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FOA - NETTING UPDATE PROJECT

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19 December 2013

Dear Sirs,

FOA netting opinion issued in relation to the FOA Netting Agreements, FOA Clearing Module and ISDA/FOA Clearing Addendum

You have asked us to give an opinion in respect of the laws of Germany on the enforceability and validity of the FOA Netting Provision, the Clearing Module Netting Provision and the Addendum Netting Provision contained in a FOA Netting Agreement or a Clearing Agreement.

We understand that your fundamental requirement is for the enforceability of the FOA Netting Provision, the Clearing Module Netting Provision and the Addendum Netting Provision to be substantiated by a written and reasoned opinion.

Further, this opinion letter ("**Opinion**") covers the enforceability of the FOA Set-Off Provisions, the Clearing Module Set-Off Provision, the Addendum Set-Off Provision and the Title Transfer Provisions.

1. TERMS OF REFERENCE AND DEFINITIONS

1.1 Subject as provided at paragraph 1.2, this Opinion is given

1.1.1 generally, in respect of Parties which are Companies (as defined in paragraph 1.8.4 below), Partnerships (as defined in paragraph 1.8.21 below), Cooperatives (as defined in paragraph 1.8.5 below), Credit Institutions (as defined in paragraph 1.8.7 below) and Financial Services Institutions (as defined in paragraph 1.8.13 below)[1]; and

[1] Credit Institutions and Financial Services Institutions which are established under German public law are not dealt with in the main body of this legal opinion but please refer to Schedule 4.

1.1.2 generally, in respect of Parties incorporated or formed under the laws of another jurisdiction which are companies, banks or insurance companies and which have a branch or branches located in Germany.

1.2 This Opinion is also given in respect of Parties that are any of the following, subject to the terms of reference, definitions, modifications and additional assumptions and qualifications set out in the applicable Schedule:

1.2.1 Insurance Companies (as defined in Schedule 1);

1.2.2 Capital Management Companies (as defined in Schedule 2);

1.2.3 Individuals (as defined in Schedule 3);

1.2.4 Public Sector Entities (as defined in Schedule 4);

1.2.5 Foundations (as defined in Schedule 5);

1.2.6 Building Societies (as defined in Schedule 6); and

1.2.7 Pension Entities (as defined in Schedule 7).

1.3 This Opinion is given in respect of the FOA Netting Agreement and the Clearing Agreement which are both expressed to be governed by English law.

1.4 This Opinion covers all types of transactions entered into under the FOA Netting Agreement, the FOA Clearing Module, the Clearing Agreement or the ISDA/FOA Clearing Addendum (as defined in Annex 3) ("**Transaction**") whether entered into on an exchange, any other forms of organised market place or multilateral trading facility, or over the counter. This Opinion is given in respect of only such of those Transactions which are capable, under their governing laws, of being terminated and liquidated in accordance with the FOA Netting Provision, the Clearing Module Netting Provision or, as the case may be, the Addendum Netting Provision, in each case, whether entered into on a recognised investment exchange, any other form of organised market place or multilateral trading facility, or over the counter.

1.5 In this Opinion, references to the word "enforceable" and cognate terms are used to refer to the ability of a Party to exercise its contractual rights in accordance with their terms and without risk of successful challenge. We do not opine on the availability of any judicial remedy.

1.6 We do not give an opinion on generally applicable regulatory restrictions which may apply to a Party.

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

1.8 Definitions

Terms used in this Opinion and not otherwise defined herein shall have the meanings ascribed to them in Annex 3 below or in the FOA Netting Agreement or the Clearing Agreement, unless the context specifies otherwise. Where, in an FOA Netting Agreement or, as the case may be, a Clearing Agreement, a defined term has been changed but the changed term corresponds to a term defined in a FOA Published Form Agreement or, as the case may, the FOA Clearing Module and/or the ISDA/FOA Clearing Addendum, or this Opinion, this Opinion may be read as if terms used herein were the terms as so changed.

1.8.1 "**CCP**" means a central counterparty as defined in Article 2 para 1 of Regulation EU No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("**EMIR**")[2].

1.8.2 "**Clearing Member**" means the entity specified as such in the Clearing Agreement.

1.8.3 "**Client Transaction**" means, with respect to a transaction entered into between a Clearing Member and a CCP, the related transaction that arises pursuant to the terms of the Clearing Agreement between the Clearing Member and the Client, as may be modified from time to time pursuant to the terms of the Clearing Agreement.

1.8.4 "**Company**" means a stock corporation (*Aktiengesellschaft*, "**AG**") established under the German Stock Corporation Act (*Aktiengesetz*), or a limited liability company (*Gesellschaft mit beschränkter Haftung*, "**GmbH**") established under the German Act on Limited Liability Companies (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung*).[3]

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

1.8.6 "**Opinion Documents**" means the FOA Netting Agreement, the FOA Clearing Module and the Clearing Agreement.

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

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

1.8.7 "**Credit Institution**"[4] means a credit institution (*Kreditinstitut*) within the meaning of section 1 para 1 of the German Banking Act (*Kreditwesengesetz*, "**KWG**").

1.8.8 "**EEA**" means the European Economic Area.

1.8.9 "**EUIR**" means Regulation (EC) No.1346/2000 of 29 May 2000 on insolvency proceedings (OJ No L 160 of 30 June 2000).[5]

1.8.10 "**Event of Default**" means an event defined in the FOA Netting Agreement or a Clearing Agreement, upon the occurrence of which the relevant FOA Netting Agreement or Clearing Agreement may either be terminated upon notice or terminates automatically.

1.8.11 "**Financial Collateral**" means an arrangement defined as such in section 1 para 17 sentence 1 and 2 KWG.

1.8.12 "**FCD**" (Financial Collateral Directive) means Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements [6] as amended by the Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims.[7]

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

1.8.14 "**FOA Member**" means a member (excluding associate members) of the Futures and Options Association which subscribes to the Futures and Options Association's Netting Analyser service (and whose terms of subscription give access to this Opinion).

1.8.15 "**Insolvency Proceedings**" means the proceedings referred to in paragraph 3.1.1.

1.8.16 "**Institutions**" means Credit Institutions and Financial Services Institutions collectively.

1.8.17 "**Insolvency Event of Default**" means any event described in the Insolvency Events of Default Clause.

1.8.18 "**Insolvency Events of Default Clause**" has meaning assigned to such term in Annex 3.

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[4] Please note that this definition of "Credit Institution" is broader than the definition of "Deposit Taking Credit Institution" in footnote 13.

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

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

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

1.8.19 "**Member State**" means a member state of the EEA.

1.8.20 "**paragraph**" means a paragraph of this Opinion.

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

1.8.22 "**Rule Set**" means, with respect to an over-the-counter derivative client clearing service specified in the Clearing Agreement, the rules, conditions, and procedures, regulations, standard terms, membership agreements, collateral addenda, notices, guidance, policies or other such documents promulgated by the relevant CCP in respect of the relevant service as amended and supplemented from time to time.

1.8.23 "**SFD**" (Settlement Finality Directive) means Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems[8] as amended.

1.8.24 "**System**" means a system within the meaning of section 1 para 16 KWG.

1.8.25 "**WUD**" (Winding-Up Directive) means Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions[9] and

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

Annex 3 contains further definitions of terms relating to the FOA Netting Agreement and the Clearing Agreement.

2. ASSUMPTIONS

We assume:

2.1 That no provision of the FOA Netting Agreement or Clearing Agreement that is necessary for the giving of our opinions and advice in this Opinion has been altered in any material respect, including by reason of a Mandatory CCP Provision (as defined

[8] OJ No L 166 of 11 June 1998, p. 45

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

in the FOA Clearing Module). In our view, an alteration contemplated in Part 2 (*Non-material Amendments*) of Annex 4 hereto would not constitute a material alteration for this purpose. We express no view whether an alteration not contemplated in Part 2 (*Non-material Amendments*) of Annex 4 hereto would or would not constitute a material alteration.

2.2 That the Opinion Documents are governed by English law.

2.3 That under their governing laws and all other relevant laws (other than the laws of Germany):

2.3.1 the relevant Opinion Document and any Transactions are legal, valid and enforceable and will at all times constitute valid and legally binding obligations of the Parties thereto, enforceable in accordance with its terms and

2.3.2 the FOA Netting Provision, the Clearing Module Netting Provision, the Addendum Netting Provision, the FOA Set-Off Provisions, the Clearing Module Set-Off Provision and the Addendum Set-Off Provision are valid and enforceable.

2.4 That each Party has the capacity, power and authority under all applicable law(s) to enter into the Opinion Documents and Transactions thereunder to perform its obligations under the Opinion Documents and that each Party has taken all necessary steps to execute, deliver and perform the Opinion Documents.

2.5 That each Party has obtained, complied with the terms of and maintained all authorisations, approvals, licences and consents required to enable it lawfully to enter into and perform its obligations under the Opinion Documents and to ensure the legality, validity, enforceability or admissibility in evidence of the Opinion Documents in Germany.

2.6 That no provision of the Opinion Documents, or a document of which an Opinion Document forms part, or any other arrangement between the Parties, or any Mandatory CCP Provision, constitutes an Adverse Amendment.

2.7 The FOA Netting Agreement or, as the case may be, the Clearing Agreement has been entered into, and each of the Transactions referred to therein is 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 and that none of the Parties has entered into or will enter into the same if entering into the same would prejudice any of its creditors.

2.8 That the Opinion Documents and any Transactions accurately reflect the true intentions of each Party.

2.9 That, in relation to a Clearing Agreement, a Party incorporated in Germany which acts as "Firm" (as defined in the FOA Clearing Module) or "Clearing Member" (as defined in the ISDA/FOA Clearing Addendum) will be (a) a clearing member in respect of any Agreed CCP Service to which the Clearing Agreement relates, and (b)

will be an Institution (including in circumstances where a Clearing Agreement was entered by an Institution through a local branch).

2.10 That each Party, when transferring collateral assets pursuant to the Title Transfer Provisions, has full legal title to such margin at the time of Transfer, free and clear of any lien, claim, charge or encumbrance or any other interest of the transferring party or of any third person (other than a lien routinely imposed on all securities in a relevant clearance or settlement system).

2.11 That all margin transferred pursuant to the Title Transfer Provisions is freely transferable and all acts or things required by the laws of this or any other jurisdiction to be done to ensure the validity of each transfer of margin pursuant to the Title Transfer Provisions will have been effectively carried out.

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

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

2.14 That where any authority or power of attorney (including sub-power of attorney) has been used to enter into in connection with an Opinion Document, or any decisions or operations contemplated thereby, such authority or power of attorney and its communication to other parties had/have under all applicable laws the effect of binding the person or entity purportedly represented under such authority or power of attorney and such power of attorney has not been revoked prior to such execution.

2.15 That each Party will perform its obligations under the Opinion Documents and any Transaction in accordance with their respective terms and nothing in the terms of any Transaction will alter the assumptions set out in this paragraph 2 or the qualifications set out in paragraph 4 below.

2.16 That none of the Opinion Documents will infringe the terms of, or constitute a default under, any trust deed, debenture, agreement or other instrument or obligation to which any of the Parties to the Opinion Documents is a Party or by which any of its property, undertaking, assets or revenues are bound.

2.17 That all Transactions are capable under their governing laws, of being included in the FOA Netting Agreement, the FOA Clearing Module or the Clearing Agreement and of being terminated and set off in accordance with the provisions of the relevant Opinion Document.

2.18 That any credit transfers and direct debits made in connection with the Clearing Documentation and Transactions comply with applicable laws on credit transfers and direct debits (*Überweisungs- und Lastschriftrecht*).

2.19 That to the extent any transfers of cash or securities or the creation of security interests over, cash or securities, are subject to mandatory property laws (*Sachenrecht*), such property laws are complied with. This includes, as may be legally required, but is not limited to, agreements, notifications and bookings.

2.20 That the obligations assumed under the Opinion Documents are mutual between the Parties, in the sense that the Parties are each personally and solely liable as regards obligations owing by each other and are solely entitled to the benefit of obligations owed to each other, respectively. "**Mutuality**" (*Gegenseitigkeit*) generally exists where each Party is personally and solely liable as regards obligations owed by it and is solely entitled to the benefit of obligations owed to it. Circumstances in which the requisite mutuality is missing include, without limitation, where a Party is acting as agent for another person, or is a trustee, or in respect of which a Party has a joint interest (including partnership) or such in respect of which a Party's rights or obligations or any interest therein have been assigned, charged or transferred (whether in whole or in part) whether unilaterally, by agreement or by operation of law.

2.21 That none of the Parties is in a situation of illiquidity, impending illiquidity or over-indebtedness (see paragraph below 3.1.2) or in any analogous situation justifying an application for the opening of insolvency, bankruptcy or other proceedings under the laws of a jurisdiction other than Germany.

2.22 That at the time at which the any Transaction is entered into under the FOA Netting Agreement, the FOA Clearing Module and the Clearing Agreement neither Party has actual notice of the inability of the other Party to pay its debts when due, the imminent threat of the other Party becoming unable to pay its debts when due or, the imposition of any regulatory or provisional insolvency measures on the other party or the opening of formal bankruptcy or insolvency proceedings in respect of the other Party.

3. OPINION

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

3.1 Insolvency, Reorganisation and related proceedings under German law

Before analysing any restrictions on the enforceability of the netting and set-off provisions in paragraphs 3.3 to 3.9 below upon an insolvency in more detail, in the following we provide an overview of insolvency, reorganisation and related proceedings under German law which are mandatory and will prevail over contractual arrangements such as the Opinion Documents, unless such agreements or transactions fall within an exemption.

3.1.1 The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which the Client (as defined in Annex 3) could be subject under the laws of Germany, and which are relevant for the purposes of this Opinion, are the procedures laid down in the German Insolvency Code (*Insolvenzordnung*, "**InsO**"). The main insolvency proceedings (*Hauptinsolvenzverfahren*) under the InsO are referred to as "**Insolvency**

Proceedings". A Party who is subject to Insolvency Proceedings is called an "**Insolvent Party**" and its counterparty is called the "**Solvent Party**". When using the term Insolvency Proceedings we do not intend to refer to opening proceedings (*Eröffnungsverfahren*), in particular we do not refer to any provisional insolvency measures (*vorläufige Maßnahmen*) taken under sections 21 *et seq.* InsO ("**Provisional Insolvency Measures**") (see also paragraph 3.1.6 below).

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

(a) Illiquidity (*Zahlungsunfähigkeit*) is defined as the debtor's inability to settle its payment obligations when due (section 17 para 1 InsO). This is generally indicated if the debtor has ceased to make payments (*Zahlungseinstellung*) (section 17 para 2 sentence 2 InsO). Illiquidity does not exist if there is only a temporary delay in payments (*Zahlungsstockung*), which according to the German Federal Supreme Court (*Bundesgerichtshof*, "**BGH**"), means the debtor's inability to make payments does not last for more than three weeks and then the debtor's gap in liquidity will be closed by expected payments, newly provided financing by other parties or the proceeds from the liquidation of assets.[10]

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

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

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

liabilities in this context, if the shareholder has subordinated its claim (section 19 para 2 sentence 2 InsO).

3.1.3 With respect to Institutions only the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "**BaFin**") may file an application for the opening of Insolvency Proceedings (section 46b para 1 sentence 4 KWG).[11] BaFin may file an application for the opening of Insolvency Proceedings by reason of impending illiquidity only upon the Institution's approval (section 46b para 1 sentence 5 KWG).

3.1.4 For purposes hereof, the opening of Insolvency Proceedings refers to the time of the issue of an opening order (*Eröffnungsbeschluss*) for the opening of main insolvency proceedings (*Hauptverfahren*) by the competent insolvency court. In the opening order the insolvency court appoints an Insolvency Representative (*Insolvenzverwalter*, "**Insolvency Representative**"). Upon the opening of Insolvency Proceedings the Insolvent Party's right to manage and transfer assets belonging to the insolvency estate will be vested in the Insolvency Representative (section 80 InsO). Any disposition of the Insolvent Party over its property made after the opening of Insolvency Proceedings is void unless the relevant insolvency court otherwise orders (section 81 para 1 InsO).[12] If a creditor of the Insolvent Party obtained a security in respect of assets that form part of the Insolvent Party's assets by means of enforcement measures (*Zwangsvollstreckungsmaßnahmen*) up to one month prior to the opening of Insolvency Proceedings or after the opening of Insolvency Proceedings, such security is void (section 88 InsO).

Where an insolvency court has, upon application of the Insolvent Party, ordered the management of the Insolvent Party to continue its activities in accordance with section 270 InsO (*Eigenverwaltung*, "**Self Administration Proceedings**"), several rights of the Insolvency Representative are exercised by the creditors' trustee (*Sachwalter*) (including any challenging rights under section 129 *et seq.* InsO as referred to in paragraph 4.1.2(a) below, see section 280 InsO). The Insolvent Party may also exercise certain rights itself but in consultation with the creditors' trustee (including the Selection Right as defined in paragraph 3.3.2(f) below, see section 279 InsO). Self Administration Proceedings are not limited to a certain type of Insolvent Party and are therefore generally available in respect of Institutions. An insolvency court may order Self Administration Proceedings when it releases an order for the opening of Insolvency Proceedings provided the Insolvent Party has applied for Self Administration Proceedings and provided further there are no circumstances which would give rise to the assumption that Self Administration Proceedings would be detrimental to the Insolvent Party's creditors (section 270 para 2 InsO).

3.1.5 Territorial scope of application of Insolvency Proceedings

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[11] Accordingly, pursuant to sections 46b para 1 sentence 1 KWG, the management of the relevant Institution is obliged to inform BaFin of an actual or impeding insolvency of such Institution or company.

[12] However, see below at paragraph 3.1.8 with respect to dispositions of Financial Collateral.

Whether or not German insolvency courts have jurisdiction for opening Insolvency Proceedings over the assets of a Clearing Member depends on the Clearing Member's jurisdiction of incorporation, under certain circumstances the location of its assets and on the rules governing the relevant proceedings. The international scope of application of Insolvency Proceedings and any Provisional Insolvency Proceedings and Regulatory Proceedings is governed by the EUIR, Article 102 of the German Introductory Act to the InsO (*Einführungsgesetz zur Insolvenzordnung*, "**EGInsO**"), sections 3, 335 *et seq.* InsO, sections 46d to 46f KWG and section 7 para 5 of the German Bank Reorganisation Act (*Kreditinstitute-Reorganisationsgesetz*, "**KredReorgG**").

The EUIR applies to insolvency proceedings as specified in Article 1 para 1, Annex A EUIR. The EUIR is not applicable to insolvency proceedings concerning insurance companies, credit institutions[13], investment undertakings (*Wertpapierfirmen*)[14] which provide services involving the holding of funds or securities for third parties, and collective investment undertakings (*Organismen für gemeinsame Anlagen*)[15] (Article 1 para 2 EUIR). The EUIR

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[13] Article 1 para 1 EUIR refers to credit institutions generally but since the EUIR must be construed in light of applicable European Union law, we take the view that it only refers to credit institutions as defined under Article 4 para 1 point 1 of Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation 648/2012 (OJ No L 176 of 27 June 2013, p. 1, "**CRR**"), i.e. an undertaking whose business is to take deposits or other repayable funds from the public and to grant credits for its own account. Under German law, such credit institutions are defined in section 1 para 3d KWG as deposit taking credit institutions (*Einlagenkreditinstitute*, "**Deposit Taking Credit Institutions**"). Article 4 para 1 point 1 CRR replaces Article 4 para 1 point 1 of the Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ No L 177 of 30 June 2006, p. 1) and will become effective on 1 January 2014. While the definition remains the same, Deposit Taking Credit Institutions will from 1 January 2014 onwards be referred to as CRR Credit Institutions (*CRR-Kreditinstitute*) rather than as Deposit Taking Credit Institutions.

[14] No definition of "investment undertaking" is provided in the EUIR but Article 4 para 1 no. 1 of the European Parliament and Council Directive 2004/39/EC on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and the Council and repealing Council Directive 93/22/EEC as amended (OJ No L 145 of 30 April 2004, "**MiFID**") defines the term "investment firm" to include any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis (see also *Virgos/Schmit*, Report on the Convention on Insolvency Proceedings, no. 59 and *Brinkmann*, in: K. Schmidt, InsO, 18th ed. (2013), Article 1 EUInsVO no. 7). The German language versions of both the EUIR and the MiFID use the term "*Wertpapierfirma*" which confirms this interpretation.

[15] Pursuant to Article 1 para 2 of the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) (OJ No L 302 of 17 November 2009, "**UCITS Directive**") the term "collective investment undertaking" means undertakings (i) the sole object of which is the collective investment in transferable securities of capital raised from the public and which operate on the principle of risk-spreading, and (ii) the units of which are, at the request of the holders, re-purchased or redeemed, directly or indirectly, out of those undertakings' assets ("**UCITS**"). This interpretation is based on the assumption made by *Virgos/Schmit* (Report on the Convention on Insolvency Proceedings, no. 56 *et seq.*) according to which the rationale behind the exceptions provided in Article 1 para 2 EUIR is to exclude such entities, which are subject to specific EU regulations and supervision by regulators in their respective Member States. Investment Companies which qualify as UCITS are regulated and supervised in accordance with the UCITS Directive and, hence, they are excluded from the scope of application of the EUIR. From our point of view, this general analysis should prevail despite the wording

applies only insofar as the insolvency proceedings have a cross-border effect in another Member State (other than Denmark).

Within this scope of application, the courts of the Member State (other than Denmark[16]) where the "centre of main interests" of a debtor is situated may open main insolvency proceedings (as specified in Annex A to the EUIR). In case of a legal entity, the place of the registered office is presumed to be the centre of its main interests in the absence of evidence to the contrary (Article 3 para 1 EUIR). This applies irrespective of whether or not such claims arise from transactions which were entered into by an establishment of such party in Germany. Insolvency proceedings are generally governed by the law of the Member State where such proceedings are opened. They are, with regard to other Member States, international in scope being effective in all Member States (other than Denmark) unless secondary proceedings are opened in another Member State. The only main insolvency proceedings permitted under Annex A of the EUIR under the laws of Germany would be Insolvency Proceedings.

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

As a result of the implementation of the WUD, the opening of secondary or territorial Insolvency Proceedings is excluded in respect of such Deposit Taking Credit Institutions (section 46e para 2 KWG). Insolvency Proceedings

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under the EUIR which might lead to the conclusion that the term "collective investment undertaking" within the meaning of the EUIR corresponds to the equivalent term in Article 3 UCITS Directive pursuant to which it is used for certain collective investment undertakings which do not qualify as UCITS as defined in the UCITS Directive. *Brinkmann*, in: K. Schmidt, InsO, 18th ed. (2013), Article 1 EUInsVO no. 7, also takes the view that the reference to collective investment undertakings in the EUIR is a reference to the definition in Article 1 point 2 UCITS Directive. It must be noted, however, that due to the lack of court precedents dealing with this issue a certain degree of uncertainty remains.

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

may only be opened by the competent authorities of the home state (*Herkunftsmitgliedsstaat*) of such Deposit Taking Credit Institution.

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

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

Where the centre of main interests of the Insolvent Party is in a Member State other than Germany or Denmark and the Insolvent Party has an establishment (within the meaning of the EUIR) in Germany, the German insolvency courts have jurisdiction in respect of such assets of the insolvent Clearing Member which are located in Germany. An establishment is defined in Article 2 lit (h) EUIR as any place of operations where the debtor carries out a non transitory economic activity with human means and goods (such term including branch offices). As mentioned above, no secondary or territorial proceedings may be opened in respect of Credit Institutions.

Where the centre of main interests of the Insolvent Party is in a Member State other than Germany or Denmark and the Insolvent Party has no establishment (within the meaning of the EUIR) in Germany, the German insolvency courts have no jurisdiction in respect of such Insolvent Party.[17]

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

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

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

Insolvent Party is located outside Germany, German insolvency courts have no jurisdiction except for the opening of (separate) territorial or secondary Insolvency Proceedings (which are limited in their scope to the assets of the Insolvent Party located in Germany).

Territorial Insolvency Proceedings can be commenced in Germany under section 354 para 1 InsO if the debtor has an establishment in Germany. Where the Insolvent Party has no establishment [18] in Germany, a sufficient basis for separate proceedings in Germany under the InsO is also provided in respect of assets located or deemed to be located in Germany upon request of a creditor, if such creditor provides evidence for its "special interest" in the opening of German territorial proceedings due to the fact that it would have worse prospects (*erheblich schlechter stehen*) for the settlement of its debt in the non-German proceedings (section 354 para 2 InsO). [19] The recognition of foreign main insolvency proceedings under section 343 InsO does not exclude secondary proceedings. If territorial or secondary insolvency proceedings are opened in Germany, they take precedence over the non-German insolvency proceedings in relation to those assets of the Insolvent Party which are subject to such secondary German insolvency proceedings. Such territorial or secondary insolvency proceedings and, thus, the applicability of German insolvency law are, however, limited in scope to the debtor's assets in Germany.

In case the Insolvent Party is a Deposit Taking Credit Institution, Insolvency Proceedings may be opened in Germany only if Germany is the home Member State. This is the case if the main office (*Hauptniederlassung*) of the Deposit Taking Credit Institution is located in Germany (section 1 para 4 KWG); the opening of secondary or territorial insolvency proceedings in other Member States is excluded (section 46e para 2 KWG).

(c) Situation of payment claims

Under the EUIR, payment claims are deemed to be situated in the Member State in which the debtor of such claim has the centre of its main interests (Article 2 lit (g) EUIR). Therefore, if the centre of main

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

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

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

As for special conflict of laws provisions governing close-out netting and set-off, please refer to paragraph 3.3.2(c) below.

3.1.6 Provisional Insolvency Measures

Upon an application for the opening of Insolvency Proceedings, but before the opening of Insolvency Proceedings, a German insolvency court may appoint a provisional insolvency representative (*vorläufiger Insolvenzverwalter*) and to release court orders to protect the Insolvent Party's assets in accordance with section 21 InsO ("**Provisional Insolvency Measures**").

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

According to the BGH, Provisional Insolvency Measures pursuant to section 21 para 2 sentence 1 nos 2 and 3 InsO do not exclude the ability of a party to set off claims since the provisions concerning insolvency set-off pursuant to sections 94 through 96 InsO (see paragraph 3.3.2(g) below) are deemed as both comprehensive and exclusive. [20] Nor is a provisional insolvency representative entitled to exercise "cherry picking" rights, i.e. to choose whether or not to perform certain contracts as stipulated by the Selection Right under section 103 InsO (see paragraph 3.3.2(f) below). The application of section 103 InsO is in terms of timing restricted to the opening of Insolvency Proceedings. According to the BGH, section 119 InsO protects

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

the Insolvency Representative's Selection Right (please refer to paragraph 3.3.2(f)) under section 103 InsO and, in the view of the BGH also applies prior to the opening of Insolvency Proceedings from the point in time in which, based on a valid application for the opening of Insolvency Proceedings, such opening of Insolvency Proceedings is to be seriously expected (*mit der Eröffnung eines Insolvenzverfahrens ernsthaft zu rechnen ist*).[21] This means that an early termination may still be invalid even if it occurred prior to the opening of Insolvency Proceedings.

The conflict of laws provisions of the InsO and the EUIR (see paragraphs 3.3.2(d) and 3.3.2(e) below) also apply to Provisional Insolvency Measures.

3.1.7 Regulatory Proceedings

Regulatory proceedings may be instituted and measures may be taken by BaFin with respect to Credit Institutions or Financial Services Institutions licensed under the KWG (sections 45 to 48s KWG) and the German Bank Reorganisation Act (*Kreditinstitute-Reorganisationsgesetz,* "**KredReorgG**") in order to avoid an insolvency of any such Institution. If the Insolvent Party is a Credit Institution, BaFin has more far-reaching powers than in respect of Financial Services Institutions.

For purposes hereof, the procedures described in this paragraph 3.1.7 are collectively referred to as "**Regulatory Proceedings**".

(a) Federal Moratorium

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

(b) Regulatory Measures by BaFin

BaFin may take various regulatory measures in respect of Institutions:

[21] BGH WM 2013, 274, 276.

Under section 45 KWG BaFin may take measures for the reinforcement of an Institution's own funds and liquidity. In particular, BaFin is empowered to prohibit withdrawals by shareholders and the distribution of dividends, restrict or prohibit the granting of loans, order the Institution to take measures to reduce risks to the extent these risks result from certain types of transactions or products or the use of certain systems or order that the Institution implement measures laid down in its recovery plan (*Sanierungsplan*).

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

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

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

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

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

(D) temporarily prohibit the disposition of assets the making of any payments by the Institution (such prohibitions which are different from those under a federal moratorium referred to in paragraph 3.1.7(a) above, to dispose assets and to make payments collectively, "**Moratorium**")[22];

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

(F) unless an applicable deposit or customer protection scheme ensures full satisfaction of the customers, prohibit the Institution from accepting payments except those made in respect of obligations owed to the Institution.[23]

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[22] There is no fixed expiry date for a Moratorium and a Moratorium may not have been revoked at the time of the opening of Insolvency Proceedings. Whilst it is difficult to predict how long such a Moratorium will be in place, under section 5 para 1 sentence 2 of the Deposit Protection and Investor Compensation Act (*Einlagensicherungs- und Anlegerentschädigungsgesetz*) BaFin is obliged to determine whether or not a "compensation event" (*Entschädigungsfall*) has occurred if the Moratorium lasted longer than six weeks.

[23] As a result of the entry into force of the German Act on the Ring Fencing of Risks and the Planning of the Recovery and Resolution of Credit Institutions (*Gesetz zur Abschirmung von Risiken und zur Planung der Sanierung und Abwicklung von Kreditinstituten*, "**Ring-Fencing Act**") on 13 August 2013, Credit Institutions which are declared to be potentially systemically important by BaFin must draw up recovery

(c) Restructuring and Reorganisation Procedures

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

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

If restructuring proceedings have failed or are without prospect of success, reorganisation proceedings (*Reorganisationsverfahren*) may be opened (section 7 KredReorgG). Reorganisation proceedings are initiated by the Credit Institution itself, or, if a restructuring proceeding has failed, by the restructuring advisor with the Credit Institution's consent, by way of notification of BaFin. The Credit Institution or the restructuring advisor must submit a reorganisation plan when notifying BaFin. Following the notification, reorganisation proceedings may be opened by the OLG Frankfurt upon an application by BaFin if there is a threat to the existence of the Credit Institution (*Bestandsgefährdung*) and this in turn may jeopardise the stability of the financial system (*Systemgefährdung*)).

Reorganisation proceedings may involve measures that affect the rights of the Credit Institution's creditors and/or its shareholders.

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plans and update them on a regular basis (section 47 KWG). The recovery plans must be submitted to BaFin and Deutsche Bundesbank (section 47b para 1 KWG). BaFin must assess the resolvability of all Credit Institutions (section 47d KWG) and is empowered to remove obstacles to the resolvability of those Credit Institutions it has declared to be potentially systemically important (section 47e KWG). BaFin is required to draw up resolution plans for each potentially systemically important Credit Institution which is not part of a potentially systemically important financial group. From 2 January 2014 onwards, further provisions of the Ring Fencing Act will gradually become effective. Amongst other things, Credit Institutions will when exceeding a certain threshold be obliged to transfer certain trading activities to a stand-alone financial trading institution. As of 1 January 2014 BaFin will further be empowered under the KWG as amended by the German Act to Implement CRD IV (*CRD IV-Umsetzungsgesetz*) to require Institutions to draw up and update recovery plans, if disruptions of their business, threats to their existence or their insolvency may jeopardise the stability of the financial system.

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

Furthermore, the KredReorgG provides for certain mandatory temporary limitations of the rights of counterparties to terminate contractual relationships with a Credit Institution that becomes subject to reorganisation proceedings (section 13 KredReorgG). Contracts may not be terminated from the day on which the notification pursuant to section 7 para 1 KredReorgG is filed with BaFin until the end of the following business day.[24] The effect of any termination events (for example in case of a payment default) occurring during this period shall be suspended until the expiration of that period. Contractual clauses that provide for the contrary (i.e. for an immediate termination) are invalid.[25]

The measures proposed in the reorganisation plan are subject to a positive majority vote of the creditors and shareholders of the respective Credit Institution accepting such measures and final approval by the OLG Frankfurt. If the OLG Frankfurt orders the implementation of reorganisation proceedings, it must make the reorganisation plan available to affected creditors and determine a meeting for discussion and voting within one month upon the order; simultaneously it must determine a date for a shareholders' meeting which should follow the date of the meeting of the affected creditors (section 16 KredReorgG). Affected creditors are to be divided into groups according to their legal status. There is no indication in the KredReorgG what legal status might mean in this context. The different groups of creditors vote in the meeting ordered by the OLG Frankfurt. The shareholders vote in a shareholder's meeting on the reorganisation plan. The majority which is required depends on the effects of the reorganisation plan (section 18 KredReorgG). In order for the reorganisation plan to be passed the shareholders' vote must be positive, the majorities of all groups of creditors must be in favour and

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

[25] Please refer to paragraph 4.3.1(d)(v) with respect to the effects of such provision on agreements not governed by German law.

the value of the claims of the creditors in favour must exceed half of the value of the claims of those creditors who voted (section 19 KredReorgG). Section 19 KredReorgG further provides that a positive vote in a group of creditors is deemed to exist even though the requisite majority has not been reached if the creditors of such group will presumably not be worse off than they would be in the absence of a reorganisation plan, these creditors adequately participate in the economic value that is created under the reorganisation plan and the majority of the voting groups has approved the reorganisation plan. Similarly, despite the approval of the shareholders not having been reached their approval will be deemed to exist if the necessary majorities within the respective groups have been reached and the measures in the reorganisation plan serve to prevent significant negative effects on other financial undertakings as a result of the credit institution's existence being endangered and on the stability of the financial system.

If the votes have been positive, the reorganisation plan must be approved by the OLG Frankfurt. The reorganisation plan becomes effective upon the OLG Frankfurt's approval (section 21 KredReorgG). If the reorganisation plan as approved by the OLG Frankfurt affects rights which are governed by non-German law, recognition of such measures will be a matter of applicable law. The German legislator takes the view that reorganisation proceedings constitute measures for purposes of Article 2 point 7 and Article 3 WUD.[26]

(d) Transfer Order

Where the BaFin determines that there is a threat to the existence of a Credit Institution (*Bestandsgefährdung*) and this in turn may jeopardise the stability of the financial markets (*Systemgefährdung*),[27] BaFin is entitled to issue a transfer order (*Übertragungsanordnung*) pursuant to sections 48a *et seq.* KWG ("**Transfer Order**").[28] By issuing a Transfer Order BaFin may transfer all or parts of the Credit Institution's property to another entity ("**Bridge Bank**"). The Transfer Order may only be issued if this is necessary to maintain or restore the stability of the financial system. If possible, given the facts of the specific case, the BaFin has to consider less intrusive measures. In particular, prior to

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

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

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

the issue of a Transfer Order BaFin may (if possible under the given circumstances) request the submission of a plan as to how to eliminate the danger to the Credit Institution's existence as a going concern from the Credit Institution and set a deadline prior to the expiry of which such reconstruction plan (*Wiederherstellungsplan*) must be submitted (section 48c para 1 KWG). A reorganisation plan which has been submitted in reorganisation proceedings under the KredReorgG may be considered as a reconstruction plan if it is suitable to eliminate the danger to the Credit Institution's existence as a going concern (section 48c para 2 KWG).

