CLIFFORD

CHANCE

GERMAN LAW OPINION OF CLIFFORD CHANCE ISSUED IN CONNECTION WITH THE EFET MASTER NETTING AGREEMENT AND THE TBMA CROSS PRODUCT MASTER AGREEMENT

1 March 2011

The European Federation of Energy Traders
Amstelveenseweg 998
1081 JS Amsterdam
The Netherlands

Dear Sirs,

Legal Opinion Regarding the Enforceability of Close-Out Netting and the Validity and Enforceability of Collateral Arrangements under the EFET Master Netting Agreement and the TBMA Cross Product Master Agreement.

We have been asked, as legal advisers to the European Federation of Energy Traders ("**EFET**"), to give an opinion in respect of the laws of the Federal Republic of Germany ("**Germany**") in relation to a number of issues and questions raised by EFET in respect of its Master Netting Agreement published in June 2010 (the "**MNA**"), the Cross Product Master Agreement published by The Bond Market Association in February 2000, as modified by the EFET (as so modified, the "**CPMA**" and, together with the MNA, the "**Master Agreements**"), the EFET Credit Support Annex to the MNA published in February 2011 (the "**2011 CSA**") and the Cross Product Credit Support Annex to the CPMA published on 23 June 2003 (the "**2003 CSA**" and, together with the 2011 CSA, the "**Credit Support Annexes**", which together with the Master Agreements are hereafter referred to as the "**Agreements**"). Terms used in this opinion and not otherwise defined herein shall have the meanings ascribed to them in the Agreements.

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1. DOCUMENTS CONSIDERED

In this opinion (the "**Opinion**") we considered the following documents:

(a) the MNA[1];

(b) the CPMA[2];

(c) EFET/IECA Commodities Schedule to the Cross-Product Master Agreement (Version 1.0. published 23 June 2003) (the "**Commodities Schedule**");

(d) the Credit Support Annexes[3].

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1 The MNA constitutes a bilateral cross-product netting agreement governing all transactions the Parties may enter into under certain master agreements as listed in Annex 2 (each a "**Netted Agreement**") falling within the scope of the MNA. The MNA provides that the MNA, all Netted Agreements and all transactions entered into thereunder form a single agreement (§ 2.3 of the MNA). Upon the occurrence of a Close-Out Event in respect of a Party, including a winding-up, insolvency or attachment, the other Party shall be entitled to terminate all transactions under all of its Netted Agreements (§ 4.1 of the MNA). Settlement Amounts are determined for the terminated Netted Agreement in accordance with their terms (§ 7.1 of the MNA) and, to the extent necessary, converted into the Base Currency. If on the Early Termination Date both Parties owe one or more Settlement Amounts under two or more Netted Agreements, such Settlement Amounts are aggregated and netted-off and only the difference, if any, between the two offsetting aggregate amounts (the "**Final Net Settlement Amount**") shall be owed by the Party with the larger aggregate obligation (§ 8.1 of the MNA).

2 The CPMA constitutes a bilateral cross-product netting agreement governing all transactions the Parties may enter into under certain Netted Agreements falling within the scope of the CPMA. If so selected by the Parties in Section 10.6 of the Commodities Schedule, the CPMA provides that it forms together with all Netted Agreements and all transactions entered into thereunder a single agreement. Upon the occurrence of a Close-Out Event in respect of a Party, including a winding-up, insolvency or attachment, the other Party shall be entitled to terminate all of its Principal Agreements (Section 2.1 of the CPMA). Settlement Amounts are determined for the terminated Netted Agreement in accordance with their terms (Section 3.1 of the CPMA) and, to the extent necessary, converted into the Base Currency. If after termination both Parties owe one or more Settlement Amounts under two or more Netted Agreements, such Settlement Amounts are aggregated and netted-off and only the difference, if any, between the two offsetting aggregate amounts (the Final Net Settlement Amount) shall be owed by the Party with the larger aggregate obligation (Section 4 of the CPMA).

3 The 2003 CSA and the 2011 CSA supplement the CPMA and the MNA. They provide for the transfer of full ownership in the collateral to the Transferee who acquires the right of complete and unrestricted use of the collateral (§ 7 of the Credit Support Annexes). Upon termination of the CPMA or the MNA, any collateral provided but not yet re-transferred by the Parties is to be valued and included in the Final Net Settlement Amount to be determined pursuant to Section 4 of the CPMA and Section 8 of the MNA (Section 11 of the 2003 CSA and section 12 of the 2011 CSA). One special feature of the 2003 CSA and the 2011 CSA is the inclusion of Letter of Credits.

This Opinion does not relate to any individual contract evidenced by a confirmation ("**Confirmation**") under the relevant master agreements which are covered by the Master Agreements ("**Individual Contracts**"). We do not opine on any tax, accounting, regulatory or related matters other than to the extent we express an opinion hereunder.

2. SCOPE OF REVIEW

2.1 The opinions given in this Opinion relate only to German law as applied by the German courts as at today's date. We express no opinion on the laws of any other jurisdiction, even where, under German law, a foreign law would be applicable. This Opinion expresses and describes German legal concepts in the English language rather than in their original form and such expressions and/or descriptions may not be fully identical in their meaning to the underlying German law concepts. Any issues of interpretation arising in respect of the Master Agreements, the Commodities Schedule, the Credit Support Annexes and any Individual Contract (to the extent governed by German law) which are in the English language or this Opinion will be determined by the German courts in accordance with German law and we express no opinion on the interpretation that the German courts may give to any such expressions or descriptions. In this respect German courts have held that, under German law, documents which are governed by German law may, if they have been executed in the English language, be interpreted with a view to the meaning of such English terms in an English law environment.

2.2 We express no opinion as to any provisions of the agreements referred to in Paragraph 1(a) through 1(d) on page 4 above, other than those to which express reference is made in this Opinion except insofar as any such provision relates to the effectiveness of the Netting Provisions.

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

2.4 This Opinion is given solely in respect of parties which are[4]:

(a) companies,

(b) partnerships,

(c) credit institutions[5],

[4] We do not give an opinion on general regulatory restrictions, including investment guidelines, under the German Insurance Supervisory Act (*Versicherungsaufsichtsgesetz*), the German Covered Bond Act (*Pfandbriefgesetz*) or the German Investment Act (*Investmentgesetz*) or other regulatory restrictions regarding entities subject to further regulatory restrictions other than those generally applicable for all credit institutions or financial services institutions under the German Banking Act.

(d) financial services institutions,

(e) investment management companies, and

(f) insurance companies,[6]

in each case incorporated, organised, established or formed under private law in accordance with the laws of Germany,

(g) the Federal Republic of Germany (*Bund*), Federal States (*Bundesländer*) of the Federal Republic of Germany and German municipalities (*Gemeinden*), and

(h) German public law entities (*juristische Personen des öffentlichen Rechts*).

2.5 For purposes hereof, a reference to a "**company**", is a reference to a stock corporation (*Aktiengesellschaft*) incorporated under the German Stock Corporation Act (*Aktiengesetz*), or a European stock company (*Societas Europaea*) incorporated under the German Act on the Introduction of the European Company (*Gesetz zur Einführung der Europäischen Gesellschaft*)[7], or a limited liability company (*Gesellschaft mit beschränkter Haftung*) incorporated under the German Act on Limited Liability Companies (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung*); a reference to a "**partnership**" is a reference to a general partnership (*offene Handelsgesellschaft*) or a limited partnership (*Kommanditgesellschaft*) organised under the German Commercial Code (*Handelsgesetzbuch*); a reference to a "**credit institution**" is a reference to a credit

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5 We do not opine on German *Pfandbrief* banks.

6 With respect to insurance companies, section 77 para. 2 sentence 2 of the Insurance Supervisory Act, imposes restrictions on the set-off of claims against claims held by insurance companies if the claim held by the insurance company belongs to its so-called "cover assets" (*Sicherungsvermögen*) within the meaning of section 66 para. 1 of the Insurance Supervisory Act (please refer to footnote 52 on page 42 below). The cover assets are part of the committed assets (*gebundenes Vermögen*) within the meaning of section 54 para. 1 of the Insurance Supervisory Act. Such committed assets are subject to certain investment restrictions to secure the financial stability of the insurance company. In addition, section 77 para. 2 sentence 2 of the Insurance Supervisory Act provides that satisfaction of a third party by way of set-off against a claim contained in the cover assets is only permitted if the claim for the benefit of which any such set-off has been effected has to be allocated to the cover assets (section 66 paras. 1 to 4 of the Insurance Supervisory Act) and if such allocation has actually been made.

7 According to Article 10 of the Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE), an SE shall be treated in every Member State as if it were a public limited-liability company formed in accordance with the law of the Member State in which it has its registered office. Thus the provisions of the German Stock Corporation Act are applicable unless the provisions of the Council Regulation prevail.

institution (*Kreditinstitut*) within the meaning of section 1 para. 1 of the German Banking Act (*Kreditwesengesetz*), and a reference to a "**German deposit taking credit institution**" is a reference to a deposit taking credit institution (*Einlagenkreditinstitut*) as defined in section 1 para. 1 para. 3d of the Banking Act, the home member state (as defined in Article 2 of the EU Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions) of which is Germany[8], and a reference to a "**European deposit taking credit institution**" is a reference to a deposit taking credit institution the home member state (*Herkunftsstaat*) of which is a member state of the European Economic Area (the "**EEA**") (other than Denmark). A reference to an "**E-money institution**" is a reference to an e-money institution within the meaning of section 1 para. 3d sentence 4 of the Banking Act, a reference to a "**German e-money institution**" is a reference to an e-money institution having its seat in Germany, and a reference to an "**European e-money institution**" is a reference to an e-money institution having its seat in a member state to the European Economic Area (other than Denmark). A reference to a "**financial services institution**" is a reference to a financial services institution (*Finanzdienstleistungsinstitut*) within the meaning of section 1 para. 1a of the Banking Act. A reference to an "**investment management company**" (*Kapitalanlagegesellschaft*) is a reference to an investment fund's management company within the meaning of section 6 para. 1 of the German Investment Act (*Investmentgesetz*). A reference to an "**insurance company**" is a reference to an insurance company (*Versicherungsunternehmen*) within the meaning of section 1 para. 1 no. 1 of the Act on the Supervision of Insurance Companies (*Versicherungsaufsichtsgesetz* – the "**Insurance Supervisory Act**"), a reference to a "**German insurance company**" is a reference to an insurance company the home state (*Herkunftsstaat*) of which is Germany[9], and a reference to an "**European insurance company**" is a reference to an insurance company the home state of which is a member state of the European Economic Area (other than Denmark).

This Opinion does also apply to any non-German company ("**foreign company**") which is a company incorporated or formed under the laws of another jurisdiction with a branch or

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8 According to section 1 para. 4 of the Banking Act, the home member state is the state where a bank has its main office (*Hauptniederlassung*).

9 The Insurance Supervisory Act does not define the term home state (*Herkunftsstaat*) with respect to an insurance company. However, section 88 para 1a sentence 1 of the Insurance Supervisory Act, which provides that insolvency proceedings regarding the assets of an insurance company in the EEA may only be opened by the competent authorities of the home state (*Herkunftsstaat*), implements 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. Article 2 lit. e of such Directive defines the term "home member state" (*Herkunftsmitgliedstaat*) as the member state of the EEA "in which an insurance undertaking has been authorised in accordance with Article 6 of Directive 73/239/EEC or Article 6 of Directive 79/267/EEC".

branches established or located in Germany. Where the foreign company is neither an insurance company (*Versicherungsunternehmen*), credit institution (*Kreditinstitut*), investment undertaking (*Wertpapierfirma*)[10] which provides services involving the holding of funds or securities for third parties, nor a collective investment undertaking (*Organismen für gemeinsame Anlagen*)[11], it is assumed that each branch will constitute an "establishment" within the meaning of EU Council Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings, which applies to all EU member states other than Denmark (the "**EU Insolvency Regulation**").

2.6 Defined terms and expressions

Unless otherwise defined herein or the context requires otherwise, words and expressions used in this Opinion have the meanings and constructions ascribed to them in the Master Agreements, the Commodities Schedule or the Credit Support Annexes.

In this Opinion, unless otherwise specified:

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10 There is no definition of "investment undertaking" in EU directives but Article 4 (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 ("**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). The German wording of both the EU Insolvency Regulation (as defined below) and the MiFID uses the term "*Wertpapierfirma*" which confirms this interpretation.

11 The term "collective investment undertaking" means, in accordance with Article 1 no. 2 of the Council Directive 86/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for the collective investment in transferable securities (UCITS) ("**UCITS Directive**" as amended) 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. This interpretation is based on the assumption made by VIRGOS/SCHMIT (Report on the Convention on Insolvency Proceedings, nos. 56 *et seq.*) according to which the rationale behind the exceptions provided in Article 1 (2) of the EU Insolvency Regulation is to exclude such entities, which are subject to specific EU regulations and supervision by regulators in their respective EU member states. Investment undertakings that 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 of the EU Insolvency Regulation. From our point of view, this general analysis prevails over the discrepant wording of the EU Insolvency Regulation that might lead to the conclusion that the term "collective investment undertaking" within the meaning of the EU Insolvency Regulation 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 due to the lack of court precedents dealing with this topic a certain degree of uncertainty remains.

(a) "**Party**" means a party to the Master Agreements;

(b) references to a "**Paragraph**" are to a paragraph of this Opinion;

(c) references to the "**Netted Agreements**" include references to any transactions thereunder unless the contrary is stated;

(d) a reference to "**Financial Collateral**" is a reference to an arrangement defined as such in section 1 para. 17 sent. 1 and 2 of the Banking Act[12]; and

(e) headings are for ease of reference only and shall not affect the interpretation.

2.7 This Opinion may only be relied upon on the express condition that any issues of interpretation arising hereunder will be governed by and construed in accordance with German law and all disputes in relation to this Opinion shall be brought before the courts of Frankfurt am Main, Germany.

2.8 **Executive summary**

On the basis of the scope of view and the assumptions in Paragraphs 2 and 3 respectively, and subject to the qualifications set out in Paragraph 5, this is an executive summary of the opinion expressed in Paragraph 4 *with regard to close-out netting only*. This executive summary does not form part of this Opinion and is provided for ease of reference only, and in no circumstances may be interpreted or read as amending, affecting or having any interpretative effect on the opinion expressed in Paragraph 4, which is the only opinion which can be relied upon. Reading this executive summary does not substitute reading the entire Opinion.

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12 Section 1 para. 17 sent. 1 and 2 of the Banking Act reads, in its non-binding English translation: "*Financial Collateral within the meaning of this act are cash deposits (Barguthaben), cash amount (Geldbeträge), securities, money market instruments and Schuldschein loans including all related rights or claims which have been transferred as collateral either by way of an in rem security arrangement (beschränktes dingliches Sicherungsrecht) or by way of a money transfer or by way of full title transfer on the basis of an agreement between a secured party and a security provider, each belonging to one of the categories named in Article 1 para. 2 lit. (a) to (e) of the Directive 2002/47/EC of the European Parliament and the Council on financial collateral ("**Financial Collateral Directive**") dated 6 June 2002. Should the security provider be a person or business undertaking named in Article 1 para. 2 lit. (e) of the Financial Collateral Directive, 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) repurchase, lending or similar transactions on financial instruments or,

(c) *loans to finance the acquisition of financial instruments.*"

(a) Close-out netting in a pre-insolvency situation is generally enforceable, see Paragraph 4.1.1(d)(i)(1) on page 23 below and Paragraph 4.1.1(h)(i) on page 43 below.

