of that date, cf. Sections 6-1 and 6-2 of the CR Act. There seems to be a consensus among legal commentators that *counterclaims* arising out of agreements concluded with the debtor prior to the opening of insolvency proceedings are to be considered as being held by the solvent party at the time of opening.[6] It is however not possible for us to give a more specific opinion on whether or not Other Amounts will be eligible for set-off against a claim, as this will vary according to the grounds for the claim.

[6] Tjaum *op.cit.* pp. 412-413; Rune Sæbø. *Motregning.* (Fagbokforlaget, 2003). pp. 432-434.

As regards the requirement that neither the claim nor the counterclaim is of a nature which would have precluded set-off if the Defaulting Party was solvent,the preparatory works of the CR Act states that whether or not this is the case depends on what is agreed between the parties and the non-mandatory rules of law governing set-off.[7] The common position held in Norwegian literature is that if the solvent party pursuant to agreement would have a right of set-off if the debtor was solvent, set-off may be exercised to the same extent towards the insolvency estate of the debtor.[8] The insolvency estate will however not have to respect an agreement which gives the solvent party a wider right of set-off upon the bankruptcy of the debtor.[9] Our position is consistent with this view. As the Default Rules contemplate set-off following the Clearing Member becoming a Defaulter, regardless of whether this is due to the insolvency of the Clearing Member or not, our view is that the nature of the claim and the counterclaim do not prevent set-off when the Defaulter is solvent.

On balance, our view is that LCH can take the termination actions listed in (i) - (vii) above in relation to Other Amounts, save with respect to claims from the Insolvency Estate against LCH due to the Insolvency Estate exercising its step-in right and performing contracts.

(c) The necessity/desirability of Automatic Early Termination

In cases where a solvent party is not able to rely on special legislation, such as Section 4-2 of the PS Act, the question of whether automatic early termination events are effective under Norwegian insolvency law, *i.e.* having the effect that agreements are considered as terminated as of the occurrence of events specified as such, to the detriment of the step-in right of the insolvency estate as discussed in paragraph 3.2.3, is not addressed under Norwegian statutory provision. The question has however been subject to some debate in Norwegian legal literature. The background for the discussion is that the preparatory works of the CR Act state that an effective termination prior to the opening of Insolvency Proceedings precludes the insolvency estate from stepping into the agreement, and this regardless of the grounds for the termination.[10] If an automatic early termination purporting to be effective at a time prior to the opening of Insolvency Proceedings, *i.e.*, in the case of Bankruptcy Proceedings, a bankruptcy petition is presented for a competent court, is recognised as effective under the CR Act, the relevant agreement would thus be considered as terminated prior to the opening of Insolvency Proceedings and therefore precluding the insolvency estate from stepping into the agreement.

The view in Norwegian legal literature is, however, that automatic early termination clauses are not effective.[11] This view is based upon the rationale given in the preparatory works of the CR Act for making the effectiveness of the termination of the agreements to the detriment of the step-in right of the Insolvency Estate conditional upon whether the

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[7] NOU 1972:20 pp. 330.
[8] Sæbø *op.cit* pp. 459; Andenæs *op.cit.* pp. 233; Tjaum *op.cit.* pp. 403.
[9] Sæbø *loc.cit*; Andenæs *loc.cit*; Tjaum *loc.cit.*
[10] NOU 1972: 20 pp. 320.
[11] Tjaum pp. 383-385; Andenæs pp. 217.

notice of termination actually has been presented to the debtor prior to the opening of Insolvency Proceedings: If the non-defaulting party actually wishes to terminate the agreement on grounds of an event of default, this has to be actually done at this stage, and not at a later stage when Insolvency Proceedings are opened. Our opinion is that Norwegian courts are most likely to take the same position, and we therefore do not deem Automatic Early Termination Events to be enforceable outside the situations where the special legislation in the PS Act applies. When the PS Act applies, Automatic Early Termination Events do not add to LCH's rights upon the insolvency of a Relevant Clearing Member. Therefore we do not deem Automatic Early Termination Events to be strictly necessary.

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?***

Section 5-9 of the CR Act contains a general rule similar to *actio pauliana*, pursuant to which a transaction which (i) improperly gives preference to one creditor at the expense of the others, (ii) prevents the debtor's assets from being used to cover the creditor's claims, or (iii) increases the debtor's liabilities in a manner which is detrimental to the creditors, may be avoided if the debtor's financial situation was weak or became seriously weakened by the transaction. The transactions may be avoided where the other party knew or should have known of the debtor's financial difficulties and the circumstances which rendered the transaction improper. The provision applies for transactions completed within the period starting 10 years prior to the Date of Filing.