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

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

Assets which have been transferred under a Transfer Order may be re-transferred upon the BaFin's order from the Bridge Bank to the Credit Institution under section 48j KWG ("**Re-Transfer Order**") (1) within 4 months after the Transfer Order without further requirements or (2) within ten business days after receipt of the termination notice if a counterparty of the Credit Institution purports to terminate or claims that an automatic termination of a transaction between the counterparty and the Credit Institution has occurred by reason of the Transfer Order. The Re-Transfer Order becomes effective upon its publication *vis-à-vis* both the Credit Institution and the Bridge Bank.

In the case of a partial transfer, i.e. where the Transfer Order provides that only part of the business of the Credit Institution will be transferred, section 48k para 2 KWG provides that Financial Collateral must be transferred together with the business parts it relates to, where assets are part of a System such assets must be transferred together with the relevant collateral. Where assets are part of an eligible netting

agreement within the meaning of section 206 para 1 of the German Solvency Regulation (*Solvabilitätsverordnung*, "**SolvV**")[29] such assets must be transferred in their entirety and together with the relevant netting agreement and the relevant master agreements which the assets are subject to. Where a partial Re-Transfer Order covers an eligible netting agreement all legal relationships to which the netting agreement applies (the netting agreement and the underlying master agreement as well as claims resulting from the exercise of rights under the netting agreement) will be deemed to have been re-transferred (section 48j para 3 sentences 2 and 3 KWG).

The consequences of a breach of section 48k para 2 KWG are not addressed comprehensively under the KWG but section 48k para 2 sentence 3 KWG provides that section 48j para 5 sentence 2 KWG shall apply analogously. According to this provision, where BaFin, contrary to section 48k para 2 KWG does not transfer assets that are part of an eligible netting agreement within the meaning of section 206 para 1 SolvV in their entirety, the eligible netting agreement, legal relationships in relation to it and transactions under it are deemed to have been transferred in their entirety as far as the legal relationship between the Credit Institution and its counterparty is concerned.[30]

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

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

Pursuant to section 206 para 2 SolvV a netting agreement is only considered to be "eligible" if

(i) it is a bilateral netting agreement between an institution and its counterparty with regard to the included transactions,

(ii) it is in standard use either domestically or internationally or has been recommended for use by a central association of credit institutions,

(iii) it ensures that, if insolvency proceedings are initiated, only a single net amount is owed by one party to the other from the netting of all claims and liabilities,

(iv) it gives the institution the right to terminate all transactions under the agreement unilaterally with effect pursuant to number (iii) above if the counterparty defaults under an individual transaction, and

(v) it contains no provisions which permit a non-defaulting party to make limited payments only, or no payments at all, to the estate of the defaulting party if the defaulting party is a net creditor.

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

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

The filing of a law suit does not suspend or otherwise affect the validity of the Transfer Order or the Re-Transfer Order.

(e) International scope of application of Regulatory Proceedings

In accordance with section 46d para 3 sentence 3 KWG, section 340 para 2 InsO (see paragraph 3.3.2(e)(ii) below) shall apply analogously to reorganisation measures (*Sanierungsmaßnahmen*). Among such reorganisation measures are, in particular, measures taken under section 46 KWG which are intended to preserve or restore the financial status of a Deposit Taking Credit Institution and which may affect existing rights of third parties in a host Member State (section 46d para 3 sentence 1 KWG). The view of the German legislator appears to be that reorganisation measures within the meaning of section 46d para 3 sentence 3 KWG also qualify as such reorganisation measures as this term is defined in Article 2 point 7 WUD because section 46d para 1 sentence 1 KWG requires BaFin to inform the competent authorities of host Member States when taking reorganisation measures under the KWG.[31] The requirement to inform the competent authorities of the host Member State is established by Article 4 WUD in respect of reorganisation measures within the meaning of the WUD. However, the scope of section 46d para 3 KWG is not clear as the term reorganisation measure is not used elsewhere in the KWG.

The same issue arises under section 7 para 5 sentence 2 KredReorgG as it provides that section 46d paras 1 to 4 KWG shall apply analogously to reorganisation proceedings under the KredReorgG. Whether restructuring proceedings (*Sanierungsverfahren*), reorganisation proceedings (*Reorganisationsverfahren*) under the KredReorgG and to the Transfer Order pursuant to sections 48a *et seq.* KWG are covered by the reference is therefore not clear although, given the purpose of the KredReorgG to stabilise Credit Institutions and to allow them to operate as going concerns, there is good reason to assume that measures under the KredReorgG qualify as reorganisation measures for purposes of the WUD and section 46d para 3 sentence 3 KWG whereas the qualification of Transfer Orders for these purposes raises various questions.

To the extent the reference in section 46d para 3 sentence 3 KWG and section 7 para 5 sentence 2 KredReorgG apply to Regulatory Proceedings and if a court followed our interpretation of sections 338 and 340 para 2 InsO under paragraph 3.3.2(e) and subject to the application of Article 9 para 2 Rome I (see below) the effects of reorganisation proceedings on the Opinion Documents or Transactions would have to be decided on the basis of English law as the law governing the Opinion Documents and Transactions. We are, however, not aware of any court decisions on this issue.

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

However, legislative reasoning[32] also shows that the German legislator considers the Termination Restrictions to constitute overriding mandatory provisions as defined under Article 9 para 1 Rome I.[33] Notwithstanding a recognition of the choice of English law, a German court may therefore apply the Termination Restrictions, if proceedings were brought in Germany and the German court followed the German legislator's reasoning (Article 9 para 2 Rome I). The idea that the Termination Restrictions constitute overriding mandatory provisions on an international level has not been expressly spelled out in the text of the law and would therefore depend on the courts' interpretation.

It is also unclear whether and to what extent Regulatory Proceedings under the KWG and the KredReorgG apply to German branches of Credit Institutions outside the EEA. Section 53 para 1 KWG provides that branches of non-EEA credit institutions in Germany shall be deemed to be German credit institutions. However, the reason why section 53 para 1 KWG provides for the treatment of non-EEA branches as separate legal entities is that these branches are subject to prudential supervision under German law. It appears that the German legislator did not consider whether the same should apply with respect to bank restructuring measures. There is therefore currently no legal certainty as to the treatment of non-EAA branches in Germany.

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

3.1.8 Exemptions for Financial Collateral

Exemptions from the above restrictions apply to Financial Collateral. An English translation of Section 1 para 17 sentence 1 and 2 KWG reads as follows:

"Financial Collateral within the meaning of this act are cash deposits (*Barguthaben*), cash amounts (*Geldbeträge*), securities, money market instruments and credit claims within the meaning of Article 2 para 1 lit (o) of Directive 2002/47/EC of 6 June 2002 on Financial Collateral Arrangements (OJ No L 168 of 27 June 2002, p. 43) as amended by Directive 2009/44/EC (OJ No L 146 of 10 June 2009, p. 37) including all related rights or claims which have been transferred as collateral either by way of an *in rem* security

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

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

arrangement (*beschränktes dingliches Sicherungsrecht*) or by way of a money transfer or by way of outright title transfer on the basis of an agreement between a secured party and a security provider, each belonging to one of the categories named in Article 1 para 2 lit (a) to (e) Directive 2002/47/EC. Should the security provider be a person or business undertaking named in Article 1 para 2 lit (e) Directive 2002/47/EC, financial collateral is only given, if the collateral secures obligations that exist under agreements on or the procurement of agreements which serve (a) the acquisition and sale of financial instruments, (b) sale and repurchase, lending or similar transactions on financial instruments or, (c) loans to finance the acquisition of financial instruments."[34]

If Parties are Institutions they will usually fall within the scope of Article 1 para 2 lit (c) FCD. However, it should be noted that the term Institution reflects German law definitions which are not fully identical to the European law definitions referred to in the FCD. When checking whether certain entities are within the scope of the FCD, this should therefore be done by referring to the applicable EU Directives or Regulations rather than to German implementing legislation.

If one of the Parties falls within the scope of Article 1 para 2 lit (e) FCD, even where a counterparty falls outside the scope of Article 1 para 2 lit (a) to (d) FCD, collateral assets posted in connection with Opinion Documents and Transactions can still constitute Financial Collateral if such Party is not a natural person and the collateral secures obligations arising under agreements or the procurement of agreements which serve the acquisition and sale of financial instruments, sale and repurchase, lending or similar transactions on financial instruments or loans to finance the acquisition of financial instruments. To the extent the Opinion Documents and Transactions involve the acquisition and sale of financial instruments, security created over cash deposits, cash amounts and securities in the form of outright transfers would therefore qualify as Financial Collateral. The same applies to a security

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

interest which qualifies as an *in rem* security arrangement (see paragraph 3.10 below).

Section 21 para 2 sentence 2 InsO provides that the institution of Provisional Insolvency Measures under section 21 InsO will not affect the validity of dispositions over Financial Collateral. The same applies if Financial Collateral was created on the day on which such order was released, provided the secured party can prove that it neither had been aware of, nor should it have been aware of, such release. Dispositions over Financial Collateral effected after the opening of Insolvency Proceedings are valid, provided that such dispositions were effected on the day of the opening of Insolvency Proceedings and the other party proves that it did not know, nor should have known, the opening of the Insolvency Proceedings (section 81 para 3 InsO). Financial Collateral further benefits from certain exemptions in respect of insolvency-related set-off, challenge in insolvency (below, paragraphs 3.3.2(h) and 4.1) and the enforcement of security. Such exemptions apply analogously to measures under section 46 para 1 sentence 2 no. 4 to 6 KWG (section 46 para 2 sentence 6 KWG) and to restructuring and reorganisation proceedings (section 23 KredReorgG). Further, section 104 InsO expressly refers to Financial Collateral as types of arrangements that are in scope of such section and therefore not subject to the Insolvency Representative's Selection Right and the detailed analysis of section 104 InsO below at (see paragraph 3.3.2(f)(iv)3.3.2(g)).

3.1.9 Exemptions for Systems

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

An English translation of section 1 para 16 sentences 1 and 2 KWG reads as follows: "A system within the meaning of section 24b is a written agreement within the meaning of Article 2 lit (a) of the Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems (OJ No L 166 of 11 June 1998, p. 45) as amended by Directive 2009/44/EC (OJ No L 146 of 10 June 2009, p. 37), including an agreement between a participant and an indirectly participating credit institution which has been notified by Deutsche Bundesbank or a competent authority of a member state of the EEA to the European Securities and Markets Authority [("**ESMA**")]. Systems from third countries are treated similar as the systems referred to in sentence 1 if they largely correspond with the requirements enumerated in Article 2 lit a of the Directive 98/26/EC."

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

"'system' shall mean a formal arrangement

- between three or more participants, excluding the system operator of that system, a possible settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant, with

common rules and standardised arrangements for the clearing, whether or not through a central counterparty, or execution of transfer orders between the participants

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

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

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

A Member State may also on a case-by-case basis designate as a system such a formal arrangement between two participants, without counting a possible settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant, when that Member State considers that such a designation is warranted on grounds of systemic risk.

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

Where the FOA Netting Agreement is not used in conjunction with a Clearing Module or an ISDA/FOA Clearing Agreement and the FOA Netting Agreement and Transactions thereunder are entered into bilaterally outside a clearing context, we believe that the provisions on Systems will generally not apply. This is because the FOA Netting Agreement does not meet the requirements in section 1 para 16 KWG (in conjunction with Article 2 lit (a) SFD) as it is not entered between three or more participants with one another is neither intended to serve the processing of transfer orders nor notified as a System. With respect to the FOA Clearing Module and the ISDA/FOA Clearing Addendum we take the view that these do (for the same reasons) not as such qualify as Systems. However, the FOA Clearing Module and the ISDA/FOA Clearing Addendum apply in the context of clearing through a CCP and it is conceivable that the relevant Rule Set qualifies as a System (given the various differences in the Rule Sets of different CCPs and the application of different national laws we are not in a position to provide more specific guidance in this respect). Depending on the precise structure of the Rule Set, the qualification of a Rule Set as a System may result in Transactions to which the FOA Clearing Module and the ISDA/FOA Clearing Addendum apply benefitting from the exemptions applicable to Systems. We

will in the following discuss the implications of the applicability of the exemption available to Systems where relevant.

Please note that we are not aware of any court decisions on the interpretation of section 1 para 16 sentence 2 KWG and that the references to the governing law (under indent 2 of Article 2 lit (a) SFD) and to the designation and notification (under indent 3 of Article 2 lit (a) SFD) are not entirely clear.[35]

If the Opinion Documents and Transactions thereunder do not benefit from the exemptions applicable to Systems, the following exemptions will not be applicable. In Insolvency Proceedings, exemptions for Systems apply with respect to insolvency related set-off (paragraph 3.3.2(g) below) and the enforcement of security (paragraph 3.10 below). Such exemptions apply analogously to measures under section 46 para 1 sentence 2 no. 4 to 6 KWG (section 46 para 2 sentence 6 KWG) and to restructuring and reorganisation proceedings (section 23 KredReorgG).

3.1.10 Exemptions for clearing

Where German insolvency laws apply, Article 102b EGInsO might create an exemption with respect to Insolvency Proceedings and Provisional Insolvency Measures. Article 102b EGInsO was introduced into German law to ensure that the implementation of certain measures under Article 48 EMIR is not hindered by the opening of Insolvency Proceedings. This exemption is therefore only available where the close-out of transactions constitutes a necessary measure of a CCP authorised under EMIR which complies with Article 48 EMIR and is within the scope of Article 102b EGInsO. It is therefore not available where the FOA Netting Provisions applies in a non-clearing context.

In accordance with Article 102b section 1 para 1 EGInsO the opening of Insolvency Proceedings must not affect (1) the performance of the necessary (*gebotene*) measures to administer, close out or otherwise settle client positions and own account positions of a clearing member in accordance with Article 48 para 2, para 3, para 5 sentence 3 and para 6 sentence 3 EMIR, (2) the necessary transfer of client positions in accordance with Article 48 paras 4 to 6 EMIR and (3) the necessary utilisation and disbursement of clients' collateral in accordance with Article 48 para 7 EMIR where such measures have been taken in accordance with Article 48 EMIR. Furthermore, Article 102b section 2 EGInsO provides that the measures referred to in section 1 of Article 102b EGInsO are not subject to insolvency challenge (see paragraph 4.1 below). Article 102b EGInsO also applies to Provisional Insolvency Measures.

Based on its wording and on the legislative reasoning according to which Article 102b EGInsO is intended to ensure the validity of certain measures a CCP takes upon the default of one of its clearing members in order to mitigate

[35] *Von Hall*, Insolvenzverrechnung in bilateralen Clearingsystemen (2010), p. 169 *et seq.*, by referring to the legislative history proposes a narrow interpretation of Article 2 lit (a) SFD.

such default[36], we construe Article 102b EGInsO as a provision of substantive law rather than as a conflict of laws provision.[37] Therefore, Article 102b EGInsO only applies if German insolvency law applies. Article 102b EGInsO is an insolvency law provision and does therefore not address any property or contractual law aspects in connection with Article 48 EMIR and any necessary measures thereunder.

Article 48 EMIR largely addresses the relationship between a CCP and its clearing members. Systematically, Article 48 EMIR is a risk management provision and mainly pursues regulatory goals.[38] Some of the measures upon a default of a clearing member also serve the interests of clearing clients but this will not necessarily result in a legal relationship between CCP and a relevant clearing client. Rather, the clearing client's interests are protected by Article 39 EMIR by requiring the segregation of assets and positions. It is therefore not entirely clear whether Article 102b EGInsO was also intended to govern the relationship between a clearing member and its clearing clients and with a view to also protecting the positions of a clearing client from the application of mandatory insolvency laws, if such mandatory insolvency laws limit the enforceability of necessary measures instituted under the relevant clearing conditions or clearing rules. This question is a matter to be determined under German law, as the reference in Article 102b EGInsO to Article 48 EMIR does not result in Article 102b EGInsO becoming a provision of EU law and the question at hand is not a question on the interpretation of Article 48 EMIR.

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

In the following, we therefore assume and understand that all necessary measures of a CCP under Article 102b section 1 para 1 no. 1 and 2 EGInsO and the utilisation and disbursement of clients' collateral under Article 102b section 1 para 1 no. 3 EGInsO will not be hindered by the opening of

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

[37] See also *Holzer*, DB 2013, 444, 445.

[38] The German legislator states that the provisions of Article 48 EMIR could be understood as merely regulatory provisions ("*lassen sich [...] auch als rein aufsichtsrechtliche Regelungen lesen*") (BT-Drucksache 17/11289, p. 27 *et seq.*).

Insolvency Proceedings and, as a consequence, some provisions under the InsO will either not apply at all or to a limited extent only. As a result, the provisions of the Rule Set will prevail over mandatory provisions under the InsO, however, only to the extent the measures under the Rule Set correspond to the measures referred to under Article 48 EMIR and Article 102b EGInsO or implement such measures provided that these measures are necessary (*geboten*) within the meaning of Article 102b section 1 para 1 EGInsO. In our view, the exemptions implemented by Article 102b EGInsO go beyond the generally applicable exemptions for Financial Collateral and Systems. Where we discuss in the following the effects of Insolvency Proceedings we refer to Article 102b EGInsO if relevant.

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

3.1.11 Based on our description of Insolvency Proceedings set out under paragraphs 3.1.1 and 3.1.2 above, we confirm that the events specified in the Insolvency Events of Default Clause adequately refer to the Insolvency Proceedings, without the need for any additions. Assuming that under the governing English law (on which we do not opine), the Insolvency Events of Default Clause can be construed as a reference to the Insolvency Proceedings, a German insolvency court would recognise such meaning of the English terms. As set out in more detail in paragraphs 3.3, 3.4 and 3.5 below, the enforceability of the FOA Netting Provision, the Clearing Module Netting Provision and the Addendum Netting Provision depends on whether the relevant agreement is terminated prior to the opening of Insolvency Proceedings and whether or not an exemption from mandatory restrictions under the InsO applies. The Insolvency Events of Default Clause therefore has to ensure that the FOA Netting Agreement is terminated prior to the opening of Insolvency Proceedings and include a provision which, according to the interpretation of such provision under English law (on which we do not opine) can be construed to refer to an Event of Default which occurs prior to the opening of Insolvency Proceedings. Further, the termination has to be either triggered automatically in case of an Event of Default which occurs prior to the opening of Insolvency Proceedings or the terminating party has to ensure that it exercises its termination right prior to the opening of Insolvency Proceedings.

3.2 Recognition of choice of law

3.2.1 The choice of English law to govern the FOA Netting Agreement or, as the case may be, the Clearing Agreement can be validly made under German law even if neither Party is incorporated or established in Germany (Article 3 para 1 Rome I).

The choice of English law also applies to the performance and the various ways of extinguishing obligations (Article 12 para 1 lit (b) and (d) Rome I),

including the exercise of any contractual early termination and set-off rights. With respect to set-off, Article 17 Rome I provides that where the right to set off is not agreed between the parties, set off shall be governed by the law applicable to the claim against which the right to set off is asserted. Given the clear wording of such provision any contractual agreements relating to set-off of netting of obligations are outside the scope of Article 17 Rome I and the parties may therefore agree on set-off or netting arrangements[39] such as the Netting Provisions in accordance with Article 3 para 1 Rome I.

3.2.2 In respect of their contractual aspects and to the extent they are governed by Rome I an Insolvency Representative or court in Germany would have regard to English law as the governing law of the FOA Netting Agreement or, as the case may be, of the Clearing Agreement, in determining the enforceability or effectiveness of (i) the FOA Netting Provision and the FOA Set-Off Provision or, as the case may be, of the Clearing Module Netting Provision and/or the Addendum Netting Provision, and the Clearing Module Set-Off Provision and/or the Addendum Set-Off Provision, and (ii) the Title Transfer Provisions.

3.3 Enforceability of FOA Netting Provision

Subject to the qualifications set out in paragraph 4 below and as discussed in the following, where German law refers to English law and assuming that under English law the enforceability of the FOA Netting Provision is not affected, in relation to an FOA Netting Agreement, or in relation to a Clearing Agreement where the Defaulting Party (as defined in Annex 3) acts as Client, the FOA Netting Provision are immediately (and without fulfilment of any further conditions) enforceable in accordance with its terms so that, following an Event of Default, including as a result of the opening of any Insolvency Proceedings:

3.3.1 the Non-Defaulting Party would be entitled immediately to exercise its rights under the FOA Netting Provision; and

3.3.2 the Non-Defaulting Party would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of Transactions, in each case, to the extent as set out in paragraphs 3.3.2(a) to 3.3.2(l) below.

We are of this opinion because:

(a) Netting - general

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

[39] *Spellenberg*, in: Münchener Kommentar BGB, 5th ed. (2010), VO (EG) 593/2008 Art. 17 Aufrechnung no. 10; *Kieninger*, in: Ferrari/Kieninger/Mankowski u.a., Internationales Vertragsrecht, 2nd ed. (2011), VO (EG) 593/2008 Art. 17 Aufrechnung no. 1.

context of master agreements for derivative transactions, the legal concept that is most relevant under German law is "close-out netting". Contractual close-out netting provisions provide for a method of reducing the parties' exposure by terminating outstanding transactions, calculating their values and determining compensation payments for all outstanding transactions that are subsequently netted against each other. Accordingly, they are subject to both the laws applicable to early termination and to set-off.[40]

(b) Conflict of laws - contractual aspects

As mentioned above, as a matter of contract law the choice of English law to govern any early termination (as a result of the exercise of a termination right or based on an agreement on an automatic termination) as well as an agreement on set-off of mutual obligations is generally recognised by German courts (paragraph 3.2 above).

(c) Conflict of laws – insolvency aspects

Where the Event of Default is related to the insolvency of the Defaulting Party, applicable insolvency laws have to be determined on the basis of the principles set out under paragraph 3.1.5.

Therefore, in the following, we first discuss the law applicable to the FOA Netting Provision if the EUIR applies and then, in a second step, the law applicable to the FOA Netting Provision if the EUIR does not apply.

(d) Application of the EUIR

Where the EUIR applies, Article 4 provides that the law applicable to insolvency proceedings and their effects shall be the law of the EU Member State in which the proceedings are opened. Secondary proceedings will be governed by the law of the EU Member State (other than Denmark) in which they are opened (Articles 3 para 2, 28 EUIR).

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

(i) Set-off under the EUIR

[40] *Ehricke*, WM 2006, 2109, 2113.

Under the EUIR, set-off is permitted if permitted under the insolvency laws of the jurisdiction in which insolvency proceedings have been opened in relation to the insolvent debtor (Article 4 para 2 lit (d) EUIR) or if permitted by the law applicable to the insolvent debtor's claim (Article 6 para 1 EUIR).[41] In our view, close-out netting arrangements will not fall within the scope of application of Article 6 para 1 EUIR. The wording of Article 6 para 1 EUIR supports this as the term "set-off" only covers one element of close-out netting but does not refer to other integral parts such as the early (closing out) termination of transactions or the valuation and conversion of the terminated transactions into claims which are eligible for set-off.

Whilst it has been argued that Article 6 para 1 EUIR shall be construed broadly to include close-out netting arrangements to enable financial market participants to choose the insolvency law applicable to close-out netting,[42] Recital 27 EUIR in connection with Article 9 EUIR clarifies that the European legislator distinguishes between set-off and netting agreements. Moreover, the European legislator uses the terms set-off and netting agreements differently in other relevant European legal acts as well.[43] Therefore, we take the view that Article 6 para 1 EUIR does not include close-out netting arrangements.

According to Article 4 para 2 lit (m) EUIR, the law of the Member State opening the insolvency proceedings (*lex fori concursus*) determines the rules relating to the voidness, voidability or unenforceability of legal acts which are detrimental to all creditors. Article 6 para 2 EUIR provides that the protection for set-off pursuant to Article 6 para 1 EUIR does not preclude actions for voidness, voidability or unenforceability as referred to in Article 4 para 2 lit (m) EUIR. Therefore, the *lex fori concursus* may consider a set-off void, voidable or unenforceable, despite Article 6 para 1 EUIR.

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

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

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

(ii) Financial markets under the EUIR

Under Article 9 para 1 EUIR, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market shall be governed solely by the law of the Member State applicable to that system or market. Whilst in our interpretation Article 9 para 1 EUIR would also cover close-out netting, Article 9 EUIR will likely not apply to the FOA Netting Agreement and the Clearing Agreement. Whether the reference to payment or settlement systems would include central counterparty clearing is not entirely clear. In our view, the definition of "System" as set out Article 2 lit (a) SFD may generally be referred to when construing Article 9 EUIR.[44] The FOA Netting Agreement and the Clearing Agreement are bilateral contracts and do therefore in our view not constitute the type of agreement which is required for a System (see generally paragraph 3.1.9). Irrespective of whether or not Article 2 lit (a) SFD would also cover central counterparty clearing the definition requires that the relevant arrangements is governed by the law of an EU Member State. What constitutes a financial market is not defined in the EUIR but is understood to be a market in an EU Member State (other than Denmark) where financial instruments, other financial assets or commodity futures and options are traded.[45] Therefore, Article 9 EUIR will likely not apply (with respect to market contracts, please refer to paragraph 3.16 below).

To summarise, following the wording of Article 6 para 1 EUIR and the use of terminology by the European legislator, the proper interpretation of Article 6 para 1 EUIR appears to be that close-out netting arrangements are not covered by such article and therefore fall within the scope of application of Article 4 para 1 EUIR, i.e. are governed by the law applicable to insolvency proceedings of the Member State in which the proceedings are opened.[46] Therefore, following the opening of insolvency proceedings over the assets of a Party the FOA Netting Agreement would, in our view be subject to the law applicable to insolvency proceedings in the Member State (other than Denmark) in which the insolvency proceedings are opened.

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

45 *Virgós/Schmit*, Report on the Convention on Insolvency Proceedings (1996), no. 120.

46 *Schneider*, in: Kohler/Obermüller/Wittig, Kapitalmarkt – Recht und Praxis, Gedächtnisschrift für Ulrich Bosch (2006), 196, 207.

(e) Application of the conflict of laws regime of the InsO

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

With respect to insolvency proceedings instituted in a jurisdiction other than Germany, section 351 InsO provides that rights *in rem* of creditors or third parties in assets of the insolvent estate will not be affected by the foreign proceedings provided that the relevant assets are located in Germany at the time of the opening of the foreign proceedings and such right *in rem* entitles the creditor or, as the case may be, the third party to segregation of the relevant asset from the insolvency estate (*Aussonderung*) or separate satisfaction (*Absonderung*).

(i) Set-off under the InsO

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

(ii) Netting under the InsO

Where the conflict of laws rules of sections 335 *et seq.* InsO apply, section 340 para 2 InsO provides for an insolvency conflict of laws rule for "netting agreements". According to our interpretation of section 340 para 2 InsO, the netting takes effect in accordance with the substantive insolvency laws of the country the laws of which have been chosen by the parties to govern the related netting agreements.

In more detail, section 340 para 2 InsO provides for the effects of Insolvency Proceedings on netting agreements (*Schuldumwandlungsverträge* und *Aufrechnungs-vereinbarungen*) to be governed by the law applicable to that agreement. Even though section 340 para 2 InsO does not provide any guidance on the interpretation of the term "netting agreement", [47] the legislative history reveals that master agreements within the meaning of section 104 para 2 sentence 3 InsO (paragraph 3.3.2(f)(iv) above) fall within the scope of section 340 para 2 InsO.[48] On that basis, we are of the view that

[47] With respect to the German terminology please see BT-Drucksache 15/16, p. 20.

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

agreements qualify as "netting agreements" for purposes of section 340 para 2 InsO, if they are entered into as bilateral agreements providing a legal framework for an indefinite number of transactions and provide for the early termination of all transactions entered into under such agreements upon the occurrence of an event of defaults, including upon insolvency.[49] Such early termination must result in the calculation of a net settlement claim with respect to all claims which are outstanding under any transactions covered by the agreement. We note, however, that there are no court decisions available on the interpretation of section 340 para 2 InsO and the term "netting agreement".

We understand that the FOA Netting Agreement and the Clearing Agreement are entered into for an indefinite number of Transactions, respectively and they provide for an early termination of all Transactions upon the occurrence of an Event of Default, including a Client's insolvency, resulting in an early termination of such Transactions. If the FOA Netting Agreement and the Clearing Agreement also enable the Parties as remedy upon an early termination to net and set off any amounts owing under the Transactions, we would conclude that the prerequisites for a "netting agreement" as we construe this term are given. However, the treatment of the Clearing Agreement as a "netting agreement" also depends on the impact of the relevant Rule Set and we cannot address the various potential modifications that may result from such impact on an abstract basis.

With respect to the legal consequences, where section 340 para 2 InsO applies, it is not entirely clear to which set of rules the wording "law of the country which governs such agreements" refers. Basically, section 340 para 2 InsO could refer to (i) the substantive insolvency laws of the jurisdiction that has been chosen by the parties to govern the relevant netting agreement,[50] (ii) the substantive contract law of the jurisdiction that has been chosen by the parties to govern the relevant netting agreement[51] or (iii) directly to the terms of the

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[49] We are not aware of any court decisions on the interpretation of the term master agreement, however, a court may, when construing such provisions, also refer to other legal provisions such as section 206 SolvV. Section 206 SolvV requires, *inter alia*, a single agreement clause and that the relevant master agreement is a standard master agreement which is customarily used or recommended by an industry association. See further footnote 29.

[50] *Tashiro*, in: Braun, 6th ed. (2012) § 340 nos. 3 and 4; *Jahn*, in: Münchener Kommentar InsO, 2nd ed. (2008) § 340 no. 6

[51] *Kindler*, in: Münchener Kommentar BGB, 5th ed. (2010), § 340 no. 5 (*lex causae*); *Stephan*, in: Heidelberger Kommentar InsO, 6th ed. (2008), § 340 nos. 6, 7.

relevant netting agreement without any regard to the substantive insolvency or contract laws.[52]

Since the wording of section 340 para 2 InsO does not provide any clear guidance as to its interpretation, both the legal history and the context of this provision have to be taken into account. Section 340 para 2 InsO implements Articles 25 and 26 WUD into German law. Whilst the wording of the WUD is not precise either, with respect to the purpose of the WUD, the European legislator apparently aims at protecting the expectation of parties to a close-out netting agreement that their agreement will remain enforceable after the opening of Insolvency Proceedings. When implementing the WUD into German law, the German legislator expressly referred to this intention behind the WUD and emphasised the necessity to ensure predictability regarding the applicable laws.[53]

It is, however, not necessary in order to achieve this purpose to give effect to the parties' agreement without having regard to the principles of insolvency law. Moreover, the wording of section 340 para 2 InsO refers to the laws of the country instead of merely referring to the terms of the agreement. Therefore, the effectiveness of close-out netting arrangements would not only be a matter of the terms of the agreement (without any reference to substantive insolvency laws) pursuant to section 340 para 2 InsO but a matter of the laws of the country by which such netting agreement is governed.

An interpretation according to which section 340 para 2 InsO would refer to the contract law of the jurisdiction that has been chosen to govern the relevant agreement is not convincing. As section 340 para 2 InsO is an insolvency conflict of law provision, the better arguments are with those who claim that this section refers to insolvency law rather than to contract law. However, we note that, as far as we are aware, the interpretation of section 340 para 2 InsO has not been the subject of any court decision yet.

Section 340 para 3 InsO provides that the effects of Insolvency Proceedings on the rights and obligations of participants in a System within the meaning of section 1 para 16 KWG shall be governed by the laws of the state which applies to that System. As under section 340 para 2 InsO, it is not clear whether section 340 para 3 InsO refers to the provisions of the relevant contractual arrangement establishing the System, substantive

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[52] This interpretation is supported by *Schneider*, in: Kohler/Obermüller/Wittig, Kapitalmarkt – Recht und Praxis, Gedächtnisschrift für Ulrich Bosch (2006), p. 211.

[53] BT-Drucksache 15/16, p. 19 *et seq.*

contract law of the jurisdiction by the laws of which the System is governed or substantive insolvency law of the jurisdiction by the laws of which the System is governed and our reasoning above applies analogously. In the absence of any court decisions on this question we therefore believe that section 340 para 3 refers to the substantive insolvency law of the jurisdiction by the laws of which the System is governed.

With respect to Transactions which are subject to clearing, in case of an insolvency of a Clearing Member or its client, it is not entirely clear whether section 340 para 2 InsO or section 340 para 3 InsO applies, i.e. whether the law governing the Clearing Agreement is applicable pursuant to section 340 para 2 InsO or whether the law applicable to a Rule Set which qualifies as a System is applicable pursuant to section 340 para 3 InsO. The existence of a clause in a relevant Clearing Agreement which provides that in case of any conflict between the provisions of the clearing agreement and the rules of the System, the latter prevails, does not necessarily result in the application of section 340 para 3 InsO. However, should the Clearing Agreement qualify as a netting agreement and be part of the rules establishing a System, we believe that section 340 para 3 InsO should prevail over section 340 para 2 InsO as section 340 para 3 InsO is even more specific than section 340 para 2 InsO.

By way of summary, if the EUIR does not apply, the enforceability of the FOA Netting Provision would in our view be a matter of English insolvency law as the law governing the FOA Netting Agreement. This also applies in respect of the Clearing Agreement unless a relevant Rule Set provides otherwise.

If a German court did not follow our reasoning as regards the applicability and interpretation of section 340 para 2 and para 3 InsO or Article 9 EUIR above, paragraph 3.4.6 above) or if Article 4 para 1 EUIR applies instead (paragraph 3.3.2(d) above), it would likely apply German insolvency laws in respect of the Netting Provisions upon the insolvency of an Insolvent Party. The following summarises the German insolvency law treatment of close-out netting provisions.

(f) Treatment of the FOA Netting Provision under substantive German insolvency law

As the FOA Netting Provision is subject to the rules on insolvency-related early termination and insolvency-related set-off (please refer to paragraph 3.3.2(a) above), we first discuss insolvency-related early termination in this paragraph and, in a second step, insolvency set-off (paragraph 3.3.2(g) below). As mentioned (paragraph 3.3.2(e), the FOA Netting Provision may form part of contractual provisions

establishing a System if used in a clearing context and exemptions applicable to Systems may therefore be relevant (paragraph 3.1.9)).

Under the InsO, following the opening of Insolvency Proceedings, executory contracts[54] which have not been effectively terminated prior to such opening of Insolvency Proceedings are, pursuant to section 103 InsO, subject to the Insolvency Representative's right to decide whether to assume or reject such contracts ("**Selection Right**" - such Selection Right by the Insolvency Representative often being referred to as "cherry-picking" right)[55].