(b) Both clauses with regard to early termination by notice and clauses with regard to automatic termination, each in the event of insolvency, will generally be upheld by a German court, see Paragraph 4.1.1(h)(ii) on page 47 below.

(c) The determination of the Final Net Settlement Amount is generally enforceable in the event of insolvency, see Paragraphs 4.1.1(c) on page 19 below.

2.9 **Assumptions and Reservations**

The opinions given in this Opinion are given on the basis of the assumptions set out under Paragraph 3 (*Assumptions*) below and are subject to the reservations set out under Paragraph 5 (*Reservations*) below in each case in their entirety. The opinions given in this Opinion are strictly limited to the matters expressly stated under Paragraph 4 (*Opinions*) below and do not extend to any other matters.

3. ASSUMPTIONS

3.1 **Assumptions relating to the Parties**

(a) Two parties enter into one of the Master Agreements and at least one of the parties is incorporated or organised or has its centre of main interest in Germany ("**Party A**").

(b) Party A qualifies as a company, credit institution or any other entity as further described under Paragraph 2.4.

(c) Each Party to the Master Agreements is, and will continue to be, a validly existing legal entity with capacity, power and authority under any applicable laws to enter into and perform its obligations under the Master Agreements, the Netted Agreements and any Individual Contract that may be entered into by the Parties, and each of the Parties have taken all necessary steps to execute, deliver and perform the Master Agreements, the Netted Agreements and any Individual Contract and to ensure their legal validity.

(d) None of the Parties qualifies as a consumer (*Verbraucher*) within the meaning of section 13 of the German Civil Code (*Bürgerliches Gesetzbuch*), 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 of the German

Commercial Code (*Handelsgesetzbuch*) or as an entrepreneur (*Unternehmer*) within the meaning of section 14 of the German Civil Code, 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.

(e) The Master Agreements, any Netted Agreement and any Individual Contract entered into thereunder will have been duly authorised, executed and delivered by each Party in accordance with all applicable laws and the Master Agreements, any Netted Agreement and any Individual Contract will have been properly completed by the Parties.

(f) Where any authority or power of attorney (including sub-power of attorney) has been used to enter into in connection with the Master Agreements, any Netted Agreement or any Individual Contract, 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.

(g) Each of the Parties has obtained, complied with the terms of, and maintained all authorisations, approvals, licences and consents required to enable it to lawfully enter into, and perform its obligations under the Master Agreements, any Netted Agreement and any Individual Contract and to ensure the legality, validity, enforceability or admissibility in evidence of the Master Agreements, any Netted Agreement and any Individual Contract.

(h) None of the Parties is entitled to claim in relation to itself or its assets immunity from suit, attachment, execution or other legal process. However, insofar as the German Federal Government (*Bundesregierung*), any German Federal State (*Bundesland*) or any entity established under German public law enters into one of the Master Agreements, the execution of such Master Agreement, any Netted Agreement and any Individual Contract constitutes, and the exercise of that Party's rights and performance of its obligations thereunder will constitute, private and commercial acts done and performed for private and commercial purposes. Such entities would not be subject to immunity.

3.2 Assumptions relating to the Master Agreements, the Netted Agreements and Individual Contracts

(a) The relevant Master Agreement, the Commodities Schedule and the Credit Support Annexes are governed by the laws of Germany, save in respect of Paragraphs 4.1.1, 4.1.2, 4.2 and 4.7, for the purposes of which the Agreements may be governed by the laws of this jurisdiction or by foreign laws. Where the relevant Master Agreement is governed by the laws of a jurisdiction other than Germany, under the laws of such jurisdiction (including its insolvency laws) and under all other relevant laws (other than the law of this jurisdiction):

(i) the relevant Master Agreement constitutes and will at all times constitute valid and legally binding obligations of the Parties thereto, enforceable in accordance with its terms;

(ii) the choice of the laws of such jurisdiction as the governing law of the relevant Master Agreement is a valid and binding selection; and

(iii) the Netting Provisions are valid and enforceable.

(b) On the basis of the terms and conditions of the Master Agreements and other relevant factors, and acting in a manner consistent with the intentions stated in the Master Agreements, the Parties over time enter into a number of Individual Contracts which belong to the Individual Contracts described in the Annex 1.

(c) Save for any specification in the election sheet relating to the MNA or the schedule relating to the CPMA (the "**Election Sheets**"), none of the terms of the Master Agreements will be varied, waived or discharged and any Individual Contract entered into after the date of this Opinion will be entered into as specified in the Netted Agreements and the Master Agreements, any Netted Agreement and each Individual Contract cannot be voided or otherwise held ineffective (in whole or in part) by reason of mistake, illegality or otherwise.

(d) Save in respect of a Termination for Close Out Events in respect of a Party, each Party will perform its obligations under the Master Agreements, the Netted Agreements and any Individual Contract in accordance with their respective terms and nothing in the terms of any Individual Contract will alter the assumptions set out under this Paragraph 3 or the reservations set out under Paragraph 5 below.

(e) The Master Agreements provide for the inclusion of some or all of the master agreements described in Annex 2, each such master agreement being a Netted Agreement.

(f) None of the Individual Contracts or operations contemplated by the Netted Agreements or the Master Agreements 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 Master Agreements, the Netted Agreements or an

Individual Contract is a Party or by which any of its property, undertaking, assets or revenues are bound.

(g) Where Individual Contracts are governed by laws other than the laws of Germany, this Opinion is given exclusively in respect of those Individual Contracts which are capable under their governing laws, of being included in the Netted Agreement and of being terminated and set-off in accordance with the provisions of the relevant Netted Agreement.

(h) The obligations under the Master Agreements, the Netted Agreements and any Individual Contract are mutual between the Parties. "**Mutuality**" 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 will not be established 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.

(i) All of the representations and warranties given by any of the Parties to the Master Agreements, the Netted Agreements or any Individual Contract (other than representations and warranties as to such matters of German law on which we express an opinion herein) are and will be, when made or repeated or when deemed to be made or repeated (as the case may be), and were at all relevant times, true and accurate. Any representation or warranty given by any of the Parties to the Master Agreements, the Netted Agreements or any Individual Contract (other than representations and warranties as to such matters of German law on which we express an opinion herein) that such Party is not aware of or has no notice of any act, matter, thing or circumstance means that the same does not exist or has not occurred.

(j) Each Close-Out Event specified as applicable pursuant to the Master Agreements is a valid, binding and enforceable termination event under the applicable underlying Netted Agreement.

3.3 **Assumptions relating to the Credit Support Annexes**

(a) The Eligible Credit Support provided under the Credit Support Annexes only takes the form of Cash (as defined therein).

(b) The provision of Eligible Credit Support is not restricted by law, contractual agreement, court order, procedural, administrative or other rulings. We give no opinion on the ownership of any of the Parties to any Eligible Credit Support or on the legal existence of any Eligible Credit Support.

(c) Each Party is at the time of the transfer of Cash under section 7 of the Credit Support Annexes the unrestricted owner of the transferred Cash and entitled to dispose of the transferred Cash, which at that time is unencumbered.

(d) All necessary steps and requirements for the valid and legally binding provision of the Eligible Credit Support that are required pursuant to the laws applicable to such provision have been taken or fulfilled in order to effect such transfer. Please note that in relation to each relevant Eligible Credit Support and its provision the applicable law has to be determined.

(e) The rights of each relevant Transferor in connection with the provision of Eligible Credit Support are not subject to any lien, right of rescission, counterclaim, set-off or other defence and the performance of any of the terms of any Eligible Credit Support or the exercise of any rights will not render such Eligible Credit Support unenforceable in whole or in part or subject it to such lien, right of rescission, set-off, counterclaim or defence.

3.4 *Bona Fide* Purpose and Insolvency

In respect of the Master Agreements, any Netted Agreement and each Individual Contract:

(i) each of the Parties has entered into and will enter into the same in good faith and for the purpose of carrying on its business;

(ii) each of the Parties has entered into and will enter into the same on arm's length commercial terms;

(iii) each of the Parties has and will have reasonable grounds for believing that the same will benefit it; and

(iv) none of the Parties has entered into or will enter into the same if entering into the same would prejudice any of its creditors.

4. OPINION AND LEGAL ANALYSIS

4.1 Enforceability of Close-out Netting

4.1.1 Winding-up, Insolvency or Attachment

(a) *Brief general discussion of the relevant German insolvency proceedings, laws and terminology applicable to Party A and the contract types listed in Annex 1*

(i) The procedures under the German Insolvency Code (*Insolvenzordnung*) are the only insolvency procedures (for example liquidation, administration, receivership or voluntary arrangement) to which a Party would be subject in Germany.

The procedures pursuant to the Insolvency Code are together called "**Insolvency Proceedings**". A Party which is insolvent is called the "**Insolvent Party**" and the other Party is called the "**Solvent Party**".

"**Insolvency Representative**" means a liquidator, administrator, administrative receiver or analogous or equivalent official appointed under the Insolvency Code in Germany.

In this Opinion, in relation to an Insolvency Proceeding under the laws of Germany, the opening of Insolvency Proceedings refers to the time of the issue of an order of commencement (*Eröffnungsbeschluss)* by the competent insolvency court.

Insolvency Proceedings over the assets of either a credit institution, a financial services institution or an insurance company may only be instituted by the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* – "**BaFin**") (section 46b para. 1 sent. 4 of the Banking Act, section 88 para. 1 of the Insurance Supervisory Act) by filing a petition for commencement of Insolvency Proceedings with the competent insolvency court. To avert Insolvency Proceedings with respect to credit and financial services institutions, the BaFin may, *inter alia*, temporarily prohibit the disposition of assets by the relevant institution and issue a payment moratorium, close the institution for ordinary business with customers and, unless a deposit or customer protection scheme applies, prohibit the institution from accepting payments except those made in respect of obligations owed to the institution (section 46 para. 1 sentence 2 no. 4 - 6 of the Banking Act). Similar orders may be issued by the BaFin in respect of insurance companies pursuant to section 89 of the Insurance Supervisory Act. Such measures are not considered to be Insolvency Proceedings themselves.

Insolvency Proceedings may not be opened over the assets of the German Federal Government or a German Federal State (section 12 para. 1 no. 1 of the Insolvency Code).

Legal entities established under public law (including German municipalities) and subject to the supervision of a German Federal State may be exempt from Insolvency Proceedings in Germany by the law of such Federal State (section 12 para. 1 no. 2 of the Insolvency Code).

Where a legal entity established under public law is exempt from Insolvency Proceedings, German insolvency law will not interfere with the provisions of a netting agreement such as the Master Agreements if such legal entity becomes insolvent. Therefore, the limitations on the enforceability of the Netting Provisions as referred to in this Opinion (please refer in particular to Paragraph 4.1.1(h)(ii) on page 43 and Paragraph 4.1.1(h)(iii) on page 51 below) will not apply to such entities. However, special rules may apply under public law to the winding-up of such entities. Where a legal entity established under public law is not exempt from Insolvency Proceedings, it will generally be treated as any other Party to the Master Agreements.

A municipality may act through an enterprise which is legally not a separate legal entity (*Eigenbetrieb*). In this case, only the municipality (which is exempt from Insolvency Proceedings) will become Party to the relevant Master Agreement.

Legal entities incorporated under private law which are publicly owned are not exempt from Insolvency Proceedings and will be treated as any other Party to the Master Agreements[13].

(ii) On 31 December 2010, the main provisions of the Act on the Restructuring and Orderly Liquidation of Credit Institutions (*Gesetz zur Restrukturierung und geordneten Abwicklung von Kreditinstituten* - "**Bank Restructuring Act**")[14] entered into force. It introduced, among others, the Bank

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13 OTT, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. (2008), § 12 no. 16.

14 Published on 14 December 2010, see BGBl. I no. 63, 2010, pages 1900 *et seq.*

Reorganisation Act (*Gesetz zur Reorganisation von Kreditinstituten*, "**KreditReorgG**") which contains a new set of pre-insolvency measures in order to limit systemic risks resulting from financial difficulties of credit institutions within the meaning of section 1 para. 1 of the Banking Act having their registered seat in Germany.

The measures implemented by the KreditReorgG (*i.e.* the restructuring proceeding (*Sanierungsverfahren*) and the reorganisation proceeding (*Reorganisationsverfahren*)) as well as the transfer order (*Übertragungsanordnung*) pursuant to sections 48a *et seq.* of the Banking Act do not qualify as Insolvency Proceedings.

However, there is no official guidance whether a reorganisation proceeding (*Reorganisationsverfahren*) pursuant to sections 7 *et seq.* of the KreditReorgG or a transfer order (*Übertragungsanordnung*) pursuant to sections 48a *et seq.* of the Banking Act should be construed as being a reorganisation measure (*Sanierungsmaßnahme*) within the meaning of the European Council Directive (EC) No. 2001/24 dated 4 April 2001 on the Reorganisation and Winding Up of Credit Institutions ("**Winding-Up Directive**")[15] with the consequence that such proceeding would have to be considered effective in all member states of the European Union upon the formal requirements being met and subject to the conflict of law provisions, both as set out in the Winding-Up Directive as implemented into the relevant national law which would also have an impact on the Netting Provision (see in more detail Paragraph 4.1.1(d)(iv)(2)(D)III on page 37 below).

The Winding-Up Directive does not specify proceedings within each member state that shall qualify as reorganisation measures. Rather, whether or not proceedings shall be qualified as reorgansiation measures must be determined by the competent authority of each member state taking into account the obligation to implement the Winding-Up Directive in order to protect creditors of credit institutions. [16]

Both proceedings as implemented by the Bank Restructuring Act refer to the formal notification procedures and other formal requirements of section 46d

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[15] Considering the reorganisation proceeding as reorganisation measures under the Winding-Up Directive: Lorenz, NZG 2010 p. 1046; with respect to the transfer order, more carefully Horst Eidenmüller in: Festschrift für Klaus J. Hopt "Unternehmen, Markt und Verantwortung", 2010 p. 1729f.

[16] See in particular Recital 28 of the Winding-Up Directive.

paras. 1 and 2 of the Banking Act which implements Art. 6 of the Winding-Up Directive into German law (see section 7 para. 5 of the KreditReorgG and section 48n of the German Banking Act).

However, while section 7 para. 5 of the KreditReorgG also refers to section 46d paras. 3 and 4 implementing further provisions of the Winding-Up Directive into German law for the reorganisation proceeding, a similar reference is not contained in the context of the procedures of a transfer order.

Thus, it is not fully clear whether a court would construe a transfer order as a reorganisation measure (*Sanierungsmaßnahme*) within the meaning of the Winding-Up Directive and give effect to the formal notification and other procedural provisions that have been implemented under the Winding-Up Directive and (e.g. by way of analogy) apply the relevant conflict of law provisions even where the German legislator has not statutorily declared them applicable (see in more detail Paragraph 4.1.1(d)(iv)(2)(D)III on page 37 below).