Section 5-7 of the CR Act contains a rule pursuant to which the creation of a pledge or other security may be avoided if (a) the pledge or security concerns debt which the debtor incurred prior to the security right was agreed or (b) the security was not perfected without undue delay after the debt was incurred may be subject to claw back, in both cases provided that the security right was perfected within the period starting three months prior to the petition for Debt Settlement Proceedings or Bankruptcy Proceedings was received by the court. However, Section 14-3 of the ST Act states that Financial Collateral granted in respect of a Relevant Clearing Member's Secured Obligations toward a Service cannot be avoided based on Section 5-7 of the CR Act. It is therefore our opinion that the Financial Collateral cannot be avoided based on Section 5-7 of the CR Act.

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

There is no such legislation of which we are aware.

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

No. Claims against a Relevant Clearing Member are converted into NOK for value at the Date of Filing.

3.3 Client Clearing

3.4 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 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 Rule applies to enter into a Security Deed; and (ii) ignore Questions 3.1.3 to 3.1.5.

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 3.1.3 to 3.1.5.

As far as we are aware, there is no Exempting Client Clearing Rule available under substantive Norwegian law. However, please see paragraph 3.4.3 for a discussion on whether the rights and obligations arising from, or in connection with, the participation of that Relevant Clearing Member within the LCH system would be determined by the application of substantive English insolvency law, being the law governing that system.

3.4.1 If LCH were to: (i) declare a Relevant Clearing Member to be in Default in circumstances other than the commencement of Insolvency Proceedings 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 Relevant Clearing Member is contractually bound to the Opinion Documents by way of its agreement to the Clearing Membership Agreement. In the absence of the insolvency of a defaulting Relevant Clearing Member, the contractual arrangements supporting the Client Clearing Arrangements should be effective in their own right. On this basis, neither the Relevant Clearing Member nor any other person should be able to successfully challenge the porting of the relevant Client Contracts and Account Balance by LCH, where Insolvency Proceedings have not been commenced.

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

Please see our response in paragraph 3.4.1 above. On this basis, neither the Relevant Clearing Member nor any other person should be able to successfully challenge the return by LCH of the Client Clearing Entitlement to the relevant Clearing Client or Defaulter, where Insolvency Proceedings have not been commenced.

3.4.3 ***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 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?***

Pursuant to the Default Rules, including in particular the Client Clearing Annex to the Default Rules, the Contracts of Clearing Clients may be (i) transferred to a Backup Clearing Member, together with the Account Balances (a process known as "porting"); or (ii) closed out and liquidated in conjunction with the return of the Client Clearing Entitlement to the Clearing Client (or to the Defaulter for the account of the Clearing Client).

It is important to note that **in both cases**, 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) which in the case of porting is transferred to the Backup Clearing Member, whilst in the case of close-out is returned to the Clearing Client (or to the Defaulter for the account of the Clearing Clients).

In order to prevent the return of the Client Clearing Entitlements or the operation of the porting mechanism from being challenged under anti-deprivation principles or other similar principles of insolvency law, LCH intends to rely on either:

(i) any law, regulation or statutory provision (having the force of law) of a governmental authority, the effect of which is to protect the operation of the LCH Rules, including in particular the Client Clearing Annex of the Default Rules, from challenge under the insolvency laws applicable to the Relevant Clearing Member (any such provision, an "**Exempting Client Clearing Rule**"); or

(ii) if no Exempting Client Clearing Rule would apply to a Relevant Clearing Member, the Security Deed (as defined below). Clearing Members in respect of whom a suitable Exempting Client Clearing Rule is not available and who wish to offer client clearing are required to enter into a security deed (the "**Security Deed**") in favour of each of their Clearing Clients. Under the terms of the Security Deed, the Relevant Clearing Member grants a security interest in favour of its Clearing Client over the receivable

from LCH in respect of assets and positions held in an account with LCH on the relevant Clearing Client's behalf.

The LCH Rulebook permits LCH to designate a Clearing Member as an "Exempt Clearing Member" if, in its sole determination, an Exemption Client Clearing Rule would apply to a Relevant Clearing Member upon it becoming a Defaulter.