An English translation of section 103 InsO reads as follows:

"Section 103

Selection Right of the Insolvency Representative

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

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

Under section 103 InsO, the Insolvency Representative has the power to exercise its Selection Right, i.e. to refuse performance of unprofitable contracts and to enforce profitable ones. In the event that the Insolvency Representative refuses to perform, the contracts are terminated and the Solvent Party may assert claims arising from non-performance. Such claims rank *pari passu* with the claims of all other unsecured creditors. Section 119 InsO provides that agreements excluding or limiting the application of sections 103 to 118 InsO in advance are invalid and therefore protects the Insolvency Representative's Selection Right (see further below). As an early

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

[55] The opening of Insolvency Proceedings does not trigger the (automatic) termination of the contractual obligation to perform. Rather, the opening of Insolvency Proceedings only affects the enforceability of the respective claims since both parties to a contract may raise the objection of non-performance of a contract (BGH ZIP 2002, 1093, 1095). Therefore, neither the opening of Insolvency Proceedings nor the decision of the Insolvency Representative directly results in a termination of the contractual agreement.

termination restricts the Selection Right an early termination under the FOA Netting Provision may be invalid if it violates sections 103, 119 InsO. In the following we will analyse the scope of sections 103, 119 InsO with respect to termination rights under the FOA Netting Provision and any potential exceptions.

Section 104 InsO provides for two major exceptions to this principle. One exception relates to outstanding contracts on the sale of tangible goods where the obligations must be fulfilled by a particular date as otherwise their fulfilment becomes worthless for the purposes of the receiving party (*Fixgeschäfte*) (section 104 para 1 InsO) and the other relates to financial transactions within the meaning of section 104 para 2 InsO. To the extent that section 104 InsO applies, it overrides the Insolvency Representative's Selection Right under section 103 InsO and therefore there is no need to protect the Selection Right under section 119 InsO, even in cases where an insolvency-related termination right has been exercised. To the extent section 103 InsO applies to exclude any contractual or statutory termination of Transactions, the portfolio of Transactions under the FOA Netting Agreement or the Clearing Agreements may be subject to disparate treatment. Pursuant to section 103 InsO, transactions which have not, or not fully, been performed by either of the parties and which have not been effectively terminated prior to the opening of Insolvency Proceedings are subject to the Insolvency Representative's Selection Right, unless such transactions would fall under an exception.

By way of background, it is disputed amongst German legal authors whether and to what extent German insolvency law prohibits contractually stipulated termination rights based on insolvency related events. The early termination (indirectly) prevents the Insolvency Representative from exercising its Selection Right under section 103 InsO to disclaim or enforce outstanding Transactions and may therefore be regarded as a circumvention of mandatory insolvency provisions regarding executory contracts. The majority of German insolvency law commentators [56] advocate a narrow application of sections 103 and 104 InsO and, hence, view a contractual right of early termination as very likely to be held valid by a German court provided that it is based on non-insolvency related events or even on a party's filing of an application to open Insolvency Proceedings against its assets and/or the existence of any material reason for such an application (such as over-indebtedness).[57] A termination right directly

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

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

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

In its judgment of 15 November 2012 [58] the BGH held that an insolvency related termination provision in a contract is invalid, because it would exclude the Selection Right of the Insolvency Representative under section 103 InsO and therefore violate section 119 InsO. Whilst the BGH's judgment related to a contract for the supply of energy we understand that the BGH intends to apply its reasoning to any other agreements as long as an early termination under such agreements will result in the exclusion of an Insolvency Representative's Selection Right.[59]

According to the BGH, insolvency related termination provisions are provisions under which a contract may be terminated upon a stoppage of payment (*Zahlungseinstellung*), the filing for insolvency proceedings (*Insolvenzantrag*) or the opening of the Insolvency Proceedings (*Insolvenzeröffnung*). In this judgment the BGH has also decided that section 119 InsO applies from the point in time in which, based on a valid application for the opening of Insolvency proceedings,

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

58 BGH WM 2013, 274.

59 See also *Obermüller*, ZInsO 2013, 476, 480. Also *Huber*, ZIP 2013, 493, 496, emphasised that the BGH has considered the most relevant arguments that have been raised in this context even though this would not have been necessary to render the judgment with respect to the case which was the subject of the decision of 15 November 2012 (BGH WM 2013, 274).

such opening of Insolvency Proceedings is to be seriously expected (*mit der Eröffnung eines Insolvenzverfahrens ernsthaft zu rechnen ist*) (please see paragraph 3.1.6 above). [60] According to the BGH, insolvency related termination provisions will only be upheld if the contractual insolvency related termination right corresponds to a statutory termination right. In the view of the BGH, "non-insolvency related" termination provisions are not intended to "erode" the Selection Right and therefore non-insolvency related termination provisions will generally not be covered by section 119 InsO.

We understand that termination rights and automatic termination events under the Opinion Documents may be triggered upon the occurrence of an insolvency-related event of default. The BGH argues that insolvency-related termination provisions can only be upheld if the contractually agreed insolvency related termination right corresponds to a statutory termination right. Whilst the BGH does not refer to section 104 InsO, in our view, section 104 InsO should be regarded as such a corresponding statutory termination right as section 104 InsO operates as a statutory termination and close-out netting provision which under any circumstances excludes the Selection Right of the Insolvency Representative under section 103 InsO. [61] Accordingly, section 104 InsO is not only a termination right but even provides for an automatic termination of the contracts falling within its scope of application. Consequently, in our view, where the relevant agreement or any transactions thereunder fall within the scope of section 104 InsO, an insolvency related contractual termination right should not be regarded as a circumvention of section 103 InsO.

(i) Exceptions under section 104 InsO

Upon the opening of Insolvency Proceedings, section 104 InsO provides for a mandatory automatic termination of those transactions which fall within its scope. If the relevant date for early termination falls after the opening of Insolvency Proceedings the provisions of section 104 InsO would govern the close-out netting of those transactions which fall within its scope. Section 104 InsO would have no effect on those obligations, which fall outside its scope and the analysis described in paragraph 3.3.20 above would apply thereto, i.e. section 103 InsO will apply to Transactions under the FOA Netting Agreement or the Clearing Agreement if they qualify as executory contracts under the FOA Netting Agreement or the Clearing Agreement and the Insolvency Representative is entitled to exercise the Selection Right.

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60 BGH WM 2013, 274.

61 *Obermüller*, ZInsO 2013, 476.

An English translation of section 104 InsO[62] reads as follows:

"Section 104

Fixed date transactions, financial transactions

(1) If a precise point in time or period has been agreed upon for the delivery of goods with a market or exchange price, and such point in time is, or such period expires, after the opening of Insolvency Proceedings, performance may not be requested, instead, only a claim for non performance may be asserted.

(2) If a specified point in time or a specified period have been agreed upon for the performance of financial transactions which have a market or listed price, and such point in time is, or such period expires, only after the opening of insolvency proceedings, performance may not be requested, only a claim for non performance may be asserted. Financial transactions include in particular:

1. the delivery of precious metals,

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

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

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

5. options and other rights to demand delivery or payments of money within the meaning of sub paragraphs 1 to 4 above, or

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

If financial transactions are combined in a master agreement for which it has been agreed that, if reasons for the opening of

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

insolvency proceedings exist, the master agreement can only be terminated in its entirety, then such contracts together are deemed to form one single mutual agreement within the meaning of sections 103, 104.

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

Section 104 para 1 InsO applies to fixed date transactions (*Fixgeschäfte*) for tangible goods only. Section 104 para 2 InsO applies to financial transactions. As section 104 InsO is a special rule to section 103 InsO, a Transaction must be mutual and qualify as an "executory contract" to fall within its scope. There is an exemption from this requirement under section 104 para 2 sentence 3 InsO with respect to financial transactions which have been entered into under a master agreement (see paragraph 3.3.2(f)(v) below). Section 104 para 3 InsO provides for a calculation method following the early termination of transactions by section 104 InsO which applies when no overriding agreement is in place.

Section 104 para 3 InsO provides for a calculation method following the early termination of transactions by section 104 InsO which applies when no overriding agreement is in place. Any automatic termination by virtue of section 104 InsO results in a claim for non-performance calculated on the basis of market or exchange prices. The parties may agree on the point in time which is be decisive for determining the market or exchange prices; such date may not exceed five business days after the opening of Insolvency Proceedings. The claim for non-performance would, irrespective of the law governing the relevant transaction or agreement, be governed by German law and would generally rank *pari passu* with claims of all other unsecured creditors in the absence of any agreements. The claim for non-performance is expressed in Euro and may be subject to set-off.[63]

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[63] Please note that section 104 para 3 InsO does in our view not provide for a set off (see also *Ehricke*, ZIP 2003, 273, 277) but, by transforming the former payment and delivery claims into a Euro denominated payment claim, provides a basis for set off (subject to the general set off restrictions under contract and insolvency law, as applicable). However, *von Hall*, Insolvenzverrechnung in bilateralen Clearingsystemen

(ii) Fixed date transactions (*Fixgeschäfte*)

Section 104 para 1 InsO applies to fixed date transactions (*Fixgeschäfte*) on tangible goods with a market or stock exchange price only. Fixed date transactions are transactions where performance has to occur at a specific point of time because the creditor puts special emphasis on the timeliness of the performance. Commodities such as electricity qualify as goods under section 104 para 1 InsO.[64] A market or exchange price is (at least also) given if the price can be determined by an expert.[65] Fixed date transactions can be classified in "absolute" fixed date transactions (*absolute Fixgeschäfte*) and "relative" fixed date transactions (*relative Fixgeschäfte*).

Regarding absolute fixed date transactions, the agreed date of performance has such an importance to at least one of the contracting parties that, in case of failure to perform in time, subsequent performance after the performance date stipulated in the contract cannot be considered as a performance of the contractual obligation anymore. Performance in time is the central point of the entire agreement (*die Leistung steht und fällt mit der Einhaltung der Leistungszeit*). [66] Delayed performance would not constitute performance in accordance with the agreement but instead a complete different performance. [67] The question as to whether a transaction qualifies as an absolute fixed date transaction depends on the terms of the agreement, the interests and intention of the parties and the circumstances of the single case, also taking customary practice into consideration.

With respect to relative fixed date transactions, timely performance is crucial as well. Relative fixed date transactions are transactions where, due to the importance to receive performance in time, the creditor may no longer be interested in receiving performance by the other party if such performance has not been made on the agreed date. In contrast to absolute

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(2010), p. 152, 156 *et seq.*, takes the view that section 104 para. 2 sentence 3 InsO already includes the set-off.

64 *Kroth*, in: Braun, InsO, 5th ed. (2012), section 104 no. 3. According to the ECJ, case C-393/92 of 27 April 1994, *Municipality of Almelo and others v NV Energiebedrijf Ijsselmij*, DVBl 1994, 852, 854) electricity qualifies as a good (*Ware*) within the meaning of the former Article 37 of the Treaty establishing the European Economic Area (now Article 37 of the Treaty on the Functioning of the European Union).

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

66 BGHZ 110, 96; BGH NJW-RR 1989, 1373.

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

fixed date transactions, however, subsequent delivery (*Nachlieferung*) of performance is still possible and the purpose of the agreement can still be achieved. [68] As delayed performance will often not be in the interest of creditors, the BGH provides for a revocation right for the non-defaulting party in such cases (section 323 para 2 no. 2 BGB). Nevertheless, the non-defaulting party does not necessarily have to exercise its revocation right. It can also choose to claim for performance and claim damages, too, provided that the obligor is in payment or delivery default pursuant to section 286 BGB.

By and large, where German law applies, the courts are reluctant to treat a transaction as a fixed date transaction merely because the agreement provides for a fixed performance or delivery date. [69] According to existing court precedents, an initial indication for the treatment of a transaction as a fixed date transaction is the wording of the agreement, in particular the use of terms such as "fix", "concise", "exactly", "without any grace period", etc.[70] In contrast, the exclusion of any grace period alone (i.e. the immediate liability for damages in case of default) does not necessarily entail the treatment as a fixed date transaction. [71]

Relative fixed date transactions fall under section 104 para 1 InsO. With regard to absolute fixed date transactions, however, this is disputed in legal literature[72]. However, the wording of section 104 para 1 InsO itself does not give any further guidance and it is also mentioned in the legislative material, that the purpose of section 104 para 1 InsO is to minimise the Insolvency Representative's ability to speculate.[73] Such purpose can only be achieved if section 104 para 1 InsO also applies to

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68 *Ernst*, in: Münchener Kommentar BGB, 6th ed. (2012), § 286 no. 40.

69 *Ibid.*

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

71 *Ernst*, in: Münchener Kommentar BGB, 6th ed. (2012), § 323 no. 117.

72 *Andres,* in: Andres/Leithaus, Insolvenzordnung, 2nd ed. (2011), § 104 no. 3 and *Köndgen*, in: Kübler/Prütting/Bork, InsO, § 104 no. 5 argue that section 104 para1 InsO covers absolute and relative fixed date transactions whereas according to *Lüer*, in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010) § 104 no. 6, section 104 para 2 sentence 2 no. 6 InsO only covers relative fixed date transactions. We also note, however, that most legal commentators do not distinguish between absolute and relative fixed date transactions or at least not addressing this issue; see: *Balthasar*, in: Nerlich/Römermann, Insolvenzordnung, 24th update (2012), § 104 no. 16; *Jahn/Fried*, in: Münchener Kommentar InsO, 3rd ed. (2013), § 104 no. 37 *et seq.*; *Braun*, in: Insolvenzordnung, 5th ed. (2012), § 104 no. 5; *Häsemayer*, Insolvenzrecht, 4th ed. (2007), p. 495 no. 20.34. This does also hold true with respect to legal commentaries on the former KO; see *Kilger*, in: Karsten Schmidt, Konkursordnung, 16th ed. (1997), p. 126, 127; *Kuhn*, in: Uhlenbruck, Konkursordnung, 11th ed. (1994), § 18 no. 3, 5.

73 BT-Drucksache 12/2443, p. 145.

absolute fixed date transactions. In the absence of any court decisions, we would construe section 104 para 1 InsO to cover both, absolute and relative fixed date transactions. The question whether Transactions can be considered as fixed date transactions pursuant to section 104 para 1 InsO depends largely on the characteristics of the relevant transactions and the intention of the parties.

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

Section 104 para 2 InsO applies to financial transactions as defined in section 104 para 2 sentence 2 InsO. As section 104 InsO is a special rule to section 103 InsO, to qualify as a "financial transaction" pursuant to section 104 para 2 InsO, a transaction must also be an "executory" contract (as defined in footnote 54 above). However, an exception from this rule applies to transactions which have been entered into under a master agreement (see paragraph 3.3.2(f)(v) below). To qualify as a financial transaction, the relevant agreement must provide for a specific time at which or period of time in which the performance has to be made.[74] Furthermore, the transaction needs to have a market or exchange price. This is the case if a replacement transaction on equivalent terms can be entered into even if the price quotations for the entering of such replacement transaction vary. If the price of a transaction can be determined by (indirectly) referring to an objective price, the transaction is considered to have a market or exchange price within the meaning of section 104 InsO[75]. Where a transaction falls within the scope of section 104 para 1 InsO, section 104 para 2 InsO will not apply.[76]

According to the majority of German legal authors [77] section 104 para 2 InsO may also apply to spot transactions (*Kassageschäfte*).[78] We are not aware of any court decisions on

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74 Section 104 para 2 sentence 1 InsO requires that the transaction is due to be performed at a certain time or within a certain period of time. This is broader than the fixed date requirement in section 104 para 1 InsO (*Lüer*, in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010), § 104 no. 18). At the same time, undated transactions (e.g. transactions which are due upon the giving of notice or transactions with an undetermined period of time) are outside the scope of application of section 104 para 2 InsO.

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

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

77 *Jahn/Fried*, in: Münchener Kommentar InsO, 3rd ed. (2013), § 104 no. 88; *Jahn*, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, 4th ed. (2011), § 114 no. 140; *Wegener*, in: Frankfurter Kommentar zur Insolvenzordnung, 7th ed. (2013), § 104 no. 21; *Bosch*, Kölner Schrift zur Insolvenzordnung, 2nd ed. (2009), p. 1027 no. 72; different view: *Meyer*, in: Smid, Insolvenzordnung, 2nd ed. (2001), § 104 no. 11.

78 One of the arguments brought forward is that there may be a risk of loss in between signing of a contract and settlement due to market movements similar to forward transactions covered by section 104 para 2 InsO.

this matter. Spot transactions are transactions with short term delivery respectively fulfilment dates which are not entered into at a futures or forward market. The participants in a spot transaction agree to buy and sell, respectively, at the present market value and to settle the transaction a few days later (usually few more or even less than two business days[79]). Spot transactions, however, have to be distinguished from mere cash transactions (*Bargeschäfte*) which are settled same-day and not covered by section 104 para 2 InsO. As the official heading of section 104 InsO changed from originally "financial futures transactions" (*Finanztermingeschäfte*) to "financial transactions" (*Finanzleistungen*), it is the prevailing view that spot transactions which are settled in two or more days may fall under section 104 para 2 InsO.

Section 104 para 2 sentence 2 InsO gives examples of financial transactions. According to the wording of section 104 para 2 sentence 2 InsO, the enumeration of covered financial transactions is not conclusive (indicated by the words "in particular").[80] However, if these enumerations were interpreted as mere examples, the scope of section 104 para 2 InsO could become limitless and the enumerated examples would be arbitrary and unhelpful.[81] The wording of section 104 para 2 sentence 2 InsO does not provide for any further guidance how

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

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

(a) two trading days;

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

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

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

broadly such provision can be construed with respect to any covered financial transactions not explicitly enumerated. Whilst other German legal provisions relating to forward, futures and options define their scope on the basis of certain elements or building blocks (for example, section 1 para 11 KWG) which can be applied to any instruments developed after such provision entered into force, section 104 para 2 sentence 2 InsO does not follow such modular approach.

As a further consequence of such different approach there is not much value in analysing other German legal provisions to define the scope of section 104 para 2 InsO. The legislative material, however, shows clearly that the words "in particular" were intended to address any future developments with respect to financial transactions.[82] Furthermore, based on the purpose of section 104 InsO to limit the Insolvency Representative's ability to speculate on price or market developments with respect to volatile instruments by not deciding whether to assume or reject any obligations subject to the Selection Right,[83] a court may accept that transactions, which show comparable features to the enumerated financial transactions and in respect of which the same concerns may arise which the legislator has raised to justify the exemptions from the Selection Right under section 104 InsO, could be covered by section 104 para 2 sentence 2 InsO even though not explicitly mentioned.[84] However, a German court will likely balance the impact of any such decision on the Selection Right and the ability of the Insolvency Representative to administer the estate.

(iv) Financial Collateral as financial transaction

Under section 104 para 2 sentence 2 no. 6 InsO, Financial Collateral within the meaning of section 1 para 17 KWG will also qualify as a financial transaction. According to the legislative reasoning this provision is intended to implement Article 7 FCD by ensuring that Financial Collateral can also be enforced by set-off under a close-out netting arrangement.[85] The wording of section 104 para 2 sentence 2 no. 6 InsO only refers to Financial Collateral, i.e. the asset constituting the Financial Collateral but it does not state that transactions which are secured by Financial Collateral will be within the scope of this provision. However, the legislative reasoning is not clear either

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82 BT-Drucksache 12/7302, p. 168.

83 BT-Drucksache 12/2443, p. 145; BT-Drucksache 12/7302, note 69 to section 118 para 1, p. 167.

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

85 BT-Drucksache 15/1853, p. 11 *et seq.*

as reference is made to the creation of Financial Collateral and that Financial Collateral, other than transactions covered by section 104 para 2 sentence 2 nos 1 to 5 InsO, will not be regarded as "main obligations" forming part of an executory contract. This appears to protect Financial Collateral as such from the Selection Right but it does not create an exemption for the transaction secured by Financial Collateral. Section 104 para 2 sentence 2 no. 6 InsO implements Article 7 FCD providing that Member States shall ensure that a close-out netting provision can take effect in accordance with its terms. To achieve the purpose of Article 7 FCD there are good arguments to construe section 104 para 2 sentence 2 no. 6 InsO broadly. However, the definition of "close-out netting" under the FCD[86] refers to financial collateral arrangements and such term again refers in our view to the collateral asset as such but not to the secured obligation or any transaction to be secured. We would therefore limit the interpretation of section 104 para 2 sentence 2 no. 6 InsO to ensure that also Financial Collateral may be included in the close-out netting and will therefore not be subject to, if any, Selection Right.[87] To summarise, in our view the mere collateralisation of a transaction normally not covered by section 104 para 2 sentence 2 or sentence 3 InsO will not result in the application of section 104 para 2 sentence 2 InsO. However, as far as we are aware, no court precedents exist in respect of the interpretation of section 104 para 2 sentence 2 no. 6 InsO.

(v) Section 104 InsO and master agreements

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

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

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

If the FOA Netting Agreement and the Clearing Agreement contains a provision pursuant to which the FOA Netting Agreement and the Clearing Agreement and all Transactions entered into thereunder for a single agreement between the Parties and that upon an Event of Default, the FOA Netting Agreement and the Clearing Agreement, including all Transactions entered into thereunder will terminate, the FOA Netting Agreement and the Clearing Agreement would in our view qualify as master agreement within the meaning of section 104 para 2 sentence 3 InsO. Sentence 3 InsO extends the scope of section 104 para 2 sentence 1 and 2 InsO also to such transactions which would normally not fall within the scope of sections 103 and 104 InsO, when they have been fully performed by a party before the opening of Insolvency Proceedings.[88]

If some of the transactions under a master agreement fall within the scope of section 104 para 2 sentence 3 InsO while other transactions do not fall within the scope of section 104 para 2 sentence 3 InsO, the question arises whether such a "mixed" master agreement falls within the scope of section 104 para 2 sentence 3 InsO. We are not aware of any court decision on this question. Among legal commentators, three different views have been discussed: [89] (1) According to the first view, section 104 para 2 InsO does not apply at all, i.e. one non-qualifying transaction would also prevent the application of section 104 para 2 InsO for such transactions which would qualify as financial transactions. (2) According to the second view, the master agreement will be split into two parts where those transactions which qualify as financial transactions (including those transactions under which one of the parties has already fully discharged its obligations) will be covered by section 104 para 2 InsO, whereby those transactions which do not qualify as financial transactions remain outside the scope of section 104 para 2 InsO and therefore each of them will be individually subject to the Selection Right. (3) According to the third view, section 104 para 2 InsO applies to all transactions, even if only one ore some of the transactions qualify as financial transactions.[90]

In our view, the view expressed under item (1) above is not convincing as it would negate the exceptions for financial transactions under section 104 para 2 InsO completely and, thus,

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88 See *Jahn/Fried*, in: Münchener Kommentar InsO, 3rd ed. (2013), § 104 no. 141.

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

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

disregard the purpose of such provision to limit the Insolvency Representative's ability to speculate.[91] The second and the third view can both be supported by good arguments. The third view is in line with the purpose of section 104 para 2 InsO, which is to limit the Insolvency Representative's ability to speculate with respect to price sensitive transactions. It is also in line with the single agreement concept which is also implied by the wording of section 104 para 2 InsO. However, section 104 InsO was enacted as an exception to the Insolvency Representative's Selection Right under section 103 InsO. Generally, exceptions to a rule have to be construed narrowly, and their interpretation must not exclusively refer to the purpose of a statutory provision.[92] The second view is in our view more in line with the wording than the other views, because section 104 para 2 sentence 3 InsO refers to financial transactions only. Section 104 para 2 sentence 3 InsO does not provide that all transactions entered into under a master agreement will be deemed to constitute one single agreement. Rather, it refers to "...contracts involving financial transactions [...] combined in a master agreement..." and then provides that "...such contracts are together deemed to form one single mutual agreement..." [(emphasis added)]. Thus, section 104 para 2 sentence 3 InsO does in our view not intend to exempt all transactions under a master agreement. Rather, its purpose is to exclude transactions from the Insolvency Representative's Selection Right generally[93] but to include financial transactions into the single agreement which would otherwise not be covered by section 104 InsO because one of the parties has already fully discharged its obligations under such transaction. Therefore, only those transactions are deemed to form a single mutual agreement, but section 104 para 2 sentence 3 InsO does not "convert" such transactions into financial transactions which would, even if they had not been performed by either party, not be covered by section 104 InsO.

The view expressed under item (3) is criticised for not being in line with the purpose of section 104 para 2 InsO and not taking into account the "single-agreement" concept. However, also this view still enables netting for enumerated financial transactions. The strongest argument in favour of this view is

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

92 *Jahn/Fried*, in: Münchener Kommentar InsO, 3rd ed. (2013), § 104 no. 180, therefore propose to exclude master agreements from the application of section 104 InsO, when transactions have been entered into which completely arbitrarily and unrelated to the other transactions ("*völlig sachfremde und willkürliche Verbindungen mit anderen Geschäften*").

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

that it is more in line with the wording than the other views as reference is made to financial transactions.[94]

To summarise, whilst the first view is not convincing, the second and the third views are both founded, but in balancing the arguments and given that no court decisions are available, we think that the third view has more merits than the second view.[95]

(vi) Partial invalidity of an insolvency related termination provision

The FOA Netting Agreement and the Clearing Agreement may include Transactions falling within the scope of section 104 InsO (as they are fixed date transactions on tangible goods or financial transactions) but might also cover Transactions not falling within these categories.

We are not aware of any court decisions discussing whether an invalid insolvency related termination of transactions falling outside the scope of section 104 InsO may "contaminate" the termination of transactions for which an insolvency related termination is permissible (as they generally fall within the scope of application of section 104 InsO), i.e. whether the invalid insolvency related termination would render the termination of all transactions invalid even though the insolveny related termination would be permissible for those transactions which fall within the scope of application of section 104 InsO.[96]

Since the FOA Netting Agreement and the Clearing Agreement are governed by English law, outside Insolvency Proceedings, a German court would have to consider section 119 InsO an "overriding

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

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

96 According to a view expressed in legal literature (*Andres*, in: Andres/Leithaus, Insolvenzordnung, 2nd ed. (2011), § 119 no. 3), section 119 InsO is a statutory prohibition (*Verbotsgesetz*) within the meaning of section 134 BGB. Pursuant to section 134 BGB and to the extent German law applies, any legal transaction (*Rechtsgeschäft*) which violates a statutory prohibition is void (i.e. the relevant insolvency related termination provision is regarded as not validly agreed), unless a contrary intention appears from such statute. However, according to our view, section 119 InsO has to be construed narrowly as it limits the parties' freedom of contract. If section 119 InsO were to be construed as a statutory prohibition of agreements which exclude or limit the application of sections 103 to 118 InsO, the relevant termination right would be void pursuant to section 134 BGB from the point in time such termination right has been agreed. Hence, there would be no room for the application of section 119 InsO, as the contemplated termination of the agreement would already be invalid pursuant to section 134 BGB. Therefore, in our view section 119 InsO cannot be regarded as a statutory prohibition in the meaning of section 134 BGB. The better arguments are therefore that section 119 InsO should be treated as procedural insolvency provision.

mandatory provision of German law" in accordance with Article 9 para 2 Rome I. Mandatory provisions within this meaning are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under Rome I. If a court considered section 119 InsO an overriding mandatory provision of German law, it would, in a second step, have to consider whether the partial invalidity of the insolvency related termination clause would extend to the insolvency related termination clause as a whole. Again, this would be a matter of the interpretation of the FOA Netting Agreement and the Clearing Agreement by such court under English law as the law governing the FOA Netting Agreement and the Clearing Agreement (Article 12 (1) Rome I).

(vii) Calculation of the Liquidation Amount

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

If Transactions fall within the scope of section 104 InsO but the insolvency related Event of Default has occurred prior to the opening of Insolvency Proceedings, it is not entirely clear whether the interpretation of section 119 InsO set out in the BGH's judgment of 15 November 2012[97] may also affect the results of such early termination and, accordingly, the determination of any Liquidation Amount. Section 104 InsO, which is equally protected by section 119 InsO, could be considered a mandatory provision which must not be contracted out either. If such interpretation holds true, the results of a contractual automatic early termination would have to be equal to the results after the application of section 104 InsO in order to be valid. However, there is no explicit statement in the BGH's judgment supporting such a strict interpretation of section 119 InsO. In particular as section 104 InsO has been designed as a statutory "close-out netting" rule, which in para 2 sentence 3 explicitly refers to contractual close-out netting in master agreements upon an insolvency related trigger event ("*bei Vorliegen eines Insolvenzgrundes*"), the German

[97] BGH WM 2013, 274.

legislator has accepted the concept of insolvency related contractual close-out netting generally.

In our view, as an insolvency related termination provision can be validly agreed within the scope as described above, the valuation method to calculate a net single compensation amount agreed by the parties should also be enforceable, irrespective of whether and when Insolvency Proceedings are opened subsequently. This should even hold true if the contractual calculation method deviates from the calculation method provided for in section 104 para 3 InsO. If the calculation method under the FOA Netting Agreement or the Clearing Agreement had to fully match the consequences of section 104 para 3 InsO, an exemption from the statutory termination regime under section 104 paras 1 and 2 by permitting a contractual termination right would only be relevant for determining the point in time when the relevant calculation is made. Accordingly, a calculation of the Liquidation Amount in accordance with the FOA Netting Provision should also be permissible to the extent it does not substantially deviate from the calculation method under section 104 para 3 InsO.[98]

We do not think that the different point in time when the calculation of the Liquidation Amount is made compared to the point in time referred to in section 104 InsO affects the calculation of the Liquidation Amount as according to our interpretation of the BGH's judgment an insolvency related early termination based on an exemption from the Selection Right is valid. However, if pursuant to its contractual termination provision the contract is not terminated prior to the opening of Insolvency Proceedings, the valuation method provided for in section 104 para 3 InsO overrides any contractually agreed valuation method. In our view, if a termination is effected prior to the opening of Insolvency Proceedings, the calculation method agreed upon by the parties to a contract within the scope of section 104 paras 1 and 2 InsO should be recognised. Accordingly, timing of the early termination is still relevant.[99]

(g) To summarise, as set out above, section 104 InsO should qualify as a "corresponding" statutory termination as referred to by the BGH in its

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98 For example, it is disputed in legal literature whether or not any fees and commissions can be added, considering such addition permissible: *Lüer* in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010) § 104 no. 40, *Köndgen*, in: Kübler/Prütting/Bork, InsO, § 104 no. 46; *Balthasar,* in: Nerlich/Römermann, Insolvenzordnung, 24th update (2012), § 104 no. 19.

99 Neither the BGH nor the preceding decisions of the lower courts (OLG Celle, 27 October 2011, File 13 U 53/11; LG Hannover, 8 February 2011, File 2 O 189/10) mentioned section 104 InsO.

judgement of 15 November 2012 and therefore, parties may agree on insolvency related termination provisions if the Transactions fall within the scope of section 104 InsO. However, if under the FOA Netting Agreement the Transactions are not terminated prior to the opening of Insolvency Proceedings, section 104 InsO overrides any contractual close-out netting provisions such as the clauses of the FOA Netting Agreement on the calculation of the Liquidation Amount.

Fixed date transactions and financial transactions falling within the scope of section 104 InsO are automatically terminated upon the opening of Insolvency Proceedings, unless such transactions have been terminated before. If the relevant financial transaction is included in a master agreement (as referred to in section 104 para 2 sentence 3 InsO) the scope of section 104 para 2 InsO is extended to cover transactions which have already been fully performed by one party. The valuation of Transactions terminated by application of section 104 paras 1 or 2 InsO must be made in accordance with section 104 para 3 InsO at the time agreed between the parties, but no later than on the fifth business day upon the opening of the Insolvency Proceedings. However, if the Transactions are terminated before the opening of Insolvency Proceedings, the results of such early termination should be as contractually agreed and therefore, the valuation has to be made at the time contractually agreed between the parties. Section 104 InsO does in our view itself not contain a statutory close-out or set-off provision. Rather, set-off can be exercised in accordance with sections 94 *et seq.* InsO. Where contractual close-out netting complies with these provisions, transactions falling under section 104 para 1 InsO and section 104 para 2 InsO can be combined in a contractual close-out netting provision. Section 104 para 3 InsO does in our view not provide for a set off but, by transforming the former payment and delivery claims into a Euro denominated payment claim, provides a basis for set off (subject to the general set off restrictions under contract and insolvency law, as applicable).[100] Therefore, the FOA Netting Provision will only be enforceable to the extent it does not violate mandatory German provisions on set-off which we address in the following. As regards any insolvency challenge rights, see paragraph 4.1 below.

(h) Set-off

(i) Contractual aspects

As a matter of contract law, agreements on set-off may be validly concluded and the choice of English law to govern the FOA Netting Agreement may be validly concluded in

[100] However, *von Hall*, Insolvenzverrechnung in bilateralen Clearingsystemen (2010), p. 152, 156 *et seq.* takes the view that section 104 para 2 sentence 3 contains such statutory close-out netting provisions.

accordance with and subject to the principles set out above, paragraph 3.2.

(ii) Set-off in Insolvency Proceedings

The following provisions govern set-off upon the opening of Insolvency Proceedings and are therefore relevant to any set-off agreements (such as settlement and general set-off arrangements irrespective of an early termination and aggregation) if German insolvency law applies. They are also relevant in respect of section 104 InsO serves the calculation of a compensation claim which may serve as a basis for set-off.

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

The right of the Non-Defaulting Party to effect set-off after the opening of Insolvency Proceedings is governed by sections 94 through 96 InsO.[101] The extent to which a

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[101] An English translation of sections 94 through 96 InsO reads as follows:

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

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

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

(1) If on the date when the Insolvency Proceedings are opened, one or more of the claims to be set off against each other are conditional, not due or do not relate to the same types of performance, such set-off may not be effected before its conditions are met. Sections 41 and 45 shall not apply. Set-off shall be excluded if the claim against which a set-off is to be effected will become unconditional and due before it may be set off.

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

Section 96 – Prohibition of Set-off

(1) Set-off shall be prohibited if

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

2. a creditor acquired his claim from another creditor only after the opening of Insolvency Proceedings;

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

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

(2) Para 1 as well as section 95 para 1 sentence 3 shall neither restrict the transfer of financial collateral within the meaning of section 1 para 17 KWG nor the set-off of claims and benefits from transfer, payment or assignment agreements between payment services providers and intermediates or orders for transfers of securities included in a system as defined in section 1 para 16 KWG serving to implement such agreements where set-off is effected at the latest on the day of opening of the Insolvency Proceedings. If the other party is an operator or participant in the system, the day of

set-off after the opening of Insolvency Proceedings is permissible mainly depends on the point in time when the situation entitles one party to the set-off comes into existence (*Entstehung der Aufrechnungslage*). This is in our view a reference to applicable contract law.

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

In contrast to the former KO, the InsO explicitly preserves rights to set off a claim under valid contractual agreements. With respect to the overall intention of the InsO in general and the purpose of section 94 InsO in particular, i.e. the aim to protect the legitimate expectations of the creditors of the Defaulting Party, the preservation of contractual rights to set off is criticised[102] since it enables the parties to extend the rights to set off to the detriment of creditors of the Defaulting Party as such agreements might reduce the assets involved in insolvency. Hence, the validity of contractual agreements concerning set-off is called into question in German legal literature and a restrictive interpretation of section 94 InsO pursuant to which agreements concerning set-off may not override prohibitions of set-off that aim at protecting third parties' rights is proposed.[103] According to this view, such agreements also have to comply with sections 95 and 96 InsO and might be challenged pursuant to sections 129 *et seq.* InsO.