(b) *Discussion on whether the contract types listed in Annex 1 are governed by different rules and whether these rules would result in a splitting-up or segregation of the portfolio of Individual Contracts under the Netted Agreement into multiple "netting pools" of disparate treatment or whether these rules would otherwise limit or render wholly or partially unenforceable the early termination and close-out netting rights provided for in the Master Agreements.*

If the contractual Netting Provisions of the Master Agreements are recognised in an Insolvency Proceeding and the relevant Master Agreement, the Netted Agreements and all Individual Contracts entered into thereunder are terminated prior to the opening of the Insolvency Proceeding (please see Paragraph 4.1.1(d) on page 23 below and Paragraph (h)(ii)(2)below), the contractual netting arrangement applies (section 94 of the Insolvency Code, please see Paragraph 4.1.1(n)(i)(1) on page 65 below) and no disparate treatment applies to the Individual Contracts.

The statutory rules provided for in sections 103 *et seq.* of the Insolvency Code apply to contracts that are terminated at the time of or after the opening of the Insolvency Proceeding (please see to Paragraph 4.1.1(h)(ii) on page 47 below).

This applies to all contract types listed in Annex 1. Therefore, such contract types are not generally subject to different rules. When sections 103 *et seq.* apply, the portfolio of Individual Contracts under the Netted Agreements may be subject to disparate treatment. Pursuant to section 103 of the Insolvency Code, transactions (in this case, Individual Contracts) 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 right to decide whether to assume or reject such transactions. Consequently, the Insolvency Representative has the power to disclaim unprofitable transactions and to enforce profitable ones ("**cherry-picking**") (please see Paragraph 4.1.1(h)(ii) on page 47 below)[17].

However, section 104 of the Insolvency Code provides for exceptions to the Insolvency Representative's "cherry-picking" right if the respective transaction qualifies as an obligation which must be fulfilled by a particular date as otherwise its fulfilment becomes worthless (*Fixgeschäft*), or if it falls within the definition of financial transactions of section 104 para. 2 of the Insolvency Code. In such case, the relevant Individual Contract may become subject to the statutory netting as set forth in section 104 of the Insolvency Code (please see Paragraph 4.1.1(h)(iii) on page 51 below).

(c) *Opinion whether the termination of the Netted Agreements or the Individual Contracts, the calculation of the Settlements Amounts, the aggregation and offsetting of such Settlement Amounts and the determination of the Final Net Settlement Amount and/or its payment is voidable, challengeable or in any way capable of being invalidated, deleted, frozen, stayed or otherwise retroactively impacted by a liquidator, receiver, other third party or the court.*

The early termination of the Netted Agreements and of the Individual Contract, the calculation of the Settlements Amounts, the aggregation and offsetting of such Settlement Amounts and the determination of the Final Net Settlement Amount and/or its payment, as provided for in the Netting Provisions could be challenged by an Insolvency Representative during suspect periods on the basis of prejudicing the Insolvent Party's creditors as set out below (Paragraph 4.1.1(h)(iv) on page 60) as with respect to netting arrangements there is no general exemption from the application of the provisions on insolvency avoidance or challenging rights of the Insolvency Representative under substantial German insolvency law.

However, even when these preconditions are fulfilled, the voidability of legal acts may be excluded by application of Article 13 of the EU Insolvency Regulation or section 339 of the Insolvency Code (please refer to Paragraph 4.2.1(d)(i)(4) on page 81 and Paragraph 4.2.1(d)(ii)(1) on page 82). Moreover, pursuant to section 142 of

17 KREFT, in: Münchener Kommentar zur Insolvenzordnung, 2[nd] ed. (2008), § 103 nos. 196 *et seq.*

the Insolvency Code, payments on the part of the Insolvent Party in return for which the Insolvent Party's property benefited directly from an equitable consideration (*gleichwertig*) may only be challenged if such payment was made with the intention to prejudice the creditors.

Under German law, a legal act made prior to the opening of Insolvency Proceedings and prejudicing the creditors of the Insolvent Party may be challenged by the Insolvency Representative under sections 129 *et seq.* of the Insolvency Code. Broadly speaking, every legal act (*Rechtshandlung*) falls within the scope of insolvency avoidance. The term "legal act" refers to acts within the scope of contractual agreements, in particular the execution of a declaration of intention but also other acts having a legal effect, as well as acts relating to the law of property such as, in particular, *in rem* transfers and assignments. Thus, the entering into the Netted Agreements or an Individual Contract under the Netted Agreements, or the termination of the Netted Agreements and the Individual Contracts, the calculation of the Settlements Amounts, the aggregation and offsetting of such Settlement Amounts and the determination of the Final Net Settlement Amount and/or its payment may be challengeable (voidable) subject to the fulfilment of the preconditions as set out below (further legal acts are for example (without being conclusive) the transfer or granting of Collateral, any payment or delivery under an Individual Contract, any modification or waiver with respect to the Netted Agreements and/or an Individual Contract, the exercise of any discretion, etc.)[18].

From our point of view, it cannot be generally predicted whether the application of the contractual provisions is more favourable than the application of statutory law and, hence, one could well argue that such provisions are not generally voidable because they are not *per se* detrimental to other creditors.

However, in case of a legal act that is subject to a condition precedent, which is for example the case if an agreement automatically terminates early if certain circumstances occur, the fulfilment of such condition precedent is not regarded as a legal act (section 140 para. 3 of the Insolvency Code). Whether or not a specific legal

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18 Regarding the question whether the determination of the Termination Amount could be qualified as a legal act, please see Paragraph 4.1.1(n)(ii) on page 68 below.

act is voidable therefore depends on the individual circumstances of the respective transaction[19].

(i) Avoidance pursuant to section 130 para. 1 sent. 1 of the Insolvency Code

Pursuant to section 130 para. 1 sent. 1 of the Insolvency Code, a legal act is voidable if it gives or makes available to a creditor security or satisfaction of a claim (i) where it was effected in the last three months prior to 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) where it was effected after 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.

Knowledge of circumstances that compel the conclusion as to the Insolvent Party's inability to make payments or of the filing for the opening of Insolvency Proceedings are regarded as equivalent to actual knowledge of the Insolvent Party's inability to make payments or of the petition for opening of Insolvency Proceedings (section 130 para. 2 of the Insolvency Code).

However, these provisions are not applicable where the legal act is based on a security agreement containing 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 sent. 2 of the Insolvency Code)[20].

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19 The following enumeration is not conclusive, as additional circumstances may be relevant for the voidability of a specific legal act. For example, section 138 of the Insolvency Code provides for a definition of "affiliates" (*nahestehende Personen*) of the debtor.

20 Notwithstanding this exemption, the provision of margin collateral may still be challengeable (voidable) pursuant to section 131 of the Insolvency Code concerning incongruent coverage since the German legislator did not take the opportunity to amend this provision when implementing the Financial Collateral Directive. However, according to the legislative materials, the German legislator recommends to interpret section 131 of the Insolvency Code in the light of the exemption made to section 130 of the Insolvency Code and the relevant provisions in the Financial Collateral Directive. It remains to be seen whether the German courts will follow this recommendation.

(ii) Avoidance pursuant to section 131 para. 1 of the Insolvency Code

Pursuant to section 131 para. 1 of the Insolvency Code, a challenging period of one to three months applies where a legal act gives or makes possible to a creditor, security or satisfaction of a claim to which it has no right or no right to claim in such manner or at such time, is voidable (i) if the legal act was effected in the last month prior to filing for the opening of Insolvency Proceedings or following such filing; or (ii) if the legal act was 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 was effected during the second or third month prior to filing for the opening of Insolvency Proceedings and the creditor had knowledge at the time of the legal act that it was detrimental to the Insolvent Party. In relation to (iii), knowledge of circumstances that compel the conclusion that a legal act is detrimental to the Insolvent Party is equivalent to actual knowledge of such detriment (section 131 para. 2 of the Insolvency Code).

(iii) Avoidance pursuant to section 132 para. 1 of the Insolvency Code

A legal act by the Insolvent Party that is directly detrimental to the creditors is voidable (i) if it was effected in the last three months prior to 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 of the Insolvency Code).

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 of the Insolvency Code).

(iv) Avoidance pursuant to section 133 para. 1 sent. 1 of the Insolvency Code

Pursuant to section 133 para. 1 sent. 1 of the Insolvency Code, a legal act made by the Insolvent Party during the last ten years prior to the request to open Insolvency Proceedings, or subsequent to such request, with the intention to disadvantage his creditors may be challenged if the other party was aware of the debtor's intention on the date of such legal act. Such awareness will be presumed if the other party knew of the imminent inability of the Insolvent Party to make payment when due, and that the legal act constituted a disadvantage for the creditors (section 133 para. 1 sent. 2 of the Insolvency Code).

The periods of time set out in Paragraph 4.1.1(c)(i) on page 21 to Paragraph 4.1.1(c)(iv) on page 22, begin to run on the day on which the filing for the commencement of the Insolvency Proceeding is received by the relevant insolvency court (section 139 para. 1 of the Insolvency Code), or, if the debtor is a credit institution or a financial services institution and the BaFin has issued an order pursuant to section 46 para. 1 sentence 2 no. 4 – 6 of the Banking Act (please see Paragraph 4.1.1(a) on page 15 above), from the time when such order is issued (section 46c of the Banking Act).

(d) *Opinion on whether or not there is a distinction in time with respect to a creditor's rights between: (i) the filing of proceedings seeking a judgment of insolvency; (ii) a bankruptcy court recognising the filing of proceedings seeking a judgment of insolvency; (iii) the date on which a bankruptcy court determines a party first becomes insolvent; and (iv) any other stage of the proceedings where a creditor's rights may be affected.*

(i) *The filing of proceedings seeking a judgment of insolvency;*

(1) Pre-insolvency proceedings by the insolvency court

Under German law, the term "commencement" of any proceedings under any insolvency law is likely to be construed to refer to the opening of Insolvency Proceedings, i.e. the time of the issue of an order of commencement (*Eröffnungsbeschluss*) by the competent insolvency court.

Upon the filing of an application for the commencement of Insolvency Proceedings and prior to that order of commencement, a German insolvency court is entitled to appoint a preliminary administrator (*vorläufiger Insolvenzverwalter*) or initiate preliminary proceedings with the following effects:

The court may, *inter alia*, enjoin the Insolvent Party from transferring assets in the course of preliminary proceedings pursuant to sections

21 *et seq.* of the Insolvency Code. However, such measures do not affect the validity of dispositions over Financial Collateral.

In the preliminary proceedings, the insolvency court's competences are restricted to attachments (freezing injunctions) that prevent the Insolvent Party from disposing of his assets and thus jeopardising the purpose of formal Insolvency Proceedings. Such a freezing injunction might refer to the current assets of the Insolvent Party or parts thereof.

In contrast, the preliminary administrator is not granted a "cherry-picking" right according to section 103 of the Insolvency Code (see Paragraph 4.1.1(h)(ii) on page 47 below). The scope of application of section 103 of the Insolvency Code is in terms of timing restricted to the opening of Insolvency Proceedings[21]. We are not aware of any legal commentaries or case law according to which section 103 of the Insolvency Code has a bearing on the preliminary proceedings that merely aim at avoiding any detriment to the financial status of the Insolvent Party and do not intend to bring about a reorganisation of the Insolvent Party's assets.

Within the scope of preliminary proceedings, the insolvency court may impose a general prohibition of transfers on the debtor (section 21 para. 2 sent. 1 no. 2 of the Insolvency Code), order that the debtor's transfers of property require the consent of the preliminary administrator (section 21 para. 2 sent. 1 no. 2 of the Insolvency Code) or order a restriction (or temporary restriction) in certain measures of enforcement (*Zwangsvollstreckungsmaßnahmen*) against the Insolvent Party (section 21 para. 2 sent. 1 no. 3 of the Insolvency Code).

According to a decision of the *Bundesgerichtshof*[22] of 2004, preliminary measures pursuant to section 21 para. 2 sent. 1 nos. 2 and 3 of the Insolvency Code do not exclude the permissibility of set-off since the provisions concerning insolvency set-off pursuant to

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21 BGH WM 2007, 2331; BGHZ 97, 87, 90; 130, 38, 42; OLG Düsseldorf ZInsO 2005, 820, 821; GOTTWALD/HUBER, Insolvenzrechts-Handbuch, 3rd ed. (2006), § 35 no. 2; WEGENER, in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010), § 103 no. 99; TINTELNOT, in: Kübler/Prütting, InsO § 103 no. 51; MAROTZKE, in: Heidelberger Kommentar zur Insolvenzordnung, 5th ed. (2008) § 103 no. 57.

22 BGH NJW 2004, 3118, 3119; BGH, ZIP 2005, 181.

sections 94 through 96 of the Insolvency Code (see Paragraph 4.1.1(n)(i)(1) on page 65 below) are deemed as both comprehensive and exclusive[23]. Pursuant to the *Bundesgerichtshof*, even though, from a genuinely economic perspective, a set-off could be deemed as a payment by the Insolvent Party, a general prohibition of transfers does not include the prohibition of set-off of claims against the Insolvent Party. In particular, a general prohibition of transfers is only targeted at the Insolvent Party and, hence, cannot effectively prevent the other party from effecting a set-off in the course of preliminary proceedings[24] such as under the Netting Provisions.

Likewise, a restriction in measures of execution against the Insolvent Party is not aimed at the other Party who can unilaterally declare set-off without the involvement of a court and/or the enforcement of a court decision. Notwithstanding the fact that a set-off achieves an economically similar effect to a measure of execution, it is therefore supported by legal literature that a restriction pursuant to section 21 para. 2 sent. 1 no. 3 of the Insolvency Code does not directly prohibit any set-offs[25].

Preliminary measures do not affect the validity of dispositions over Financial Collateral and the validity of the netting of obligations based on transfer orders that have been entered into a payment system pursuant to section 1 para. 16 of the Banking Act (see Paragraph 4.1.1(n)(i)(7) on page 68 below)[26].

(2) Pre-insolvency proceedings by the BaFin

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23 See also LÜKE, in: Kübler/Prütting, InsO § 94 no. 88; GERHARDT, Festschrift für Zeuner, p. 353, 366; HÄSEMEYER, Kölner Schrift zur Insolvenzordnung, 2nd ed. (1999), p. 663 no. 50; BRANDES, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. (2007), § 94 nos. 41 *et seq.*

24 BGH ZInsO 2004, 852.

25 HAARMEYER, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. (2007), § 21 nos. 72 *et seq.*; LÜKE, in Kübler/Prütting/Bork, InsO, (September 2009), § 94 no. 88 with the argument that section 96 no. 3 of the Insolvency Code is an adequate protection against unjustified set-off which does not leave room for any analogies as regards section 21 para. 2 sent. 1 nos. 2 and 3 of the Insolvency Code.

26 LINDEMANN, in: Boos/Fischer/Schulte-Mattler, KWG, 3rd ed. (2008), § 46a nos. 37 *et seq.*

With respect to credit institutions, financial services institutions and insurance companies only, it is not undisputed whether or not after the filing of a petition for the opening of Insolvency Proceedings or after an order by the BaFin according to the Banking Act has been issued an obligation could validly be included in the calculation of the termination payment in accordance with the Netting Provisions and whether contractual set-off would any longer be permitted.