In accordance with the provisions of the Client Clearing Annex an Exempt Clearing Member must either:

(i) pay or deliver to or to the order of LCH the Account Balances of those of its Clearing Clients whose contracts are ported to a Backup Clearing Member; or

(ii) pay or deliver to or to the order of LCH the Client Clearing Entitlements of its Individual Segregated Account Clients, Affiliated Omnibus Segregated Clearing Clients and Identified Omnibus Segregated Clearing Clients whose contracts are closed out and liquidated,

which obligations constitute an "Undertaking to Pay and Deliver" between the Exempt Client Clearing Member and LCH and are secured under the Deed of Charge. The Undertaking to Pay and Deliver applies to those Clearing Clients who are Individual Segregated Account Clearing Clients and those Clearing Clients that are all Identified Omnibus Segregated Clearing Clients or Affiliated Omnibus Segregated Clearing Clients comprising a single Omnibus Segregated Account who have appointed a single Backup Clearing Member. It does not apply to Non-Identified Omnibus Segregated Clearing Clients. For these Clearing Clients an "Aggregate Omnibus Client Clearing Entitlement" will always be returned to the Defaulting Clearing Member, regardless of whether the Defaulting Clearing Member is an Exempt Clearing Member.

If a Relevant Clearing Member were designated as an Exempt Client Clearing Member, then the operation of the Client Clearing Annex of the Default Rules should be capable of being protected from challenge under the insolvency laws of Norway, being the laws applicable to the Relevant Clearing Member upon its insolvency, and the entering into of a Security Deed would not be necessary.

If a Clearing Member does not qualify as an "Exempt Clearing Member" then it must enter into a Security Deed in respect of each Clearing Client which is an Individual Segregated Account Client, Affiliated Omnibus Segregated Clearing Client or Identified Omnibus Segregated Clearing Client.

We understand that substantive English insolvency law (in particular Part VII) would give effect to the provisions in the LCH Rules entitling LCH to either port the Relevant Contracts and Account Balance of a Clearing Client to a Backup Clearing Member or to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such Clearing Client, irrespective of the existence and/or enforceability of a Security Deed entered into between the Clearing Member and its Clearing Clients. Part VII

would therefore operate for English law purposes as an Exempting Client Clearing Rule (in which we kindly refer you to the English law opinion provided by CC London).

Article 8 of the Settlement Finality Directive provides "*in the event of insolvency proceedings being opened against a participant in a system, the rights and obligations arising from, or in connection with, the participation of that participant shall be determined by the law governing that system*". It is our opinion that this provision imposes an obligation on Norway to ensure that, in the event of opening of insolvency proceedings in Norway are opened in relation to a participant in a system, the effect of such insolvency proceedings on the rights and obligations of that participant is determined by the substantive insolvency law of the law governing the system. As is evidenced by the Recitals of the Settlement Finality Directive, in particular Recital 17, Article 8 aims to protect the orderly operation and the finality of settlements in payment and clearing systems by allowing such a system to rely on its relevant governing law to determine the effects of the insolvency of a participant. Furthermore, pursuant to Article 10 of the Settlement Finality Directive, Members States shall specify the systems, and the respective system operators, included in the scope of that directive. For the purposes of giving this opinion, we understand that LCH has been designated by the United Kingdom as a Securities Settlement System for the purposes of the Settlement Finality Directive, which specification applies to all of the LCH Services.

Pursuant to Article 2(j) of the Settlement Finality Directive, insolvency proceedings mean any collective measure provided for in the law of a Member State, or a third country, either to wind up the participant or to reorganise it, where such measure involves the suspending of, or imposing limitations on, transfers or payments. Bankruptcy Proceedings and Public Administration will be deemed as insolvency proceedings for these purposes, which means that Norway is obliged to ensure that the effect of these proceedings on the participation of a Relevant Clearing Member will be governed by English law.

Pursuant to Subsection 2 of Section 4-3 of the PS Act (which implements the Settlement Finality Directive in Norwegian law), the law elected in accordance with Subsection 1 of Section 4-3 of the PS Act by the participants in a system as governing that system determines the rights and obligations of an insolvent participant in its capacity as a participant in the system. Subsection 1 of Section 4-3 provides that the participant may only elect the law of an EEA State where at least one of the participants has its main office. Uncertainty of the scope of these provisions arises due to Section 4-1 of the PS Act, from which it follows that the provisions of Chapter 4 of the PS Act, this including Section 4-3, is only applicable to Securities Settlement Systems with permission from the FSAN and which pursuant to the election of its participants are governed by Norwegian law. A literal interpretation of Section 4-1 would render Section 4-3 non-applicable to LCH.

The preparatory works of the PS Act do not shed any light on the Norwegian legislature's interpretation of Article 8 of the Settlement Finality Directive or the question of the effect of Section 4-1 is intentional.