However, this restrictive approach particularly applies to agreements that deviate from the requirement of mutuality (*Gegenseitigkeit*) of the claims[104] and should not affect the validity of the contractual provision of

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opening of Insolvency Proceedings shall be determined in accordance with the definition of business day as stipulated by section 1 para 16b KWG."

[102] *Kroth*, in: Braun, InsO, 5th ed. (2012), § 95 no. 20. *Uhlenbruck*, in: Uhlenbruck, InsO, 13th ed. (2010), § 94 nos. 8 *et seq.*

[103] *Kroth*, in: Braun, InsO, 5th ed. (2012).

[104] *Schwahn*, NJW 2005, 473, 475.

automatic aggregation and set-off of all existing mutual payment obligations of the Parties under the transactions where the relevant contractual provisions do not contain a contractual deviation from the requirement of mutuality of the claims.

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

Limitations on contractual set-off arrangements apply to agreements that deviate from the requirement of mutuality of the claims. Pursuant to the BGH section 96 para 1 no. 2 InsO applies to agreements which provide for the right to set off claims of an affiliated company by another company against the claims of a third party (*Konzernverrechnungsklausel*). [105] The BGH took the view that after the opening of Insolvency Proceedings, a set-off with claims not owned by the offsetting party but by its affiliate is ineffective. This applies even if such "tri-party" set-off had been agreed upon by the three parties involved before the opening of Insolvency Proceedings.

[105] BGH NJW 2004, 3185.

(C) Restrictions under section 95 InsO

Where the right to set off emerges after the opening of Insolvency Proceedings, set-off is only permissible if the mutual claims originated before the opening of Insolvency Proceedings. If on the date on which Insolvency Proceedings are opened, one or more of the claims to be set off against each other are conditional, not yet due or do not cover similar types of obligations, such set-off cannot be effected before such conditions are met (section 95 para 1 sentence 1 InsO). Pursuant to section 95 para 1 sentence 2 InsO, section 41 InsO[106] concerning claims not yet due at the date when Insolvency Proceedings are opened and section 45 InsO[107] concerning the conversion of certain claims do not apply.

Set-off is excluded if the claim against which a set-off is to be effected becomes unconditional and mature before it may be set-off (section 95 para 1 sentence 3 InsO). With respect to set-off after the opening of Insolvency Proceedings, timing, therefore, is of fundamental importance. Set-off is permissible if the non-Defaulting Party's claim is unconditional and mature prior to the Defaulting Party's claim or at the same time at the latest. Provided that the contractual close-out netting provision is structured in a way that ensures that claims arising thereunder come into existence at the same time, the statutory limitation pursuant to section 95 para 1 sentence 3 InsO would not apply.[108]

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

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

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

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

only after the opening of Insolvency Proceedings,[109] (iii) a creditor in the Insolvency Proceedings acquired the opportunity to set off his claim by a legal act (*Rechtshandlung*) subject to challenge [110] or (iv) a creditor with a claim to be satisfied from the debtor's free property is a debtor of the insolvency estate (section 96 para 1 InsO).

(D) Set-off and insolvency challenge

In the event an insolvency creditor acquired the right to set off his claim by way of a transaction which is subject to a right of challenge (*anfechtbar*), set-off is prohibited pursuant to section 96 para 1 no. 3 InsO. This prohibition applies irrespective of whether or not the Insolvency Representative actually challenges the transaction. The BGH has decided that a legal act is not prevented from becoming subject to a challenge in insolvency and, consequently, the prohibition on set-off under section 96 para 1 no 3 InsO is not excluded if the relevant legal act caused the claim against which set-off is declared to come into existence.[111] In particular, the BGH rejected the argument that the fact that such a legal act does not only create the right to set-off but also the claim against which set-off is declared and which becomes part of the Insolvent Party's assets, should be taken into account in determining whether the legal act is detrimental to creditors (as required by section 129 para 1 InsO (paragraph 4.3.1(h)(ii) above)). Therefore, if a German court took the view that German law on insolvency-related set-off applies to the FOA Netting Agreement or a Clearing Agreement (see, however, paragraphs 3.3.2(d)(i) and 3.3.2(e)(i) above with respect to the conflict of laws analysis), it could reach the conclusion that the exercise of powers to bring claims into existence under the FOA Netting Agreement or a Clearing Agreement as a result of a counterparty's default constitute legal acts which are potentially subject to challenge in insolvency and therefore prevent

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[109] Accordingly, set-off would be generally permissible if a creditor in the Insolvency Proceedings acquired his claim from another creditor prior to the opening of Insolvency Proceedings. However, depending on the circumstances of the case, such acquisition of a claim prior to Insolvency Proceedings could itself be subject to challenge with the consequence that section 96 para 1 no. 3 InsO applied, i.e. the set-off were invalid (without the need to separately challenge it) as the claim were acquired by a legal act subject to challenge.

[110] This prohibition applies irrespective of whether or not the Insolvency Representative actually challenged the Transaction (*Höhn/Kaufmann*, JuS 2003, 751, 753).

[111] BGH WM 2013, 1132, 1133.

set-off in respect of claims created by such legal acts pursuant to section 96 para 1 no 3 InsO.

(E) Further restrictions under section 96 InsO

Set-off is statutorily prohibited if (i) a creditor in the Insolvency Proceedings has become a debtor of the insolvency estate only after the opening of Insolvency Proceedings, (ii) a creditor in the Insolvency Proceedings acquired his claim from another creditor only after the opening of Insolvency Proceedings,[112] (iii) a creditor in the Insolvency Proceedings acquired the opportunity to set off his claim by a legal act (*Rechtshandlung*) subject to challenge in insolvency [113] or (iv) a creditor with a claim to be satisfied from the debtor's free property is a debtor of the insolvency estate (section 96 para 1 InsO).

(F) Exemptions

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

(i) Regulatory Proceedings

Further, under the rules of the laws of Germany set out in paragraph 3.1.7(a) above, a moratorium or stay such as the Moratorium could be imposed which would prevent, delay or otherwise affect the exercise of such rights by the Non-Defaulting Party.

(i) Moratorium

BaFin may - prior to the filing of an application for the opening of Insolvency Proceedings - issue certain measures under section 46 KWG (above, paragraph 3.1.7(b)) including a Moratorium.

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[112] Accordingly, set-off would be generally permissible if a creditor in the Insolvency Proceedings acquired his claim from another creditor prior to the opening of Insolvency Proceedings. However, depending on the circumstances of the case, such acquisition of a claim prior to Insolvency Proceedings could itself be subject to challenge with the consequence that section 96 para 1 no. 3 InsO applied, i.e. the set-off were invalid (without the need to separately challenge it) as the claim were acquired by a legal act subject to challenge.

[113] This prohibition applies irrespective of whether or not the Insolvency Representative actually challenged the Transaction (*Höhn/Kaufmann*, JuS 2003, 751, 753).

It has been suggested that a Moratorium by BaFin has the effect of a deferral (*Stundung*), i.e. extension of the due date.[114] Accordingly, a set-off of obligations would not be permissible in such circumstances (as set-off may not be effected where the claim against which it is to be effected is not due).

However, in its decision of 12 March 2013, the BGH has held that a Moratorium would not result in a deferral.[115] Instead, the Moratorium creates a temporary obstacle to specific performance and entitles a Clearing Member to refuse specific performance for as long as the Moratorium is in place (based on an analogous application of section 275 para 1 BGB[116]).[117] As an administrative act (*Verwaltungsakt*) directed against an Institution it would have to be published *vis-à-vis* such Institution to become effective (section 43 para 1 sentence 1 of the German Act on Administrative Proceedings (*Verwaltungsverfahrensgesetz*)) but would not become effective *vis-à-vis* its creditors as a publication vis-à-vis the creditors is not provided for under applicable laws.[118] Moreover, the counterparty's set-off right which is a protected property right under the German Constitution (*Grundgesetz*) cannot be restricted without a clearly defined legal basis.[119]

Whilst the BGH has left this question open, it has made *obiter* remarks indicating that a Moratorium does not prevent set-off. The BGH points out that the purpose of section 46 para 1 sentence 2 no. 4 KWG, i.e. to secure the assets of the Institution concerned and to prevent its insolvency, would not prevent set-off. Even Provisional Insolvency Measures and the opening of Insolvency Proceedings would not generally prevent set-off (see above, paragraphs 3.1.6 and 3.1.7) and section 46 para 1 sentence 2 no. 4 KWG is not intended to impose restrictions

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

[115] BGH WM 2013, 742, 748.

[116] An English translation of section 275 para 1 BGB reads as follows: "The claim for specific performance is excluded, if performance is impossible for every person or for the debtor."

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

[118] BGH WM 2013, 742, 747.

[119] BGH WM 2013, 742, 744.

beyond the restrictions Insolvency Proceedings entail.[120] From a German law perspective these remarks are, in our view, convincing. The BGH does, however, not address the question whether a temporary obstacle for the performance of a claim would still prevent set-off against such claim given that German civil law allows for set-off only, if the claim against which set-off is to be effected can be performed (*Erfüllbarkeit der Hauptforderung*) (section 387 BGB[121]). Whether and under which circumstances set-off in accordance with non-German law against claims of a Clearing Member which is subject to the Moratorium can be effected is an open question.[122]

The protection afforded to Systems and Financial Collateral under the InsO applies to every Moratorium by way of analogy (section 46 para 2 sentence 6 KWG). Where measures under section 46 KWG are taken in respect of set-off or netting agreements sections 338 and 340 InsO (above, paragraphs 3.3.2(c) to 3.3.2(e)) apply analogously (section 46d para 3 sentence 2 KWG).

(ii) Terminations Restrictions

The Termination Restrictions may further affect netting outside an insolvency and notwithstanding the choice of English law to govern the Clearing Rules (paragraph 3.1.7(e)) but an exemption is, with respect to section 13 KredReorgG, 3.1.7(e) available if the Opinion Documents would indirectly benefit from the protection afforded to Systems and in respect of any Financial Collateral. As mentioned above, under section 7 para 5 sentence 2 KredReorgG in connection with section 46d para 3 KWG, section 340 InsO also applies to reorganisation proceedings.

(iii) Transfer Order

BaFin may further issue a Transfer Order where the existence of a Credit Institution is jeopardised and this in turn jeopardises the stability of the financial system. As mentioned, a Transfer Order (or a Re-Transfer Order) must transfer eligible netting agreements in their entirety (above, paragraph 3.1.7(c)).

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[120] BGH WM 2013, 742, 747.

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

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

Similarly, assets for which Financial Collateral has been provided must not be transferred without such Financial Collateral and where assets are included in a System they must be transferred together with any collateral which has been provided in respect of these assets.

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

(j) Provisional Insolvency Measures

As mentioned previously, Provisional Insolvency Measures do not prevent set-off (above, paragraph 3.1.6). A prohibition to make any dispositions (section 21 para 2 no 2 InsO), however, prevents the exercise of termination rights by a Party which is subject to Provisional Insolvency Measures. Section 103 InsO does not apply where Provisional Insolvency Measures have been taken (paragraph 3.1.6). This should, in our view, also extend to section 104 InsO which relates to and is a special provision in respect of, section 103 InsO and therefore the imposition of Provisional Insolvency Measures will not generally affect netting. Since Article 102b EGInsO applies to Provisional Insolvency Measures these restrictions under the InsO will particularly not affect netting where netting constitutes a necessary measure under Article 48 EMIR.

(k) Where German insolvency law applies the amendments to the FOA Netting Provision set out in Annex 5 are desirable

The likelihood of the application of German insolvency laws should be analysed. As described at paragraphs 3.3.2(c) to 3.3.2(e), this depends on the applicable insolvency conflict of laws regime.

As set out in more detail in paragraph 3.3.2(g) above, where German insolvency laws apply, section 104 InsO applies to all Transactions under the FOA Netting Agreement which fall within the scope of section 104 InsO and which are not terminated at the time the Insolvency Proceeding is opened and the Insolvency Representative is entitled to exercise its Selection Right in respect of all those Transactions which do not fall within the scope of section 104 InsO.

(i) Where section 103 InsO applies it should be ensured that an early termination (automatic or by giving notice) is actually exercised before the opening of Insolvency Proceedings. This would be the point in time when an application for the opening of Insolvency Proceedings can be seriously expected.

Alternatively, it could be considered to provide for an early termination event which is not insolvency-related. The Core Provision which provides that an Event of Default occurs if "a party fails to make any payment when due under or to make delivery of any property when due under this Agreement" (Annex 4 Part A paragraph 4(a)(i)) is in our view not an insolvency-related termination event and should therefore enable parties to terminate Transactions which fall within the scope of section 103 InsO.

(ii) Where section 104 InsO applies, it is unclear whether the valuation of Transactions within its scope is made in accordance with section 104 InsO or whether the valuation under the FOA Netting Provision would apply. Thus, if the Parties to the FOA Netting Agreement would like to terminate and value such Transactions in accordance with the provisions of the FOA Netting Agreement, it is desirable that such Transactions are terminated in accordance with English contract law before Insolvency Proceedings are opened (Paragraph 3.3.2(f)).

We note that the Core Provision set out in section 4(a)(iii) of Part 1 of Annex 4 stipulates that an Event of Default occurs if "an involuntary case or other procedure is commenced against a party seeking or proposing liquidation, reorganisation, or moratorium, or other similar relief with respect to it or its debts under any bankruptcy, insolvency, regulatory, or similar law or seeking the appointment of a Custodian of it or any substantial part of its assets." Such provision would in our view not allow for a termination before the opening of Insolvency Proceedings. Likewise, we note that the Core Provision set out in section 4(ii) of Part A of Annex 4 stipulates that an Event of Default occurs if "a party commences a voluntary case or other procedure seeking or proposing liquidation, reorganisation, moratorium, or other similar relief with respect to itself or to its debts under any bankruptcy, insolvency, regulatory, or similar law or seeking the appointment of a trustee, receiver, liquidator, conservator, administrator, custodian, examiner or other similar official (each a "**Custodian**") of it or any substantial part of its assets, or takes any corporate action to authorise any of the foregoing". According to our understanding, this provision would also not clearly stipulate that an Event of Default is necessarily triggered already with the filing for the opening of Insolvency Proceedings because the wording relates to actions by the relevant party only.

(l) Where section 104 InsO potentially applies, the following amendment to the FOA Netting Provision is desirable: If the FOA Netting Agreement specifies the filing for an Insolvency Proceeding as an

Event of Default, to avoid triggering an Event of Default if the other Party or a third party creditor files an unfounded application for the opening of Insolvency Proceedings with respect to the assets of one of the Parties, the FOA Netting Agreement should further stipulate that an Event of Default only occurs if either the relevant Party has filed the application itself or is generally unable to pay its debts as they become due or is in any other situation which justifies the commencement of such proceedings (see Annex 5).[123]

3.4 Enforceability of the Clearing Module Netting Provision

The opinions stated in paragraph 3.3 generally apply to close-out netting agreements and must therefore be taken in account when assessing legal risks in connection with the Clearing Module Netting Provision. One key consideration in this respect is whether German Regulatory Proceedings, Provisional Insolvency Measures and Insolvency Proceedings affect the enforceability of the Clearing Module Netting Provision, which will, in the first place, depend on the conflict of laws analysis.

Where German insolvency laws and regulatory laws do not apply, in relation to a Clearing Agreement which includes the Clearing Module Netting Provision, the Clearing Module Netting Provision is immediately (and without fulfilment of any further conditions) enforceable in accordance with its terms so that, following (i) a Firm Trigger Event or (ii) a CCP Default, the Parties would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of the relevant individual Client Transactions that are terminated in accordance with the Clearing Agreement.

With respect to the disapplication of a client's termination rights under the FOA Clearing Module, the close-out of Transactions entered into with a Clearing Member in the case of a Firm Trigger Event and the calculation of separate netting sets for each CCP service the following must be taken in account:

3.4.1 The choice of English law to govern the Clearing Agreement and the Clearing Module Netting Provision can be validly made under German law (please refer to paragraph 3.2 above).

3.4.2 In case of a non-insolvency related Firm Trigger Event, the close-out netting of the Client Transactions in accordance with Clause 5.2 of the FOA Clearing Module is recognised under German law but Regulatory Proceedings may affect close-out netting even if no Provisional Insolvency Measures are imposed and no Insolvency Proceedings are opened. Exemption are potentially available (paragraphs 3.1.7 to 3.1.10).

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[123] For example, Clause 7 sub-Clause (2) of the German Master Agreement for Financial Derivatives Transactions (*Rahmenvertrag für Finanztermingeschäfe*) specifies the insolvency of a party as an event of default and further provides that "an insolvency shall be given, if an application is filed for the commencement of bankruptcy or other insolvency proceedings against the assets of either party and such party either has filed the application itself or is generally unable to pay its debts as they become due or is in any other situation which justifies the commencement of such proceedings.

3.4.3 In case of a CCP Default, the close-out netting of the Client Transactions in accordance with Clause 5.3 of the FOA Clearing Module would be recognised under German law. If German law applies, the mandatory provisions set out under paragraphs 3.3.2(f) and 3.3.2(g) may affect the close-out netting. In particular, each Transaction may, depending on its legal qualification be subject to the Selection Right. Where this is not the case and section 104 InsO applies, contractual provisions on close-out netting should generally be permissible although it is not entirely clear whether and to what extent contractually agreed valuation methods will be upheld (paragraph 3.3.2(f)(vii)). Where a relevant CCP that has been authorised in accordance with EMIR takes measures under Article 48 EMIR which are necessary within the meaning of Article 102b EGInsO, such measures would be exempt from the effects of Provisional Insolvency Measures and Insolvency Proceedings (paragraph 3.1.10).

3.4.4 In case of an insolvency related Firm Trigger Event, our conflict of laws analysis set out in paragraphs 3.3.2(c) to 3.3.2(e) above would apply *mutatis mutandis*. The Clearing Agreement would in our view qualify as a netting agreement as set out in section 340 para 2 InsO to the extent it does not form part of contractual arrangements establishing a System. If section 340 para 2 InsO applies, the enforceability of the Clearing Module Netting Provision would therefore in our view be a matter of English insolvency law. However, if a court applied section 340 para 3 InsO to the Client Transactions, the enforceability of the Clearing Module Netting Provision would be a matter of the insolvency law applicable to the substantive law applicable to the System to which section 340 para 3 InsO refers.

3.4.5 In case German insolvency law governs the insolvency of the CCP, German insolvency law would not affect the enforceability of section 5.3 of the FOA Clearing Module Netting Provision which applies between two Parties. Mandatory German insolvency law would not affect the legal relationship between a Clearing Member and a client upon the opening of Insolvency Proceedings of a relevant CCP. However, if the FOA Clearing Module Netting Provision is superseded or modified by provisions of a relevant CCP's Rule Set, then German insolvency law may also affect the enforceability of the FOA Clearing Module Netting Provision.

3.4.6 In case German insolvency law governs the insolvency of a Party, our discussion of the enforceability of contractual close-out netting provisions in paragraphs 3.3.2(c) and 3.3.2(g) above applies *mutatis mutandis* with respect to insolvency related Firm Trigger Events. Therefore, Client Transactions falling within the scope of section 104 InsO would be terminated in accordance with Clause 5.2 of the FOA Clearing Module, provided that they are terminated, according to the terms of the FOA Clearing Module, prior to the opening of Insolvency Proceedings. Transactions which do not fall within the scope of section 104 InsO would be subject to the Insolvency Representative's Selection Right. Article 102b EGInsO would likely only indirectly affect Transactions between a Clearing Member and a relevant Party, if at all.

3.4.7 In our view, the Parties to the FOA Netting Agreement may agree to calculate a separate Cleared Set Termination Amount with respect to each relevant CCP under English contract law and German courts would apply English law in determining the validity and enforceability of such calculation (see paragraph 3.2.1).

Regulatory measures under German law may affect this analysis as set out in paragraphs 3.1.7 and 3.3.2(i). In this context, it should be noted that eligible netting agreements may only be transferred in their entirely under a Transfer Order or a Re-Transfer Order (paragraph 3.1.7(d)).

Further, German insolvency laws may affect the calculation of a separate Cleared Set Termination Amount with respect to each relevant CCP. In particular, section 104 para 2 sentence 3 InsO provides that "where the contracts involving financial transactions are combined in a master agreement for which it has been agreed that, where reasons for the opening of Insolvency Proceedings exist, it can only be terminated in its entirety, then such contracts together are deemed to form one single mutual agreement within the meaning of sections 103, 104." However, in our view, it does not follow from this provision that netting under a master agreement is only enforceable if the master agreement provides that only one single close-out netting amount will be calculated with respect to all transactions under such master agreement. Rather, as already set out in paragraph 3.3.2(f)(v) above, the purpose of such provision is to include financial transactions into the single master agreement which would otherwise not be covered by section 104 InsO because one of the parties has already fully discharged its obligation under such transaction.

3.4.8 As set out in paragraph 3.3.2(f)(vii) above, to the extent an insolvency related termination of Client Transactions is valid, in our view, the Parties may also agree on the calculation of the close-out netting amount. However, as further set out in paragraph 3.3.2(f)(vii) above, it is not entirely clear whether German courts would also uphold a valuation method which deviates substantially from the method stipulated by section 104 para 3 InsO to the detriment of the Defaulting Party, because section 104 InsO is also among the statutory provisions protected by section 119 InsO. Therefore, it constitutes mandatory law that generally cannot be contracted out. We understand that pursuant to the definition of the term "Firm/CCP Transaction Value", the relevant values are calculated on the basis of the relevant Rules Sets which we have not reviewed. Thus, the calculation of the relevant Firm/CCP Transaction Value under the Rule Set of the relevant CCP and its results may substantially deviate from section 104 para 3 InsO and may therefore not be enforceable.

3.4.9 The enforceability of the Hierarchy of Events (with respect to situations where more than one termination right exists) set out in Clause 5.4 of the FOA Clearing Module would, as a contractual matter, be a matter of English law: However, to the extent applicable, sections 103 *et seq.* InsO prevail over the contractual close-out netting provisions.

3.4.10 For a discussion on the regulatory restrictions under the laws of Germany which might prevent, delay or otherwise affect the exercise of rights under the

Clearing Module Netting Provision, please refer to paragraph 3.1.7 above. The potential effects of a Moratorium, the Termination Restriction or a Transfer Order are discussed in relation to the FOA Netting Provision at paragraph 3.3.2(i).

3.4.11 The following amendments to the Clearing Module Netting Provision may be considered:

As already set out in detail in paragraph 3.3.2(f) above, there is a significant legal risk that contractual netting provisions are subject to the Selection Right if outside the scope of section 104 InsO. Further, if Transactions are within the scope of section 104 InsO, such Transactions would not be subject to the Selection Right but it is unlear to what extent the legal consequences of an early termination would be modified by section 104 InsO. The Clearing Module Netting Provision provides for a termination upon a Firm Trigger Event. Pursuant to the definition of such term in Clause 11 of the FOA Clearing Module, a Firm Trigger Event occurs if the relevant CCP formally declares that an event constitutes a default in respect of the Firm or in case an event occurs that results in the automatic termination of all relevant Firm/CCP Transactions. In either case, the termination of the Client Transactions may occur prior to or after the opening of Insolvency Proceedings. Therefore, in case Client Transactions have not been terminated when Insolvency Proceedings are opened, they will be terminated and valuated in accordance with section 104 paras 2 and 3 InsO or be subject to the Selection Right (paragraph 3.3.2(f)). To minimise the risk of the application of section 104 InsO, the Clearing Module Netting Provision would have to ensure that the Client Transactions are terminated before the opening of Insolvency Proceedings could be seriously expected (with respect to those Transactions which are within the scope of section 103 InsO and therefore potentially subject to the Selection Right) or before the opening of Insolvency Proceedings (with respect to those Client Transactions which are within the scope of section 104 InsO and would therefore potentially be terminated in accordance with section 104 para 2 sentence 3 InsO). Therefore, the Firm Trigger Event should (1) (where Client Transactions are within the scope of section 103 InsO) either (x) refer to an event unrelated to an application for the opening of Insolvency Proceedings (see paragraph 3.3.2(k) above) or (y) result in the termination of Client Transactions before the opening of the Insolvency Proceeding could be seriously expected or (2) (with respect to Transaction within the scope of section 104 InsO) that the Client Transactions are automatically terminated upon the occurrence of a Firm Trigger Event prior to circumstances when Insolvency Proceeding are opened (please refer to paragraphs 3.3.2(k) and 3.3.2(l) above and Annex 5).

3.5 Enforceability of the Addendum Netting Provision

As set out in our discussion at paragraph 3.3 where German regulatory and insolvency laws do not apply, in relation to a Clearing Agreement which includes the Addendum Netting Provision, the Addendum Netting Provision will be immediately (and without fulfilment of any further conditions) enforceable in accordance with its terms so that,

following (i) a CM Trigger Event or (ii) a CCP Default, the Parties would be entitled to receive or obliged to pay only the net sum of the positive and negative mark-to-market values of the relevant individual Client Transactions that are terminated in accordance with the Clearing Agreement.

However, under German insolvency law, sections 103 and 104 InsO as well as section 96 *et seq.* InsO may affect any contractual close-out netting arrangements (paragraph 3.3). Further regulatory restrictions may affect the Parties' ability to exercise any termination or set-off rights (paragraphs 3.1.7 and 3.3.2(i)).

3.6 Use of FOA Clearing Module or ISDA/FOA Clearing Addendum not detrimental to FOA Netting Provision

In relation to a Clearing Agreement, the opinions expressed at paragraph 3.3 above in relation to the FOA Netting Provision are not affected by the use of the FOA Clearing Module or the ISDA/FOA Clearing Addendum in conjunction with the FOA Netting Agreement except that, where the FOA Netting Agreement may benefit indirectly from exemptions for Systems and the exemptions under Article 102b EGInsO as described at paragraphs 3.1.9 and 3.1.10. This is because at paragraph 3.3 we describe mandatory German insolvency law, which supersedes contractual netting agreements as set out further above. For the same reason, in relation to a Clearing Agreement, the opinions expressed at paragraph 3.3 above in relation to the FOA Netting Provision are not affected by the use of the FOA Clearing Module or the ISDA/FOA Clearing Addendum in conjunction with the FOA Netting Agreement. In a case where a Party, who would (but for the use of the FOA Clearing Agreement or the ISDA/FOA Clearing Agreement) be the Defaulting Party for the purposes of the FOA Netting Agreement, acts as Firm or Clearing Member, the question as to whether the FOA Netting Provision will, to the extent inconsistent with the Clearing Module Netting Provision or, as the case may be, the Addendum Netting Provision, be superseded by the Clearing Module Netting Provision or, as the case may be, the Addendum Netting Provision would be determined under the governing law of the Clearing Agreement as this is a contractual matter and our reasoning at paragraph 3.2 therefore applies.

3.7 Enforceability of the FOA Set-Off Provisions

To analyse the enforceability of contractual set-off provisions, a distinction has to be made between contract law, regulatory law and insolvency law. As mentioned, the choice of English law, including in respect of set-off arrangements, can be validly made under German law (paragraph 3.2.1). Therefore, as matter of contract law, any set-off agreements under English law are generally enforceable in Germany if they are valid and enforceable under English law.

The opening of Regulatory Proceedings or Insolvency Proceedings as well as the imposition of Provisional Insolvency Measures may restrict a Party's ability to exercise set-off rights (paragraphs 3.3.2(h)(ii) to 3.3.2(j)) However, depending on the circumstances, German conflict of laws provisions may refer to English law with respect to effects of regulatory and insolvency laws (above, paragraphs 3.1.7(e) 3.3.2(d) and 3.3.2(e)) and, there are exemptions available for Financial Collateral and Systems as well as under Article 102b EGInsO (paragraphs 3.1.8 to 3.1.10).

Outside an insolvency, a Moratorium, a Transfer Order or a Re-Transfer Order may affect a Party's ability to set off obligations but exemptions are available.

Under German law Provisional Insolvency Measures do not affect set-off rights and generally it should also be possible to exercise set-off rights under English despite the imposition of Provisional Insolvency Measures. However, where any of the restrictions set out under paragraph 3.1.6 would restrict any of the rights of a relevant Party in connection with a relevant set-off agreement under English law, a Party's ability to exercise set-off rights in accordance with the terms of the underlying agreements may be affected.

The opening of Insolvency Proceedings does not generally remove a relevant Party's ability to set off obligations but the restrictions set out under paragraph 3.3.2(h)(ii) apply.

Therefore:

3.7.1 Where German substantive insolvency law does not apply (see our reasoning at paragraphs 3.3.2(c) to 3.3.2(e)) in relation to an FOA Netting Agreement which includes the FOA Set-Off Provisions, the FOA Set-Off Provisions are, from a German conflict of laws perspective, immediately (and without fulfilment of any further conditions) enforceable in accordance with their terms (based on our assumption that this is the case under English law), so that following an Event of Default, the Non-Defaulting Party would immediately be entitled to exercise its rights under either or both of the FOA Set-Off Provisions, and in particular so that, upon the exercise of such rights:

(i) where the FOA Set-Off Provisions include the General Set-Off Clause:

(a) the value of any cash balance owed by the Non-Defaulting Party to the Defaulting Party would be set off against the Liquidation Amount (where such liquidation amount is owed by the Defaulting Party); or

(b) the value of any cash balance owed by the Defaulting Party to the Non-Defaulting Party would be set off against the Liquidation Amount (where such liquidation amount is owed by the Non-Defaulting Party); or

(ii) where the FOA Set-Off Provisions comprise the Margin Cash Set-Off Clause only, the value of any cash margin owed by the Firm to the Client would be set-off against the Liquidation Amount (where such Liquidation Amount is owed by the Client).

We are of this opinion because a contractual agreement on set-off such as the FOA Set-Off Provisions would generally be recognised by German courts (see paragraph 3.2.1) below. Whether the FOA Set-Off Provisions and the Clearing Module Set-Off Provision and/or the Addendum Set-Off Provision would be immediately enforceable in accordance with their terms upon the opening of Insolvency Proceedings over the assets of the Defaulting Party would be

dependent on whether or not the restrictions set out under paragraphs 3.3.2(h)(ii) apply.

No amendments to the FOA Set-Off Clause and the Margin Cash Set-Off Clause are necessary in order for the opinions expressed in this paragraph 3.7.1 to apply.

3.7.2 Where German substantive insolvency law does not apply, in relation to a Clearing Agreement which includes the FOA Set-Off Provisions and the Clearing Module Set-Off Provision and/or the Addendum Set-Off Provision, the FOA Set-Off Provisions are immediately (and without fulfilment of any further conditions) enforceable in accordance with their terms, so that following an Event of Default in respect of the Client, the Firm or, as the case may be, the Clearing Member would be immediately entitled to exercise its rights under either or both of the FOA Set-Off Provisions, and in particular so that, upon the exercise of such rights:

(i) where the FOA Set-Off Provisions includes the General Set-Off Clause:

(a) the value of any cash balance owed by the Firm or, as the case may be, the Clearing Member to the Client would be set off against the Liquidation Amount (where such liquidation amount is owed by the Client); or

(b) the value of any cash balance owed by the Client to the Firm or, as the case may be, the Clearing Member would be set off against the Liquidation Amount (where such liquidation amount is owed by the Firm or, as the case may be, the Clearing Member); or

(ii) where the FOA Set-Off Provisions comprise the Margin Cash Set-Off Clause only, the value of any cash margin owed by the Firm or, as the case may be, the Clearing Member to the Client would be set-off against the Liquidation Amount (where such Liquidation Amount is owed by the Client).

We are of this opinion because a contractual agreement on set-off such as the FOA Set-Off Provisions and the Clearing Module Set-Off Provision and/or the Addendum Set-Off Provision would generally be recognised by German courts (see paragraph 3.2.1) below. Whether the FOA Set-Off Provisions and the Clearing Module Set-Off Provision and/or the Addendum Set-Off Provision would immediately be enforceable in accordance with their terms upon the opening of Insolvency Proceedings over the assets of the Defaulting Party would be dependent on whether or not the restrictions set out under paragraphs 3.3.2(h)(ii) apply.

No amendments to the General set-Off Clause and the Margin Cash Set-Off Clause are necessary in order for the opinions expressed in this paragraph 3.7.2 to apply.

3.8 Set-Off under a Clearing Agreement with a Clearing Module Set-Off Provision

The opening of Regulatory Proceedings or Insolvency Proceedings as well as the imposition of Provisional Insolvency Measures may restrict a Party's ability to exercise set-off rights (paragraphs 3.3.2(h)(ii) to 3.3.2(j)). However, depending on the circumstances, German conflict of laws provisions may refer to English law with respect to effects of regulatory and insolvency laws (above, paragraphs 3.1.7(e) 3.3.2(d) and 3.3.2(e)) and, there are exemptions available for Financial Collateral and Systems as well as under Article 102b EGInsO (paragraphs 3.1.8 to 3.1.10).

Outside an insolvency, a Moratorium, a Transfer Order or a Re-Transfer Order may affect a Party's ability to set off obligations but exemptions are available.

Under German law Provisional Insolvency Measures do not affect set-off rights and generally it should also be possible to exercise set-off rights under English despite the imposition of Provisional Insolvency Measures. However, where any of the restrictions set out under paragraph 3.1.6 would restrict any of the rights of a relevant Party in connection with a relevant set-off agreement under English law, a Party's ability to exercise set-off rights in accordance with the terms of the underlying agreements may be affected.

The opening of Insolvency Proceedings does not generally remove a relevant Party's ability to set off obligations but the restrictions set out under paragraph 3.3.2(h)(ii) apply.

Therefore:

3.8.1 Where German substantive insolvency law does not apply, in relation to a Clearing Agreement which includes the Clearing Module Set-Off Provision (whether or not the FOA Set-Off Provisions is a Disapplied Set-Off Provisions, insofar as constituting part of the Clearing Agreement), the Clearing Module Set-Off Provision is immediately (and without fulfilment of any further conditions) enforceable in accordance with its terms so that the Firm would be immediately entitled to exercise its rights under the Clearing Module Set-Off Provision, and in particular, upon the exercise of such rights:

(a) if the Client is a Defaulting Party, so that the value of any cash balance owed by the Firm to the Client would be set-off against any Liquidation Amount owed by the Client to the Firm; and

(b) if there has been a Firm Trigger Event or a CCP Default, so that the value of any cash balance owed by one Party to the other would, insofar as not already brought into account as part of the Relevant Collateral Value, be set off against any Available Termination Amount owed by the Party entitled to receive the cash balance.

We are of this opinion because a contractual agreement on set-off such as the Clearing Module Set-Off Provision would generally be recognised by the German courts (see paragraph 3.2.1) below. Whether the Clearing Module

Set-Off Provision would be immediately enforceable in accordance with their terms upon the opening of Insolvency Proceedings over the assets of the Defaulting Party would be dependent on whether or not the restrictions set out under paragraph 3.3.2(h)(ii) apply. No amendments to the Clearing Module Set-Off Provision are necessary in order for the opinions expressed in this paragraph 3.8.1 to apply.