With regard to credit institutions, financial services institutions and insurance companies, Insolvency Proceedings may only be instituted by the BaFin.

Furthermore, the BaFin may - prior to such petition for the opening of Insolvency Proceedings - issue certain measures (including a temporary ban on sales and payments by the institution) according to section 46 para. 1 of the Banking Act if the institution's capacity to fulfil its obligations with respect to its creditors, particularly the security of assets entrusted to the institution, is in jeopardy. Such temporary measures aim at maintaining the institution's capability of being restructured[27]. Similar orders may be issued by the BaFin in respect of insurance companies pursuant to section 89 of the Insurance Supervisory Act. However, the scope of such measures is disputed in legal literature.

In particular, it is disputed whether a ban on sales and payments equally precludes a creditor from setting off his claims against the institution. The prevailing view in German legal literature is that a creditor is not permitted to set off as long as the ban endures[28] while others argue set-off should be permissible[29]. Section 46 para. 1 sentence 2 no. 4 of the Banking Act does not explicitly refer to set-off. However, this provision explicitly enumerates measures that are permissible after the issuing of a ban on sales and payments. This enumeration does not include set-off of claims against the institution.

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27 LINDEMANN, in: Boos/Fischer/Schulte-Mattler, KWG, 3rd ed. (2008), § 46a no. 7.

28 SZAGUNN/HAUG/ERGENZINGER, Gesetz über das Kreditwesen, 6th ed. (1997), § 46 KWG no. 4b; KOKEMOOR, in Beck/Samm/Kokemoor, KWG, October 2009, § 46a no. 28; ZIETZSCH WM 1997, 954, 956 *et seq.*, PANNEN, Krise und Insolvenz bei Kreditinstituten, 2nd edition 2005, p. 55.

29 LINDEMANN, in: Boos/Fischer/Schulte-Mattler, KWG, 3rd ed. (2008), § 46a no. 24

Therefore, it is argued that such a set-off would be precluded because, from an economic perspective, such set-off could be deemed as a payment by such institution and, hence, would fall within the scope of the ban.

As the ban is considered to have the effect of a deferral (*Stundung*)[30], *i.e.* prolongation of the due date, some legal authors[31] argue that a set-off against the deferred obligations is not permissible under such circumstances. This view is supported by a similar rule in insurance law[32]. Under section 89 of the Insurance Supervisory Act, a ban on payments will result in a right of the relevant insurance company to defer any of its payments which may also be construed to preclude set-off[33]. With respect to the Banking Act, legal commentators propose a uniform interpretation of the provision of the Banking Act with the corresponding provision of the Insurance Supervisory Act[34].

A ban of sales and payments would – according to a view in legal literature – not exclude the possibility of set-off to the extent such possibility of set-off came into existence prior to the coming into force of the measures described above[35]. Such ban is only directed towards the institution which is subject to supervisory measures by the BaFin and, hence, should not prevent the institution's counterparty from unilaterally declaring a set-off.

Furthermore, section 46 para. 1 of the Banking Act should be construed in the light of the above described decision of the *Bundesgerichtshof* (see Paragraph 4.1.1(d)(i)(1) on page 23 above), pursuant to which preliminary measures pursuant to section 21 para. 2

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30 BT-Drucksache 14/8017, p. 141.

31 SZAGUNN/HAUG/ERGENZINGER, Gesetz über das Kreditwesen, 6th ed. (1997), § 46 KWG no. 4a; ZIETZSCH WM 1997, 954, 956 *et seq.* This view is rejected by LINDEMANN, in: Boos/Fischer/Schulte-Mattler, KWG, 3rd ed. (2008), § 46a no. 24.

32 SZAGUNN/HAUG/ERGENZINGER, Gesetz über das Kreditwesen, 6th ed. (1997), § 46 no. 4a.

33 KOLLHOSSER, in: Prölss, VAG, 12th ed. (2005), § 89 no. 10.

34 KOLLHOSSER, in: Prölss, VAG, 12th ed. (2005), § 89 no. 10.

35 This view is taken by Lindemann, in: Boos/Fischer/Schulte-Mattler, KWG, 3rd ed. (2008) § 46a nos. 22 to 24 and Binder, Bankeninsolvenzen im Spannungsfeld zwischen Bankaufsichts- und Insolvenzrecht, 2005, pages 313 to 316.

sent. 1 nos. 2 and 3 of the Insolvency Code do not exclude the permissibility of set-off.

It is possible that Insolvency Proceedings are opened over the institution by a German court after application by the BaFin without the ban having been lifted before.

With respect to agreements governed by a law other than German law, section 46d para. 3 sent. 3 of the Banking Act makes reference to section 340 of the Insolvency Code which stipulates that in case of an insolvency "netting agreements" shall be governed solely by the law of the contract which governs such agreement. For a detailed analysis of the effects of section 340 of the Insolvency Code we refer to Paragraph 4.2.1(d)(ii)(2) on page 83 below.

(3) Challenging of the Insolvent Party's transactions

The time of filing of a petition for the opening of Insolvency Proceedings, or, if the debtor is a credit institution or a financial services institution and the BaFin has issued an order pursuant to section 46 para. 1 of the Banking Act (please see Paragraph 4.1.1(a) on page 15 above), the time when such order is issued (section 46c of the Banking Act) is decisive for the calculation of suspect periods (section 139 para. 1 sent. 1 of the Insolvency Code) (please see Paragraph 4.1.1(c)(iv) on page 22 above).

(ii) *A bankruptcy court recognising the filing of proceedings seeking a judgment of insolvency;*

The recognition of the filing of proceedings seeking a judgment of insolvency does not qualify as a technical term under the Insolvency Code referring to a specific procedural step of Insolvency Proceedings. Section 26 of the Insolvency Code provides that the bankruptcy court shall reject such filing in case the assets of the insolvent debtor are insufficient to compensate for the costs of the Insolvency Proceeding (*Abweisung mangels Masse*). However, such rejection has no impact on statutory netting or the enforceability of the contractual Netting Provisions.

(iii) *The date on which a bankruptcy court determines a party first becomes insolvent; and*

In case of the opening of Insolvency Proceeding, an insolvency court does not determine the date when the Insolvent Party has become insolvent. It rather determines that the Insolvent Party is insolvent at the point in time of issuing the order for the opening of the Insolvency Proceedings. The date when the Insolvent Party has become insolvent is only relevant when a legal act of an Insolvent Party can be challenged by an Insolvency Representative (please see Paragraph 4.1.1(c) on page 19 above) and the relevant suspect period refers to such date. Therefore, we only refer to the point in time of the opening of the Insolvency Proceedings.

(iv) *Any other stage of the proceedings where a creditor's rights may be affected*

(1) Besides the filing for the opening of Insolvency Proceedings, the actual opening of Insolvency Proceedings is relevant for the enforceability of the Netting Provisions.

The opening of Insolvency Proceedings is decisive for whether the Netting Provisions apply or whether such provisions are overridden by the statutory provisions of the Insolvency Code (please see Paragraph 4.1.1(n)(i) on page 63 below).

In addition, pursuant to section 81 of the Insolvency Code, any dispositions of the Insolvent Party over its property made after the opening of Insolvency Proceedings are void unless the relevant court otherwise orders. However, dispositions over Financial Collateral effected after the actual opening of Insolvency Proceedings are valid, provided that such dispositions were effected on the day of the opening of Insolvency Proceedings and the other party proves that it did not know, nor should have known of the opening of the Insolvency Proceedings.

(2) Termination rights under the Master Agreements may be affected by restructuring measures under the KreditReorgG and the Banking Act applicable to credit institutions within the meaning of section 1 para. 1 of the Banking Act.

(A) The KreditReorgG provides for a restructuring proceeding (*Sanierungsverfahren*) involving the appointment of a restructuring advisor (*Sanierungsberater*) to implement a restructuring plan. Restructuring proceedings will be voluntarily initiated by the credit institution itself in close consultation with the BaFin and will be commenced by a court order of the higher regional court of Frankfurt am Main (*Oberlandesgericht Frankfurt am Main* – "**OLG Frankfurt**") upon application. The restructuring proceedings shall not affect creditors' rights.[36]

(B) If restructuring proceedings have failed or are without prospect of success, a reorganisation proceeding (*Reorganisationsverfahren*) may be commenced. Reorganisation proceedings will be voluntarily initiated by the credit institution itself in close consultation with the BaFin and will be commenced by a court order of the OLG Frankfurt upon application. Reorganisation proceedings shall only be commenced if the ongoing existence of the credit institution is endangered and this in turn may endanger the stability of the financial system. Together with the application for commencement of a reorganisation proceeding, a reorganisation plan shall be filed as prepared by the relevant credit institution. The measures proposed in the reorgansation plan are subject to a positive majority vote of the creditors and shareholders of the respective credit institution accepting such measures. The KreditReorgG stipulates detailed rules on the voting process and on the required majorities and to what extent negative votes rejecting such measures may be disregarded.[37]

[36] Section 2 para. (2) of the KreditReorgG provides that the restructuring plan may foreseeprovide that certain loans granted in the context of the restructuring within the approved aggregate limit not exceeding 10% of the own capital of the relevant institution may rank superior to claims of all other insolvency creditors in case that insolvency proceedings are commenced within a period of three years following the commencement of the restructuring proceeding.

[37] The general concept of the reorganisation plan is based on that of an insolvency plan under existing German insolvency law. According to sections 14 *et seq.* of the KreditReorgG, those creditors whose rights will be affected by the reorganisation plan must approve the reorganisation plan by voting whereby the credit institution has the right to group creditors into different voting groups each containing creditors with similar specific interests. The reorganisation plan is approved by a positive vote of the majority of each voting group of creditors which means that negative votes of a minority of creditors can be overruled. The reorganisation plan (including the grouping of creditors into voting groups and the measures affecting their rights) has to be approved by the competent higher regional court after having been approved by reaching the relevant majorities among the voting groups of creditors.

The reorganisation proceeding may involve measures that affect the rights of the credit institution's creditors and/or its shareholders.

I. According to section 12 of the KreditReorgG the reorganisation plan as approved by the OLG Frankfurt court may provide that claims of creditors are partially reduced, deferred or modified in another way. Only 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 as regards collateral with respect to which they are entitled to separate satisfaction (*absonderungsberechtigt*) such as pledges over securities by applying section 223 of the Insolvency Code analogously to the reorganisation proceeding.[38] However, pursuant to section 223 para. 1 sent. 2 of the Insolvency Code the insolvency plan shall not affect creditors' rights with respect to collateral where the collateral granted qualifies as Financial Collateral.[39]

Section 9 of the KreditReorgG provides that claims of a creditor may even be converted into equity, however, only with the specific creditor's consent.

II. Furthermore, the KreditReorgG provides for certain mandatory temporary limitations of the rights of counterparties to terminate contractual relationships with a German credit institution that becomes subject to reorganisation proceedings (section 13 of the KreditReorgG). Contracts may not be terminated starting

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[38] According to the legislative reasoning for the Bank Restructuring Act (BT-DrS. 17/3024 p. 49) a reorgansiation plan may contain all measures that can be contained in an insolvency plan within the meaning of section 217 *et seq* of the Insolvency Code.

[39] Such right is equally excluded where collateral has been granted for the benefit of a participant in a system within the meaning of section 1 para. 16 of the Banking Act to secure his claims from the system, or for the benefit of the central bank of a Member State of the European Union or the European Central Bank.

from the day on which the notification for the commencement of a reorganisation proceeding pursuant to section 7 para. 1 of the KreditReorgG is filed with BaFin until the end of the next following business day (such term to be determined in accordance with section 1 para. 16b of the Banking Act with a view to relevant "systems" within the meaning of Directive 98/26 EC on settlement finality in payment and securities settlement systems as amended by Directive 2009/44/EC). The effectiveness of other termination events (for example in case of a payment default) occurring during this period shall be postponed until the expiration of that period. Contractual clauses that provide for the contrary (*i.e.* for an immediate termination) shall be invalid.

Where the notification for the commencement of a reorganisation proceeding is made less than two business days prior to termination upon the application of BaFin for the opening of insolvency proceedings, this suspensive effect would also hold true for a(n automatic) termination based on such event of default.

(C) Furthermore, pursuant to sections 48a *et seq.* of the Banking Act the BaFin has the right to issue a transfer order (*Übertragungsanordnung*) by which the BaFin may force the credit institution to transfer all or parts of its (systemically important) business to another entity (so-called "**bridge bank**"). Precondition is that the BaFin determines (in consultation with *Deutsche Bundesbank*) that the ongoing existence of the credit institution is endangered and this in turn may endanger the stability of the financial markets.

I. Termination restriction upon transfer order

Also the provisions on the transfer order under the Banking Act provide for certain limitations of the rights of counterparties. Contractual relationships may not be terminated at all upon a transfer order pursuant to section

48g para. 7 of the Banking Act[40] (this limitation of third parties' termination rights together with section 13 of the KreditReorgG (see Paragraph 4.1.1(d)(iv)(2)(B) on page 30 above) is hereinafter referred to as the "**Termination Restrictions**"). The transfer order shall also not result or give rise to an automatic termination. Contractual clauses that provide for the contrary shall be invalid. However, if the reason for the termination is related to the bridge bank (for example as the lender would otherwise breach a large exposure limit), or if a termination is not simply based on the transfer itself (for example in case of violation of contractual obligations or other reasons, such as the filing of an application for insolvency proceedings by BaFin), termination shall be permitted and valid.

II. Partial Transfer

In the case of a partial transfer, *i.e.* where the transfer order provides that only part of the business of the transferring bank is to be transferred, pursuant to section 48k para. 2 of the Banking Act termination rights are not suspended in case such partial transfer is in breach of the statutory restrictions applicable to such transfer, *i.e.*

(a) where Financial Collateral is not transferred together with the business parts it relates to,

(b) where assets that are part of a payment or settlement system are not transferred together with the relevant collateral, or

[40] Section 48g (7) of the Banking Act reads as follows: "Contractual relationships may not be terminated solely because they shall be subject to a transfer. The transfer order and spin-off shall not result in an automatic termination of contractual relationships. Any contractual provisions providing for the contrary shall be invalid.

Sentences 1 to 3 shall not apply where

1. termination rights are not solely based on the fact that the contractual relationship is transferred or the preconditions for a transfer are met;

2. termination rights with respect to or relating to the succeeding entity;

3. in case of a partial transfer, the preconditions of section 48k (2) sent. 1 to 3 have not been met."

(c) where assets that are part of an eligible netting agreement within the meaning of section 206 para. 1 of the German Solvability Regulation (*Solvabilitätsverordnung*)[41] are not transferred in their entirety or without the relevant netting agreement and the relevant master agreement.

(D) Conflict of law provisions regarding the proceedings under the Bank Restructuring Act where the Master Agreement is governed by another law than German law

We do not give an opinion whether reorganisation proceedings and transfer orders may be qualified as Events of Default as defined in the Master Agreements (to the extent not governed by German law) as this would be a matter of the law governing the Master Agreement.