Based on the above, there appears to be a conflict between, on the one hand, Norway's obligations pursuant to the EEA Agreement and, on the other, the wording of the PS Act.

Under Norwegian law, there exists a principle pursuant to which Norwegian law shall be interpreted in conformity with EEA law to the extent possible. In cases of conflict, it follows from a judgment of the Norwegian Supreme Court the plain meaning of Norwegian statutory provisions will carry more weight where such provisions governs the relationship between private parties than where the statutory provision governs the relationship between the government and private parties and EEA law confers rights upon private parties. This is due to the consideration of legal certainty, meaning that private parties should be able to rely on the plain meaning of Norwegian statutes reflects the legal situation. Although statutory provisions governing the effects of Insolvency Proceedings governs the relationship between private parties, namely the insolvency estate/the debtor under Public Administration (as applicable) and its solvent counterparties, we hold the view that the said consideration does not carry as much weight as in relation to other provision governing private relations in cases where the EEA law is to the benefit of the solvent party. This is due to the simple fact that an insolvency estate/the debtor under Public Administration is at the time of entry into the affected agreements incapable of establishing any expectations as to the effects of Insolvency Proceedings on the contracts of the debtor, as at that time the insolvency estate does not yet exist and the administration board of the debtor under Public Administration has not yet been appointed. Having regard to, firstly, that considerations regarding legal certainty does not offer a weighty counter-argument against interpreting Norwegian law in conformity with Article 8 of the Settlement Finality Directive and, secondly, that there exists no evidence in the preparatory works that the Norwegian legislature had an express intention of non-compliance with Article 8, our best opinion is therefore that Norwegian law will be interpreted in conformity with Article 8 of the Settlement Finality Directive, and therefore that the effects of Insolvency Proceedings on the rights and obligations arising from, or in connection with, the participation of a participant in LCH will be governed by English law.

We are therefore of the opinion that, in the event of Insolvency Proceedings being commenced against a Relevant Clearing Member, such that it is designated as a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event), the effect of the Systems Carve Out (i.e. the national legislation incorporating the Settlement Finality Directive) and designation of LCH as a system is that the rights and obligations arising from, or in connection with, the participation of that Relevant Clearing Member within the LCH system would be determined by the application of substantive English insolvency law, being the law governing that system. Accordingly, Part VII, which operates as an Exempting Client Clearing Rule, would apply to any Relevant Clearing Member which is a Defaulter.

We are therefore also of the opinion that if LCH were to seek to port the Relevant Contracts and Account Balance of a Clearing Client to a Backup Clearing Member, neither an insolvency officer appointed in respect of the Defaulter, nor any other person, could successfully challenge the actions of LCH and claim for the amount of the Account Balance, to the extent that such challenge is not possible under substantive English insolvency law (in which we kindly refer you to the English law opinion provided by CC London, pursuant to which no such challenge would be possible in accordance with the provisions set out in Chapter VII).

It is questionable whether the Systems Carve Out would also capture the mechanism of the Security Deed. However, the mechanism of the Security Deed is intended to operate only in the absence of an Exempting Client Clearing Rule and on the basis of our above opinion would not therefore be necessary in respect of Relevant Clearing Members.

3.4.4 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 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?

If porting does not take place, then pursuant to the Client Clearing Annex LCH shall close out the contracts and calculate the entitlement to collateral, being the "Client Clearing Entitlement", of the Defaulter in respect of each Clearing Client. LCH will then take instruction from those Clearing Clients who are Individual Segregated Account Clients, Identified Omnibus Segregated Clearing Clients and Affiliated Omnibus Segregated Clearing Clients and either (i) pay the Client Clearing Entitlements to the Defaulter (or its insolvency officer) for the account of the relevant Clearing Clients or (ii) pay the Client Clearing Entitlement directly to the relevant Clearing Client (subject to execution of documentation required by LCH). In each case this applies to both Clearing Clients who are exercising their rights under a Security Deed and Clearing Clients of an Exempt Client Clearing Member, following acceleration of its "Undertaking to Pay and Deliver", as provided for in the LCH Rulebook. In respect of all Non-Identified Omnibus Segregated Clearing Clients, an "Aggregate Omnibus Client Clearing Entitlement" will always be returned to the Defaulter (or its insolvency officer) for the account of the relevant Clearing Clients.