Furthermore, in addition to the highlighted words, it is not necessary that the words shown as underlined in Part 1 of Annex 4 be treated as Core Provisions in order for the opinions expressed in this paragraph 3.8.1 to apply.

3.8.2 Where German substantive insolvency law does not apply, in relation to a Clearing Agreement which includes the Clearing Module Set-Off Provision for which the FOA Set-Off Provision (insofar as constituting part of the FOA Netting Agreement) is not a Disapplied Set-Off Provision, the Clearing Module Set-Off Provision is immediately (and without fulfilment of any further conditions) enforceable in accordance with its terms, as set out in paragraph 3.8.1 above; and the FOA Set-Off Provision is, to the extent that set-off is not already covered by the Clearing Module Set-Off Provision, immediately (and without fulfilment of any further conditions) enforceable in accordance with its terms, as set out in paragraph 3.7.1 above.

3.9 Set-Off under a Clearing Agreement with an Addendum Set-Off Provision

The opening of Regulatory Proceedings or Insolvency Proceedings as well as the imposition of Provisional Insolvency Measures may restrict a Party's ability to exercise set-off rights (paragraphs 3.3.2(h)(ii) to 3.3.2(j)) However, depending on the circumstances, German conflict of laws provisions may refer to English law with respect to effects of regulatory and insolvency laws (above, paragraphs 3.1.7(e) 3.3.2(d) and 3.3.2(e)) and, there are exemptions available for Financial Collateral and Systems as well as under Article 102b EGInsO (paragraphs 3.1.8 to 3.1.10).

Outside an insolvency, a Moratorium, a Transfer Order or a Re-Transfer Order may affect a Party's ability to set off obligations but exemptions are available.

Under German law Provisional Insolvency Measures do not affect set-off rights and generally it should also be possible to exercise set-off rights under English despite the imposition of Provisional Insolvency Measures. However, where any of the restrictions set out under paragraph 3.1.6 would restrict any of the rights of a relevant Party in connection with a relevant set-off agreement under English law, a Party's ability to exercise set-off rights in accordance with the terms of the underlying agreements may be affected.

The opening of Insolvency Proceedings does not generally remove a relevant Party's ability to set off obligations but the restrictions set out under paragraph 3.3.2(h)(ii) apply.

Therefore:

In relation to a Clearing Agreement which includes the Addendum Set-Off Provision, the Addendum Set-Off Provision will be immediately (and without fulfilment of any further conditions) enforceable in accordance with its terms so that following (i) a CM Trigger Event (as defined in the ISDA/FOA Clearing Addendum) or (iii) a CCP Default (as defined in the ISDA/FOA Clearing Addendum):

(a) in the case of a CM Trigger Event, the Client (as defined in the ISDA/FOA Clearing Addendum); or

(b) in the case of a CCP Default, either Party (the "**Electing Party**"),

would be immediately entitled to exercise its rights under the Addendum Set-Off Provision, and in particular so that, upon the exercise of such rights, in the case of a CM Trigger Event, any Available Termination Amount would be reduced by its set-off against any cash balance which constitutes a termination amount payable by (or to) the Party which is owed (or owes) the Available Termination Amount, insofar as not already brought into account as part of the Relevant Collateral Value.

We are of this opinion because a contractual agreement on set-off such as the Addendum Set-Off Provision would generally be recognised by the German courts (see paragraph 3.2.1) below. Whether the Addendum Set-Off Provision would be immediately enforceable in accordance with their terms upon the opening of Insolvency Proceedings over the assets of the Defaulting Party would be dependent on whether or not the restrictions set out under paragraph 3.3.2(h)(ii) apply. No amendments to the Addendum Set-Off Provision are necessary in order for the opinions expressed in this paragraph 3.9 to apply.

Furthermore, in addition to the highlighted words, it is not necessary that the words shown as underlined in Part 1 of Annex 4 be treated as Core Provisions in order for the opinions expressed in this paragraph 3.9 to apply.

3.10 **Enforceability of the Title Transfer Provisions**

In the following we describe the treatment of the inclusion of claims that arise under outright title transfers of collateral in the calculation of the Liquidation Amount (which is our understanding of how the Title Transfer Provisions work). In this context, we assume that in accordance with and subject to our reasoning given at paragraph 3.3, the FOA Netting Agreement and the Clearing Agreement would be enforceable under German law.

(a) The contractual validity of the inclusion or relevant claims in the calculation of the Liquidation Amount would be a matter of English law. Therefore, with respect to contractual matters, in relation to an FOA Netting Agreement (with Title Transfer Provisions) and in relation to a Clearing Agreement which includes the Title Transfer Provisions where the Client is a Defaulting Party, following the specification or deemed occurrence of a Liquidation Date, the Non-Defaulting Party would be immediately (and without fulfilment of any further condition) entitled to exercise its rights under the Title Transfer

Provisions, so that the Default Margin Amount (as defined in Annex 4 and as calculated pursuant to the terms of the Title Transfer Provisions) have to be taken into account for the purposes of calculating the Liquidation Amount pursuant to the FOA Netting Provision.

(b) In relation to a Clearing Agreement which includes the Title Transfer Provisions, and in the case of a Firm Trigger Event, a CM Trigger Event, or a CCP Default, the value of the Transferred Margin (as defined in clause 10 of the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version)) would be taken into account as part of the Relevant Collateral Value.

(c) The courts of Germany would not re-characterise transfers of collateral assets under the Title Transfer Provisions of an FOA Netting Agreement (with Title Transfer Provisions) or, as the case may be, a Clearing Agreement which includes the Title Transfer Provisions as creating a security interest.

(d) A Party is entitled to use or invest for its own benefit, as outright owner and without restriction, any collateral assets transferred to it pursuant to the Title Transfer Provisions of an FOA Netting Agreement (with Title Transfer Provisions) or, as the case may be, a Clearing Agreement which includes the Title Transfer Provisions.

(e) No amendments to the Title Transfer Provisions are necessary in order for the opinions expressed in this paragraph 3.10 to apply.

(f) Furthermore, in addition to the highlighted words, it is not necessary that the words shown as underlined in Part A of Annex 4 be treated as Core Provisions in order for the opinions expressed in this paragraph 3.10 to apply.

With respect to the close-out netting as such, our reasoning given above (paragraph 3.3) applies. Further, the following considerations apply with respect to any collateral assets.

3.10.1 Relevant considerations in respect of security interests and outright title transfers

We understand that pursuant to the Title Transfer Provisions, the value of the Transferred Margin, which may include cash and securities collateral and which has been transferred by the Client to the Firm or, as the case may be, the Clearing Member is included in the calculation of the Liquidation Amount. The FOA Netting Agreement and the Clearing Agreement only stipulate that the Client is obliged to provide collateral, but the actual transfer of cash or securities collateral is not affected by the FOA Netting Agreement and the Clearing Agreement. We further understand that the collateral which is provided pursuant to the Title Transfer Provisions is provided in the form of an outright title transfer, not by the creation of a security interest such as a pledge or a lien. However, a FOA Netting Agreement which includes the Title Transfer Provisions may also include the Non-Cash Security Interest Provisions (used with or without the Rehypothecation Clause) and/or the

Client Money Additional Security Clause, which provide for the creation of a security interest under English law. We opine on the Non-Cash Security Interest Provisions (used with or without the Rehypothecation Clause) and/or the Client Money Additional Security Clause in paragraph 3.11 below. However, the following discussion of the law applicable to the provision of collateral does not only include collateral in the form of an outright title transfer, but also collateral in the form of a security interest because the rules governing a transfer under German law and the rules governing the creation of a security interest under German law are closely related.

3.10.2 Security under German law - general

Under German law, a distinction has to be drawn between the obligation to provide collateral and the act of proving of such collateral itself. The FOA Netting Agreement and the Clearing Agreement are contractual arrangements and the choice of English law is, as a matter of contract law, recognised under the laws of Germany pursuant to Article 3 para 1 Rome I. Thus, the obligation to provide collateral by way of an outright transfer of cash or securities pursuant to the Title Transfer Provisions would be recognised by the German courts on the basis of a valid choice of English law to govern the FOA Netting Agreement and the Clearing Agreement.

The law applicable to the actual transfer of the collateral (i.e. the *in rem* title transfer) needs to be determined on the basis of applicable German conflict of laws principles and would, *inter alia*, depend on the nature of the relevant asset and its location and the rights the security provider intends to give to the secured party in respect of the relevant type of collateral. From a German law perspective, the law governing the outright transfer also determines the rights of the secured party under such security interest or outright transfer. In respect of the security interest, depending on the type of security interest, different legal and factual requirements must be fulfilled to ensure the validity and enforceability of such security interest.

(a) Security over cash

By a "title transfer" of cash we understand an arrangement under which the security provider makes a payment to an account held in the name of the secured party. Cash credited to an account is represented by the repayment claim of the relevant account holder against the entity maintaining the account, such as a bank or a custodian. Hence, under German law, a security interest over cash credited to an account is established by creating a security interest in the relevant repayment claim. However, where the account is held in the name of the secured party, any transfers of cash made into such account will *prima facie* constitute assets of the secured party and no security interest needs to be created over such account because the account already belongs to the secured party. In other words, where the cash is transferred into an account opened in the name of the secured party it will be treated as an "outright title transfer" arrangement (*Vollrechtsübertragung*), rather than as a security interest (*Sicherheit or beschränkt dingliches Recht*).

Where the cash is booked in an account held in the name of the security provider, a security interest over such account needs to be created.[124]

(b) Security over contractual claims

Article 14 Rome I contains the relevant conflict of laws provisions for the creation of security interest over contractual claims, such as repayment claims under an account agreement.[125] Article 14 para 1 Rome I provides that the relationship between an assignor and an assignee shall be governed by the law that applies to the agreement between an assignor and assignee, i.e. the parties when transferring a contractual claim may choose the governing law in accordance with Article 3 para 1 Rome I. Recital 38 Rome I clarifies that this also covers the property aspects of the assignment in jurisdictions such as Germany where these property law aspects are legally separate from the law of obligations. The same applies in respect of a pledgor and a pledgee in case the repayment claim is pledged (Article 14 para 3 Rome I). The law governing the pledged claim is relevant in determining whether the claim can be pledged, the relationship between the pledgee and the pledgor, the conditions under which the pledge can be invoked against the pledgor and whether the pledgor's obligations have been discharged (Article 14 para 2 Rome I).

In principle, depending on the parties' agreement, different types of security interests over cash held in an account can be created under German law, such as a pledge (*Pfandrecht*),[126] an assignment for security purposes (*Sicherungsabtretung*). In addition, Collateral can be provided by way of an outright title transfer. As mentioned above,

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[124] Where an account is held in the name of the accountholder but for the account of another person, for example a fiduciary account (*Treuhandkonto*), a pledgee should verify whether the account holder may dispose of such account and validly create a pledge over such account or, as the case may be, the relevant beneficiary under such account has approved the creation of the pledge. If the pledgee is aware that the account is a trust account (*offenes Treuhandkonto*), the pledgee may not in good faith acquire a pledge in the assets booked into the account. If the pledgee is not aware that the account is a trust account (*verdecktes Treuhandkonto*), the pledgee may acquire a pledge in the account. However, when a pledgee later becomes aware the relevant account is a trust account, it must not enforce a pledge acquired in such account or exercise any set-off rights (BGH WM 1990, 1954, 1955; BGH WM 1996, 249, 251; *Hadding/Häuser*, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, 4th ed. (2011), § 37 nos. 43 *et seq.*).

[125] Article 14 Rome I reads as follows:

"1. The relationship between assignor and assignee under a voluntary assignment or contractual subrogation of a claim against another person (the debtor) shall be governed by the law that applies to the contract between the assignor and assignee under this Regulation.

2. The law governing the assigned or subrogated claim shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment or subrogation can be invoked against the debtor and whether the debtor's obligations have been discharged.

3. The concept of assignment in this Article includes full transfers of claims, transfers of claims by way of security and pledges or other security rights over claims."

[126] Pledges of rights are subject to sections 1273 *et seq.* BGB.

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

(c) Security over securities

Under German conflict of laws provisions, the validity of the transfer of title in securities is generally determined by the laws of the jurisdiction in which the securities are located (*lex cartae sitae*) in accordance with Article 43 of the German Introductory Act to the Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch*, "**EGBGB**"[127]) (*Wertpapiersachstatut*).[128] The following principles apply in respect of the in rem title to any physical certificate of a security. The rights represented by the securities (*Wertpapierrechtsstatut*) (e.g. the acquisition of voting, dividend or interest rights) are determined by the laws governing such right, for example in relation to shares the jurisdiction in which the issuer is located or established and in relation to bonds the jurisdiction the issuer has chosen to govern the bonds.

Subject to the rules on collectively held securities set out below, if the law governing the transfer of title in securities provides that the transfer of title in the securities requires the delivery of a certificate (such as bearer securities under German law, Inhaberpapiere), the transfer of title in such securities is governed by the laws of the jurisdiction in which the certificate is physically located.[129]

In respect of negotiable registered securities (*Orderpapiere*), on the other hand, the analysis under German conflict of laws is different.[130] The law governing the rights represented by the securities (*Wertpapierrechtsstatut)* determines whether the transfer of the title in the negotiable registered securities requires an endorsement, delivery of the certificate or both. If negotiable registered securities bears a blank endorsement (*Blankoindossament*) and the law which governs the securities provides that the transfer of title in the securities may be transferred by delivery of the certificate, the transfer of title in such

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

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

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

(3) If a right to an object which is brought to Germany has not been established yet, processes in another country s taken into account in the same manner as processes in Germany for purposes of the establishment."

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

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

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

negotiable registered securities is governed by the laws of the jurisdiction in which the certificates are physically located.

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

Where section 17a of the German Safe Custody Act (*Depotgesetz*, "**DepotG**")[131] applies the aforementioned conflict of laws provisions are modified (*lex cartae sitae*). Section 17a DepotG provides that in respect of "collectively held securities" which are transferable by booking into an account with constitutive legal effect for the benefit of the transferee, the law governing the legal acts (*Verfügungen*, e.g. the transfer of, or creation of a security interest over, securities)) of such securities is determined by reference to the location of the principal or branch office of the custodian bank (or, as the case may be, the central securities depository) making the account entry in favour of the transferee. "Collectively held securities" are (i) securities which are kept in collective safe custody (*Sammelverwahrung*) by a central securities depository, (ii) securities represented by a global certificate, or (iii) securities represented by a book entry for a central securities depository (for example, certain German government bonds).

With respect to "dematerialised securities" which are transferable by book entry in a register with constitutive legal effect for the benefit of the transferee, section 17a DepotG provides that the law governing the transfer of such securities is determined by reference to the jurisdiction of the country under whose supervision the register is maintained making the account entry in favour of the transferee. "Dematerialised securities" are securities which are represented by a book entry in a register (*Buchrechte*). However, up to date, certain questions relating to section 17a DepotG remain unresolved, and no court precedents exist in respect of the interpretation of such rule, in particular with respect to the meaning of "constitutive legal effect".[132]

(d) Outright title transfers

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

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

In our view, an outright title transfer for security purposes can be validly made under German law. Parties are entitled to agree expressly that the secured party shall become the unrestricted title holder in respect of assets which are transferred for security purposes. Such an outright title transfer arrangement does in our view not violate general principles of property laws. In particular, the requirement that property rights must be established in accordance with the enumerative list of eligible property rights or *in rem* rights under German law (*numerus clausus*) is not affected because outright title transfers can be made in accordance with the laws governing transfers of assets in general. Furthermore, the concept of outright title transfers in order to collateralise obligations has been established under German law in section 1 para 17 KWG which refers to outright title transfers[133] as one form of Financial Collateral.[134] Whilst there are no German court decisions confirming the validity of an outright title transfer to collateralise an obligation, we take the view that an outright title transfer should be valid under German law. In particular, in our view, an agreement on an outright title transfer to collateralise an obligation should not be regarded as a loan agreement, as in case of such an outright title transfer agreement the secured party is not obliged to return the collateral assets following a default of the security provider. Such agreement does therefore not provide for an obligation which is characteristic (*vertragstypische Leistungspflicht*) for a loan agreement, such as the repayment of the loan amount upon maturity.

(e) Right of re-use

Whether or not a right of re-use is recognised under German law depends on the law governing the relevant security interest as determined under German conflict of laws principles. Generally, where a security interest is created under German law, the secured party is not entitled to dispose of collateral assets prior to the occurrence of an enforcement event.[135] Assuming German law applies, and title has been transferred under a title transfer arrangement, the relevant title holder may dispose of such collateral subject to any agreement between the

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

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

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

parties to the contrary.[136] If a security interest in the form of a pledge under German law has been created, the secured party may generally not dispose of the pledged assets.[137] Under an assignment for security purpose, the secured party is bound by an underlying fiduciary relationship to dispose of the claim only in accordance with the security purpose agreement.[138] However, we understand that it is generally accepted that the parties may waive such a fiduciary duty.[139]

(f) Recharacterisation

The BGB uses the term "re-characterisation" (*Umdeutung*) only in the context of the re-characterisation of a void legal transaction (*Rechtsgeschäft*) into another type of legal transaction, if the requirements for such other type of legal transaction are met and the entry into such other legal transaction reflects the intentions of the parties (section 140 BGB). However, where a transaction is valid, German courts seek to give effect to the true economic intentions of the parties as a matter of interpretation (*Auslegung*). As a result, under German law, a German court may re-characterise a purported outright title transfer as a transfer for security purposes e.g. in the form of a security assignment, if it finds that the security assignment reflects the true economic intentions of the parties. If German law applies, German courts therefore generally recognise the validity of the agreement between the parties on an outright title transfer of collateral unless they find that an outright title transfer does not reflect the true economic intentions of the parties. Where a German court construes a purported outright title transfer as a security interest, a right of re-use or re-hypothecation may be restricted and different realisation rules may apply in Insolvency Proceedings.[140] If English law applies but German courts have jurisdiction, German courts will re-characterise an outright title transfer only if they find that English law (as to which we express no opinions) requires such re-characterisation.

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

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

[138] Although such contractual restriction does not remove its ability to dispose of such claim, this would constitute a breach of contract.

[139] *Ganter*, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, 4th ed. (2011), § 95 no. 127.

[140] Unless the assets which have been transferred for security purposes constitute Financial Collateral the Insolvency Representative would be entitled to enforce the collateral assets and transfer any proceeds realised after deduction of a lump sum fee for the determination of the existence of the security interest amounting to 4 per cent (*Feststellungskosten*) plus up to 5 per cent (in certain cases even more than 5 per cent) for any cost incurred in the context of the realisation of the security interest (*Verwertungskosten*) (plus applicable VAT on the proceeds of realisation) to the relevant secured party (section 166, 170 InsO).

(g) Renvoi

Under Article 20 Rome I, the application of the law of any country specified by Rome I generally means the application of the rules of law in force in that country other than its rules of conflict of laws (exclusion of *renvoi*). By way of contrast, where the EGBGB applies (see above, paragraph 4.2.2(b)(iii)), Article 4 para 1 sentence 1 EGBGB provides that any references of German law to the laws of another jurisdiction include the conflict of laws provisions of this other jurisdiction. If these conflict of laws provisions refer back to German law, German courts will accept such reference (*renvoi*) and apply German substantive law (Article 4 para 1 sentence 2 EGBGB). It is unclear whether Article 4 para 1 EGBGB also applies to section 17a DepotG.

To summarise, as matter of contract law, a choice of law concerning the obligation to create security would generally be recognised by the German courts. German courts also generally recognise the choice of English law to govern "outright title transfers" of cash. Upon the opening of Insolvency Proceedings mandatory restrictions may affect the enforceability of security (below, paragraph 4.4.1(b)).

(h) Summary

By way of summary, the choice of English law to govern the obligation to transfer collateral by way of outright title transfer or to create a security interest would be recognised under German law. The actual transfer of the collateral, or the creation of a security interest in such collateral, may be subject to German law under mandatory German conflict of laws rules. The outright title transfer of collateral or the creation of a security interest in such collateral under English law would be recognised under German law and German courts would re-characterise if such re-characterisation were required under English law. If German law applies under German conflict of laws rules, German courts would recognise the intention of the parties to effect an outright title transfer of, or the creation of a security interest in the collateral and such outright title transfer or creation of a security interest would be regarded as valid, provided that all requirements for the outright title transfer or the creation of a security interest are fulfilled under German law. If a Clearing Agreement provides that the value of the Transferred Margin will be taken into account as part of the Relevant Collateral Value, German law would recognise such contractual provision on the determination of the Relevant Collateral Value, subject to the potential limitations on contractual arrangements regarding the determination of a close-out netting set out in paragraph 3.3.12(f) above.

3.11 Use of security interest margin not detrimental to Title Transfer Provisions

In relation to an FOA Netting Agreement (with Title Transfer Provisions) and in relation to a Clearing Agreement which includes the Title Transfer Provisions, the opinions expressed above in paragraph 3.10 (*Enforceability of the Title Transfer Provisions*) in relation to the Title Transfer Provisions, are not affected by the use also in the same agreement of the Non-Cash Security Interest Provisions used with or without the Rehypothecation Clause) and/or the Client Money Additional Security Clause, provided always that:

(i) a provision in the form of, or with equivalent effect to, Clauses 4.3 and/or 4.4 of the FOA Clearing Module is used or the agreement otherwise unambiguously specifies the circumstances in which the security interest provisions or the Title Transfer Provisions apply in respect of any given item of margin so that it is not possible for both the security interest provisions and the Title Transfer Provisions to apply simultaneously to the same item of margin;

(ii) the pool of margin subject to a security interest and the pool of margin subject to the Title Transfer Provisions are operationally segregated.

This is because the enforceability of the Title Transfer Provisions would, from a German conflict of laws perspective, be a matter of English contract law, irrespective of the use also in the same agreement of the Non-Cash Security Interest Provisions used with or without the Rehypothecation Clause) and/or the Client Money Additional Security Clause. Mandatory restrictions in Regulatory Proceedings, Insolvency Proceedings and upon the imposition of Provisional Insolvency Measures would also apply irrespective of the use also in the same agreement of the Non-Cash Security Interest Provisions used with or without the Rehypothecation Clause) and/or the Client Money Additional Security Clause.

3.12 Single Agreement

It is not entirely clear whether it is necessary under the laws of Germany for the Transactions and the FOA Netting Agreement or, as the case may be, the Clearing Agreement to be part of a single agreement in order for the conflict of laws analysis provided above (paragraphs 3.3.2(c) to 3.3.2(e)) to apply as section 340 para 2 InsO and Article 25 WUD (please refer to our reasoning at paragraph 3.3.2(e)(ii)). We understand that the FOA Netting Agreement or, as the case may be, the Clearing Agreement and Transactions are part of a single agreement under English law and based on this assumption a German court would have to treat the FOA Netting Agreement or, as the case may be, the Clearing Agreement and Transactions as part of a single agreement as a result of its recognition of the choice of English law (paragraph 3.2.1).

3.13 Automatic Termination

From a German law perspective, while not strictly necessary, the Parties should consider whether to agree to an automatic, rather than an optional, termination and liquidation under the FOA Netting Provision, the Clearing Module Netting Provision

and/or the Addendum Netting Provision to ensure the effectiveness of netting under the FOA Netting Agreement or, as the case may be, the Clearing Agreement in the event of bankruptcy, liquidation, or other similar circumstances.

Where German law refers to English law as regards the enforceability of the provisions of the FOA Netting Agreement and the Clearing Agreement and the question therefore needs to be assessed in light of English law (as to which we express no opinions).

Where German insolvency law applies, it is desirable to agree on an automatic early termination. Where under German insolvency law Parties may agree on the termination of Transactions falling within the scope of section 104 InsO, such agreement will only be enforceable in accordance with its terms if the Transactions, according to their terms, are terminated before Insolvency Proceedings are opened (please refer to paragraph 3.3.2(f) above). Such early termination may be automatic or dependent on the exercise of termination rights but an automatic termination may be advantageous as there is a risk that a Party misses the appropriate time for termination when relying on the exercise of an optional termination right.

3.14 Multibranch Parties

We do not consider that the use of the FOA Netting Agreement or, as the case may be, the Clearing Agreement by a party with branches in a number of different jurisdictions, including some where netting may not be enforceable, would jeopardise the enforceability of the FOA Netting Provision, the Clearing Module Netting Provision, the Addendum Netting Provision, the FOA Set-Off Provision, the Clearing Module Set-Off Provision, the Addendum Set-Off Provision or the Title Transfer Provisions in so far as the laws of Germany are concerned.

Where Insolvency Proceedings that are opened over the assets of such a party are exclusively governed by German insolvency law, then our conclusions concerning the enforceability of netting would not change with respect to those Transactions which have been entered into by a party through its German main office and also through one or more branches located in other countries prior to its insolvency. Insolvency Proceedings under German law apply universally to all assets of the Insolvent Party, irrespective of the location of such assets (*Universalitätsprinzip*), subject to recognition under applicable foreign laws where such assets are from a German law perspective deemed to be located outside Germany.

However, the laws of all jurisdictions involved must analysed in detail to assess all potential. legal risks

3.15 Insolvency of Foreign Parties

Where a Party is incorporated or formed under the laws of a jurisdiction other than Germany and an Event of Default or a Firm Trigger Event or, as the case may be, a CM Trigger Event occurs in respect of such Party (a "**Foreign Defaulting Party**") the Foreign Defaulting Party can generally be subject to Insolvency Proceedings in Germany.

As set out in paragraph 3.1.5 above, whether or not German insolvency courts have jurisdiction for opening Insolvency Proceedings over the assets of a Foreign Defaulting Party depends on the rules governing the relevant proceedings. To summarise:

3.15.1 The EUIR is not applicable, *inter alia*, to Deposit Taking Credit Institutions, insurance undertakings and investment undertakings which provide services involving the holding of funds or securities for third parties and collective investment undertakings.

Within this scope of application, the courts of the Member States (other than Denmark) where the "centre of main interests" of a debtor is situated may open main insolvency proceedings (as specified in Annex A to the EUIR). In case of a legal entity, the place of the registered office is presumed to be the centre of its main interests in the absence of proof to the contrary (Article 3 para 1 EUIR). These proceedings are generally governed by the law of the Member State where such proceedings are opened

Where the centre of main interests of the insolvent Foreign Defaulting Party is in an Member State other than Germany or Denmark and the insolvent Foreign Defaulting Party has an establishment (within the meaning of the EUIR) in Germany, the German insolvency courts have jurisdiction in respect of such assets of the insolvent Foreign Defaulting Party which are located in Germany. An establishment for purposes of the EUIR is any place of operations where the debtor carries out a non-transitory economic activity with human means and goods (such term including branch offices).

Where the centre of main interests of the insolvent Foreign Defaulting Party is in a Member State other than Germany or Denmark and the insolvent Foreign Defaulting Party has no establishment (within the meaning of the EUIR) in Germany, the German insolvency courts have no jurisdiction in respect of such insolvent Foreign Defaulting Party.

3.15.2 Outside the scope of application of the EUIR, if the insolvent Foreign Defaulting Party has its place of general jurisdiction in Germany, Insolvency Proceedings may be opened in Germany with respect to the insolvent Foreign Defaulting Party irrespective of whether or not the relevant authorities in any other jurisdiction have initiated proceedings in respect of a branch of the insolvent Foreign Defaulting Party in such jurisdiction. In case of a legal entity, the place of general jurisdiction is the registered seat. If the centre of that legal entity's independent business activity is located elsewhere such place determines the competent insolvency court. If the centre of an independent business activity of the insolvent Foreign Defaulting Party is located outside Germany, German insolvency courts have no jurisdiction except for the opening of (separate) territorial or secondary Insolvency Proceedings (which are limited in their scope to the assets of the insolvent Foreign Defaulting Party located in Germany).

Territorial Insolvency Proceedings can be commenced in Germany under section 354 para 1 InsO if the debtor has an establishment in Germany (as

mentioned, the meaning of "establishment" is not the same under the EUIR on the one hand and the InsO on the other hand (paragraph 3.1.5 above).

3.15.3 As a result of the implementation of the WUD, the opening of secondary or territorial insolvency proceedings is excluded in respect of Deposit Taking Credit Institutions (section 46e para 2 KWG). Insolvency Proceedings may only be opened by the competent authorities of the home Member State (*Herkunftsmitgliedsstaat*) of such Deposit Taking Credit Institution.

3.16 Special legal provisions for market contracts

There are special provisions of law which affect the opinions given in this paragraph 3 which would apply to a Transaction between two Parties as a result of the fact that such Transaction was entered into on an exchange (in this or another jurisdiction), or is cleared at a central counterparty.

3.16.1 As set out in paragraph 3.3.2(d) above, under Article 9 para 1 EUIR, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market are be governed solely by the law of the Member State applicable to that system or market.

3.16.2 Similarly, section 340 para 3 InsO contains a special conflict of laws provisions for Systems paragraph 3.3.2(e)) and section 340 para 1 InsO contains a special conflict of laws provisions for organised markets.[141]

3.16.3 As mentioned, Article 102b EGInsO protects necessary measures taken by a CCP under EMIR from the effects of the opening of Insolvency Proceedings and the imposition of Provisional Insolvency Measures (paragraph 3.1.10).

4. QUALIFICATIONS

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

4.1 Challenge in insolvency

Where German insolvency laws apply, any legal acts performed in accordance with the provisions referred to in paragraphs 3.3 to 3.16 above may be subject to challenge in insolvency.

4.1.1 Conflict of laws rules governing challenge in insolvency

(a) Where the EUIR applies, Article 13 EUIR provides that German provisions on challenge in insolvency do not apply, if the beneficiary of the relevant act proves that the act as a whole is subject to the laws

[141] "Organised market" means a system operated in Germany or another country of the EEA authorised, regulated and supervised by public entities, which brings together or facilitates the bringing together of multiple third party buying and selling interests in financial instruments in the system and in accordance with its nondiscretionary rules in a way that results in a contract, in respect of the financial instruments (section 2 para 5 of the German Securities Trading Act (*Wertpapierhandelsgesetz*)).

of a Member State other than Germany and that such law does not allow any means of challenging the act at the case in point. [142]

(b) Where the InsO applies, section 339 InsO provides that German provisions on challenge in insolvency do not apply, if the beneficiary of the relevant act proves that the act as a whole is subject to the laws of a state other than Germany and that such law does not allow any means of challenging the act at the case in point.[143]

4.1.2 German insolvency challenge in general

(a) In accordance with section 129 para 1 InsO any legal act (*Rechtshandlung*) which is detrimental to the creditors of the Insolvent Party and was made during challenge periods prior to the opening of Insolvency Proceedings may be subject to challenge in insolvency by an Insolvency Representative under sections 130 to 146 InsO. Challenge periods will have to be ascertained separately in respect of each legal act. For example, if margin is delivered, substituted or returned in connection with the FOA Netting Agreement, the Clearing Agreement or the ISDA/FOA Clearing Addendum, the delivery, substitution or return qualify as new legal acts.

In case of a legal act that is subject to a condition precedent, which is for example the case if an agreement automatically terminates when certain circumstances occur, the satisfaction of such condition precedent is not regarded as a legal act (section 140 para 3 InsO). This means that in such case the (earlier) agreement on the condition precedent rather than the (later) occurrence of the event which triggers the condition precedent is the relevant legal act for purposes of challenge in insolvency. However, our understanding of relevant court precedents and statements in legal literature is that the formal opening of Insolvency Proceedings may not be agreed as a condition precedent for purposes of section 140 para 3 InsO.[144] The filing of an application for the opening of Insolvency Proceedings, on the other hand, should

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[142] Article 13 EUIR reads as follows: "Article 4 (2) lit (m) shall not apply where the person who benefited from an act detrimental to all the creditors provides proof that: the said act is subject to the law of a Member State other than that of the State of the opening of proceedings, and that law does not allow any means of challenge in insolvency that act in the relevant case."

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

[144] The condition precedent must not refer to an "insolvency event" (*Insolvenzfall*) which we understand is the case if it refers to the formal opening of Insolvency Proceedings; see *Huhn/Bayer*, ZIP 2013, p. 1965 *et seq.*; *Kirchhof*, in: Münchener Kommentar InsO, 3rd ed. (2013), § 140 no. 52c; German Federal Employment Court (*Bundesarbeitsgericht*, "**BAG**") NZI 2007, p. 58 *et seq.* (while the BAG does not define the insolvency event, we understand from its reasoning that it refers to the opening of Insolvency Proceedings), p. 61; however, see also *v. Wilmowsky*, ZIP 2007, 553, 562; *Rogge*, in: Hamburger Kommentar InsO, 3 ed (2009), § 140 no. 34. See further paragraph 3.3.2(f).

in our view be an event which can be agreed on as a condition precedent.

(b) If BaFin has, prior to a Party's insolvency, issued provisional insolvency measures under section 46 para 1 KWG such as a Moratorium to prevent the Party from becoming illiquid (see paragraph 3.1.7(b) above) and Insolvency Proceedings are subsequently opened, challenge periods will begin to run (counting backwards) on the day on which such an order has been issued (section 46c para 1 KWG) rather than on the later day of the filing for Insolvency Proceedings which is usually relevant (see paragraph 4.1.2 above). Furthermore, where legal acts have been made between the imposition of regulatory measures by BaFin in accordance with section 46 para 1 sentence 2 nos. 4 to 6 KWG and an application for the opening of Insolvency Proceedings, such legal acts are deemed not to be detrimental to the creditors of the Insolvent Party (section 46 para 2 sentence 1 KWG).

4.1.3 Challenge provisions relevant to the the FOA Netting Agreement, the Clearing Agreement or the ISDA/FOA Clearing Addendum

Legal acts made in connection with the the FOA Netting Agreement, the Clearing Agreement or the ISDA/FOA Clearing Addendum may, in particular, be subject to challenge in insolvency under the following circumstances:

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

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

(b) Where a legal act gives or makes possible to a creditor, security or satisfaction to which it has no right or no right to claim in such manner or at such time, the legal act is subject to challenge action, (i) if the legal act is effected during the last month prior to filing for the opening of Insolvency Proceedings or following such filing; or, (ii) if the legal act is effected during the second or third month prior to filing for the opening of Insolvency Proceedings and the Insolvent Party was unable

to make payments at the time of the legal act; or, (iii) if the legal act is effected during the second or third month prior to filing for the opening of Insolvency Proceedings and the creditor has knowledge at the time of the legal act that it is detrimental to the insolvent party. In relation to (iii), knowledge of circumstances that necessarily lead to the conclusion that a legal act is detrimental to the insolvent party is equivalent to actual knowledge of such detriment (section 131 para 2 InsO ("incongruent coverage" (*inkongruente Deckung*)).

(c) A legal act by the Insolvent Party that is directly detrimental to the creditors is subject to challenge in insolvency, (i) if it was effected in the last three months prior to the filing for the opening of Insolvency Proceedings, if the Insolvent Party was unable to pay its debts when due at the time of the legal act and if the other party had knowledge of such inability to make payments at such time; or, (ii) where it was effected after filing for the opening of Insolvency Proceedings and the other party had knowledge of the inability of the insolvent party to make payments or of the petition for opening of Insolvency Proceedings at the time of the legal act (section 132 para 1 InsO). A legal act which involves the Insolvent Party losing a right, or pursuant to which the Insolvent Party is no longer able to assert such a right, or which results in a property claim against the Insolvent Party being maintained or becoming enforceable is equivalent to a legal act that is directly detrimental to the creditors (section 132 para 2 InsO) (and the same challenge period as for section 132 para 1 InsO applies).