A termination of a Master Agreement upon the occurrence of a reorganisation proceeding or a transfer order would be subject to the Termination Restrictions as described above, to

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41 According to section 206 para. 1 of the SolvV, eligible netting agreements are netting agreements covering derivatives, reciprocal cash balances, non-derivative transactions with remargining (as defined in section 209 of the SolV), cross-product netting agreements (as defined in section 210 of the SolvV). For this purpose securities lending agreements should regularly qualify as "non-derivative transactions with remargining" within the meaning of section 209 para. 1 of the SolvV or, where the transactions under such agreement do not only constitute securities lending transactions, may qualify as a cross-product netting agreement within the meaning of section 210 of the SolvV.

In any such case, according to section 206 para. 2 of the 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.

the extent the Termination Restrictions are applied by a German or foreign court.

The official reasoning of the Bank Restructuring Act explains that pursuant to German conflict of law rules the Termination Restrictions shall be mandatory law on an international level, serving the public interest by protecting political and economic organisation. However, this legal character has not been statutorily determined.[42]

I. Art. 34 of the EGBGB

Where an agreement is entered into prior to 17 December 2009, Art. 34 of the EGBGB is the relevant applicable conflict of law provision.[43]

According to the official reasoning of the Bank Restructuring Act, the Termination Restrictions should, thus, be qualified as compulsory provisions (*zwingende Bestimmungen*) [44] within the meaning of Art. 34 of the EGBGB which provides that the choice of a foreign law for an agreement shall not affect the application of the provisions of German law, that regulate a situation by compulsory provisions without regard to the law applicable to the contract. Thus, a German court would generally have to recognise the Termination Restrictions in accordance with Art. 34 of the EGBGB, subject to Paragraph 4.1.1(d)(iv)(2)(D)III on page 37 below [45]

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[42] BT-DrS. 17/3024, pages 52 and 67.

[43] Please note that it is not clear from the wording of Art. 28 of the Regulation (EC) No 593/2008 of the European Parliament and of the Council on the law applicable to contractual obligations (Rome I) ("**Rome I Regulation**") and disputed in legal literature to what extent Art. 34 of the EGBGB would also be applicable to an agreement concluded before but modified after 17 December 2009 and that there is no guidance as to which conflict of law provision would be applied to master agreements entered into prior to 17 December 2009 where Individual Contracts thereunder were concluded after such date.

[44] BT-DrS. 17/3024, pages 52 and 67.

[45] For the obligation of a German court to directly apply German overriding mandatory provisions directly irrespective of a contradicting governing law, see also Münchener Kommentar zum BGB – Martiny, 5th Ed. 2010, VO (EG) 593/2008 Art. 9, nos. 104-105 .

irrespective of the law governing the Master Agreement and/or Netted Agreements.

Whether a non-German court would apply the Termination Restrictions as compulsory provisions of German law would fully depend on the conflict of law regime applied by such court.

II. Rome I Regulation

For an agreement entered into after 17 December 2009 the conflict of law provisions regarding contractual relationships as contained in the Rome I Regulation apply.

According to the official reasoning of the Bank Restructuring Act the Termination Restrictions shall be qualified as overriding mandatory provisions within the meaning of Art. 9 para. 1 of the Rome I Regulation. [46] Thus, a German court would generally have to recognise the Termination Restrictions in accordance with Art. 9 para. 2 of the Rome I Regulation, subject to paragraph 4.1.1(d)(iv)(2)(D)III on page 37 below[47] irrespective of the law governing the Master Agreement and/or Netted Agreements.

However, a non-German court would have to consider applying the Termination Restrictions in accordance with Art. 9 para. 3 of the Rome I Regulation if the obligations arising out of the Master Agreements had to be or have been performed in Germany. In such case, effect may be given to the overriding mandatory provisions of German law, in so far as those overriding mandatory provisions render the performance of the contract unlawful. In considering whether to give effect to those provisions, in accordance with our understanding of the Rome I

[46] BT-DrS. 17/3024, pages 52 and 67.

[47] For the obligation of a German court to directly apply German overriding mandatory provisions directly irrespective of a contradicting governing law, see also Münchener Kommentar zum BGB – Martiny, 5th Ed. 2010, VO (EG) 593/2008 Art. 9, nos. 104-105 .

Regulation the relevant court shall consider their nature and purpose and to the consequences of their application or non-application.

Even if the Termination Restrictions are overriding mandatory provisions within the meaning of Art. 9 para. 1 of the Rome I Regulation, this would not require a non-German court to apply the Termination Restrictions if obligations arising out of a Master Agreement were not to be performed in Germany.

III. Winding-Up Directive

According to Art. 3 para. 2 of the Winding-Up Directive, which is applicable to deposit-taking credit institutions and e-money institutions only, reorganisation measures shall be applied in accordance with the laws, regulations and procedures applicable in the relevant home Member State, unless otherwise provided in the Winding-Up Directive.

It is not clear whether a court would construe the reorganisation proceeding under the KreditReorgG as a reorganisation measure (*Sanierungsmaßnahme*) within the meaning of the Winding-Up Directive and the situation is even less clear for a transfer order, please see already Paragraph 4.1.1(a)(ii) on page 16 above.

According to Art. 3 para. 2 of the Winding-Up Directive the statutory provisions of an EU-member state in the context of reorganisation measures (such as the Termination Restrictions) shall generally be fully effective throughout the EU without any further formalities. However, this applies only where the Winding-Up Directive does not provide anything to the contrary.

In this context, the conflict of law rule Art. 25 of the Winding-Up Directive needs to be taken into account with respect to netting agreements. It has been implemented into German law by section 340 para. 2 of the German Insolvency Code, stipulating that "*netting agreements* *shall be governed solely by the law of the contract which governs such agreements*".

According to section 7 para. 5 sent. 2 of the KreditReorgG in connection with section 46d para. 3 of the Banking Act, this provision also applies for reorganisation proceedings.

Based on our interpretation of section 340 para. 2 of the Insolvency Code (see in detail Paragraph 4.2.1(d)(ii)(2) on page 83 below), we would come to the conclusion that a German court which would have to consider whether or not the Netting Provisions should be effective or whether their effectiveness should be affected by the Termination Restrictions would refer to the substantive laws (including insolvency/reorganisation laws) of the country the laws of which have been chosen by the parties to govern the relevant agreement, rather than applying German law

Thus, a German court could, by applying section 340 para. 2 of the Insolvency Code, come to the conclusion that the Termination restriction of section 13 of the KreditReorgG should not be applied in case a netting agreement is governed by a foreign law. However, absent any case law and a detailed analysis in legal literature yet, it is unclear in which way a German court would resolve the conflict between section 340 of the Insolvency Code particularly for reorganisation measures on the one hand and the direct application of overriding mandatory provisions of German law on the other hand.

The provisions of the Banking Act on the transfer order do not contain a reference to section 46d para. 3 of the Banking Act, which provides for an application of section 340 of the Insolvency Code. Thus, this conflict of law provision is not applicable. A court should, thus, consider the Termination Restriction of section 48g para. 7 of the Banking Act as an overriding mandatory provision within the meaning of Art. 9 para. 1 of the Rome I Regulation.

Please note that as the Bank Restructuring Act has 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, there do not exist any court decisions. Furthermore, a more detailed analysis and debate in legal literature on the relevant provisions has only just commenced.

(e) *Opinion on whether the German insolvency law provides for a "safe harbour" for certain derivatives or other categories of transactions and whether the contract types listed in Annex 1 would benefit from such provision(s).*

We understand that the term "safe harbour" refers to a provision according to which the opening of an Insolvency Proceeding would not affect the enforceability of claims under the relevant transaction. Such provisions do not exist under German law. However, section 104 of the Insolvency Code provides for an exception to the Insolvency Representative's "cherry-picking" right (please see Paragraph 4.1.1(h)(ii) on page 47 below). Most of the contract types listed in the Annex would benefit from such exception (see in more detail Paragraph 4.1.1(h)(iii) on page 51 below).

However, German substantial insolvency law does not provide for an exception from the statutory provisions of insolvency avoidance. In this respect (see Paragraph 4.1.1(c) on page 19 above).

(f) *Opinion on whether there is publicly available information that would confirm any of the procedural steps mentioned above under (a) through (d) or other solvency related facts (e.g., financial statements, corporate actions, etc.).*

According to section 9 of the Insolvency Code, several procedural steps, including the court order on the opening of Insolvency Proceedings (*Eröffnungsbeschluss*) or the decision by a court not to open Insolvency Proceedings due to insufficient funds (*mangels Masse*) have to be published on the internet by the insolvency court. The relevant website is established for Germany by the Ministry of Justice of the Federal State of North-Rhine Westphalia and is www.insolvenzbekanntmachungen.de. This website is updated several times a day. Thus, depending on the time when the opening of the Insolvency Proceeding is ordered, the announcement may be made on the same day or the day after the announcement. Additional publications may be made in print media.[48]

48 The information as published under www.insolvenzbekanntmachungen.de must also be published in the company register (*Unternehmensregister*) according to section 8b para. 2 no. 11 of the German Commercial Code and is accessible via the electronic Federal Gazette (*elektronischer Bundesanzeiger*) under www.unternehmensregister.de.

The filing for insolvency may also be made public by the relevant company itself. There is no general obligation on behalf of the insolvent party to publish the fact that it has submitted an insolvency filing. However, if a company qualifies as a domestic issuer (*Inlandsemittent*, as defined in section 2 para. 7 of the German Securities Trading Act (*Wertpapierhandelsgesetz* – the "**WpHG**")) and has issued financial instruments which are admitted for trading on a German exchange, such company will be subject to the *ad hoc* requirements provided for in the WpHG (section 15 of the WpHG). The *ad hoc* requirement applies to all information which, *inter alia*, is not known to the public and may, if it becomes public, have a significant effect on the price of the relevant financial instrument. Thus, the filing for the opening of an Insolvency Proceeding and the Insolvency Court's order on the commencement of an Insolvency Proceeding will likely be subject to the *ad hoc* publication requirement. An *ad hoc* publication has to be made without undue delay (*unverzüglich*).

In case of an insolvency filing by the BaFin with respect to a credit institution, a financial services institution or an insurance company, the filing for insolvency is likely to be announced on the BaFin's website (www.bafin.de).

In case of an Insolvency Proceeding over the assets of a German deposit taking credit institution or a German e-money institution, the announcement of an Insolvency Proceeding will also be published in the Official Journal of the EU and two nationwide newspapers (section 46e para. 3 sentence 2 of the Banking Act). In case of an Insolvency Proceeding over the assets of a German insurance company, the announcement of an Insolvency Proceeding will also be published in the Official Journal of the EU (section 88 para. 3 sentence 3 of the Insurance Supervisory Act).

(g) *Opinion on whether German laws consider early termination, set-off and close-out netting as legally distinct and separate or similar rights, similar or related rights or whether they make no such distinctions between them.*

Under German law, "netting" does technically not qualify as a legal term referring to a specific and clearly defined legal concept. Instead, "netting" may denote a variety of legal concepts such as payment or payment netting[49], netting by novation (*Schuldersetzung*), and close-out netting (*Liquidations-Netting*)[50].

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49 Under German law, the immediate automatic netting of claims booked into a bank account qualifies as equated current account (*Staffelkontokorrent*).

50 For an overview please refer to: EUROPEAN FINANCIAL MARKETS LAWYERS GROUP, Protection for Bilateral Insolvency Set-off and Netting Agreements under EC Law, A report by the European Financial Market Lawyers Group (EFMLG), October 2004, Annex 6, p. 75.

In the context of master agreements for derivative transactions, the legal concept that is most relevant under German law is "close-out netting" which provides 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. This concept is distinct from the statutory concept of set-off[51] as the corresponding obligations that may be subject to close-out netting do neither need to be of the same nature nor to fall due at

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51 Under German statutory law, set-off (*Aufrechnung*) is understood as the mutual discharge of two corresponding obligations of the same nature. The rules relating to set off are contained in sections 387 *et seq.* of the German Civil Code. According to this provision, a party that demands payment – or of whom payment is demanded – is entitled to unilaterally declare that the debt is extinguished by a set-off provided that the legally defined set-off requirements are met. The statutory right to set off requires that (i) both parties have claims against each other (mutuality - *Gegenseitigkeit*), (ii) such claims are of similar nature (similarity - *Gleichartigkeit*) and (iii) the claim with which set-off is to be effected is valid, due and enforceable (*Wirksamkeit, Fälligkeit und Durchsetzbarkeit der Gegenforderung*) and (iv) the other claim (against which set-off is to be effected) can be fulfilled (*Erfüllbarkeit der Hauptforderung*). Pursuant to section 388 para. 1 of the German Civil Code, a set-off right is exercised by giving notice of set-off to the other party (*Aufrechnungserklärung*). The right to set off may only be exercised if set-off is neither excluded by law nor by agreement. There are several exceptions where the law prohibits a party to set off, for example, if an obligation arises from a claim for compensation for an intentional tort (section 393 of the German Civil Code) or if one of the debts is not subject to attachment (section 394 of the German Civil Code)(for an overview see Schlüter, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch, 5th ed. (2007), § 387 nos. 56 *et seq.*).

The concept of "close-out netting" is distinct from the statutory concept of set-off as the corresponding obligations that are normally subject to close-out netting are neither of the same nature nor due at the same time. However, according to the principles of contractual freedom and party autonomy, contractual set-off agreements (*Aufrechnungsvertrag* or *Aufrechnungsvereinbarung*) are permissible. To the extent that the arrangements do not conflict with mandatory provisions of German law, the parties are allowed to deviate from the statutory requirements for set-off (such as the requirement that the claim with which set-off is to be effected is due and payable) by agreement. Such an agreement can modify the requirements for set-off or extend the right to set off (for example, by enabling the party to set off against a claim of a third party.

We do not give an opinion on German corporate law where, in specific cases, restrictions on set-off apply (sections 19 of the German Act on Limited Liability Companies and section 66 of the Stock Corporation Act) which restrict the right of a shareholder or partner to set off against its obligation to provide equity contributions). Set-off is generally subject to restrictions in specific circumstances according to sections 392 *et seq.* of the German Civil Code, i.e. in case of confiscated claims, claims due to an intentionally committed tort and unpledgeable claims. Obligations under the Netted Agreement and the Individual Contracts should generally not qualify as unpledgeable claims within this meaning.