On the basis of our opinion at paragraph 3.4.3 above, an Exempting Client Clearing Rule would apply to a Relevant Clearing Member. Subsection 2 of Section 4-3 of the PS Act states that the law governing the system shall also govern the "*rights and obligations [...] as a participant in the system*" of the Defaulter in the event of the Defaulter's insolvency. It is our view that LCH's right to return the Client Clearing Entitlement is an "*obligation*" of the Defaulter for the purposes of Section 4-3 of the PS Act, and that this will therefore be governed by the law governing the Service, i.e. the laws of England and Wales.

Accordingly, we are of the opinion that if LCH were to seek to return the Client Clearing Entitlement to the relevant Clearing Client directly, or to the Defaulter for the account of such client, then neither an insolvency officer appointed to the Defaulter could successfully challenge the actions of LCH and claim for the amount of Client Clearing Entitlement to the extent that such challenge is not possible under substantive English insolvency law (in which we kindly refer you to the English law opinion provided by CC London, pursuant to which no such challenge would be possible in accordance with the provisions set out in Chapter VII).

3.4.5 ***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?***

It is our opinion that Debt Settlement Proceedings do not constitute insolvency proceedings for the purposes of the Settlement Finality Directive. This would mean that Norway is not pursuant to EEA law obliged to ensure that the effects of Debt Settlement Proceedings are governed by the law governing the Service.

Furthermore, Subsection 2 of 4-3 of the PS Act states that the law governing the system determines the rights and obligations of an *insolvent* participant in the system. This suggests that Subsection 2 of Section 4-3 does not affect the law governing the effects of Debt Settlement Proceedings, as it is Insolvency Proceedings which are applicable in the event of insolvency. Our opinion is therefore that the effects of the opening of Debt Settlement Proceedings will be Norwegian law, and that there therefore an Exempting Client Clearing Rule is not available. It should however be reiterated that, as stated in paragraph 3.2.1(b), Guaranteed Institutions can only be subject to Public Administration, and not Debt Settlement Proceedings. Accordingly, the opinions expressed in this paragraph 3.4.5 will only be of consequence where the Relevant Clearing Member is not a Guaranteed Institution, which based on our experience to date, is unlikely.

Our understanding is that porting of Client Contracts may be effectuated by either (i) a close-out of the relevant Client Contracts between LCH and the Defaulter followed by the replication of such Contacts (by the opening of new Client Contracts on the same terms) between LCH and the Backup Clearing Member; or (ii) a transfer of the relevant Client Contracts (in the form of open positions and without close-out) from the Defaulter to a Backup Clearing Member. The effectiveness of these two forms of porting is discussed separately below.

(a) *Porting by close-out of relevant Client Contracts*

Where the porting of Client Contracts is effectuated by a close-out of the relevant Client Contracts between LCH and the defaulting clearing member, it is, following the discussion in paragraph 3.2.3(b)(ii) above, our opinion that LCH may close-out the Client Contracts pursuant to Section 4-2(1) of the PS Act regardless of the 'opening of insolvency' proceedings (as this term is defined in the PS Act). As the definition of the term 'opening of insolvency proceedings' contained in Section 1-3 of the PS Act comprises the opening of Debt Settlement Proceedings, Section 4-2(1) of the PS Act ensures the enforceability of porting of the relevant Client Contracts, regardless of the opening of such proceedings. Furthermore, following the discussion in paragraph 3.4.7 below, it is our opinion that the Security Deed will be enforceable. Provided that the Client pursuant to the contractual terms of the Security Deed is entitled to realise the charge by requiring the transfer of the Account Balance to a Backup Clearing Member, it is therefore our opinion that an

insolvency officer appointed to the Defaulter or any other person could not successfully challenge the actions of LCH and claim for the amount of the Account Balance.

(b) *Porting by transfer of relevant Client Contracts*

Our understanding is that porting by transfer of open positions results in the discharge of all of the rights and obligations of the Defaulter and LCH, without this resulting in any amount being due to or owed by LCH for the net loss or gain (as the case may be) resulting from the discharge of its rights and obligations. The consequence of this is that the porting will be viewed as a termination for the purposes of Section 7-3a of the CR Act, which, as discussed in paragraph 3.2.3(b) above, requires the existence of an applicable exemption. Due to the fact that the agreements are not closed out, a clause providing for the transfer of open Relevant Contracts will not be deemed to be a netting provision for the purposes of Section 4-2(1) of the PS Act, cf. the discussion in paragraph 3.2.3(b)(ii) above. While it cannot be ruled out that LCH will be entitled to terminate certain Contracts pursuant to Section 7-3(2)(1) of the CR Act cf. Section 7-3a(2) of the CR Act, we are not able to give a clear opinion that this will be the case, cf. the discussion in paragraph 3.2.3(b)(i) above.