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

(e) Under section 133 para 2 InsO, a contract for a consideration entered into by the insolvent party and a person with whom the insolvent party has a close relationship which is directly detrimental to the creditors will be subject to challenge in insolvency unless it was entered into more than two years prior to the filing for the opening of Insolvency Proceedings or the other party was unaware of an intention of the insolvent party to prejudice the creditors.[145] In respect of person with

[145] If Insolvency Proceedings are opened with respect to a legal person, the term "person with whom the insolvency debtor has a close relationship" means pursuant to section 138 para 2 InsO:

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

whom the insolvency debtor has a close relationship, the requisite knowledge or awareness of the relevant circumstance under the different challenge provisions will be presumed (sections 130 para 3, 131 para 2 sentence 2 and 132 para 2 InsO).

(f) Under section 147 sentence 1 InsO legal acts performed after the opening of the Insolvency Proceedings but being legally effective in accordance with section 81 para 3 sentence 2 InsO may be subject to insolvency challenge. The provisions governing the challenge in respect of legal acts performed before the Insolvency Proceedings were opened apply under section 147 sentence 1 InsO as if the relevant legal acts had been made before Insolvency Proceedings were opened. The application of section 147 sentence 1 InsO shall, however, in respect of legal acts relating to claims and performances which fall within the scope of section 96 para 2 InsO (please see paragraph 3.3.2(h)(ii)(F) above) not reverse the set-off of account balances or affect the validity of the payment orders, orders of payment services providers or intermediate providers or orders for the transfer of securities (section 147 sentence 2 InsO).

4.1.4 Defence to insolvency challenge

Section 130 para 1 sentence 1 InsO is not applicable where the relevant legal act is based on a security agreement which contains the obligation to provide Financial Collateral, to replace Financial Collateral by other Financial Collateral or to provide additional Financial Collateral in order to readjust the relation between the value of the obligation and the value of the collateral as set forth in the security agreement (*Margensicherheit*; margin collateral (section 130 para 1 sentence 2 InsO). Any security interest or outright title transfer qualifying as Financial Collateral would therefore not be subject to challenge in insolvency pursuant to section 130 para 1 sentence 1 InsO to the extent any legal assets serve the provision or replacement of (additional) Financial Collateral in order to readjust the relation between the value of the obligation and the value of the collateral as set forth in the security agreement.

Section 142 InsO provides that payments on the part of a Insolvent Party in return for which the Insolvent Party's estate benefited directly from an equivalent (*gleichwertig*) consideration (i.e. there was an exchange of services or goods of the same value within a narrow time frame)[146] would only be subject to challenge action, if the payment was made with the intention to

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

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

[146] BGH NJW 2002, 1722, 1724.

prejudice the creditors as set out under section 133 para 1 InsO (see paragraph 4.1.3(d) above).

As mentioned before (paragraph 3.1.10), under Article 102b section 2 EGInsO all necessary measures which are permissible in accordance with Article 102b section 1 para 1 EGInsO will not be subject to challenge in insolvency.

4.2 **Non-material Amendments**

Where the InsO applies (please see paragraph 3.3.2(c) above), timing is of the essence as regards the enforceability of the Netting Provisions and the Set-Off Provisions since at the point in time where section 104 of InsO applies, it will supersede contractual arrangements (please see paragraph 3.3.2(e)(ii) above).

A non-material Amendment which has the effect of delaying the occurrence of an insolvency-related Event of Default will hence increase the likelihood of the application of section 104 InsO and thus, the Netting Provisions and the Set-Off Provisions would be likely not to be enforceable in accordance with their terms.

4.3 **Transactions entered into after restructuring**

The opinions stated in this Opinion only apply to such Transactions under the FOA Netting Agreement, the FOA Clearing Module and the Clearing Agreement which are entered into prior to the formal commencement of any insolvency, bankruptcy, reorganisation or similar proceedings or any provisional insolvency or regulatory measures by competent authorities of any relevant jurisdiction.

4.4 **Applicable law**

Even where a German court would normally have to recognise the choice of English law to govern the Opinion Documents,

4.4.1 it may give effect to mandatory provisions (i.e. provisions regarded as crucial for a country's safeguarding of its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the Opinion Documents (Article 9 para 1 Rome I) of the law of the country where the obligations arising out of the Opinion Documents have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the contract unlawful (Article 9 para 3 Rome I);

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

4.4.3 it may refuse to apply a rule under a law chosen in the Opinion Documents if such application is manifestly incompatible with the public policy of Germany (Article 21 Rome I or Article 6 EGBGB, as the case may be) and

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

4.5 Principles of German Contract Law

The German law principle of *Treu und Glauben* (section 242 BGB) requires that contracts are performed in good faith (*bona fides*). Actions *contra bonos mores* may provide certain rights in favour of a contracting party or may render contracts or commitments void or voidable. In addition, public policy may lead to "equitable" rights being upheld in German courts or may make contracts or commitments void or voidable or may lead to the re-characterisation of such contracts or commitments and German courts may declare provisions providing for strict liability invalid.

4.6 Exchange Controls

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

4.7 Financial Sanctions

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

4.8 Data Protection and bank secrecy

The collection, processing, use and transfer of personal data by any party to the Opinion Documents must comply with the requirements of the applicable data protection laws. The Federal Data Protection Act (*Bundesdatenschutzgesetz*, "**BDSG**") only provides for the protection of data relating to natural persons (which includes sole traders and professionals and any natural person who is a partner in a partnership). Any contractual provision relating to the collection, processing or use of such data which does not comply with the BDSG may be held to be invalid and unenforceable and the persons responsible for such provision and/or its implementation/execution may be fined as an administrative or even criminal offence by the competent regulatory authority; to the extent the information being transferred, collected or processed relates to corporations (not natural persons), the BDSG does not apply. Credit Institutions are further bound, as a matter of German contract law, to maintain banking secrecy with respect to client-related information even in the absence of an express agreement to maintain banking secrecy and irrespective of whether the client is a legal entity or a natural person.

4.9 **Cross-border payments**

In respect of cross-border cash payments the notification requirements under the German Foreign Trade Act (*Außenwirtschaftsgesetz*) and the German Foreign Trade Regulation (*Außenwirtschaftsverordnung*) need to be observed. The reports have to be submitted to the *Deutsche Bundesbank* using the applicable notification forms. A failure to do so would, however, not affect the validity of the respective transaction.

4.10 **Mandatory Clearing of OTC Derivatives**

We express no opinion as to whether any Party has complied with EMIR; any delegated or implementing acts adopted under EMIR, the provisions of the KWG, the WpHG or the BörsG, which were amended or enacted to implement EMIR, or any regulations adopted thereunder in respect of anything done by it in relation to or in connection with any of the Opinion Documents. If EMIR is applicable, Article 12 para 3 EMIR provides that any infringement of the rules under Title II of EMIR "shall not affect the validity of an OTC derivative contract or the possibility for the parties to enforce the provisions of an OTC derivative contract"; consequently any failure by a Party to so comply should not make the Opinion Documents invalid or unenforceable.

This opinion is given for the sole benefit of the Futures and Options Association and such of its members (excluding associate members) as subscribe to the Futures and Options Association's opinions library and whose terms of subscription give them access to this opinion (each a "subscribing member").

This opinion may not, without our prior written consent, be relied upon for any other purpose or be disclosed to or relied upon by any other person save that it may be disclosed without such consent to:

(a) any affiliate of a subscribing member (being a member of the subscribing member's group, as defined by the UK Financial Services and Markets Act 2000) and the officers, employees, auditors and professional advisers of such affiliate;

(b) any person to whom disclosure is required to be made by applicable law or court order or pursuant to the rules or regulations of any supervisory or regulatory body or in connection with any judicial proceedings;

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on the basis that (i) such disclosure is made solely to enable any such person to be informed that an opinion has been given and to be made aware of its terms but not for the purposes of reliance, and (ii) we do not assume any duty or liability to any person to whom such

disclosure is made and in preparing this opinion we have only had regard to the interests of our client.

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

Yours faithfully,



Dr Marc Benzler

CLIFFORD CHANCE PARTNERSCHAFTSGESELLSCHAFT

SCHEDULE 1
INSURANCE COMPANIES

Subject to the modifications and additions set out in this Schedule 1 (Insurance Companies) the opinions, assumptions and qualifications set out in this Opinion also apply in respect of Parties which are Insurance Companies. For the purposes of this Schedule 1 (Insurance Companies), "**Insurance Companies**" means insurance undertakings (*Versicherungsunternehmen*) within the meaning of section 1 para 1 no. 1 VAG established as an AG or a mutual insurance association (*Versicherungsverein auf Gegenseitigkeit*) in accordance with section 15 VAG which are subject to supervision by BaFin.[147]

Except where the context otherwise requires, references to "sections" are to sections of this Schedule.

1. MODIFICATIONS TO OPINIONS

On the basis of the terms of reference and assumptions and subject to the qualifications (in each case set out in this Opinion as modified, or added to, by this Schedule), we are of the following opinion:

1.1 Insolvency Proceedings

1.1.1 As a result of the implementation of Directive 2001/17/EC of the European Parliament and the Council of 19 March 2001 on the Reorganisation and Winding-up of Insurance Undertakings, the opening of secondary or territorial insolvency proceedings is excluded in respect of insurance undertakings which have their seat in another Member State and are subject to the EU Insurance Directives ("**EU Insurance Companies**") (section 88 para 1b VAG in connection with section 110d para 1 VAG).[148] Insolvency Proceedings may only be opened by the competent authorities of the home Member State (section 88 para 1a VAG). Germany is the home Member State of an EU Insurance Company if the seat of the EU Insurance Company is in Germany (section 88 para 1a sentence 1 VAG in connection with section 110a para1 sentence 1 VAG).

1.1.2 If an audit of the management and financial position of an Insurance Company leads to the conclusion that the Insurance Company will not permanently be able to meet its liabilities, but it seems to be in the best interest of the insured

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[147] See Schedule 4 (Public Sector Entities) as regards Insurance Companies organised under public law.

[148] For purposes hereof, the "**EU Insurance Directives**" are the Directives on the insurance business referred to in section 110d para 1 VAG, including Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance (OJ No L 345 of 19 December 2022, p. 1) ("**Life Insurance Directive**") and the First Council Directive of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance (73/239/EEC) (OJ No L 228 of 16 August 1973, p. 4) ("**Direct Insurance Directive**"). Article 3 of the Life Insurance Directive and Article 3 of the Direct Insurance Directive enumerates activities which are excluded from the scope of these Directives, i.e. the opening of secondary or territorial insolvency proceedings would not be excluded in respect of insurance companies engaging in these activities (see also BT-Drucksache 12/6959, p. 43; *Kollhosser*, in: Prölss; Versicherungsaufsichtsgesetz, 12th ed. (2005), § 110d no. 2).

to avoid Insolvency Proceedings, BaFin may release orders under section 89 para 1 VAG, in particular,

(a) require the representatives of the Insurance Company to change the basis for the operating principles within a certain period, or to otherwise remedy the deficiencies and

(b) temporarily prohibit all kinds of payments, in particular the payment of insurance benefits, profit distributions and, for life insurance, surrenders or policy loans or advances.

Such measures are called "**VAG Regulatory Measures**".

1.2 Enforceability of FOA Netting Provision, the Clearing Module Netting Provision, the Addendum Netting Provision and the FOA Set-Off Provisions

1.2.1 The EUIR is not applicable to EU Insurance Companies. Whilst the EUIR contains no definition of "insurance undertaking", it is commonly accepted that the term refers to insurance undertakings which have received official authorisation in accordance with Article 6 Life Insurance Directive or Article 6 Direct Insurance Directive as the insolvency of such institutions is dealt with under the Directive 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings.[149]

1.2.2 Section 340 paras 2 and 3 InsO therefore applies in respect of such EU Insurance Companies and the conclusions reached under paragraph 3.3.2(e) apply analogously.

1.2.3 Section 340 paras 2 and 3 InsO also applies in respect of EU Insurance Companies which are subject to any VAG Regulatory Measures which are intended to preserve or restore its financial status and affect third party rights (section 89b para 3 sentence 3 VAG), i.e. VAG Regulatory Measures under the VAG would appear not to affect the FOA Netting Provision, the Clearing Module Netting Provision and the Addendum Netting Provision. We note, however, that there is no administrative practice and we are not aware of any court decisions on this issue.

1.2.4 Insurance Companies which are not EU Insurance Companies would be subject to the provisions of the EUIR and our conclusions reached above at paragraph 3.3.2(d) would apply analogously.

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[149] OJ No L 110 of 20 April 2001 p. 28. See *Virgós/Schmit*, Report on the Convention on Insolvency Proceedings, no. 57; *Braun/Heinrich*, Finanzdienstleister in der "grenzüberschreitenden" Insolvenz - Lücken im System? - Ein Beitrag zu der Verordnung (EG) Nr. 1346/2000 des Rates vom 29. 5. 2000 über Insolvenzverfahren, NZI 2005, 578, 581. See further paragraph 3.1.5(a).

2. ADDITIONAL QUALIFICATIONS

Insurance Companies are subject to a number of regulatory provisions which impose restrictions on the entry into the FOA Netting Agreement or the Clearing Agreement and Transactions thereunder.

2.1 Restricted Assets

The VAG contains investment restrictions regarding the guarantee assets (*Sicherungsvermögen*, "**guarantee assets**") and other restricted assets (*sonstiges gebundenes Vermögen*) (together, the "**restricted assets**" *(gebundenes Vermögen)*) of Insurance Companies. The investment and disposition of restricted assets by an Insurance Company is subject to various restrictions on which we do not opine.

2.2 Transfers of guarantee assets

Any transfer of guarantee assets is subject to the consent of the statutory trustee (*Treuhänder*) of the Insurance Company pursuant to section 72 para 1 VAG.

2.3 Permissible Transactions

2.4 An Insurance Company may only deal in futures, options and other financial instruments if these instruments hedge against price and interest rate risks in connection with existing assets or future purchases of securities or if any additional return is to be generated on existing securities, without performance of delivery obligations causing a shortfall of the restricted assets (section 7 para 2 sentence 2 VAG).[150]

2.5 Generally, the German courts take the view that violations of regulatory law do not render contractual agreements void.[151] Where provisions under regulatory law serve to protect the interests of a certain counterparty, such counterparty may, however, be entitled to claim damages in tort in order to be put in the position it would be in, if no violation of regulatory law had occurred.[152]

2.6 Restrictions regarding set-off

2.6.1 Claims which form part of the guarantee assets are subject to a statutory prohibition of set-off. Pursuant to section 77 para 2 sentence 2 VAG, set-off against a claim contained in the guarantee assets is only permitted to the extent that the Insurance Company has been required by law to make allocations to the guarantee assets by law (section 66 paras 1 to 4 VAG). This primarily covers claims of insured persons resulting from their insurance contracts with the relevant Insurance Company because the purpose of section 77 para 2

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[150] Guidance on these restrictions can be found in the circular R/2000 of 19 October 2000 of the former Federal Insurance Supervisory Authority (*Bundesaufsichtsamt für das Versicherungswesen*), one of BaFin's predecessors.

[151] BGH NJW 2011, 3024, 3025; BGH NJW 1980, 1394; BGH WM 1978, 785:

[152] BGH NJW 2005, 2703 *et seq.*; BGH NJW-RR 2006, 1713 *et seq.*

VAG is to protect the claims of the insured persons which, in an insolvency would rank higher than any other claims (section 77a VAG).

2.6.2 Section 77 para 2 VAG may be considered as an overriding mandatory provision within the meaning of Article 9 para 1 Rome I.[153] As Article 9 para 2 Rome I provides that nothing in Rome I restricts the application of the overriding mandatory provisions of German law, a German court would generally have to apply section 77 para 2 VAG to contracts governed by English law.

[153] See generally paragraph 4.4 above. We are not aware of any court decisions on this question.

SCHEDULE 2
CAPITAL MANAGEMENT COMPANIES

Subject to the modifications and additions set out in this Schedule 2 (Capital Management Companies), the opinions, assumptions and qualifications set out in this Opinion also apply in respect of parties which are Investment Companies. For the purposes of this Schedule 2 (*Capital Management Companies*), "**Capital Management Companies**" means German Capital Management Companies (*Kapitalverwaltungsgesellschaften*) as defined under section 17 para 1 of the German Capital Investment Code (*Kapitalanlagegesetzbuch*, "**KAGB**") which manage investment assets (*Investmentvermögen*, "**Investment Assets**") or alternative investment funds (*alternative Investmentvermögen*, "**AIF**") (Investment Assets and AIF collectively "**Funds**") on behalf of investors and are subject to supervision by BaFin.[154] We do not express any opinions on Capital Management Companies managing Funds which are not governed by or subject to, German law.

Except where the context otherwise requires, references to "sections" are to sections of this Schedule.

1. MODIFICATIONS TO OPINIONS

1.1 Insolvency Proceedings

1.1.1 Only BaFin may file for the opening of Insolvency Proceedings over the assets of a Capital Management Company (section 43 KAGB in conjunction with section 46b para 1 sentence 4 KWG).

1.1.2 BaFin may take appropriate measures if a Capital Management Company fails to meet own funds requirements under the KAGB (section 41 KAGB)) or if there is a threat to the Capital Management Company for other reasons, amongst other things, there is a danger in respect of the fulfilment of the Capital Management Company's obligations *vis-à-vis* its creditors (section 43 KAGB). In the absence of case-law or administrative practice it has been suggested in German legal literature that the powers conferred on BaFin by virtue of section 43 KAGB include the right to issue a Moratorium.[155] It is, however, doubtful whether BaFin may take far-reaching measures as provided under the KWG where the German legislator did not explicitly confer such powers on BaFin.

1.1.3 It is not entirely clear whether a Capital Management Company qualifies as a collective investment undertaking within the meaning of Article 1 para 2 EUIR (and, as a consequence, falls outside the scope EUIR).

(a) The term "collective investment undertaking" means, in accordance with Article 1 no. 2 of the Directive 2009/65/EC of the European

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[154] Investment Stock Corporations (*Investmentaktiengesellschaften*) within the meaning of section 108 KAGB and open-ended or closed ended Limited Investment Partnerships (*offene or geschlossene Investmentkommanditgesellschaften*) within the meaning of sections 124 and 149 KAGB, respectively, are therefore excluded.

[155] *Beckmann*, in: Beckmann/Scholtz/Vollmer, Investment, § 19j no. 34 (2nd supplemental 2011).

Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) ("**UCITS Directive**") undertakings (i) the sole object of which is the collective investment in transferable securities of capital raised from the public and which operate on the principle of risk-spreading, and (ii) the units of which are, at the request of the holders, re-purchased or redeemed, directly or indirectly, out of those undertakings' assets ("**UCITS**"). This interpretation is based on the assumption made by *Virgós/Schmit* (Report on the Convention on Insolvency Proceedings, no. 56 *et seq.*) according to which the rationale behind the exceptions provided in Article 1 para 2 EUIR is to exclude such entities, which are subject to specific EU Regulations and supervision by regulators in their respective Member States. Investment Companies which qualify as UCITS are regulated and supervised in accordance with the UCITS Directive and, hence, they are to be excluded from the scope of application EUIR. From our point of view, this general analysis should prevail over the wording EUIR which might lead to the conclusion that the term "collective investment undertaking" within the meaning EUIR corresponds to the equivalent term in the UCITS Directive according to which it is used for such undertakings which do not qualify as UCITS as defined in the UCITS Directive. It must be noted, however, that in the absence of any court decisions dealing with this issue a certain degree of uncertainty remains. Further, the KAGB (in particular the general provisions dealing with Capital Management Companies) not only implements the UCITS Directive but also Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 ("**AIFMD**"). It is unclear how funds and their managers (such as Capital Management Companies) which fall within the scope of the AIFMD should to be qualified for purposes of the EUIR.[156]

(b) Furthermore, by referring to collective investment undertakings Article 1 para 2 EUIR seems to cover collective investment schemes only (i.e. the pool of collective investments). However, where such collective investment undertakings have no separate legal personality as it would be the case under German law with respect to Funds, we would construe Article 1 para 2 EUIR so as to apply to the management company provided that such management company is focusing on the administration and managements of such collective investment undertaking's assets.

[156] Article 1 point 2 lit (d) of the Commission's draft for a revised EUIR (footnote 43 above) refers to "collective investment undertakings" without drawing a distinction between AIF and UCITS (and their managers).

(c) As a consequence, the international scope of application of Insolvency Proceedings of a Capital Management Company should regularly be governed by the InsO where the Funds managed by such Capital Management Company qualify as UCITS. Section 340 paras 2 and 3 InsO hence applies where an Insolvent Party qualifies as a Capital Management Company and that the conclusions reached under paragraphs 3.33.5 apply in respect of such Capital Management Companies, i.e. the FOA Netting Provisions and the Clearing Module Netting Provision should be enforceable in accordance with their terms (based on the assumption that they are enforceable in accordance with their terms under English law) *vis-à-vis* such a Capital Management Company because the EUIR is inapplicable and the InsO refers in our view to English law as the law governing the Opinion Documents.

2. ADDITIONAL QUALIFICATIONS

2.1 Insolvency Proceedings

The right of the Capital Management Company to manage a Fund which is a German special pool of assets (*Sondervermögen*) as defined under section 1 para 10 KAGB[157] ("**Fund**") will cease to exist, if Insolvency Proceedings are opened over the assets of the Capital Management Company (section 99 para 3 KAGB). The Fund's assets must be kept separate from the Capital Management Company's assets (section 92 para 1 sentence 2 KAGB) and do not form part of the insolvency estate in the Capital Management Company's insolvency (section 99 para 3 sentence 3 KAGB).[158] As soon as the right to manage the Fund expires, the Fund or, as the case may be, the right to make dispositions with regard to the Funds passes on to the depositary (*Verwahrstelle*) with which the assets of the Fund are deposited (section 100 para 1 KAGB). The depositary will then either wind up the Fund and distribute the assets of the Fund to the investors of the Fund (section 100 para 2 KAGB) or, if BaFin approves, entrust the management of the Fund to another Capital Management Company (section 100 para 3 sentence 1 KAGB).

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[157] An English translation of section 1 para 10 KAGB reads as follows: "Special Funds are German open-ended investment assets constituted under contract law which are managed by a Capital Management Company in accordance with this Act and the investment rules which determine the legal relationship of the Capital Management Company and the investors."

[158] According to section 92 para 1 sentence 1 KAGB, Special Funds may be established under two different structures: either in the form of a separate asset pool the assets of which are in the joint ownership of the investors in the Fund (*Miteigentumsstruktur*) and the Capital Management Company merely administers the relevant assets or in the form of a separate asset pool the assets of which are in the ownership of the Capital Management Company as trustee for the investors which are beneficial owners (*Treuhandstruktur*).

2.2 Enforceability of the FOA Netting Provision, the Clearing Module Netting Provision, the Addendum Netting Provision and the FOA Set-Off Provisions

2.2.1 Pursuant to section 93 para 6 sentence 1 KAGB, claims against the Capital Management Company and claims which belong to the assets of a Fund may not be set off against each other. This prohibition is framed broadly and should therefore apply to any set-off or netting agreements.

2.2.2 Pursuant to section 93 para 6 sentence 2 KAGB the prohibition of set-off does not apply to master agreements or transactions pursuant to sections 197 para 3 no 3, 200, and 203 KAGB or which have been concluded with prime brokers for which it has been agreed that the claims arsing from these transactions or master agreements which have been concluded for the account of the Fund shall be netted automatically or upon the declaration of a party or that they shall be replaced by a single compensation claim in the event of the termination as a result of non-performance or insolvency. However, the scope of application of section 197 para 3 no. 3 KAGBs is expressly limited to derivatives which are not traded on an exchange or another organised market.[159]

2.2.3 Section 93 para 5 KAGB provides that assets which belong to a Fund may not be pledged or otherwise encumbered, assigned or transferred for security purposes and that any actions to the contrary is void *vis-à-vis* investors. However, it also provides for an exemption which applies, amongst other things, to the entry into financial and currency forward transactions and swaps and similar contracts entered into in accordance with section 197 KAGB.[160]

2.2.4 Generally, the German courts have taken the view that violations of regulatory law do not render contractual agreements void.[161] Where provisions of regulatory law serve the protection of the interests of a certain counterparty, such counterparty may, however, be entitled to claim damages in tort in order to be put in the position it would be in, if no violation of regulatory law had occurred.[162]

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[159] Section 197 para 3 no. 3 KAGB should arguably be construed broadly to apply to exchange traded derivatives as well. Sections 31 para 6 of the former German Investment Act (*Investmentgesetz*, "**InvG**") and 9 para 6 of the former German Capital Investment Act (*Gesetz über Kapitalanlagegesellschaften*) which preceded section 197 para 3 no 3 KAGB was enacted primarily to clarify that netting agreements in standardised master agreements are permissible but not to establish a different treatment of OTC and exchange traded derivatives (see BT-Drucksache 14/8601, S. 21). However, *Möllers*, BKR 2011, 353, 358 *et seq.* proposes a restrictive interpretation of section 9 para 6 InvG.

[160] An English translation of section 197 para 1 KAGB reads as follows: The special fund may, for investment purposes, only invest in derivatives which derive from securities, money market instruments, investment shares within the meaning of section 196, financial indices within the meaning of Article 9 para 1 of the Directive 2007/16/EC, interest rates, foreign exchange rates and currencies in which the special fund may invest according to its contract terms. Sentence 1 shall apply analogously to financial instruments with derivative features within the meaning of the Directive 2007/16/EC.

[161] BGH NJW 2011, 3024, 3025; BGH NJW 1980, 1394; BGH WM 1978, 785.

[162] BGH NJW 2005, 2703 *et seq.*; BGH NJW-RR 2006, 1713 *et seq.*

2.2.5 The restrictions laid down under section 93 paras 5 and 6 KAGB may be applicable despite the choice of English law to govern the FOA Netting Agreement or the Clearing Agreement, if a German court qualifies section 93 paras 5 and 6 KAGB to constitute an overriding mandatory provision within the meaning of Article 9 para 1 Rome I.[163] Since Article 9 para 2 Rome I provides that nothing in Rome I restricts the application of the overriding mandatory provisions of German law section 93 paras 5 and 6 KAGB would be applicable to the FOA Netting Agreement or the Clearing Agreement based on an interpretation of 93 paras 5 and 6 KAGB as an overriding mandatory provision.

[163] See paragraph 4.4 above.

SCHEDULE 3
INDIVIDUALS

Subject to the modifications and additions set out in this Schedule 3 (*Individuals*), the opinions, assumptions and qualifications set out in this Opinion also apply in respect of Parties which are Individuals. For the purposes of this Schedule 3 (*Individuals*), "**Individuals**" means natural persons (*natürliche Personen*) who have their habitual residence (*Wohnsitz*) as defined in section 7 para 1 BGB in Germany and whose legal capacity (*Geschäftsfähigkeit*) as defined under section 116 BGB is not restricted.

Except where the context otherwise requires, references to "sections" are to sections of this Schedule.

1. MODIFICATIONS TO ASSUMPTIONS

1.1 The assumption in paragraph 2.13 does not apply to this Schedule.

1.2 Any relevant Individual has the requisite capacity, power and authority to enter into the Opinion Documents and Transactions.

2. MODIFICATIONS TO OPINIONS

On the basis of the terms of reference and assumptions and subject to the qualifications (in each case set out in this opinion letter as modified, or added to, by this Schedule), we are of the following opinion:

2.1 Choice of law

The conclusions reached under paragraph 3.2 above apply. In addition, the recognition of choice of law may be further restricted in respect of Individuals who qualify as consumers[164] in accordance with the following provisions:

2.1.1 Article 6 paras 1 and 2 Rome I provide that a contract concluded between a professional and a consumer is with respect to mandatory consumer protection laws be governed by the laws of the country where the consumer has its habitual residence, if (i) the professional pursues its commercial or professional activities in the country of the consumer's habitual residence or (ii) by any means directs its activities to that country and the contract falls within the scope of such activities.

(a) Mandatory consumer protection laws would in light of recital 25 Rome I appear to be such rules of the country of the consumers' habitual residence that cannot be derogated from by agreement.

(b) Article 6 paras 1 and 2 Rome I do, however, not apply

(i) to a contract for the supply of services where the services are to be supplied to the consumer exclusively in a country other than

[164] For purposes Rome I, an Individual qualifies as a consumer, if it concludes a contract for a purpose which can be regarded as being outside its trade or profession (Article 6 para 1 Rome I).

that in which he has his habitual residence (Article 6 para 4 lit. (a) Rome I); and

(ii) to rights and obligations which constitute a financial instrument and rights and obligations constituting the terms and conditions governing the issuance or offer to the public and public take-over bids of transferable securities, and the subscription and redemption of units in collective investment undertakings in so far as these activities do not constitute the provision of a financial service.[165]

2.1.2 A number of EU consumer protection Directives contain provisions which oblige the Member States to ensure that that consumers do not lose the protection granted by such Directives by virtue of the choice of the law of a non-Member State as the law applicable to the contract if the latter has a close connection with the territory of one or more Member States.

Germany has transposed these provisions by enacting Article 46b EGBGB which stipulates that national provisions transposing consumer protection directives[166] apply to contracts which contain a choice of the laws of a non-Member State, if the contract bears a close connection to one or several Member States. Such close connection is presumed in situations where (i) the professional pursues its trade or profession in the Member State where the consumer has its habitual residence or (ii) if it by any means directs such activities to one or several Member States and the contract falls within the scope of these activities (Article 46b para 2 EGBGB).

2.1.3 Individuals may therefore validly enter into the FOA Netting Agreement or the Clearing Agreement but it has to be checked in each case, in particular, whether the Individual qualifies as a consumer and what special legal protection it may therefore benefit from.

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[165] See Article 4 para 1 point (17) MiFID for the respective definitions. Financial services which are not within the scope of the exemption under Article 6 para 4 lit (d) Rome I are, *inter alia*, reception and transmission of orders in relation to one or more financial instruments, execution of orders on behalf of clients, dealing on own account, portfolio management, investment advice, safekeeping and administration of financial instruments for the account of clients including custodianship and related services such as cash/collateral management and granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction (Annex I sections A and B MiFID).

[166] The Directives covered by Article 46b EGBGB are

(i) Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts;
(ii) Directive 97/7/EC of 20 May 1997 on the protection of consumers in respect of distance contracts;
(iii) Directive 1999/44/EC of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees;
(iv) Directive 2002/65/EG of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC; and
(v) Directive 2008/48/EC of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC.

2.2 **Enforceability FOA Netting Provision, the Clearing Module Netting Provision, the Addendum Netting Provision and the FOA Set-Off Provisions**

The conclusions reached above under paragraph 3.3.2(d) apply. The FOA Netting Provisions and the Clearing Module Netting Provision are therefore subject to the EUIR and which should generally refer to German insolvency laws in respect of Individuals.

3. ADDITIONAL QUALIFICATIONS

3.1 Insolvency Proceedings

3.1.1 For Individuals which have not pursued and do not pursue an independent economic profession, the InsO prescribes a procedure under which the consumer and its creditors have to attempt to agree on a plan of liquidation of debts which is given effect by the competent insolvency court if agreement is reached. If no agreement can be reached, Insolvency Proceedings may be instituted pursuant to the general rules but some modifications apply for the purpose of simplification. Natural persons who have pursued an economic profession may fall under the above-mentioned rules provided their financial circumstances are unambiguous and there are no unsettled claims from legal relationships under employment law against them.

3.1.2 Once Insolvency Proceedings are opened, under sections 286 *et seq.* of the InsO, an Individual may be relieved of obligations which remain unperformed. This is achieved by means of a residual debt relief (*Restschuldbefreiung*). Such residual debt relief will be effective if a court orders so and is subject to a number of obligations of the debtor (e.g. assignment of the debtor's current earnings to the extent permitted by law for a period of six years to a trustee appointed by the court).

3.1.3 Where the Insolvent Party is an Individual, for purposes of insolvency clawback persons with whom the debtor has a close relationship (see above, paragraph 4.1.3(e) are

(i) the debtor's spouse even if the marriage was concluded only after the relevant legal act or was dissolved during the last year prior to the relevant legal act;

(ii) the ascendants or descendants of the debtor or of the spouse, the brothers and sisters related by consanguinity and affinity to the debtor and the spouse designated, and the spouses of such persons; and

(iii) persons living in the debtor's household or having lived in the debtor's household during the last year prior to the relevant legal act.

3.2 Consumer protection laws

Consumer protection laws under German civil law may apply despite a choice of English law. We cannot address all relevant consumer protection laws

comprehensively. It is, however, noteworthy, that, if German law were applicable, the provisions of the FOA Netting Agreement or the Clearing Agreement would likely be treated as general business conditions (*Allgemeine Geschäftsbedingungen*), i.e. pre-formulated conditions which are imposed by one party on its counterparty without being negotiated. Sections 305 to 310 BGB confer a high level protection on any person to whom general business conditions are presented by its counterparty. Since the choice of English law to govern the FOA Netting Agreement or the Clearing Agreement would generally be recognised, sections 305 to 310 BGB would not normally be applicable to the FOA Netting Agreement or the Clearing Agreement but sections 305 to 310 BGB would be likely to qualify as mandatory consumer protection laws if used *vis-à-vis* consumers (Article 6 Rome I).[167]

[167] Sections 305 to 310 BGB serve, amongst other things, the implementation of Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

SCHEDULE 4
PUBLIC SECTOR ENTITIES

Subject to the modifications and additions set out in this Schedule 4 (*Public Sector Entities*), the opinions, assumptions and qualifications set out in this Opinion also apply in respect of Parties which are Public Sector Entities. For the purposes of this Schedule 4 (*Public Sector Entities*), "**Public Sector Entities**" means the Federal Republic of Germany (*Bundesrepublik Deutschland*, "**Federal Republic**"), the Federal States of Germany (*Länder*, "**Federal States**"), German municipalities (*Gemeinden*, "**Municipalities**"), other legal corporations established under public law (*Körperschaften des öffentlichen Rechts*) ("**Public Law Corporations**") and institutions established under public law with full legal capacity (*vollrechtsfähige Anstalten des öffentlichen Rechts*) ("**Public Law Institutions**"). Public Sector Entities are therefore such German public law entities which have full legal capacity and which may sue and be sued before the German courts in their own names.

Except where the context otherwise requires, references to "*sections*" are to sections of this Schedule.

1. ADDITIONAL ASSUMPTIONS

1.1 None of the Parties is entitled to claim in relation to itself or its assets immunity from suit, attachment, execution or other legal process.

1.2 Where a Public Sector Entity enters into the FOA Netting Agreement or the Clearing Agreement, the execution of the FOA Netting Agreement or the Clearing Agreement and any Transactions constitutes, and the exercise of that Party's rights and performance of its obligations thereunder constitutes, commercial acts done and performed under private law.

2. MODIFICATIONS TO OPINIONS

On the basis of the terms of reference and assumptions and subject to the qualifications (in each case set out in this opinion letter as modified, or added to, by this Schedule), we are of the following opinion.