Pursuant to section 94 of the Insolvency Code and subject to the challenging of transactions in Insolvency Proceedings, such a contractual agreement concerning set-off is generally enforceable, even in case of the insolvency of either or both parties. However, there is a view supporting a narrow interpretation of section 94 of the Insolvency Code to restrict the scope of permissible agreements concerning set-off in case of insolvency with a view to ensure an appropriate equal treatment of all creditors (Schwahn NJW 2005, 473, 474).

the same time. Rather, the parties are allowed to deviate from the statutory requirements for set-off, subject to certain restrictions due to mandatory provisions of German law.[52]

(h) *Assuming the Parties have* <u>*not*</u> *specified that Automatic Termination (as defined in § 6.3 of the MNA or Part II.B of the Commodities Schedule) applies, are the provisions of the Master Agreements permitting the other Party (the "Terminating Party" or "Closing-Out Party") to terminate the Netted Agreements including all Individual Contracts upon the occurrence of a Close-Out Event enforceable under the laws of Germany or is there a risk that (i) the entering into Master Agreements, (ii) the entering into Netted Agreements or Individual Contracts thereunder or (iii) the early termination by notice described in § 5.1 of the MNA or Section 2.2 of the*

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52 Limitation on contractual set-off arrangements will in particular apply to agreements which deviate from the requirement of mutuality of the claims. For example, in 2004, the *Bundesgerichtshof* decided that section 96 para. 1 no. 2 of the Insolvency Code applies analogously 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*)(see BGH NJW 2004, 3185). The *Bundesgerichtshof* therein 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 as in the specific case the set-off declaration had been made only after the opening of Insolvency Proceedings and, accordingly, the preconditions of section 94 of the Insolvency Code had not been met. With respect to "tri-party" set-off, the *Bundesgerichtshof* argued in its judgment that the situation entitling to a set-off (*Aufrechnungslage*) which is protected by section 94 of the Insolvency Code does not come into existence prior to the declaration of set-off.

In addition, statutory provisions may limit or prohibit set-off with respect to certain entities, including, for example, insurance companies and investment management companies:

(1) With respect to insurance companies, section 77 para. 2 sentence 2 of the Insurance Supervisory Act limits the possibility of set-off against claims belonging to the so-called "cover assets" *(Sicherungsvermögen)* of an insurance company. According to the legislative reasoning of section 77 para. 2 sentence 2 of the Insurance Supervisory Act, this provision primarily intends to prevent a reinsurance company from setting off its claims vis-à-vis a direct insurance company (*Erstversicherer*) vis-à-vis the claims such insurance company has against the reinsurance company, as such set-off which would result in a decrease of the assets from which the direct insurance company could satisfy claims of the insurance holders (BT-Drucksache 16/6518, page 18). However, the scope of application of section 77 para. 2 sentence 2 of the Insurance Supervisory Act is not limited to claims of a reinsurance company against a direct insurance company.

(2) With respect to investment management companies, section 31 para. 6 of the Investment Act provides that claims against an investment management company cannot be set off against a claim of an investment fund. However, this does not apply to master agreements on derivatives transactions which provide that claims arising from transactions under the master agreement or claims arising from the master agreement itself are automatically set off or may be set off by a party or which, in the case of a termination of the master agreement due to a default or insolvency, are replaced by a single compensation claim.

CPMA itself could be challenged by a liquidator, administrator, receiver or third party?

(i) Enforceability of the termination rights under the Master Agreements prior to the commencement of Insolvency Proceedings

Prior to the commencement of Insolvency Proceedings, the law applicable to the termination of the Master Agreements depends on the law governing the relevant Master Agreement.

(1) Enforceability of the termination rights if the Master Agreements are governed by a law other than German law

Pursuant to Article 12 para. 1 of the Rome I Regulation[53], the law applicable to a contract is generally decisive for its interpretation, the performance of the obligations created by it, within the limits of the powers conferred on the court by its procedural law, the consequences of a total or partial breach of obligations, including the assessment of damages in so far as it is governed by rules of law, the various kinds of extinguishing obligations, and prescription and limitation of actions and the consequences of the nullity of the contract.

According to Article 12 para.1 lit. d) of the Rome I Regulation, the validity of the termination of a transaction, which is not governed by German law, is to be determined under the law that governs such transaction. To the extent the termination is valid under the law governing the Master Agreements, for example, English law, German law will recognise the validity of such contractual early termination.

(2) Enforceability of the termination rights if the Master Agreements are governed by German law

53 The Rome I Regulation applies to contracts concluded as from 17 December 2009 (Article 28 of the Rome I Regulation). Contracts entered into prior to that date are subject to the Introductory Law of the German Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch*).

(A) Close Out Events in § 3 of the MNA[54] and in Section 2.1 of the CPMA[55] and termination for serious cause according to section 314 para. 1 of the German Civil Code

If the Master Agreements are governed by German law, the Master Agreements may generally be terminated upon the occurrence of a serious cause (*wichtiger Grund*). Generally, section 314 para. 1 of the German Civil Code provides for the termination of a contract for the performance of a continuing obligation on notice with immediate effect upon a serious cause. Serious cause is given if, after having regard to all circumstances of the specific case and balancing the interests of both parties, the terminating party cannot reasonably be expected to continue the contractual relationship until the agreed termination date or until the end of a notice period. The serious cause might consist in the infringement of a duty under the contract or a material change of circumstances.

Under the principles of contractual freedom and party autonomy, the parties to an agreement may agree on termination rights which specify or supplement the statutory termination rights for serious cause. Parties to an agreement may specify individual events giving rise to a termination right for serious cause by individual agreement (*Individualvereinbarung*).

Therefore, the events specified as a Close Out Event in § 3.1 MNA or in Section 2.1 of the CPMA are construed as an agreement between the parties that such events qualify as a

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54 § 3.1 of the MNA and the Election Sheet permit the Parties to identify and customize those events, the occurrence of which would permit the early termination and close out of the MNA, the Netted Agreements and the Individual Contracts entered into thereunder.

55 According to Section 2.1 of the CPMA, any event that would result in the close out of a Netted Agreement becomes a contractual basis for the party entitled to close out that Netted Agreement and to close out all (but not fewer than all) other Netted Agreements that, in that party's good faith judgment, may legally be closed out. In addition, a party's breach of a representation, warranty or covenant under the CPMA itself will entitle the other party to close out all (but not fewer than all) Netted Agreements that may be legally closed out.

serious cause for purposes of section 314 para. 1 of the German Civil Code[56].

In case of a provision such as § 3.1 MNA or in Section 2.1 of the CPMA, in which the parties agree on a specific set of termination events which shall give rise to an early termination without any notice period, the terminating party only needs to prove the relevant facts giving rise to such termination event. No proof as to whether such termination event would actually qualify as serious cause needs to be given by the terminating party since the parties have agreed already that such event is a serious cause. In such case, the other party would explicitly have to establish that despite of the occurrence of such event which both parties had explicitly agreed to be serious cause, it were not unreasonable to continue the contractual relationship.[57]

According to German case law, termination rights may not be exercised at an inappropriate point in time (*Kündigung zur Unzeit*), *i.e.* the terminating party must consider prior to any termination whether the point in time when the termination right is exercised would impose an additional significant burden on the other party to the contract that could be prevented by taking less severe steps[58]. Whether the point in

56 Such enumeration will not be construed as a conclusive enumeration of all events which may qualify as a serious cause under section 314 para. 1 of the German Civil Code. A limitation of the termination right for serious cause by standard terms and conditions would not be binding (BGH ZIP 1986, 919, 920). Furthermore, even by individual agreement the parties cannot entirely waive the termination right for serious cause (BGH BB 1973, 819).

57 Generally it depends on the individual circumstances whether an event constitutes a serious cause pursuant to section 314 para. 1 of the German Civil Code and has to be determined on a case-by-case basis. Absent any contractual agreement between the parties to a contract, the terminating parties would have to prove the existence of the facts that give rise to a serious cause and would also have to demonstrate that in balancing the interests of both parties it cannot reasonably be expected to continue the contractual relationship in case of a dispute over the validity of a termination pursuant to section 314 para. 1 of the German Civil Code. Where an event is contractually agreed to constitute "serious cause", the burden of proof as described would be on the non-terminating party.

58 LG Frankenthal ZIP 2006, 752; Schleswig Holsteinisches OLG, 3 May 2010 (5 U 29/10); OLG München BB 1997, 435, 436; OLG Frankfurt, WM 1992, 1018; BGH WM 1985, 1136; BGH DB 1959, 594. Whereas most courts have rejected the defence that a termination was exercised at an inappropriate point in time, LG Frankenthal considered

time when the relevant Master Agreement, the Netted Agreements and all Individual Contracts entered into thereunder are terminated may be regarded as inappropriate depends on the specific circumstances of the individual case. The party raising this argument would have to give conclusive evidence that its particular interest to defer the termination and continue the agreement is to be considered more justified than the interest of the terminating party to terminate the relevant Master Agreement, the Netted Agreements and all Individual Contracts entered into thereunder *i.e.* that the other party has used its contractual right in an abusive manner (*rechtsmißbräuchlich*).

(B) Termination rights under the single agreement concept

According to the single agreement concept contained in § 2.3 of the MNA and, if so selected in Part VIII Section 10.6 of the Commodities Schedule, in the CPMA, all Netted Agreements and Individual Contracts entered into under the relevant Master Agreement shall be governed by the terms of such Master Agreement, and such Master Agreement, all Netted Agreements and Individual Contracts form a single agreement between the parties. Thus, the afore-mentioned termination rights also apply to each of the Netted Agreements and each of the Individual Contracts.

Thus, the right to terminate the Master Agreements, the Netted Agreements and all Individual Contracts entered into thereunder for a Close Out Event would generally be enforceable.

(3) Where a Netted Agreement is governed by a law other than the law governing the Master Agreement, a termination pursuant to such Master Agreement could be effected under the governing law of the relevant Master Agreement pursuant to Art. 3 paras. 1 and 2 of the Rome I Regulation, notwithstanding Art. 12 para.1 of the Rome I

the termination of a loan ineffective as the termination right was exercised by the terminating party "out of the blue" (*aus heiterem Himmel*) without any consideration of less severe steps.

Regulation.[59] According to Art. 3 para.1 of the Rome I Regulation, the parties are free to chose the law that shall govern their legal relationship including a split choice of law. According to Art. 3 para. 2 of the Rome I Regulation the parties may furthermore agree any time to govern a Netted Agreement by a law other than that which previously governed it, e.g. the law governing the Master Agreement.

(ii) Enforceability of contractually stipulated Early Termination rights in case of insolvency

A contractual termination right following Close Out Event as stipulated in the Master Agreements would be recognised by a German court even if Insolvency Proceedings were conclusively commenced against the assets of one of the Parties after the termination, as the termination right would not be considered to aim at preventing the application of mandatory insolvency provisions regarding executory contracts. However, such termination may still be subject to the Insolvency Representative's right to challenge legal acts falling within certain periods prior to the commencement of the Insolvency Proceeding (please see paragraph 4.1.1(c) on page 19 above).

However, under German insolvency law, following the opening of Insolvency Proceedings, executory contracts[60] which have not been effectively terminated prior to such opening of Insolvency Proceedings are, pursuant to section 103 of the Insolvency Code, subject to the Insolvency Representative's right to decide whether to assume or reject such contracts[61].

(1) The Insolvency Representative's cherry-picking right

Pursuant to section 103 of the Insolvency Code, the Insolvency Representative therefore has the power to disclaim unprofitable contracts and to enforce profitable ones ("**cherry-picking**"). In the

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59 MARTINY, in: Münchener Kommentar zum BGB, Vol. 5, 5th ed. (2010) I Rom I-VO no. 67.

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

61 The opening of Insolvency Proceedings does not lead to the 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 result directly in a termination of the contractual agreement.

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.

However, in this context there are 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 (*Fixgeschäfte*) (section 104 para. 1 of the Insolvency Code; see Paragraph 4.1.1(h)(iii)(2) on page 54 below) and the other relates to financial transactions within the meaning of section 104 para. 2 of the Insolvency Code (see Paragraph 4.1.1(h)(iii)(3) on page 55 below). To the extent that section 104 of the Insolvency Code applies, it supersedes the Insolvency Representative's "cherry-picking" right according to section 103 of the Insolvency Code.

(2) Contractual termination rights based on insolvency-related events

It is disputed amongst German legal authors whether and to which extent German insolvency law prohibits contractually stipulated termination rights based on insolvency-related events as a circumvention of mandatory insolvency provisions regarding executory contracts, including the Insolvency Representative's right to "cherry-pick" under section 103 of the Insolvency Code. An early termination of transactions indirectly prevents the Insolvency Representative from exercising his statutory right to disclaim or enforce outstanding transactions. However, such right of the Insolvency Representative is protected by section 119 of the Insolvency Code.

Section 119 of the Insolvency Code [62] provides that contractual agreements which exclude or limit the application of the statutory insolvency provisions regarding executory contracts, such as section 103 of the Insolvency Code, in advance are void. The validity of contractually stipulated termination rights that are based on

[62] Section 119 of the Insolvency Code (Invalidity of Agreements Derogating from the Foregoing Provisions) reads in its non-binding English translation as follows: "*Agreements excluding or limiting the application of sections 103 to 118 in advance shall be invalid.*"

insolvency-related events therefore depends on whether or not the respective agreement is deemed as an exclusion or limitation of the application of the mandatory insolvency provisions regarding executory contracts.

The majority of German insolvency law commentators[63] advocate a narrow application of sections 103 and 104 of the Insolvency Code and, hence, view a contractual early termination right as to be held valid by a German court[64] provided that it is based on non-insolvency related events or on a party's application to commence Insolvency Proceedings against its assets and/or the existence of any material reason for such an application (such as over-indebtedness). A termination right directly and exclusively based on an actual opening of Insolvency Proceedings is, however, considered to be legally ineffective.

In our opinion, this majority view is convincing and should be followed. Section 103 of the Insolvency Code matches its predecessor, i.e. section 17 of the Bankruptcy Code. Hence, the reasoning concerning the interpretation of sections 103 and 119 of the Insolvency Code largely corresponds to the arguments provided under the Bankruptcy Code[65]. Neither the wording[66] of the relevant

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63 For example: WILMOWSKY ZIP 2007, 553, 554 *et seq.*; JAHN, in: Münchener Kommentar zur Insolvenzordnung, Vol. 2, 2nd ed. (2008), § 104 nos. 152 *et seq.*; HUBER, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. (2008), § 103 no. 90, 201; *idem*, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. (2008), § 119 nos. 23 *et seq.*; *idem*, NZI 1998, 97, 99; BOSCH, in: Kölner Schrift zur Insolvenzordnung, 2nd ed. (1999), 1009 *et seq.*; WORTBERG ZinsO 2003, 1032 *et seq.*

64 Up to now, there is no case law on this issue under the legal regime of the Insolvency Code. Nonetheless, based on several and, in our view, persuasive judgments of the *Bundesgerichtshof* under the former Bankruptcy Code, the predecessor of the Insolvency Code (BGHZ 96, 34, 37 *et seq.*; BGHZ 124, 76 = NJW 1994, 449), legal commentators assume that contractual termination provisions based on insolvency-related events should principally be enforceable.

65 Under the Bankruptcy Code, it was held that section 17 of the Bankruptcy Code was a mandatory rule of law and that consequently any agreement directly derogating from this provision was null and void. Notwithstanding this prohibition, mere indirect derogations were considered to be enforceable and have been accepted by the courts. In 1985, for instance, the *Bundesgerichtshof* sustained an early termination clause contained in a standard form construction contract entitling the customer to terminate the contract upon the opening of Insolvency Proceedings over the assets of the contractor and to claim compensation for non-performance from the contractor. According to the legal reasoning of the court, contractual agreements detrimental to the assets involved in Insolvency Proceedings should only be invalidated if and to the extent they fall under the provisions of insolvency avoidance or challenging

provisions of the Insolvency Code nor its legislative history[67] require a deviation from the long-established line of opinion applied by the German courts prior to the enactment of the Insolvency Code.