3.4.6 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?

Debt Settlement Proceedings do not entail a general seizure of the Relevant Clearing Member's assets. Accordingly, no representative appointed to reorganise/manage the Defaulter could successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement.

3.4.7 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?

As stated in paragraph 3.4.3 above, we are of the opinion that, in the event of Insolvency Proceedings being commenced against a Relevant Clearing Member, such that it is designated as a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event), the effect of the Systems Carve Out (i.e. the national legislation incorporating the Settlement Finality Directive) and designation of LCH as a system is that the rights and obligations arising from, or in connection with, the participation of that Relevant Clearing Member within the LCH system would be determined by the application of substantive English insolvency law, being the law governing that system. Based on the legal opinion given by Clifford Chance LLP, we understand that Part VII, which operates as an Exempting Client Clearing Rule, would apply to a Relevant Clearing Member which is a Defaulter. It is however unclear whether the Systems Carve Out applies to Reorganisation Proceedings. Therefore a Security

Deed may be required to prevent a challenge to the actions of LCH in the event that a Relevant Clearing Member is subject to Reorganisation Proceedings.

Please note however that a Guaranteed Institution cannot be subject to Reorganisation Proceedings. Accordingly, in our view it is unnecessary to require a Relevant Clearing Member which is a Guaranteed Institution to enter into a Security Deed.

Our understanding of the Security Deed, read in conjunction with Regulation 20 of the General Regulations, is that the following applies in respect of Collateral transferred by the relevant Clearing Member to LCH: Save in the case of non-cash Collateral, the transfer of Collateral will be effectuated as a title-transfer. In the case of non-cash Collateral, it will be held by LCH as custodian for the Clearing Member. This would mean that the security interest created by the Clearing Member in favour of the relevant Clearing Client in cash Collateral is a security interest in the contingent monetary claim the Clearing Member holds against LCH. Conversely, the security interest created in the non-cash Collateral would be a security interest in the non-cash Collateral itself.

Outside of Insolvency Proceedings, the Relevant Clearing Member would be contractually bound to respect the terms of the Security Deed, and the Security Deed provides an effective security interest under the laws of this jurisdiction.

In respect of Debt Settlement Proceedings, a question would be whether the automatic continuation of the debtor's Contracts under which the Client Clearing Entitlement arises pursuant to Section 7-3a of the CR Act, to the detriment of the relevant Clearing Client. The Security Deed would constitute an effective security interest in the event of Debt Settlement Proceedings.

Once Insolvency Proceedings have been commenced, the question of which law that governs the effects of opening of Insolvency Proceedings in Norway on the security arrangements of the debtor is a question of Norwegian international private law. Which law that Norwegian international private law designates as applicable to this question varies from asset class to asset class. Our understanding is, pursuant to the definition of Collateral in the General Regulations, three types of assets may be used as Collateral: cash, gold and securities. Which law that provides the applicable effects on security arrangements following the opening of Insolvency Proceedings in Norway is discussed below separately for each asset class.

(a) Cash

As referred above, our understanding is that in relation to the part of the Relevant Client Clearing Return or the Relevant Account Property (as applicable) consisting of cash, the security created is in the Clearing Members contingent monetary claim for repayment. This would mean that the security interest under the Deed of Security is created in a monetary claim. The question of which law that regulates the effect of Insolvency Proceedings on security arrangements in monetary claims is due to lack of statutory provisions or court precedents uncertain under Norwegian international private law. A recent submission by a Norwegian legal scholar argues that the alternatives are (i) the law governing the claim(s)

and (ii) the law of the chargor's country of incorporation. In the case of a Clearing Member incorporated in Norway, this would mean that either Norwegian or English law would govern the effects of the opening of Insolvency Proceedings on the security arrangement. Regardless of whether it is Norwegian or English law that is applicable the security interest established by the Security Deed should be effective. We are of this opinion because the Security Deed clearly indicates that the Parties' intention is to establish a security interest over an asset which can also be legally assigned under Norwegian law. Furthermore, the perfection requirements for such security (notification to LCH) correspond under Norwegian and English law, meaning that the security interest established under the Security Deed would be perfected even though Norwegian courts should hold that Norwegian law governs the Security Deed in Insolvency Proceedings.