2.1 Insolvency Proceedings

2.1.1 Insolvency Proceedings may not be opened over the assets of the Federal Republic a Federal State (section 12 para 1 no 1 InsO). Public Sector Entities which are subject to the supervision of a Federal State may be exempt from Insolvency Proceedings in Germany by the law of such Federal State (section 12 para 1 no 2 InsO). Instead, special rules may apply or be enacted under public law to the winding-up of such entities and such special rules may have an impact on the enforceability of the FOA Netting Provision, the Clearing Module Netting Provision, the Addendum Netting Provision and the Set-Off Provisions as well the enforcement of any security interest or title transfer arrangements on which we cannot opine on an abstract basis. Where a legal entity established under public law is not exempt from Insolvency Proceedings, it will generally be treated similar to entities established under

private law. Legal entities incorporated under private law which are publicly owned are not exempt from Insolvency Proceedings.[168]

2.1.2 Certain German public law entities such as Deutsche Bundesbank, the German central bank, and the Kreditanstalt für Wiederaufbau ("**KfW**") may only be dissolved by an act of the German Federal Parliament.[169] As a result, they may not be subject to Insolvency Proceedings (which would result in their liquidation).[170]

2.1.3 The conclusions reached above (paragraphs 3.3 to 3.5) therefore apply analogously to Public Sector Entities except that, as a rule, Public Sector Entities may not legally become insolvent, even if they are unable to meet their payment obligations. German insolvency law should therefore not affect the FOA Netting Provisions and the Clearing Module Netting Provision or the Set-Off Provisions, if a Public Sector Entity is unable to make any payments.

3. ADDITIONAL QUALIFICATIONS

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

3.1 Set-off

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

3.2 The German public law doctrine of *ultra vires*

Under the German public law doctrine of *ultra vires*, the power and capacity of a Public Sector Entity to validly enter into a legally binding agreement under private law is limited. Public Sector Entities may only enter into transactions that fall within their scope of competence (*Verbandskompetenz*) and functions (*Wirkungskreis*) as defined by the laws establishing or applicable laws conferring its powers and capacities upon such Public Sector Entity.[171] If a Public Sector Entity purports to enter into a contract under private law that is beyond or exceeding its functions, such a contract might be considered *ultra vires* and therefore void.[172] Provided that the *ultra*

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

[169] Section 44 sentence 1 of the Act on Deutsche Bundesbank (*Gesetz über die Deutsche Bundesbank*) and section 13 para 1 Act on KfW (*KfW-Gesetz*), respectively.

[170] *Ott/Vuia*, in: Münchener Kommentar InsO, 3rd ed. 2013, § 12 no. 13; *Ehricke*; in: Jaeger, Insolvenzordnung, 2004, § 12 no. 14.

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

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

vires doctrine is applicable, it applies regardless of the good faith of the counterparty or any representation by the public law entity to the contrary. As a rule, *ultra vires* measures are unenforceable. They may not be ratified.

However, a crucial distinction needs to be drawn between the Federal Republic and the Federal States on the one hand and other Public Sector Entities. Whilst the Federal Republic the Federal States are sovereigns and do not derive their power from a superior body but are only limited by their respective constitutions, other Public Sector Entities have limited functions which may be exercised only in accordance with their legal purpose. Only the latter entities are subject to the doctrine of *ultra vires* meaning that legal acts outside the scope of their legal functions are void.[173]

3.3 The prohibition on speculation

It is often argued that Public Sector Entities are subject to a prohibition on speculation even though the legal basis of such prohibition is very unclear.[174] The prohibition on speculation would prevent Public Sector Entities from entering into Transactions for speculative purposes. In the absence of a clear legal basis or this principle the position of German courts is that the prohibition on speculation – irrespective of the question whether and to what extent it constitutes a rule of law – does not lead to the voidness of contracts under section 134 BGB.[175]

3.4 Budgetary laws

Budgetary provisions are under German law considered to constitute internal law of the Federal Republic, the Federal States and Municipalities. meaning that the violation of the budgetary laws does not affect the dealings with third parties.[176] In particular, it would not make contracts void in accordance with section 134 BGB which provides for the voidness of contracts violating a legal prohibition (*Verbotsgesetz*). However, under extraordinary circumstances the violation of budgetary provisions may make agreements entered into by a Public Sector Entity void. The German courts might in severe cases reach the conclusion that the entry into an agreement by a Public Sector Entity may threaten third parties or if the entry into the FOA Netting Agreement or the Clearing Agreement is highly detrimental to the public good and therefore void under section 138 para 1 BGB.[177] The latter may be

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[173] *Forsthoff*, Lehrbuch der Verwaltungsrechts Band I: Allgemeiner Teil, 10th ed. 1973, 583 *et seq*; *Kewenig/Schneider*, Swap-Geschäfte der öffentlichen Hand in Deutschland, WM-Sonderbeilage Nr. 2, 1992, 1, 5.

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

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

[176] German Federal Constitutional Court (*Bundesverfassungsgericht*, "**BVerfG**"), BVerfGE 20, 56, 89 *et seq.*; *Kirchhof*, NVwZ 1983, 505, 506.

[177] BGH NJW 2005, 1490, 1491.

given, if there is a violation of budgetary provisions which can be "subjectively attributed" (*subjektiv zugerechnet werden*) to both parties.[178]

3.5 The principle of connectivity

There is also considerable uncertainty as to whether a principle of connectivity (*Konnexität*) applies in respect of derivatives entered into by Public Sector Entities.[179] The principle of connectivity would require Public Sector Entities to only enter into Transactions to hedge against certain risks from underlying contracts which the Transaction matches.

3.6 Investment advice

In one case, a German court has argued that Credit Institutions may be under an obligation to inform a Public Sector Entity of its restrictions under public law prior to the entry into a derivative and, failing to do so, that it may be liable to pay damages for wrongful investment advice.[180]

We do not express any opinions on the existence and scope of duties of disclosure and advice a party may have *vis-à-vis* another party which is a Public Sector Entity.

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[178] BGH NVwZ-RR 2007, 47, 48; BGH NJW 1962, 955, 956 *et seq.* The BGH's statement may be interpreted so as to require a collusion (*Kollusion*) of the parties to the relevant agreement, i.e. a situation where the parties coordinate to act to the detriment of the public budget.

[179] *Endler*, in: Zerey, Finanzderivate, 3rd ed. 2012, § 28 no. 89.

[180] OLG Naumburg NJOZ 2005, 3420, 3427 *et seq.*

SCHEDULE 5
FOUNDATIONS

Subject to the modifications and additions set out in this Schedule 5 (*Foundations*), the opinions, assumptions and qualifications set out in this Opinion also apply in respect of Parties which are Foundations. For the purposes of this Schedule 5 (*Foundations*), "**Foundations**" means foundations (*Stiftungen*) with unrestricted legal capacity within the meaning of section 80 para 1 BGB which have been recognised by the competent authority of the Federal State within which they are located.

Except where the context otherwise requires, references to "sections" are to sections of this Schedule.

ADDITIONAL QUALIFICATIONS

1. ESTABLISHMENT AND CONSTITUTION OF FOUNDATIONS

The valid establishment of a Foundation not only requires a legal act under private law (*Stiftungsgeschäft*) but also an administrative act by the competent authority under which the Foundation is recognised as such. Once established, the Foundation is subject to supervision of the competent authority of the Federal State in which the Foundation is located. The private law act establishing the Foundation has to determine the Foundation's purpose (*Stiftungszweck*) (section 81 para 1 sentence 3 no. 3 BGB).

2. ENTRY INTO THE FOA NETTING AGREEMENT OR THE CLEARING AGREEMENT

2.1 Despite the requirement of recognition by the competent authority, Foundations qualify as private law entities and hence are not subject to the public law doctrine of *ultra vires* (above, section 3.2 of Schedule 3).[181] There is no concept of *ultra vires* under German private law.[182]

2.2 Whether there are any restrictions on the entry into enter into the Opinion Documents largely depends on applicable public law of the Federal States which needs to be checked in each individual case. However, the power of representation of the management (*Vorstand*) of the Foundation may be restricted under section 86 in conjunction with section 26 para 1 BGB and, therefore, where a member of the Foundation's management purports to enter into a transaction on behalf of the Foundation which is outside its purpose, the transaction may not be binding on the Foundation. In such case there is a risk that the relevant manager as an individual rather than the Foundation is bound by the terms of the Opinion Documents or must pay damages.

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[181] *Reuter*, in: Münchener Kommentar BGB, 6th ed. (2012), § 81 no. 97; *Hadding*, in Soergel, 13th ed. (2000), Vor § 21 no. 24.

[182] *Boesche*, in: Oetker, Handelsgesetzbuch, 3rd ed. (2013), § 126 no. 5; *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2nd ed. (2010), § 78 no. 9.

SCHEDULE 6
BUILDING SOCIETIES

Subject to the modifications and additions set out in this Schedule 6 (*Building Societies*), the opinions, assumptions and qualifications set out in this Opinion will also apply in respect of Parties which are Foundations. For the purposes of this Schedule 6 (*Building Societies*), "**Building Societies**" means German law building societies (*Bausparkassen*) within the meaning of the Act on Building Societies (*Bausparkassengesetz*, "**BauSparkG**"), i.e. Credit Institutions in the form of an AG or as a Public Sector Entity (in which case the opinions given in Schedule 3 apply) which are subject to BaFin's supervision.

Except where the context otherwise requires, references to "sections" are to sections of this Schedule.

ADDITIONAL QUALIFICATIONS

1.1 The BauSparkG contains various restriction on Building Societies' ability to enter into agreements. The purpose of these restrictions is to ensure that Building societies focus on deposit-taking and the granting of loans related to the construction or purchase of housing. In particular, section 4 BauSparkG sets out conclusively the activities a Building Society may engage in. All these activities relate to the purchase and construction of housing.

1.2 In its decision on the construction of section 4 BauSparkG dated 26 January 2005 (BA 3 21.00), BaFin stated that Building Societies may engage in derivatives transactions not expressly mentioned under section 4 BauSparkG, if such derivatives transactions hedge against risks from permissible transactions and do not create further independent risks. It is unclear what consequences violations of section 4 BauSparkG will have under civil law. Generally, the German courts take the view that violations of regulatory law do not render contractual agreements void.[183] Where provisions of regulatory law serve to protect the interests of a certain counterparty, such counterparty may, however, be entitled to claim damages in tort in order to be put in the position it would be in, if no violation of regulatory law had occurred.[184]

1.3 Further to the Regulatory Proceedings (paragraph 3.1.7), BaFin is entitled to order a Building Society not make payments of certain types of payments (section 15 BauSparkG) if the fulfilment of a Building Society's obligations is jeopardised and the avoidance of the opening of Insolvency Proceedings is necessary having regard to the interest of the Building Society's creditors and building society savers (*Bausparer*). The provisions of the InsO which protect Financial Collateral and Systems are, however, applicable by way of analogy. Section 15 BauSparkG does not apply to Bulding Societies which are under special state supervision (section 17 BauSparkG).

1.4 To manage currency risks Building Societies must allocate separate pools of assets for building savings contracts (*Bausparverträge*) (section 6a BauSaprkG). It is not clear

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[183] BGH NJW 2011, 3024, 3025; BGH NJW 1980, 1394; BGH WM 1978, 785.

[184] BGH NJW 2005, 2703 *et seq.*; BGH NJW-RR 2006, 1713 *et seq.*

whether violations of this obligation may affect a Building Society's transactions with third parties, for example, by resulting in a restriction on set-off.

1.5 The German Federal Finance Minister (*Bundesminister der Finanzen*) is empowered to enact regulations specifying certain aspects of Building Societies' business, in particular granting of loans and the allocation of saving amounts to secure the fulfilment of Building Societies' creditors (section 10 BauSparkG).

SCHEDULE 7
PENSION ENTITIES

Subject to the modifications and additions set out in this Schedule 7 (*Pension Entities*), the opinions, assumptions and qualifications set out in this Opinion will also apply in respect of Parties which are Pension Entities. For the purposes of this Schedule 7 (*Pension Entities*), "**Pension Entities**" means pension funds (*Pensionsfonds*) within the meaning of section 112 VAG ("**Pension Funds**") and pension schemes (*Pensionskassen*) within the meaning of section 118a VAG ("**Pension Schemes**").

Except where the context otherwise requires, references to "sections" are to sections of this Schedule.

ADDITIONAL QUALIFICATIONS

1. PENSION FUNDS

1.1 Pension Funds are regulated under the VAG and subject to BaFin's supervision. Whilst they do not qualify as Insurance Companies, many provisions of the VAG apply analogously (section 113 VAG) and the modifications to opinions and qualifications set out in Schedule 1 (*Insurance Companies*) generally apply. In the absence of any specific guidance, we take the view that in particular the restrictions on the scope of permissible transactions apply analogously (section 2.3 of Schedule 1 (*Insurance Companies*)).

1.2 However, whether the EUIR rather than the InsO is applicable in respect of the conflict of insolvency laws (i.e sections 1.2.1 to 1.2.3 of Schedule 1 are inapplicable). This is because Pension Funds are regulated on European Union level in accordance with Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision[185] ("**Pension Entities Directive**") and therefore not cvered by the EU Insurance Directives (above, footnote 148 at Schedule 1 (*Insurance Companies*)).

2. PENSION SCHEMES

Pension Schemes do qualify as Insurance Companies under section 118a VAG (but are exempt from a number of provisions applicable to Insurance Companies generally) but as Pension Funds, they are regulated on European Union level in accordance with the Pension Entities Directive and our statement given in respect of Pension Funds therefore apply analogously. In the absence of any guidance from German courts or regulators, we take the view that in particular the restrictions on the scope of permissible transactions apply analogously (section 2.3 of Schedule 1 (*Insurance Companies*)).

[185] OJ No L 235 of 23 September 2003, p. 10.

ANNEX 1
FORMS OF FOA NETTING AGREEMENTS

3. Master Netting Agreement - One-Way (1997 version) (the "**One-Way Master Netting Agreement 1997**")

4. Master Netting Agreement - Two-Way (1997 version) (the "**Two-Way Master Netting Agreement 1997**")

5. Default, Netting and Termination Module (One-Way Netting) (2007 version) (the "**Long-Form One-Way Clauses 2007**")

6. Short Form Default, Netting and Termination Module (One-Way Netting) (2007 version) (the "**Short-Form One-Way Clauses 2007**")

7. Short Form Default, Netting and Termination Module (One-Way Netting) (2009 version) (the "**Short-Form One-Way Clauses 2009**")

8. Short Form Default, Netting and Termination Module (One-Way Netting) (2011 version) (the "**Short-Form One-Way Clauses 2011**")

9. Default, Netting and Termination Module (Two-Way Netting) (2007 version) (the "**Long-Form Two-Way Clauses 2007**")

10. Default, Netting and Termination Module (Two-Way Netting) (2009 version) (the "**Long-Form Two-Way Clauses 2009**")

11. Default, Netting and Termination Module (Two-Way Netting) (2011 version) (the "**Long-Form Two-Way Clauses 2011**")

12. Short Form Default, Netting and Termination Module (Two-Way Netting) (2007 version) (the "**Short-Form Two-Way Clauses 2007**")

13. Short Form Default, Netting and Termination Module (Two-Way Netting) (2009 version) (the "**Short-Form Two-Way Clauses 2009**")

14. Short Form Default, Netting and Termination Module (Two-Way Netting) (2011 version) (the "**Short-Form Two-Way Clauses 2011**")

15. Professional Client Agreement (2007 Version), including Module G (Margin and Collateral) (the "**Professional Client (with Security Provisions) Agreement 2007**")

16. Professional Client Agreement (2009 Version), including Module G (Margin and Collateral) (the "**Professional Client (with Security Provisions) Agreement 2009**")

17. Professional Client Agreement (2011 Version) including Module G (Margin and Collateral) (the "**Professional Client (with Security Provisions) Agreement 2011**")

18. Professional Client Agreement (2007 Version), excluding Module G (***Margin and Collateral***) but incorporating the Title Transfer Securities and Physical Collateral

Annex to the Netting Module (2007 or 2011 Version) (the "**Professional Client (with Title Transfer Provisions) Agreement 2007**")

19. Professional Client Agreement (2009 Version), excluding Module G (***Margin and Collateral***) but incorporating the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version) (the "**Professional Client (with Title Transfer Provisions) Agreement 2009**")

20. Professional Client Agreement (2011 Version), excluding Module G (***Margin and Collateral***) but incorporating the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version) (the "**Professional Client (with Title Transfer Provisions) Agreement 2011**")

21. Retail Client Agreement (2007 Version) including Module G (Margin and Collateral) (the "**Retail Client (with Security Provisions) Agreement 2007**")

22. Retail Client Agreement (2009 Version) including Module G (Margin and Collateral) (the "**Retail Client (with Security Provisions) Agreement 2009**")

23. Retail Client Agreement (2011 Version) including Module G (Margin and Collateral) (the "**Retail Client (with Security Provisions) Agreement 2011**")

24. Retail Client Agreement (2007 Version), excluding Module G (***Margin and Collateral***) but incorporating the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version) (the "**Retail Client (with Title Transfer Provisions) Agreement 2007**")

25. Retail Client Agreement (2009 Version), excluding Module G (***Margin and Collateral***) but incorporating the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version) (the "**Retail Client (with Title Transfer Provisions) Agreement 2009**")

26. Retail Client Agreement (2011 Version), excluding Module G (***Margin and Collateral***) but incorporating the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version) (the "**Retail Client (with Title Transfer Provisions) Agreement 2011**")

27. Eligible Counterparty Agreement (2007 Version) including Module G (***Margin***) (the "**Eligible Counterparty (with Security Provisions) Agreement 2007**")

28. Eligible Counterparty Agreement (2009 Version) including Module G (***Margin***) (the "**Eligible Counterparty (with Security Provisions) Agreement 2009**")

29. Eligible Counterparty Agreement (2011 Version) including Module G (***Margin***) (the "**Eligible Counterparty (with Security Provisions) Agreement 2011**")

30. Eligible Counterparty Agreement (2007 Version) excluding Module G (***Margin***) but incorporating the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version) (the "**Eligible Counterparty (with Title Transfer Provisions) Agreement 2007**")

31. Eligible Counterparty Agreement (2009 Version) excluding Module G (***Margin***) but incorporating the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version) (the "**Eligible Counterparty (with Title Transfer Provisions) Agreement 2009**")

32. Eligible Counterparty Agreement (2011 Version) excluding Module G (***Margin***) but incorporating the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 or 2011 Version) (the "**Eligible Counterparty (with Title Transfer Provisions) Agreement 2011**")

Where an FOA Published Form Agreement expressly contemplates the election of certain variables and alternatives, the Agreements listed above are deemed to include any such document in respect of which the parties have made such expressly contemplated elections (and have made any deletions required by such elections, where such deletions are expressly contemplated in the event of such election by the applicable FOA Published Form Agreement), provided that any election made does not constitute an Adverse Amendment.

Each of the Agreements listed at items 13 to 30 of this Annex 1 may be deemed to include FOA Netting Agreements identical to the relevant FOA Published Form Agreement, save for the substitution of Two Way Clauses in place of the equivalent terms in the FOA Published Form Agreement, in which case references to the Insolvency Events of Default and FOA Netting Provision in respect of such FOA Netting Agreements shall mean the Insolvency Events of Default and FOA Netting Provision in relation to the Two Way Clauses.

ANNEX 2
LIST OF TRANSACTIONS

The following groups of Transactions may be entered into under the FOA Netting Agreements or Clearing Agreements:

(A) (Futures and options and other transactions) Transactions as defined in the FOA Netting Agreements or Clearing Agreements:

(i) a contract made on an exchange or pursuant to the rules of an exchange;

(ii) a contract subject to the rules of an exchange; or

(iii) a contract which would (but in terms of maturity only) be a contract made on, or subject to the rules of, an exchange and which, at the appropriate time, is to be submitted for clearing as a contract made on, or subject to the rules of, an exchange,

in any of cases (i), (ii) and (iii) being a future, option, contract for difference, spot or forward contract of any kind in relation to any commodity, metal, financial instrument (including any security), currency, interest rate, index or any combination thereof; or

(i) a transaction which is back-to-back with any transaction within paragraph (i), (ii) or (iii) of this definition, or

(ii) any other Transaction which the parties agree to be a Transaction;

(B) (fixed income securities) Transactions relating to a fixed income security or under which delivery of a fixed income security is contemplated upon its formation;

(C) (equities) Transactions relating to an equity or under which delivery of an equity is contemplated upon its formation;

(D) (commodities) Transactions relating to, or under the terms of which delivery is contemplated, of any base metal, precious metal or agricultural product.

(E) (OTC derivatives) Transactions which fall within paragraphs (4) to (10) of Section C of Annex 1 to Directive 2004/39/EC, including (but not limited to) interest rate swaps, credit default swaps, derivatives on foreign exchange, and equity derivatives, provided that, where the Transaction is subject to the Terms of a Clearing Agreement, the Transaction (or a transaction which is back-to-back with the Transaction) is eligible to be cleared by a central counterparty.

ANNEX 3
DEFINITIONS RELATING TO THE AGREEMENTS

"**Addendum Inconsistency Provision**" means (subject to any selections or amendments required or permitted to be made on the face of the ISDA/FOA Clearing Addendum) Clause 1(b) (i) of the ISDA/FOA Clearing Addendum.

"**Addendum Netting Provision**" means (subject to any selections or amendments required or permitted to be made on the face of the ISDA/FOA Clearing Addendum):

(a) Clause 8(b) (Clearing Member Events), 8(c) (CCP Default) and 8(d) (Hierarchy of Events) of the ISDA/FOA Clearing Addendum, ; or

(b) any modified version of such clauses provided that it includes at least those parts of paragraph 6 of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow,

"**Addendum Set-Off Provision**" means (subject to any selections or amendments required or permitted to be made on the face of the ISDA/FOA Clearing Addendum):

(a) Clause 8(e) (Set-Off) of the ISDA/FOA Clearing Addendum, where constituted as part of a Clearing Agreement, ; or

(b) any modified version of such clause provided that it includes at least those parts of paragraph 8 of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow,

"**Adverse Amendments**" means (a) any amendment to a Core Provision and/or (b) any other provision in an agreement that may invalidate, adversely affect, modify, amend, supersede, conflict or be inconsistent with, provide an alternative to, override, compromise or fetter the operation, implementation, enforceability or effectiveness of a Core Provision (in each case in (a) and (b) above, excepting any Non-material Amendment).

"**Clearing Agreement**" means an agreement:

(a) on the terms of the FOA Netting Agreement when used (i) in conjunction with the FOA Clearing Module and/or the ISDA/FOA Clearing Addendum, or (ii) in conjunction with a Clearing Module Netting Provision and/or an Addendum Netting Provision and with or without a Clearing Module Set-Off Provision and/or an Addendum Set-Off Provision;

(b) which is governed by the law of England and Wales; and

(c) which contains an Addendum Inconsistency Provision, a Clearing Module Inconsistency Provision, or another provision with equivalent effect to either of them.

"**Clearing Module Inconsistency Provision**" means (subject to any selections or amendments required or permitted to be made on the face of the FOA Clearing Module) Clause 1.2.1 of the FOA Clearing Module.

"**Clearing Module Netting Provision**" means (subject to any selections or amendments required or permitted to be made on the face of the FOA Clearing Module):

(a) Clause 6.2 (*Firm Events*), 6.3 (*CCP Default*) and 6.4 (*Hierarchy of Events*) of the FOA Clearing Module, together with the defined terms required properly to construe such Clauses; or

(b) any modified version of such clauses provided that it includes at least those parts of paragraph 6 of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow,

"**Clearing Module Set-Off Provision**" means (subject to any selections or amendments required or permitted to be made on the face of the FOA Clearing Module):

(a) Clause 6.5 (*Set-Off*) of the FOA Clearing Module together with the defined terms required properly to construe such Clause; or

(b) any modified version of such clause provided that it includes at least those parts of paragraph 7 of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow,

"**Client**" means, in relation to an FOA Netting Agreement or a Clearing Agreement, the Firm's or, as the case may be, Clearing Member's counterparty under the relevant FOA Netting Agreement or Clearing Agreement.

"**Core Provision**" means those parts of the clauses or provisions specified below in relation to a paragraph of this opinion letter (and any equivalent paragraph in any Schedule to this opinion letter), which are highlighted in Annex 4:

(a) for the purposes of paragraph 3.3 (*Enforceability of FOA Netting Provision*) and 3.6 (Use of FOA Clearing Module or ISDA/FOA Clearing Addendum not detrimental to FOA Netting Provision), the Insolvency Events of Default Clause and the FOA Netting Provision;

(b) for the purposes of paragraph 3.4 (*Enforceability of the Clearing Module Netting Provision*), the Clearing Module Netting Provision together with the defined terms "Aggregate Transaction Value", "Firm/CCP Transaction Value" and "Relevant Collateral Value";

(c) for the purposes of paragraph 3.5 (*Enforceability of the Addendum Netting Provision*), the Addendum Netting Provision together with the defined terms "Aggregate Transaction Value", "CM/CCP Transaction Value" and "Relevant Collateral Value";

(d) for the purposes of paragraph 3.7.1, the Insolvency Events of Default Clause, the FOA Netting Provision and either or both of the General Set-off Clause and the Margin Cash Set-off Clause;

(e) for the purposes of paragraph 3.7.2, the Insolvency Events of Default Clause, the FOA Netting Provision, either or both of the General Set-off Clause and the Margin Cash Set-off Clause, and the Clearing Module Set-Off Provision and/or the Addendum Set-Off Provision;

(f) for the purposes of paragraph 3.8.1, the Clearing Module Netting Provision together with the defined terms "Aggregate Transaction Value", "Firm/CCP Transaction Value" and "Relevant Collateral Value", and the Clearing Module Set-Off Provision;

(g) for the purposes of paragraph 3.8.2, the Clearing Module Netting Provision together with the defined terms "Aggregate Transaction Value", "Firm/CCP Transaction Value" and "Relevant Collateral Value", the Clearing Module Set-Off Provision and the FOA Set-Off Provision;

(h) for the purposes of paragraph 3.9 (*Set-Off under a Clearing Agreement with Addendum Set-Off Provision*), the Addendum Netting Provision together with the defined terms "Aggregate Transaction Value", "CM/CCP Transaction Value" and "Relevant Collateral Value", and the Addendum Set-Off Provision;

(i) for the purposes of paragraph 3.10.1, (i) in relation to an FOA Netting Agreement, the Insolvency Events of Default Clause, the FOA Netting Provision and the Title Transfer Provisions; and (ii) in relation to a Clearing Agreement, the Clearing Module Netting Provision together with the defined terms "Aggregate Transaction Value", "Firm/CCP Transaction Value" and "Relevant Collateral Value" or, as the case may be, the Addendum Netting Provision together with the defined terms "Aggregate Transaction Value", "CM/CCP Transaction Value" and "Relevant Collateral Value", and the Title Transfer Provisions; and

(j) for the purposes of paragraphs 3.10.3 and 3.10.4, the Title Transfer Provisions;

in each case, incorporated into an FOA Netting Agreement or a Clearing Agreement together with any defined terms required properly to construe such provisions, in such a way as to preserve the essential sense and effect of the highlighted parts.

References to "**Core Provisions**" include Core Provisions that have been modified by Non-material Amendments.

"**Defaulting Party**" includes, in relation to the One-Way Versions, the Party in respect of which an Event of Default entitles the Non-Defaulting Party to exercise rights under the FOA Netting Provision.

"**Eligible Counterparty Agreements**" means each of the Eligible Counterparty Agreement (with Security Provisions) Agreement 2007, the Eligible Counterparty Agreement (with Title Transfer Provisions) Agreement 2007, the Eligible Counterparty Agreement (with Security Provisions) Agreement 2009, the Eligible Counterparty Agreement (with Title Transfer Provisions) Agreement 2009, the Eligible Counterparty Agreement (with Security Provisions) Agreement 2011 or the

Eligible Counterparty Agreement (with Title Transfer Provisions) Agreement 2011 (each as listed and defined at Annex 1).

"**Firm**" means, in relation to an FOA Netting Agreement or a Clearing Agreement which includes an FOA Clearing Module, the Party providing the services under the relevant FOA Netting Agreement or Clearing Agreement which includes an FOA Clearing Module.

"**FOA Clearing Module**" means the FOA Client Cleared Derivatives Module as first published on 9 October 2013 or any subsequent published version up to the date of this opinion letter.

"**FOA Netting Agreement**" means an agreement:

(a) on the terms of the forms specified in Annex 1 to this opinion letter or which has broadly similar function to any of them, when not used in conjunction with the FOA Clearing Module and/or the ISDA/FOA Clearing Addendum and/or a Clearing Module Netting Provision and/or an Addendum Netting Provision;

(b) which is governed by the law of England and Wales; and

(c) which contains the Insolvency Events of Default Clause and the FOA Netting Provision, with or without the FOA Set-Off Provision, and with or without the Title Transfer Provisions, with no Adverse Amendments.

"**FOA Netting Agreements (with Title Transfer Provisions)**" means each of the Professional Client (with Title Transfer Provisions) Agreement 2007, the Professional Client (with Title Transfer Provisions) Agreement 2009, the Professional Client (with Title Transfer Provisions) Agreement 2011, the Retail Client (with Title Transfer Provisions) Agreement 2007, the Retail Client (with Title Transfer Provisions) Agreement 2009, the Retail Client (with Title Transfer Provisions) Agreement 2011, the Eligible Counterparty (with Title Transfer Provisions) Agreement 2007, the Eligible Counterparty (with Title Transfer Provisions) Agreement 2009 and the Eligible Counterparty (with Title Transfer Provisions) Agreement 2011 (each as listed and defined at Annex 1) or an FOA Netting Agreement which has broadly similar function to any of the foregoing.

"**FOA Netting Provision**" means (in each case subject to any selections or amendments required or permitted to be made on the face of the document in the relevant form referred to in Annex 1):

(a) in relation to the terms of the Long Form One-Way Clauses 2007 and the Long Form Two-Way Clauses, Clause 2.2 (***Liquidation Date***), Clause 2.4 (***Calculation of Liquidation Amount***) and Clause 2.5 (***Payer***);

(b) in relation to the terms of the Short Form One-Way Clauses and the Short Form Two-Way Clauses, Clause 2.1 (***Liquidation Date***), Clause 2.3 (***Calculation of Liquidation Amount***) and Clause 2.4 (***Payer***);

(c) in relation to the terms of the Master Netting Agreements, Clause 4.2, Clause 4.4 and Clause 4.5;

(d) in relation to the terms of the Eligible Counterparty Agreements, Clause 10.1 (***Liquidation Date***), Clause 10.3 (***Calculation of Liquidation Amount***) and Clause 10.4 (***Payer***);

(e) in relation to the terms of the Retail Client Agreements, Clause 11.2 (***Liquidation Date***), Clause 11.4 (***Calculation of Liquidation Amount***) and Clause 11.5 (***Payer***);

(f) in relation to the terms of the Professional Client Agreements, Clause 11.2 (***Liquidation Date***), Clause 11.4 (***Calculation of Liquidation Amount***) and Clause 11.5 (***Payer***); or

(g) any modified version of such clauses provided that it includes at least those parts of paragraph 1 of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow.

"**FOA Published Form Agreement**" means a document listed at Annex 1 in the form published by the Futures and Options Association on its website as at the date of this opinion.

"**FOA Set-off Provisions**" means:

(a) the "**General Set-off Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement (with Security Provisions) 2007 and Professional Client Agreement (with Security Provisions) 2009, clause 15.11 (***Set-off***);

(ii) in the case of Agreements in the form of the Professional Client Agreement (with Security Provisions) 2011, clause 15.13 (***Set-off***);

(iii) in the case of Agreements in the form of the Retail Client Agreement (with Security Provisions) 2007 and the Retail Client Agreement (with Security Provisions) 2009, clause 15.12 (***Set-off***);

(iv) in the case of Agreements in the form of the Retail Client Agreement (with Security Provisions) 2011, clause 15.13 (***Set-off***);

(v) in the case of Agreements in the form of the Eligible Counterparty Agreement (with Security Provisions) 2007 and the Eligible Counterparty Agreement (with Security Provisions) 2009, clause 14.8 (***Set-off***);

(vi) in the case of Agreements in the form of the Eligible Counterparty Agreement (with Security Provisions) 2011, clause 14.10 (***Set-off***);

(vii) in the case of the Agreements in the form of One-Way Master Netting Agreement (1997 version), clause 5 (***Set-Off***);

(viii) in the case of the Agreements in the form of Two-Way Master Netting Agreement (1997 version), clause 5 (***Set-Off***); or

(ix) any modified version of such clauses provided that it includes at least those parts of paragraph 2 of Part 1 (Core Provisions) of Annex 4 which are highlighted in yellow; and/or

(b) the "**Margin Cash Set-off Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement (with Security Provisions) 2007 and the Professional Client Agreement (with Security Provisions) 2009, clause 8.5 (***Set-off on default***);

(ii) in the case of Agreements in the form of the Professional Client Agreement (with Security Provisions) 2011, clause 8.4 (***Set-off upon default or termination***);

(iii) in the case of Agreements in the form of the Retail Client Agreement (with Security Provisions) 2007 and the Retail Client Agreement (with Security Provisions) 2009, clause 8.7 (***Set-off on default***),

(iv) in the case of Agreements in the form of the Retail Client Agreement (with Security Provisions) 2011, clause 8.6 (***Set-off upon default or termination***);

(v) in the case of Agreements in the form of the Eligible Counterparty Agreement (with Security Provisions) 2007 and the Eligible Counterparty Agreement (with Security Provisions) 2009, clause 7.5 (***Set-off on default***);

(vi) in the case of Agreements in the form of the Eligible Counterparty Agreement (with Security Provisions) 2011, clause 7.4 (***Set-off upon default or termination***); or

(vii) any modified version of such clauses provided that it includes at least those parts of paragraph 3 of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow.

"**Insolvency Events of Default Clause**" means (in each case subject to any selections or amendments required or permitted to be made on the face of the document in the relevant form referred to in Annex 1):

(a) where the FOA Member's counterparty is not a natural person:

(i) in relation to the terms of the Long-Form Two-Way Clauses and the Long Form One-Way Clauses 2007, Clause 1 (b) to (d) (inclusive) and Clause 1 (h) and (i);

(ii) in relation to the terms of the Short Form One-Way Clauses and Short Form Two-Way Clauses, Clauses 1.1 (a) to (c) (inclusive);

(iii) in relation to the terms of the Master Netting Agreements, Clause 4.1 (i) to (iii) (inclusive);

(iv) in relation to the terms of the Eligible Counterparty Agreements, Clause 9.1 (a) to (c) (inclusive);

(v) in relation to the terms of the Retail Client Agreements and the Professional Client Agreements, Clause 10.1(a) to (c) (inclusive); or

(vi) provided that any modification of such clauses include at least those parts of paragraph 4(a) of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow; and

(b) where the FOA Member's counterparty is a natural person:

(i) in relation to the terms of the Long-Form Two-Way Clauses and the Long Form One-Way Clauses 2007, Clause 1 (b) to (d) (inclusive) and Clause 1 (h) and (i);

(ii) in relation to the terms of the Master Netting Agreements, Clause 4.1 (i) and (iv);

(iii) in relation to the terms of the Retail Client Agreements and the Professional Client Agreements, Clause 10.1(a) and (d); or

(iv) any modified version of such clauses provided that it includes at least those parts of paragraph 4(b) of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow.