Furthermore, from our point of view an extensive interpretation of section 119 of the Insolvency Code would be inconsistent with section 112 of the Insolvency Code that explicitly prohibits the termination of tenancy or lease contracts (*Miet- oder Pachtverhältnisse*) after the opening of Insolvency Proceedings based on the default in the payment of tenancy or lease fees arising before

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rights. Principally (and subject to insolvency avoidance or challenging rights), the Insolvent Party had to accept the insolvency estate in such state as it existed at the time of the opening of Insolvency Proceedings (BGHZ 96, 34, 37 *et seq.*). Subsequently, the *Bundesgerichtshof* has confirmed this position (BGHZ 124, 76).

66 The wording of section 119 of the Insolvency Code does not distinguish between direct and indirect restrictions of the mandatory insolvency provisions. Thus, both interpretations of this provision are in principle compatible with the so-called literal rule according to which words that are capable of only one meaning must be given that meaning whatever the result (*wortlautgebundene Auslegung*).

67 With respect to the legislative procedure, both legal authors supporting the restrictive interpretation of section 119 of the Insolvency Code and legal commentators advocating its extensive interpretation reclaim the legislator's intention to support their respective views. The official draft of the Insolvency Code that was published by the German Federal Government (BT-Drucksache 12/2443) contained a provision (section 137 para. 2 sent. 1 of the official draft of the Insolvency Code) 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 null and void. The Committee on Legal Affairs of the German Federal Parliament, however, proposed to waive this prohibition. The Committee on Legal Affairs of the German Federal Parliament conceded that such contractual early termination rights indirectly restrict the Insolvency Representative's right to request or reject performance to the contractual obligation. According to the Committee on Legal Affairs of the German Federal Parliament, however, this indirect impact on the Insolvency Representative's option does not justify such a far-reaching restriction of the parties' freedom of 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 of the Insolvency Code emphasise that the legislator rejected an explicit prohibition by adopting the amended version of the act. This intention necessitates a restrictive interpretation of section 119 of the Insolvency Code (see HUBER, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. (2008), § 119 nos. 29 *et seq.*). On the contrary, the proponents of the extensive interpretation purport that section 137 para. 2 sent. 1 of the official draft of the Insolvency Code did not have a constitutive effect and, hence, its deletion does not have an impact on the scope of application of section 119 of the Insolvency Code (see BERSCHEID, in: Uhlenbruck, Insolvenzordnung, 12th ed. (2003), § 119 nos. 15 *et seq.*, however, a differentiated view is now taken by SINZ, in: Uhlenbruck, Insolvenzordnung, 13th ed. (2010), § 119 nos. 13 *et seq.*; TINTELNOT, in: Kübler/Prütting, InsO, § 119 nos. 15 *et seq.*). From our point of view, the latter opinion is not convincing since the omission of an explicit regulation is deemed as a deliberate rejection of a regulation because the legislator was aware of the demand for such a regulation when passing an act of law.

an application for the opening of the Insolvency Proceedings was filed or because of a deterioration of the debtor's financial situation. Under the assumption that section 119 of the Insolvency Code establishes a comprehensive prohibition of an early termination of contracts (for the performance of a continuing obligation), the special provision concerning tenancy and lease contracts would be deprived of any real effect[68]. Nonetheless, some authors[69] argue that this is not the case since this provision also applies to sale and purchase agreements (*Kaufverträge*). However, with respect to the relevant context, we assume that this view is targeted at instalment sale agreements (*Abzahlungsverträge*) only and, hence, should not apply to transactions under the Master Agreements.

Since § 3 of the MNA and Section 2 of the CPMA (in connection with the Close Out Events included in the relevant Netted Agreements) stipulate early termination rights which are not directly based on the opening of such proceedings but precede the opening of such proceedings, we take the view that the early termination would be legally effective (subject to the Insolvency Representative's right to challenge legal acts falling within certain periods prior to the commencement of the Insolvency Proceeding (please see paragraph 4.1.1(c) on page 19 above) provided that the termination is effected before an actual opening of Insolvency Proceedings.

(iii) *Limitations stipulated by section 104 of the Insolvency Code*

On the assumption that a Close Out Event has occurred in relation to a Party and that the date for early termination falls after the opening of Insolvency Proceedings, the provisions of sections 103, 104 of the Insolvency Code would override the Netting Provisions.

Upon the opening of Insolvency Proceedings, section 104 of the Insolvency Code provides for a mandatory automatic termination of those obligations which fall within the scope of section 104 of the Insolvency Code.

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68 HUBER, in: Münchener Kommentar zur Insolvenzordnung, 2nd ed. (2008), § 119 no. 31.

69 MAROTZKE, in: Heidelberger Kommentar zur Insolvenzordnung, 5th ed. (2008), §112 no. 23, 24; KROTH, in: Braun, Insolvenzordnung, 4rd ed. (2010), § 112 no. 14.

If the relevant date for early termination falls after the opening of Insolvency Proceedings the provisions of section 104 of the Insolvency Code would govern the close-out netting of those obligations which fall within its scope. Section 104 of the Insolvency Code would have no effect on those obligations, which fall outside its scope and the analysis described in Paragraph 4.1.1(h)(ii) on page 47 above would apply thereto, i.e. section 103 of the Insolvency Code would apply in relation to executory contracts under the Master Agreements. Accordingly, the Insolvency Representative may have a right to assume or reject each Individual Contract entered into under the relevant Netted Agreement (cherry picking).

Section 104 of the Insolvency Code[70] reads in its non-binding English translation as follows:

"*Section 104*

Fixed date transactions, financial transactions

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

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

1. *delivery of precious metals,*

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

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70 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).

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

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

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

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

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

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

(1) Overview

In replacing section 18 of the former Bankruptcy Code, section 104 para. 1 of the Insolvency Code applies to fixed date transactions (*Fixgeschäfte*) on tangible goods only[71]. Para. 2 of section 104 of the Insolvency Code applies to financial transactions; sent. 3 of para. 2 is

[71] Under the German Civil Code and Commercial Code fixed date transactions are transactions where due to the importance to receive performance in time the creditor is no longer interested in performance by the other party if such performance has not been made on the agreed date; see section 323 para. 2 no. 2 of the German Civil Code, section 376 para. 1 sent. 1 of the Commercial Code.

intended to ensure that all transactions entered into under a master agreement may be terminated at the same time (in case a transaction has already been fully performed by either of the parties; see Paragraph 4.1.1(h)(iii)(4) on page 58 below). Finally, para. 3 of section 104 of the Insolvency Code provides for the calculation method following the early termination of transactions by section 104 of the Insolvency Code.

Any automatic termination by virtue of section 104 of the Insolvency Code results in a claim for non-performance calculated on the basis of the difference between the agreed price and the market or exchange prices. The parties may agree on the point in time which shall be decisive for determining the market or exchange prices; such date may not exceed five working days after the opening of Insolvency Proceedings. The claim for non-performance would, irrespective of the law governing the relevant transaction or agreement, be governed by German law and to the extent unsecured, it would rank *pari passu* with the claims of all other unsecured creditors. The claim for non-performance will be expressed in Euro and may be available for set off[72].

To summarise, even though section 104 of the Insolvency Code may override contractual close-out netting provisions, it achieves effects comparable to such provision, i.e. a termination and liquidation of the obligations to form a basis for set-off. However, the amount of the net obligation arising pursuant to the operation of section 104 of the Insolvency Code may differ from the amount of the obligation, which would have resulted from the operation of contractual close-out netting provisions because timing and price sources may be determined in different ways.

(2) Fixed date transactions (*Fixgeschäfte*)

Section 104 para. 1 of the Insolvency Code applies to fixed date transactions (*Fixgeschäfte*) on tangible goods only. Whether or not an Individual Agreement qualifies as a fixed date transaction depends on

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72 Please note that section 104 para. 3 of the Insolvency Code does not provide for a set-off but may, by transforming the former payment and delivery claims into a Euro denominated payment claim, form a basis for a set off (subject to the general set off restrictions under contract and insolvency law, as applicable).

the intention of the parties to such agreement. [73] If the individual delivery obligations under such agreement must be fulfilled by the agreed date as otherwise their fulfilment becomes worthless, the agreement will qualify as a fixed date transaction, and thus, be terminated automatically by virtue of section 104 para. 1 of the Insolvency Code. Assuming that the delivery times or dates are exactly defined by the parties and that the party obliged to deliver is aware that any deliveries not in time would render such delivery for the party to take delivery worthless, the underlying transaction would be regarded as a fixed date transaction.

(3) Financial transactions within the meaning of section 104 para. 2 of the Insolvency Code

Only transactions which are "executory" contracts (as defined in footnote 60 above on page 45 above) can qualify as financial transactions within the meaning of section 104 para. 2 of the

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73 The decisive criteria for the distinction between the agreement on a fixed date transaction on the one hand and the mere determination of a delivery date on the other hand have been established on a case by case basis by the German courts. By and large, the courts are reluctant to qualify a transaction as a fixed date transaction merely because a contract provides for a fixed delivery date. According to the existing case law, an initial indication for the qualification 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 period of grace", etc. 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 qualification as a fixed date transaction since the parties to a contract may agree on severe contractual penalties in the event of default without agreeing on a fixed date transaction. Provided that the counterparty can change the supplier at short notice or if a delayed delivery is (broadly speaking) better than no delivery at all, the transaction does not constitute a fixed date transaction. The agreement on a specific delivery date alone is not sufficient for the qualification as a fixed date transaction. Instead, additional characteristics to be met are that the contract automatically ends through rescission in case the agreed delivery date is not met and that compensation for damages can be demanded provided that the supplier is at fault. Willingness to fix date transactions please also refer to our German Law Opinion of Clifford Chance issued in connection with the General Agreement concerning the delivery and acceptance of electricity to the European Federation of Energy Traders dated 15 November 2010 and the German Law Opinion of Clifford Chance issued in connection with the General Agreement concerning the delivery and acceptance of natural gas to the European Federation of Energy Traders dated 23 December 2010.

Regarding physically-settled Transactions, the qualification as a fixed date transaction and consequently the application of section 104 para. 1 of the Insolvency Code (leading to an automatic termination and a claim for financial damages rather than a continued delivery obligation) may in certain cases not be in the interest of the relevant parties, specifically where the purchaser of emission allowances needs the allowances to be able to meet its obligations regarding the emission of greenhouse gases (see for an explanation of fixed date transactions footnote 73 above). The contractual agreement of a subsequent delivery (*Nachlieferung*) would exclude the qualification as a fixed date transaction.

Insolvency Code.[74] However, an exemption from this rule applies to transactions which have been entered into under a master agreement (see Paragraph 4.1.1(h)(iii)(4) on page 58 below). Section 104 of the Insolvency Code constitutes a special rule to section 103 of the Insolvency Code and, therefore, also requires that the agreements are mutual and have not, or not fully, been performed by either party at the time of the opening of Insolvency Proceedings[75].

Furthermore, the transaction must provide for a specific time at which or period of time in which the performance has to be made[76].

To constitute a financial transaction the transaction needs to have a market or exchange price[77]. This is the case if a replacement

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74 In our view, emission allowances may not be qualified as commodities within the meaning of section 104 para.1 of the Insolvency Code which refers to commodities within the meaning of goods (or even corporeal objects, see LÜER in Uhlenbruck, Insolvenzordnung 13th edition 2010, § 104 no. 7, who seems, however, to indicate that the definition may be construed broader if a "commodity" would not otherwise fall under section 104 para. 2 of the Insolvency Code).

Furthermore, according to our understanding, emission allowances should not qualify as securities or comparable rights within the meaning of section 104 para. 2 sent 2 no. 2 of the Insolvency Code. This view is supported by two arguments, first the categorisation of section 1 para. 11 sent. 4 no. 2 of the German Banking Act which considers emissions allowances as an own category of assets different from securities and comparable instruments and, second the ratio of section 104 para. 2 of the Insolvency Code which shall be interpreted not to cover all types of financial instruments as covered by section 1 para. 11 of the Banking Act, JAHN, in: Münchener Kommentar zur InsO, Vol. 2, 2nd Ed. (2008), § 104 no. 51.

On the other hand, given the continued qualification of emission allowances as being regulated under capital markets laws, one cannot fully exclude that they could be qualified as being the object of financial services within the meaning of section 104 para. 2 of the Insolvency Code as instruments comparable to securities as they are transferable and tradeable on organized markets, at least when cash settled. This holds in particular true as the legislator has chosen a broad and explicitly non-conclusive wording of the provision in order not to be required to change the law in case of future developments (JAHN, in: Münchener Kommentar zur InsO, Vol. 2, 2nd Ed. (2008), § 104 no. 52, BALTHASAR in: Nerlich/Römermann, Insolvenzordnung, 17th update 2009, section 104 no. 34.

75 See JAHN, in: Münchener Kommentar zur InsO, Vol. 2, 2nd ed. (2008), § 104 no. 141

76 Section 104 para. 2 sent. 1 of the Insolvency Code 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 of the Insolvency Code (GOTTWALD, in: Insolvenzrechtshandbuch, 3rd ed. (2006), § 102 no. 47). 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 of the Insolvency Code.

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 of the Insolvency Code[78].

Section 104 para. 2 sent. 2 of the Insolvency Code provides examples of financial transactions by referring to the obligations under the relevant transaction. Section 104 para. 2 sent. 2 of the Insolvency Code enumerates only the most common financial transactions and is not conclusive[79]. However, if these enumerations were interpreted as mere examples, the scope of section 104 para. 2 of the Insolvency Code could become limitless and the enumerated examples would be arbitrary and unhelpful. On the basis of this interpretation, we come to the following conclusion:

– Commodity transactions, including option transactions, in electricity or natural gas only qualify as financial transactions within the meaning of section 104 para. 2 of the Insolvency Code if they are cash settled[80].

– Commodity transactions, including option transactions, in emission rights should not qualify as financial transactions within the meaning of section 104 para. 2 of the Insolvency Code, irrespective of whether they are physically settled or cash settled. In our view, emissions allowances should not qualify as securities or comparable rights within the meaning of section 104 para. 2 sent 2 no. 2 of the Insolvency Code.

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77 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 sent. 1 of the Insolvency Code is to be interpreted broadly.

78 JAHN, in: Münchener Kommentar zur Insolvenzordnung, Vol. 2, 2nd ed. (2008), § 104 no. 57.

79 JAHN, in: Münchener Kommentar zur Insolvenzordnung, Vol. 2, 2nd ed. (2008), § 104 no. 59.

80 According to section 104 para. 2 sent. 2 no. 1 of the Insolvency Code, only physically settled commodity transactions in precious metals qualify as financial transactions. However, physically settled commodity transactions in electricity or natural gas may fall under section 104 para. 1 of the Insolvency Code if they qualify as fixed date transactions (please see Paragraph 4.1.1(h)(iii)(2) on page 54 above).