(b) Securities

In relation to the part of the Relevant Client Clearing Return or the Relevant Account Property (as applicable) consisting of securities, Section 9 of the FC Act implements the conflict of laws rule contained in Article 9 of Directive 2002/47/EC (as amended). This means that *inter alia* the requirements for perfection and provision of book entry securities collateral under financial collateral arrangements, and more generally the completion of the steps necessary to render such an arrangement and provision effective against third parties, is governed by the law of the country in which the relevant account is maintained. According to our understanding, this would imply England in relation to the Deed of Security.

(c) Gold

Pursuant to Norwegian international private law, the law governing the effects of the opening of Insolvency Proceedings on security arrangements concerning movable property has traditionally been considered to be the *lex rei sitae*. It is our view that gold would be considered as movable property in this context. This would mean that the law of the location of the gold provided as Collateral would be the law governing such effects.

3.4.8 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?

(a) *Monetary claims*

In the event Norwegian law applies to the effects of the opening of Insolvency Proceedings in Norway, no perfection requirements need to be taken under the laws of Norway other than notification to the debtor of the Client Clearing Entitlement, which we understand is already provided for under the Security Deed.

(b) *Securities*

No additional perfection steps are required under the laws of Norway in order for the Security Deed to be effective.

(c) *Gold*

A Relevant Clearing Member granting security over gold would have to be physically deprived of its ability to dispose over the gold, typically by way of transferring it to the holder of a security interest or a third party acting on the instructions of the holder of the security interest.

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

If a Relevant Clearing Member is placed under Debt Settlement Proceedings, any enforcement of security rights over its assets during the first six months of the Debt Settlement Proceedings is subject to restructuring board's consent. This six month restriction period runs from the opening of Debt Settlement Proceedings, and is not subject to extension. The restructuring board could also consent to enforcement of security although the stay period has not expired. It should be noted that only actual enforcement actions (e.g. forced sale) is subject to the six month restriction period; preparatory actions such as petitions, court hearings and all other actions necessary to lay the ground for an actual enforcement action can be carried out unhindered of the restriction.

However, the above-mentioned stay period does not apply to security granted over monetary claims and Financial Collateral. Our understanding is that the Security Deed establishes, in favour of the Clearing Client, a security interest over the Relevant Clearing Member's claim against LCH for the relevant Client Clearing Entitlement, which consists of monetary claims and Financial Collateral. Based on this understanding, no stay will apply to the enforcement of security established over these assets under the Security Deed. The six month stay would however apply to other types of collateral (if any) granted under the Security Deed.

3.4.10 ***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 have not identified any such issues.

* * * *

In this opinion, Norwegian legal concepts are described in English terms and not by their original Norwegian terms. The concepts concerned may not correspond to the concepts described by the same English terms as they exist under the laws of other jurisdictions. This opinion may, therefore, only be relied upon on the express condition that any issues of interpretation or liability arising hereunder will be governed by Norwegian law and be brought before a Norwegian court.

This advice is given for the exclusive benefit of LCH. It may not, without our prior written consent, be relied on by any other person. We consent to a copy of this advice being made publically available on LCH's website, for information purposes only and solely on a non-reliance basis.

Yours sincerely,

Advokatfirmaet BA-HR DA

Arne Tjaum
attorney

Schedule 1 Assumptions

For the purposes of this opinion, we have assumed:

(a) that the Opinion Documents are legal, valid, binding and enforceable under English law;

(b) the compliance with all relevant perfection requirements and the effectiveness of the collateral arrangements provided for under the Deed of Charge under the law of any jurisdictions other than Norway;

(c) that the Opinion Documents are entered into prior to the commencement of any Insolvency Proceedings against either Party;

(d) that all transactions are entered into and all acts are performed in accordance with the terms of the Opinion Documents;

(e) that each party to the Opinion Documents has duly executed the Opinion Documents;

(f) that the rights and obligations of each party under the Opinion Documents are valid, binding and enforceable under the jurisdiction of each such party (other than a Relevant Clearing Member);

(g) that there are not any other agreements, instruments or arrangements between the Parties which modify or supersede the terms of the Arrangements and/or any Opinion Document;

(h) that the Opinion Documents have been entered into, and each of the Contracts referred to therein are carried out, by each of the Parties thereto in good faith, for the benefit of each of them respectively, on arms' length commercial terms and for the purpose of carrying on, and by way of, their respective businesses;

(i) that the Relevant Clearing Member is an institution for the purposes of the Settlement Finality Directive (Directive 98/26/EC) (as amended);

(j) that LCH is at all material times a recognised clearing house (Norwegian: *sentral motpart*) within the meaning of the PS Act;