"**ISDA/FOA Clearing Addendum**" means the ISDA/FOA Client Cleared OTC Derivatives Addendum as first published on 11 June 2013, or any subsequent published versions up to the date of this opinion letter.

"**Limited Recourse Provision**" means Clause 8.1 of the FOA Clearing Module or Clause 15(a) of the ISDA/FOA Clearing Module.

"**Long Form Two-Way Clauses**" means each of the Long-Form Two-Way Clauses 2007, the Long-Form Two-Way Clauses 2009 and the Long-Form Two-Way Clauses 2011 (each as listed and defined at Annex 1).

"**Master Netting Agreements**" means each of the One-Way Master Netting Agreement 1997 and the Two-Way Master Netting Agreement 1997 (each as listed and defined at Annex 1).

"**Non-Defaulting Party**" includes, in relation to the One-Way Versions, the Party entitled to exercise rights under the FOA Netting Provision.

"**Non-material Amendment**" means an amendment having the effect of one of the amendments set out at Annex 4.

"**One-Way Versions**" means the Long Form One-Way Clauses 2007, the Short Form One-Way Clauses, the One-Way Master Netting Agreement 1997, and the FOA Netting Provision as published in the Retail Client Agreements and the Professional Client Agreements in each case in the form of an FOA Published Form Agreement.

"**Party**" means a party to an FOA Netting Agreement or a Clearing Agreement.

"**Professional Client Agreements**" means each of the Professional Client Agreement (with Security Provisions) Agreement 2007, the Professional Client Agreement (with Title Transfer Provisions) Agreement 2007, the Professional Client Agreement (with Security Provisions) Agreement 2009, the Professional Client Agreement (with Title Transfer Provisions) Agreement 2009, the Professional Client Agreement (with Security Provisions) Agreement 2011 or the Professional Client Agreement (with Title Transfer Provisions) Agreement 2011 (each as listed and defined at Annex 1).

"**Rehypothecation Clause**" means:

(a) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.13 (***Rehypothecation***);

(b) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.15 (***Rehypothecation***);

(c) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.13 (***Rehypothecation***); or

(d) any modified version of such clauses provided that it includes at least those parts of paragraph 4 of Part 3 (*Security Interest Provisions*) of Annex 4 which are highlighted in yellow.

"**Retail Client Agreements**" means each of the Retail Client Agreement (with Security Provisions) Agreement 2007, the Retail Client Agreement (with Title Transfer Provisions) Agreement 2007, the Retail Client Agreement (with Security Provisions) Agreement 2009, the Retail Client Agreement (with Title Transfer Provisions) Agreement 2009, the Retail Client Agreement (with Security Provisions) Agreement 2011 or the Retail Client Agreement (with Title Transfer Provisions) Agreement 2011 (each as listed and defined at Annex 1).

"**Non-Cash Security Interest Provisions**" means:

(a) the "**Non-Cash Security Interest Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 8.6 (***Security interest***);

(ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 8.6 (***Security interest***);

(iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.7 (***Security interest***);

(iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 8.8 (***Security interest***);

(v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 8.8 (***Security interest***);

(vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.9 (***Security interest***);

(vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 7.6 (***Security interest***);

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 7.6 (***Security interest***);

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.7 (***Security interest***); or

(x) any modified version of such clauses provided that it includes at least those parts of paragraph 1 of Part 3 (*Security Interest Provisions*) of Annex 4 which are highlighted in yellow; and

(b) the "**Power of Sale Clause**", being:

(i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 8.11 (***Power of sale***);

(ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 8.11 (***Power of sale***);

(iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 8.11 (***Power of sale***);

(iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 8.13 (***Power of sale***);

(v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 8.13 (***Power of sale***);

(vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 8.13 (***Power of sale***);

(vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 7.11 (***Power of sale***);

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 7.11 (***Power of sale***);

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 7.11 (***Power of sale***); or

(x) any modified version of such clauses provided that it includes at least those parts of paragraph 2 of Part 3 (*Security Interest Provisions*) of Annex 4 which are highlighted in yellow.

(c) the "**Client Money Additional Security Clause**", means:

(i) in the case of Agreements in the form of the Professional Client Agreement 2007, clause 7.8 (***Additional security***) at module F Option 4 (where incorporated into such Agreement);

(ii) in the case of Agreements in the form of the Professional Client Agreement 2009, clause 7.9 (***Additional security***) at module F Option 1 (where incorporated into such Agreement);

(iii) in the case of Agreements in the form of the Professional Client Agreement 2011, clause 7.9 (***Additional security***) at module F Option 1 (where incorporated into such Agreement);

(iv) in the case of Agreements in the form of the Retail Client Agreement 2007, clause 7.8 (***Additional security***) at module F Option 4 (where incorporated into such Agreement);

(v) in the case of Agreements in the form of the Retail Client Agreement 2009, clause 7.9 (***Additional security***) at module F Option 1 (where incorporated into such Agreement);

(vi) in the case of Agreements in the form of the Retail Client Agreement 2011, clause 7.9 (***Additional security***) at module F Option 1 (where incorporated into such Agreement);

(vii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2007, clause 6.8 (***Additional security***) at module F Option 4 (where incorporated into such Agreement);

(viii) in the case of Agreements in the form of the Eligible Counterparty Agreement 2009, clause 6.9 (***Additional security***) at module F Option 1 (where incorporated into such Agreement);

(ix) in the case of Agreements in the form of the Eligible Counterparty Agreement 2011, clause 6.9 (***Additional security***) at module F Option 1 (where incorporated into such Agreement); or

(x) any modified version of such clauses provided that it includes at least those parts of paragraph 3 of Part 3 (*Security Interest Provisions*) of Annex 4 which are highlighted in yellow.

"**Short Form One Way-Clauses**" means each of the Short-Form One-Way Clauses 2007, the Short-Form One-Way Clauses 2009 and the Short-Form One-Way Clauses 2011 (each as listed and defined at Annex 1).

"**Short Form Two Way-Clauses**" means each of the Short-Form Two-Way Clauses 2007, the Short-Form Two-Way Clauses 2009 and the Short-Form Two-Way Clauses 2011 (each as listed and defined at Annex 1).

"**Title Transfer Provisions**" means (in each case subject to any selections or amendments required or permitted to be made on the face of the document in the relevant form referred to in Annex 1):

(a) clauses 5 and 7.2 of the Title Transfer and Physical Collateral Annex to the Netting Module (2007 or 2011 Version); or

(b) any modified version of such clauses provided that it includes at least those parts of paragraph 5 of Part 1 (*Core Provisions*) of Annex 4 which are highlighted in yellow.

"**Two Way Clauses**" means each of the Long-Form Two Way Clauses and the Short-Form Two Way Clauses.

ANNEX 4

PART A
CORE PROVISIONS

For the purposes of the definition of Core Provisions in Annex 3, the wording highlighted in yellow below shall constitute the relevant Core Provision:

1. **FOA Netting Provision**:

(a) **Liquidation date**: Subject to the following sub-clause, at any time following the occurrence of an Event of Default in relation to a party, then the other party (the "**Non-Defaulting Party**") may, by notice to the party in default (the "**Defaulting Party**"), specify a date (the "**Liquidation Date**") for the termination and liquidation of Netting Transactions in accordance with this clause.

(b) **Calculation of Liquidation Amount**: Upon the occurrence of a Liquidation Date:

(i) neither party shall be obliged to make any further payments or deliveries under any Netting Transactions which would, but for this clause, have fallen due for performance on or after the Liquidation Date and such obligations shall be satisfied by settlement (whether by payment, set-off or otherwise) of the Liquidation Amount;

(ii) the Non-Defaulting Party shall as soon as reasonably practicable determine (discounting if appropriate), in respect of each Netting Transaction referred to in paragraph (a), the total cost, loss or, as the case may be, gain, in each case expressed in the Base Currency specified by the Non-Defaulting Party as such in the Individually Agreed Terms Schedule as a result of the termination, pursuant to this Agreement, of each payment or delivery which would otherwise have been required to be made under such Netting Transaction; and

(iii) the Non-Defaulting Party shall treat each such cost or loss to it as a positive amount and each such gain by it as a negative amount and aggregate all such amounts to produce a single, net positive or negative amount, denominated in the Non-Defaulting Party's Base Currency (the "**Liquidation Amount**").

(c) **Payer**: If the Liquidation Amount is a positive amount, the Defaulting Party shall pay it to the Non-Defaulting Party and if it is a negative amount, the Non-Defaulting Party shall pay it to the Defaulting Party. The Non-Defaulting Party shall notify the Defaulting Party of the Liquidation Amount, and by which Party it is payable, immediately after the calculation of such amount."

2. **General Set-Off Clause:**

"**Set-off**: Without prejudice to any other rights to which we may be entitled, we may at any time and without notice to you set off any amount (whether actual or contingent, present or future) owed by you to us against any amount (whether actual or contingent, present or future) owed by us to you. For these purposes, we may

ascribe a commercially reasonable value to any amount which is contingent or which for any other reason is unascertained."

3. **Margin Cash Set-Off Clause:**

"**Set-off upon default or termination**: If there is an Event of Default or this Agreement terminates, we may set off the balance of cash margin owed by us to you against your Obligations (as reasonably valued by us) as they become due and payable to us and we shall be obliged to pay to you (or entitled to claim from you, as appropriate) only the net balance after all Obligations have been taken into account. [The net amount, if any, payable between us following such set-off, shall take into account the Liquidation Amount payable under the Netting Module of this Agreement.]"

4. **Insolvency Events of Default Clause:**

(a) In the case of a Counterparty that is not a natural person:

"The following shall constitute Events of Default:

(i) a party fails to make any payment when due under or to make delivery of any property when due under, or to observe or perform any other provision of this Agreement, [and such failure continues for [one/two] Business Day[s] after notice of non-performance has been given by the Non-Defaulting Party to the Defaulting Party];

(ii) a party commences a voluntary case or other procedure seeking or proposing liquidation, reorganisation, moratorium, or other similar relief with respect to itself or to its debts under any bankruptcy, insolvency, regulatory, or similar law or seeking the appointment of a trustee, receiver, liquidator, conservator, administrator, custodian, examiner or other similar official (each a "**Custodian**") of it or any substantial part of its assets, or takes any corporate action to authorise any of the foregoing;

(iii) an involuntary case or other procedure is commenced against a party seeking or proposing liquidation, reorganisation, or moratorium, or other similar relief with respect to it or its debts under any bankruptcy, insolvency, regulatory, or similar law or seeking the appointment of a Custodian of it or any substantial part of its assets."

(b) In the case of a Counterparty that is a natural person:

"The following shall constitute Events of Default:

(i) a party fails to make any payment when due under or to make delivery of any property when due under, or to observe or perform any other provision of this Agreement, [and such failure continues for [one/two] Business Day[s] after notice of non-performance has been given by the Non-Defaulting Party to the Defaulting Party];

(ii) you die, become of unsound mind, are unable to pay your debts as they fall due or are bankrupt or insolvent, as defined under any bankruptcy or insolvency law applicable to you; or any indebtedness of yours is not paid on the due date therefore, or becomes capable at any time of being declared, due and payable under agreements or instruments evidencing such indebtedness before it would otherwise have been due and payable, or any suit, action or other proceedings relating to this Agreement are commenced for any execution, any attachment or garnishment, or distress against, or an encumbrancer takes possession of, the whole or any part of your property, undertaking or assets (tangible and intangible)."

5. **Title Transfer Provisions**:

(a) "**Default**: If a Liquidation Date is specified or deemed to occur as a result of an Event of Default, the Default Margin Amount as at that date *will* be deemed to be [a gain (if we are the Non-Defaulting Party) or a cost (if you are the Non-Defaulting Party)] [a gain by us] for the purposes of calculating the Liquidation Amount. For this purpose, "**Default Margin Amount**" means the amount, calculated in the Base Currency of the aggregate value as at the relevant Liquidation Date (as determined by us) of the Transferred Margin.

(b) **Clean title**: Each party agrees that all right, title and interest in and to any Acceptable Margin, Equivalent Margin, Equivalent Dividends or Interest (each as defined in the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2011 Version) or the Title Transfer Securities and Physical Collateral Annex to the Netting Module (2007 Version)) which it transfers to the other party shall vest in the recipient free and clear of any security interest, lien, claims, charges, encumbrance or other restriction. Notwithstanding the use of terms such as "margin" which are used to reflect terminology used in the market for such transactions, nothing in these provisions is intended to create or does create in favour of either party a mortgage, charge, lien, pledge, encumbrance or other security interest in any Acceptable Margin, Equivalent Margin, Equivalent Dividends or Interest Transferred hereunder."

6. **Clearing Module Netting Provision / Addendum Netting Provision:**

(a) [Firm Trigger Event/CM Trigger Event]

Upon the occurrence of a [Firm Trigger Event/CM Trigger Event], the Client Transactions in the relevant Cleared Transaction Set will, except to the extent otherwise stated in the [Core Provisions of the] relevant Rule Set, be dealt with as set out below:

(i) each Client Transaction in the relevant Cleared Transaction Set will automatically terminate [upon the occurrence of a Firm Trigger Event] [at the same time as the related CM/CCP Transaction is terminated or Transferred] and, following such termination, no further payments or deliveries in respect of such Client Transaction [as specified in the Confirm] or any default interest, howsoever described, on such payment obligations will be required to be made but without prejudice to the other provisions of the Clearing Agreement, and the amount payable following such termination will be the Cleared Set

Termination Amount determined pursuant to this [Clause 5.22 Section 8(b)(ii)];

(ii) the value of each such terminated Client Transaction for the purposes of calculating the applicable Cleared Set Termination Amount and Aggregate Transaction Values will be equal to the relevant [Firm/CM]/CCP Transaction Value or the relevant part thereof;

(iii) the applicable Cleared Set Termination Amount will be determined by Client on, or as soon as reasonably practicable after, (x) if there were no outstanding Client Transactions immediately prior to the occurrence of a [Firm/CM] Trigger Event, the date on which the [Firm/CM] Trigger Event occurred, or (y) if there were outstanding Client Transactions immediately prior to the occurrence of a [Firm/CM] Trigger Event, the day on which the relevant Client Transactions [had all been/were] terminated (in either case, provided that, if [Firm/Clearing Member] gives notice to Client requiring it to determine such amount and Client does not do so within two Business Days of such notice being effectively delivered, [Firm/Clearing Member] may determine the applicable Cleared Set Termination Amount) and, in either case, will be an amount equal to the sum, but without duplication, of (A) the Aggregate Transaction Value, (B) any amount which became payable, or which would have become payable but for a condition precedent not being satisfied, in respect of any such Client Transaction on or prior to the termination of such transactions but which remains unpaid at the time of such termination, together with interest on such amount in the same currency as such amount for the period from, and including, the original due date for payment to, but excluding, the date of termination, if applicable (expressed as a positive amount if such unpaid amount is due from [Firm/Clearing Member] to Client and as a negative amount if such unpaid amount is due from Client to [Firm/Clearing Member]), (C) an amount [(which may be zero)] equal to the Relevant Collateral Value in respect of the relevant Client Transactions and (D) any other amount attributable to the relevant Client Transactions under the Clearing Agreement[or any related Collateral Agreement], pro-rated where necessary if such amount can be partially [attributed] [attributable] to transactions other than the relevant Client Transactions, which was payable but unpaid at the time of termination and is not otherwise included [Clauses 5.2.2(c)(4) to 5.2.2(c)(C)] [Sections 8(b)(ii)(3)(A) to 8(b)(ii)(3)(C)], together with interest on such amount in the same currency as such amount for the period from, and including, the original due date for payment to, but excluding, the date of termination, if applicable (expressed as a positive amount if such unpaid amount is due from [Firm/Clearing Member] to Client and as a negative amount if such unpaid amount is due from Client to [Firm/Clearing Member]);

(iv) if a Cleared Set Termination Amount is a positive number, it will be due from [Firm/Clearing Member] to Client and if a Cleared Set Termination Amount is a negative number, the absolute value of the Cleared Set Termination Amount will be due from Client to [Firm/Clearing Member], and in each case will be payable in accordance with this [Module/Addendum].

(b) CCP Default

Upon the occurrence of a CCP Default, the Client Transactions in the relevant Cleared Transaction Set will, except to the extent otherwise stated in the [Cor Provisions of the relevant] Rule Set, be dealt with as set out below:

(i) each Client Transaction in the relevant Cleared Transaction Set will automatically terminate at the same time as the related [Firm/CM]/CCP Transaction and following such termination no further payments or deliveries in respect of such Client Transaction[as specified in the Confirm] or any default interest, howsoever described, on such payment obligations will be required to be made but without prejudice to the other provisions of the Clearing Agreement, and the amount payable following such termination will be the Cleared Set Termination Amount determined pursuant to this [Clause 5.3 Section 8(c)];

(ii) the value of each such terminated Client Transaction for the purposes of calculating the applicable Cleared Set Termination Amount and Aggregate Transaction Values will be equal to the relevant [Firm/CM]/CCP Transaction Value or relevant part thereof;

(iii) the applicable Cleared Set Termination Amount will be determined by [Firm/Clearing Member] on, or as soon as reasonably practicable after, (x) if there were no outstanding Client Transactions immediately prior to the occurrence of a CCP Default, the date on which the CCP Default occurred, or (y) if there were outstanding Client Transactions immediately prior to the occurrence of a CCP Default, the day on which the relevant Client Transactions had all been terminated and, in either case, will be an amount equal to the sum, but without duplication, of (1) the Aggregate Transaction Value, (2) any amount which became payable, or which would have become payable but for a condition precedent not being satisfied, in respect of any such Client Transaction on or prior to the termination of such transactions but which remains unpaid at the time of such termination, together with interest on such amount in the same currency as such amount for the period from, and including, the original due date for payment to, but excluding, the date of termination, if applicable (expressed as a positive amount if such unpaid amount is due from [Firm/Clearing Member] to Client and as a negative amount if such unpaid amount is due from Client to [Firm/Clearing Member]), (3) an amount [(which may be zero)] equal to the Relevant Collateral Value in respect of the relevant Client Transactions and (4) any other amount attributable to the relevant Client Transactions under the Clearing Agreement[and any related Collateral Agreement], pro-rated where necessary if such amount can be partially [attributable] to transactions other than the relevant Client Transactions, which was payable but unpaid at the time of termination and is not otherwise included in [Clauses 5.3.3(1) to 5.3.3(3)] [Sections 8(c)(iii)(1) to 8(c)(iii)(3)], together with interest on such amount in the same currency as such amount for the period from, and including, the original due date for payment to, but excluding, the date of termination, if applicable (expressed as a positive amount if such unpaid amount is due from

[Firm/Clearing Member] to Client and as a negative amount if such unpaid amount is due from Client to [Firm/Clearing member]);

(iv) if a Cleared Set Termination Amount is a positive number, it will be due from [Firm/Clearing Member] to Client and if a Cleared Set Termination Amount is a negative number, the absolute value of the Cleared Set Termination Amount will be due from Client to [Firm/Clearing Member], and in each case will be payable, in accordance with this [Module/Addendum].

(c) Hierarchy of Events

[If Client Transactions are capable of being terminated pursuant to more than one [Clause/Section], then the [clause/section] in respect of which a party first exercises any right to terminate Client Transactions (or, the [clause/section] pursuant to which Client Transactions are otherwise terminated, if earlier) will prevail for the purposes of the relevant Client Transactions.]

Or

[If Client Transactions are capable of being terminated pursuant to more than one [Clause/Section], then the [clause/section] in respect of which a party first exercises any right to terminate Client Transactions (or, the [clause/section] pursuant to which Client Transactions are otherwise terminated, if earlier) will prevail for the purposes of the relevant Client Transactions.]

Or

[If Client Transactions are capable of being terminated pursuant to more than one [Clause/Section], then the [clause/section] in respect of which a party first exercises any right to terminate Client Transactions (or, the clause pursuant to which Client Transactions are otherwise terminated, if earlier) will prevail for the purposes of the relevant Client Transactions.]

(d) **Definitions**

"**Aggregate Transaction Value**" means, in respect of the termination of Client Transactions of a Cleared Transaction Set, an amount (which may be positive or negative or zero) equal to the aggregate of the [Firm/CM]/CCP Transaction Values for all Client Transactions in the relevant Cleared Transaction Set or, if there is just one [Firm/CM]/CCP Transaction Value in respect of all such Client Transactions, an amount (which may be positive or negative or zero) equal to such [Firm/CM]/CCP Transaction Value.

"**[Firm/CM]/CCP Transaction Value**" means, in respect of a terminated Client Transaction or a group of terminated Client Transactions, an amount equal to the value that is determined in respect of or otherwise ascribed to the related [Firm/CM]/CCP Transaction or group of related [Firm/CM]/CCP Transactions in accordance with the relevant Rule Set following a [Firm/CM] Trigger Event or CCP Default (to the extent such Rule Set contemplates such a value in the relevant circumstance). If the value determined in respect of or otherwise ascribed to the

related [Firm/CM]/CCP Transaction(s) under the relevant Rule Set reflects a positive value for [Firm/Clearing Member] vis-à-vis the Agreed CCP, the value determined in respect of such terminated Client Transaction(s) will reflect a positive value for Client vis-à-vis [Firm/Clearing Member] (and will constitute a positive amount for any determination under this [Module/Addendum]) and, if the value determined in respect of the related terminated [Firm/CCP]/CCP Transaction(s), under the relevant Rule Set reflects a positive value for the relevant Agreed CCP vis-à-vis [Firm/Clearing Member], the value determined in respect of [or otherwise ascribed to] such terminated Client Transaction(s) will reflect a positive value for [Firm/Clearing Member] vis-à-vis Client (and will constitute a negative amount for any determination under this [Module/Addendum]). The value determined in respect of or otherwise ascribed to the related [Firm/CM]/CCP Transaction(s) under the relevant Rule Set may be equal to zero.

"**Relevant Collateral Value**" means, in respect of the termination of Client Transactions in a Cleared Transaction Set, the value (without applying any "haircut" but otherwise as determined in accordance with the [Agreement/Collateral Agreement]) of all collateral that:

(a) is attributable to such Client Transactions;

(b) has been transferred by one party to the other in accordance with the [Agreement/Collateral Agreement or pursuant to Section 10(b)] and has not been returned at the time of such termination or otherwise applied or reduced in accordance with the terms of the [Agreement/relevant Collateral Agreement]; and

(c) is not beneficially owned by, or subject to any encumbrances or any other interest of, the transferring party or of any third person.

The Relevant Collateral Value will constitute a positive amount if the relevant collateral has been transferred by Client to [Firm/Clearing Member] and it or equivalent collateral has not been returned at the time of termination or otherwise applied or reduced in accordance with the terms of the [Agreement/Collateral Agreement] and a negative amount if the relevant collateral has been transferred by [Firm/Clearing Member] to Client and it or equivalent collateral has not been returned at the time of termination or otherwise applied or reduced in accordance with the terms of the [Agreement/Collateral Agreement].

7. Clearing Module Set-Off Provision

Firm may at any time and without notice to Client, set-off any Available Termination Amount against any amount (whether actual or contingent, present or future) owed by Firm to Client under the Clearing Agreement or otherwise. For these purposes, Firm may ascribe a commercially reasonable value to any amount which is contingent or which for any other reason is unascertained.

This Clause shall apply to the exclusion of all Disapplied Set-off Provisions in so far as they relate to Client Transactions; provided that, nothing in this Clause shall

prejudice or affect such Disapplied Set-off Provisions in so far as they relate to transactions other than Client Transactions under the Agreement.

8. **Addendum Set-Off Provision**

(i) Any Available Termination Amount will, at the option of (A) Client, in the case of an Available Termination Amount due in respect of a CM Trigger Event and without prior notice to Clearing Member, be reduced by its set-off against any other termination amount payable by Clearing Member to Client under the Clearing Agreement at such time ("**CM Other Amounts**"), or (B) either party, in the case of an Available Termination Amount due in respect of a CCP Default, and without prior notice to the other party, be reduced by its set-off against any other termination amount payable by or to X (where "**X**" means, in the case of Section 8(i)(A), Client or, in the case of Section 8(i)(B), the party electing to set off) under the Clearing Agreement at such time ("**EP Other Amounts**" and together with CM Other Amounts, "**Other Amounts**"), provided that in the case of Section 8(i)(A) or Section 8(i)(B), at the time at which X elects to set off, where Clearing Member is X, a CM Trigger Event has not occurred and is not continuing or, where Client is X, an event of default, termination event or other similar event, howsoever described, in respect of Client in the Agreement, has not occurred and is not continuing. To the extent that any Other Amounts are so set off, those Other Amounts will be discharged promptly and in all respects. X will give notice to the other party promptly after effecting any set-off under Section 8(i)(A) or Section 8(i)(B).

(ii) For the purposes of this Section 8(ii):

(A) all or part of the Available Termination Amount or the Other Amounts (or the relevant portion of such amounts) may be converted by X into the currency in which the other amount is denominated at the rate of exchange at which such party would be able, in good faith and using commercially reasonable procedures, to purchase the relevant amount of such currency;

(B) if any Other Amounts are unascertained, X may in good faith estimate such Other Amounts and set off in respect of the estimate, subject to the relevant party accounting to the other when such Other Amounts are ascertained; and

(C) a "termination amount" may, for the avoidance of doubt, be another Cleared Set Termination Amount or another termination amount due under the Agreement including, in either case, any such amount that has previously been reduced in part by set-off pursuant to this Section 8(e).

(iii) Nothing in this Section 8(e) will be effective to create a charge or other security interest. This Section 8(e) will be without prejudice and in addition to any right of set-off, offset, combination of accounts, lien, right of retention or withholding or similar right or requirement to which Client or Clearing Member is at any time otherwise entitled or subject (whether by operation of

law, contract or otherwise), provided that, notwithstanding anything to the contrary in the Clearing Agreement or any related Collateral Agreement, no party may exercise any rights of set-off in respect of Excluded Termination Amounts.

PART B
NON-MATERIAL AMENDMENTS

1. Any change to the numbering or order of a provision or provisions or the drafting style thereof (e.g., addressing the other party as "you", "Counterparty", "Party A/Party B", using synonyms, changing the order of the words) provided in each case that the plain English sense and legal effect both of each such provision and of the agreement as a whole (including the integrity of any cross references and usage of defined terms) remains unchanged.

2. Any change to a provision or provisions for the purposes of correct cross-referencing or by defining certain key terms (e.g., party, exchange, currency, defaulting party or non-defaulting party) and using these terms in large caps throughout the agreement provided in each case that the plain English sense and legal effect both of each such provision and of the agreement as a whole (including the integrity of any cross references and usage of defined terms) remains unchanged.

3. A change which provides that the agreement applies to existing Transactions outstanding between the parties on the date the agreement takes effect.

4. Any change to the scope of the agreement clarifying that certain transactions (e.g., OTC derivatives governed by an ISDA Master Agreement) shall not be transactions or contracts for purposes of the agreement.

5. Any change to an Insolvency Event of Default (i) introducing a grace period for the filing of a petition for bankruptcy proceedings (of e.g. 15 or 30 days), (ii) modifying or deleting any such grace period, (iii) requiring that the filing of the petition is not frivolous, vexatious or otherwise unwarranted or (iv) that the non-defaulting party has reasonable grounds to conclude that the performance by the defaulting party of its obligations under the agreement, Transactions, or both, is endangered.

6. Any change to an Insolvency Event of Default more particularly describing (i) the relevant procedures that would or would not constitute such event of default or termination event (ii) the relevant officers the appointment of which would or would not constitute such Insolvency Event of Default.

7. Any change to an Insolvency Event of Default extending its scope to events occurring with respect to the credit support provider, an affiliate, a custodian or trustee of a Party.

8. Any change to an Insolvency Event of Default replacing such event of default with a provision aligned to Section 5(a)(vii) of the 1992 or 2002 ISDA Master Agreement (or relevant part thereof).

9. In the case of any agreement incorporating the Two-Way Clauses, any change to the Insolvency Events of Default which has the effect of providing that when one or several specified events (which would constitute Insolvency Events of Default) occur in relation to one specified Party, such event shall not constitute an Event of Default under the agreement.

10. Any change to the agreement requiring the Non-Defaulting Party when exercising its rights under the FOA Netting Provision, Clearing Module Netting Provision, Addendum Netting Provision, FOA Set-off Provisions, Clearing Module Set-Off Provision, Addendum Set-Off Provision or Title Transfer Provisions (or other provisions) or making determinations to act in good faith and/or a commercially reasonable manner.

11. Any change modifying the currency of Liquidation Amount, Available Termination Amount, Cleared Set Termination Amount or of any amount relevant to the FOA Set-Off Provisions, Clearing Module Set-Off Provision, Addendum Set-Off Provision or Title Transfer Provisions.

12. Any change to the FOA Netting Provision, the FOA Set-Off Provisions, the Clearing Module Netting Provision, the Clearing Module Set-Off Provision, the Addendum Netting Provision or the Addendum Set-Off Provision clarifying that (i) any account subject to set-off must be owned by the same party or (ii) the Non-Defaulting Party must, or may, notify the other party of its exercise of rights under such provision or other provision.

13. Any change to the FOA Set-Off Provision, the Clearing Module Set-Off Provision or the Addendum Set-Off Provision (a) clarifying (i) at which time set-off may be exercised by a Party (with or without limitation), (ii) the amounts that may be set-off (with or without limitation, whether in relation to the agreement(s) under which such amounts arise or to the parties from which they are due), (iii) the scope of the provision where a Party acts as agent, (iv) the use of currency conversion in case of cross-currency set-off, (v) the application or disapplication of any grace period to set-off, (vi) the exercise of any lien, charge or power of sale against obligations owed by one Party to the other; or (b) allowing the combination of a Party's accounts.

14. Any change to the FOA Netting Provision adding or taking from the amounts to be taken into account for the calculation of the Liquidation Amount.

15. Any addition to any of the Core Provisions that leaves both the plain English sense and legal effect of such provision unchanged.

16. Any change converting the Core Provisions of the FOA Netting Provision to a 'one-way' form in the style of the One-Way Master Netting Agreement 1997 (in which only the default of one Party is contemplated).

17. Including multiple forms of netting provision in respect of Client Transactions, in any of the following combinations:

- more than one ISDA/FOA Clearing Addendum or Addendum Netting Provision
- more than one FOA Clearing Module or Clearing Module Netting Provision
- one or more ISDA/FOA Clearing Addendum or Addendum Netting Provision and one or more FOA Clearing Module or Clearing Module Netting Provision

provided that the agreement specifies unambiguously that only one such netting provision shall apply in respect of any given Client Transaction.

18. Including the Title Transfer Provisions together with provisions which create a security interest over cash and/or non-cash margin, provided that a provision in the form of, or with equivalent effect to, clauses 4.3 and/or 4.4 of the FOA Clearing Module is used or the agreement otherwise unambiguously specifies the circumstances in which the security interest or the Title Transfer provisions apply in respect of any given item of margin so that it is not possible for both the security interest and the Title Transfer Provisions to apply simultaneously to the same item of margin.

19. Adding to the definition of "Firm Trigger Event" or, as the case may be, "CM Trigger Event" (or defined terms equivalent thereto) any further events of default in relation to the Firm or, as the case may be, the Clearing Member, including those in the definition of Events of Default appearing in an FOA Published Form Agreement (including as modified in accordance with paragraph 5 above).

20. Any change to the FOA Netting Provision providing that any applicable Liquidation Amount will be determined by the Defaulting Party.

21. Any addition to the Clearing Module Netting Provision or the Addendum Netting Provision providing that, if any Firm/CCP Transaction or CM/CCP Transaction and its related collateral or margin has been ported to another clearing member of the Agreed CCP Service following a Firm Trigger Event or CM Trigger Event, the Party in charge of the calculation of the Cleared Set Termination Amount can ascribe an appropriately reduced value (including zero) to the Client Transaction and related margin or collateral corresponding to the Firm/CCP Transaction or CM/CCP Transaction and its related collateral or margin so ported.

PART C
SECURITY INTEREST PROVISIONS

1. **Security Interest Clause:**

"As a continuing security for the performance of the Secured Obligations under or pursuant to this Agreement, you grant to us, with full title guarantee, a first fixed security interest in all non-cash margin now or in the future provided by you to us or to our order or under our direction or control or that of a Market or otherwise standing to the credit of your account under this Agreement or otherwise held by us or our Associates or our nominees on your behalf."

2. **Power of Sale Clause:**

"If an Event of Default occurs, we may exercise the power to sell all or any part of the margin. The restrictions contained in Sections 93 and 103 of the Law of Property Act 1925 shall not apply to this Agreement or to any exercise by us of our rights to consolidate mortgages or our power of sale. We shall be entitled to apply the proceeds of sale or other disposal in paying the costs of such sale or other disposal and in or towards satisfaction of the Secured Obligations."

3. **Client Money Additional Security Clause**

"As a continuing security for the payment and discharge of the Secured Obligations you grant to us, with full title guarantee, a first fixed security interest in all your money that we may cease to treat as client money in accordance with the Client Money Rules. You agree that we shall be entitled to apply that money in or towards satisfaction of all or any part of the Secured Obligations which are due and payable to us but unpaid."

4. **Rehypothecation Clause**

"You agree and authorise us to borrow, lend, appropriate, dispose of or otherwise use for our own purposes, from time to time, all non-cash margin accepted by us from you and, to the extent that we do, we both acknowledge that the relevant non-cash margin will be transferred to a proprietary account belonging to us (or to any other account selected by us from time to time) by way of absolute transfer and such margin will become the absolute property of ours (or that of our transferee) free from any security interest under this Agreement and from any equity, right, title or interest of yours. Upon any such rehypothecation by us you will have a right against us for the delivery of property, cash, or securities of an identical type, nominal value, description and amount to the rehypothecated non-cash margin, which, upon being delivered back to you, will become subject to the provisions of this Agreement. We agree to credit to you, as soon as reasonably practicable following receipt by us, and as applicable, a sum of money or property equivalent to (and in the same currency as) the type and amount of income (including interest, dividends or other distributions whatsoever with respect to the non-cash margin) that would be received by you in respect of such non-cash margin assuming that such non-cash margin was not rehypothecated by us and was retained by you on the date on which such income was paid.".

ANNEX 5
NECESSARY OR DESIRABLE AMENDMENTS

Desirable amendment for the purposes of paragraphs 3.3.2(k), 3.3.2(l) and 3.4.11:

> "The following shall constitute Events of Default:
>
> [...]
>
> An application is filed for the commencement of bankruptcy or other insolvency proceedings against the assets of either party and such party either has filed the application itself or is generally unable to pay its debts as they become due or is in any other situation which justifies the commencement of such proceedings ("**Insolvency Event of Default**").
>
> [...]
>
> A Liquidation Date shall occur immediately without notice upon the occurrence of an Insolvency Event of Default with respect to a party."