(k) that LCH has been duly notified to the European Commission in accordance with the Settlement Finality Directive (Directive 98/26/EC) (as amended);

(l) that any Secured Obligations (as defined in the Deed of Charge) have been incurred with respect to a Service;

(m) that the "relevant account" (as defined in the Deed of Charge) is located in England and Wales;

(n) that any Securities granted as Collateral will be book-entry Securities held in the "relevant account";

(o) that each Relevant Clearing Member has good legal or other title to the assets or rights which are expressed to be subject to a security interest under the Deed of Charge;

(p) that the Charged Property (as defined in the Deed of Charge) constitutes Financial Collateral;

(q) that any transaction which the Deed of Charge secures or purports to secure has been duly entered into the relevant Service prior to the commencement of any Insolvency Proceedings against the relevant Clearing Member;

(r) that there is no other agreement, instrument or other arrangement between any of the parties to the Opinion Documents which modifies or supersedes the Opinion Documents; and

(s) that no laws other than the laws of Norway will affect any of the opinions given herein.

Schedule 2 Reservations

This opinion is subject to the following reservations:

(a) Our advice is given in respect of the specific questions raised by LCH as set out in the Instructions. We express no opinion in this advice as to the validity and enforceability of any provisions of LCH's Rulebook or the Procedures not explicitly addressed in the Instructions.

(b) We do not express any opinion as to any matters of fact.

(c) The opinions expressed herein are confined to and given on the basis of the laws of Norway as currently in force and applied by the courts of Norway. We have made no investigation of and express no opinions as to matters under or involving the laws of any jurisdiction other than the laws of Norway.

(d) We do not opine on any matters of tax.

(e) Norwegian courts may require documents in foreign languages to be translated into Norwegian if such documents are to be used as evidence before Norwegian courts.

(f) A determination, calculation or certificate of any Party to the Opinion Documents as to any matter provided for therein might in certain circumstances be held by the courts not to be conclusive if it could be shown to have an unreasonable or arbitrary basis (as described in paragraph 3.1.7 above) or in the event of manifest error despite any provision in any document to the contrary.

(g) If any document is held to contain provisions that are illegal, invalid or unenforceable, the severance of such provisions from the remaining provisions of such document will be subject to the exercise of the discretion of the Norwegian courts.

(h) Norwegian law permits a judgement debtor to pay a judgement debt (even though denominated in a foreign currency) in Norwegian Kroner.

(i) Claims may become time barred under limitations acts or may become subject to counterclaims, set-off or other defences.

(j) A Norwegian court may reject the right to take proceedings in Norway if proceedings which have led or may lead to a judgement which is enforceable in Norway have already been taken in another court of competent jurisdiction within or outside Norway.

(k) A clause in the Opinion Documents where a Relevant Clearing Member gives an irrevocable power of attorney, the irrevocability and scope of such would, for the Relevant Clearing Member, be subject to acts under such a power of attorney being in compliance with duties and obligations the Relevant Clearing Member has under Norwegian law or under contract with third parties.

(l) This opinion refers to certain rules of the CR Act which attach legal effect to the opening of Debt Settlement Proceedings and Bankruptcy Proceedings. The Guarantee Schemes Act does not provide any guidance as to when this event is deemed to take place when applying the CR Act "*accordingly*" to Public Administration, cf. the discussion in paragraph 3.2.1(b) above. This issue does neither appear to have been addressed in the preparatory works of the Guarantee Schemes Act. Section 4-6(1)(e) of the Guarantee Schemes Act does however offer some guidance, by specifying that the "*date of filing*" for the purposes of the application of the CR Act shall be deemed to be when the Norwegian Ministry of Finance resolves that the Guaranteed Institution shall be placed under Public Administration. As the opening of Debt Settlement Proceedings, Bankruptcy Proceedings and other proceedings regulated by the CR Act is never earlier than the "date of filing" corresponding to such proceedings, this indicates that the opening of Public Administration will not be considered to be at an earlier time than the "*date of filing*" for the Public Administration. It also seems as the most logical to consider this point in time as the opening of Public Administration for the purposes of applying the CR Act to Public Administration. Our opinion is therefore that Norwegian courts when applying the CR Act to Public Administration will most likely construe references to the opening of proceedings as when the Norwegian Ministry of Finance resolves that the Guaranteed Institution shall be placed under Public Administration.

(m) The opinions herein are rendered only as of the date hereof and we assume no obligation to update or supplement this opinion to reflect any facts or circumstances which may hereafter come to our attention or to any changes in law which may occur.