Pursuant to section 15 of the German Greenhouse Gas Emissions Trading Act (*Treibhausgas-Emissionshandelsgesetz* – "**TEHG**"), emissions allowances are explicitly not defined as financial instruments within the meaning of the Banking Act. Rather, in section 1 para. 11 sent. 4 no. 2 of the Banking Act they are considered as an own category of rights different from securities and comparable instruments and section 104 para. 2 of the Insolvency Code shall be interpreted not even to cover all types of financial instruments as covered by section 1 para. 11 of the Banking Act.[81] Furthermore, emission allowances may neither be qualified as commodities nor services within the meaning of section 104 para. 2 sent. 2 no. 4 of the Insolvency Code. [82]

Unpaid amounts, *i.e.* amounts that became due and payable before the relevant early termination date and which remain unpaid as of such date, would also fall within the scope of section 104 para. 2 of the Insolvency Code provided that the underlying transaction giving rise to such amounts qualifies as financial transaction and neither party has fully performed its obligations under the respective transaction.

(4) Section 104 of the Insolvency Code and master agreements

Section 104 para. 2 sent. 3 of the Insolvency Code 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 shall together be deemed to form one single mutual agreement within the meaning of sections 103, 104*".

Sentence 3 therefore extends the scope of section 104 para. 2 sent. 1 and 2 of the Insolvency Code also to such transactions which would normally not fall within the scope of sections 103 and 104 of the Insolvency Code, since they have been fully performed by a party before the opening of Insolvency Proceedings. However, section 104

81 JAHN, in: Münchener Kommentar zur Insolvenzordnung, Vol. 2, 2nd ed. (2008), § 104 no. 51

82 See, however, in more detail footnote 74 above.

para. 2 sent. 3 of the Insolvency Code does not derogate from any other requirements for qualifying as a financial transaction[83].

According to the single agreement concept contained in § 2.3 of the MNA and, if so selected in Part VIII Section 10.6 of the Commodities Schedule, in the CPMA, the relevant Master Agreement, all Netted Agreements and Individual Contracts entered into under the relevant Master Agreement shall be governed by the terms of such Master Agreement, and such Master Agreement, all Netted Agreements and Individual Contracts form a single agreement between the parties. Therefore, the Master Agreements would qualify as master agreement within the meaning of section 104 para. 2 sent. 3 of the Insolvency Code.

(5) Section 104 of the Insolvency Code and contractual close-out netting provisions

Section 104 of the Insolvency Code overrides any contractual close-out netting provisions if the relevant transactions fall within the scope of section 104 of the Insolvency Code. However, section 104 of the Insolvency Code does not generally exclude contractual close-out netting provisions, for example where the early termination falls before the opening of Insolvency Proceedings it is outside the scope of section 104 of the Insolvency Code.

To summarise, financial transactions falling within the scope of section 104 of the Insolvency Code will be automatically terminated upon the opening of Insolvency Proceedings, unless such transactions

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83 According to a view in legal literature (JAHN, in: Münchner Kommentar zur InsO, 2nd Edition (2008), section 104 no. 144) the Insolvency Representative's right to "cherry-pick" shall be limited by the "single-agreement concept" to whether or not assuming or rejecting master agreements (such as the Netted Agreements or even the Master Agreements) and all individual contracts thereunder as a whole. The argument is that section 104 para. 2 sent. 3 of the Insolvency Code shall be construed to be a general rule also applying to section 103 of the Insolvency Code. This means, an Insolvency Representative should have to acknowledge the "single agreement concept" even if the preconditions of section 104 of the Insolvency Code were not fully met.

However, in our view, the wording of the provision speaks against such interpretation. Section 104 para.2 sent. 3 of the Insolvency Code explicitly refers to "*contracts involving financial transactions*" as being treated as a "single agreement". This sentence should rather be construed as merely extending the effect of section 104 para. 2 sent. 1 and 2 to transactions having been fully performed by one of the parties, thus, not qualifying as "executory contracts" any more (see also LÜER, in: Uhlenbruck, Insolvenzordnung, 13th Ed. (2010), § 104 no. 37).

have been terminated before. If the relevant cash-settled transaction is included in a master agreement (as referred to in section 104 para. 2 sent. 3 of the Insolvency Code) the scope of section 104 of the Insolvency Code will be expanded to cover transactions which have already been fully performed by one party. Transactions which neither fall within the scope of section 104 of the Insolvency Code nor have been terminated before the opening of Insolvency Proceedings may be subject to "cherry-picking" by the Insolvency Representative pursuant to section 103 of the Insolvency Code (see Paragraph 4.1.1(h)(ii) on page 47).

(iv) *Challengeability of the entering into the Master Agreements, the entering into the Netted Agreements thereunder, the entering into the Individual Contracts thereunder and the early termination*

The entering into the Master Agreements, the entering into the Netted Agreements thereunder, the entering into the Individual Contracts thereunder and the early termination may be challenged by the Insolvency Representative under sections 129 *et seq.* of the Insolvency Code upon the opening of Insolvency Proceedings within the suspect periods as specified in Paragraph 4.1.1(c) on pages 19 *et seq.* above.

All of the afore-mentioned activities qualify as legal acts within the scope of insolvency avoidance except where early termination occurs as an automatic consequence of the fulfilment of a pre-agreed condition precedent. Our answers under Paragraph 4.1.1(c) on page 19 above apply *mutadis mutandis*.

(i) *Assuming the Parties have elected Automatic Termination to apply, are the provisions of the Master Agreements terminating the Netted Agreements including all Individual Contracts upon the occurrence of a Close-Out Event described in § 6.3 of the MNA or Part II.C of the Commodities Schedule enforceable under the laws of Germany or is there a risk that the automatic termination could be challenged by a liquidator, administrator, receiver or third party?*

Our answers under Paragraph 4.1.1(c) on page 19 above apply *mutadis mutandis*.

(j) *Would you recommend to elect Automatic Termination to apply upon a Winding-up, Insolvency or Attachment (as defined in § 3.1(C)(III) of the MNA) or similar event?*

To avoid "cherry-picking" rights and to ensure that all Individual Contracts entered into under the Netted Agreement (entered into under the relevant Master Agreement) are terminated in time and can be set off before the opening of Insolvency Proceedings, it is highly recommendable to choose Automatic Termination pursuant to § 6 of the MNA or pursuant to Part II C of the Commodities Schedule in respect of German counterparties. [84] In this context, it has to be considered whether a grace period such as provided in § 3.1 (C)(III)(d) of the MNA should apply.[85]

(k) *Please specify such event or events and indicate whether it would be necessary or advisable to specify, or to refrain from specifying, a certain grace period to provide for optimal timing of such termination under local law?*

As set out under above under Paragraph 4.1.1(h)(ii) on page 47 above, an automatic termination based on non-insolvency related events or on a party's application to commence Insolvency Proceedings against its assets and/or the existence of any material reason for such an application (such as over-indebtedness) is enforceable under German law. Only a termination right directly based on an actual opening of Insolvency Proceedings is considered to be legally ineffective.

Subject to our answers given under Paragraph 4.1.1(n) on page 63 below, if parties intend that the contractual provisions agreed under the Master Agreements, rather than the German mandatory insolvency provisions (where applicable), shall continue to apply, the parties should provide for an Automatic Termination which triggers sufficiently early enough to prevent the application of mandatory insolvency provisions. For such purposes, Automatic Termination should be triggered by the event that an application has been filed for the commencement of Insolvency Proceedings or other bankruptcy proceedings against the assets of any Party as is provided for in § 3.1 (C)(III)(d) of the MNA. However, in order to avoid that Automatic Termination is triggered even if a third party has frivolously filed an application for the opening of Insolvency Proceedings it is possible to refer to the adverse economic situation of the relevant Party which would either be evidenced if this Party has either filed the application itself or if reference were made to the Party

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84 Please note that this recommendation is given from a strict legal perspective given the missing legal certainty to receive information about impending Insolvency Proceedings in time and does not consider any risks or further consequences of an Automatic Termination generally.

85 When granting such a grace period, it should be considered that it is not predictable within which period from the application for the commencement of Insolvency Proceedings an Insolvency Court would issue its order of commencement (*Eröffnungsbeschluss*). From a legal perspective, it should be ensured that Automatic Termination occurs prior to the opening of Insolvency Proceedings.

being insolvent or otherwise in a situation which justifies the opening of such proceedings.[86]

(l) *If you are recommending that a grace period be made applicable, what, in your best estimation is the minimum reasonable period of time required by a party whose creditor(s) have instituted an unsubstantiable or otherwise clearly frivolous involuntary bankruptcy proceeding against it in the insolvency courts of your jurisdiction to have that proceeding dismissed or otherwise terminated?*

We recommend not to provide for a grace period such as provided in § 3.1 (C)(III)(d) of the MNA, because in such case, the termination (either on the basis of a contractual termination right or by way of Automatic Termination) may only become effective after the opening of insolvency proceedings and therefore, not the contractual provisions agreed under the Master Agreements, rather than the German mandatory insolvency provisions (where applicable) may apply (please see Paragraph 4.1.1(n) below).

With reference to our comments in Paragraph 4.1.1(k)on page on page 61 above, in order to avoid that Automatic Termination is triggered by unsubstantiable or otherwise clearly frivolous petitions for the opening of Insolvency Proceedings, the following wording could be added to the definition of § 3.1 (C)(III)(d) of the MNA: "*and either this Party itself or its responsible regulatory authority has presented the petition, or such Party is insolvent or otherwise in a situation which justifies the opening of such proceedings.*"

(m) *If you are recommending that Automatic Termination be made applicable in respect of parties subject to the insolvency laws of your jurisdiction, what is the optimal timing for that Automatic Termination to take effect? In this event, please supply specific recommended language for purposes of customizing the Automatic Termination provisions to implement such optimal termination timing.*

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86 With respect to credit institutions, financial services institutions or insurance companies, parties may agree upon an Automatic Termination which is triggered on measures taken by the BaFin or any relevant other supervisory authority according to section 46 of the Banking Act or section 89 of the Insurance Supervisory Act if parties are of the view that such measures (in particular the imposition of a ban on payments under section 46 para. 1 sentence 2 no. 4 of the Banking Act or section 89 para. 1 of the Insurance Supervisory Act) may in fact create a risk to netting (taking into account that such measures are taken to stabilise the financial situation of the credit institution, financial services institution or insurance company (sections 46d para. 3 of the Banking Act, 89b para. 3 of the Insurance Supervisory Act)) (please see Paragraph 4.1.1(d)(i)(2) on page 25 above).

As set out in Paragraph 4.1.1(k) on page on page 61 above, the Automatic Termination should take effect at the time an application has been filed for the commencement of Insolvency Proceedings or other bankruptcy proceedings against the assets of any Party and this Party has either filed the application itself or is insolvent or otherwise in a situation which justifies the opening of such proceedings[87].

(n) *Are the provisions in § 8 of the MNA and Section 4 of the CPMA providing for the offsetting of all positive and negative Settlement Amounts in determining the Final Net Settlement Amount enforceable under the laws of Germany or is there a risk that such determination could be challenged by a liquidator, administrator, receiver or third party?*

With respect to the application of German law to the calculation of the Final Net Settlement Amount, we refer to Paragraph 4.1.1(h)(i) on page 43 above.

(i) *Enforceability of close out-netting*

German law recognises close-out netting in principle. Parties may specify certain events in an agreement upon the occurrence of which payments under such agreement become immediately due. Furthermore, under German statutory law, set-off (*Aufrechnung*) is understood as the mutual discharge of two corresponding obligations of the same nature. The rules relating to set off are contained in sections 387 *et seq.* of the German Civil Code. According to this provision, a party that demands payment – or of whom payment is demanded – is entitled to unilaterally declare that the debt is extinguished by a set-off provided that the legally defined set-off requirements are met (see Paragraph 4.1.1(g) on page 40 above).

However, in case of the insolvency of a Party, the enforceability of contractual close-out netting depends on the point in time when the outstanding transactions are terminated. Contractual close-out netting provisions are enforceable if the outstanding transactions are terminated and set off prior to the opening of Insolvency Proceedings. In contrast, the statutory close-out netting regime applies if termination of the outstanding transactions takes place at or after the opening of Insolvency Proceedings.

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87 With respect to credit or financial services institutions or insurance companies, please refer to Paragraph 4.1.1(a) on page 15 above.

In Germany, the contractual provision of automatic aggregation and set-off of all existing mutual payment obligations of the Parties under the Master Agreements, including payment obligations not yet due and payable at this time, upon occurrence of a Close Out Event would be recognised if such set-off was effected prior to the opening of Insolvency Proceedings even if Insolvency Proceedings are finally commenced against the assets of one of the Parties (please refer to Paragraph 4.1.1(h)(ii) on page 47 above). Therefore, if an insolvency-related Close Out Event in relation to a Party occurred, which resulted in aggregation and set off according to the Netting Provisions, this would result in a single obligation equalling the balance of all of the mutual payment claims of the Parties.

The right of a Solvent Party to effect set-off after the opening of Insolvency Proceedings is governed by sections 94 through 96 of the Insolvency Code[88].

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[88] Sections 94 through 96 of the Insolvency Code read in their non-binding English translation as follows:

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

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

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

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

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

Section 96 – Prohibition of Set-off

(1) Set-off shall be prohibited if

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

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

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

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

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

(1) Existence of a situation giving one party the right to set off at the time of the opening of Insolvency Proceedings

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

The Insolvency Code explicitly preserves rights to set off a claim under valid contractual agreements. With respect to the overall intention of the Insolvency Code in general and the purpose of section 94 of the Insolvency Code in particular, *i.e.* the aim to protect the legitimate expectations of the creditors of the Insolvent Party, the preservation of contractual rights to set off is criticised since it enables the parties to extend the rights to set off to the detriment of creditors of the Insolvent Party as such agreements might reduce the assets involved in insolvency. Hence, the validity of contractual agreements concerning set-off is called into question by some legal authors[89] that advocate a restrictive interpretation of section 94 of the Insolvency Code according to which agreements concerning set-off may not override prohibitions of set-off that aim at protecting third parties' rights. According to these legal authors, such agreements also have to

(2) Para. 1 as well as section 95 para. 1 sent. 3 shall neither restrict the transfer of financial collateral as defined pursuant to section 1 para. 17 of the Banking Act nor the set-off of claims and benefits from transfer, payment or assignment agreement included into a payment system as defined by section 1 para. 16 of the Banking Act serving to implement such agreements where set-off is effected at the latest on the day of opening of the insolvency proceedings."

89 KROTH, in Braun, Insolvenzordnung, 4th ed. (2010), § 95 no. 20.

comply with sections 95 and 96 of the Insolvency Code and might be challenged pursuant to sections 129 *et seq.* of the Insolvency Code.

However, this restrictive approach particularly applies to agreements deviating from the requirement of mutuality of the claims[90] and should not affect the validity of the contractual provision of automatic aggregation and set-off of all existing mutual payment obligations of the Parties under the transactions where the relevant contractual provisions do not contain a contractual deviation from the requirement of mutuality of the claims.

(2) Statutory deviation from the requirement of similarity of the claims

Pursuant to section 95 para. 2 of the Insolvency Code[91], set-off is not 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 the set-off is to be effected. The claims have to be converted according to the exchange value applicable to this place at the time of receipt of the declaration to set-off.

(3) Set-off with voidable claims

In the event an insolvency creditor acquired the right to set off his claim by a transaction which may be challenged as void, set-off is prohibited pursuant to section 96 para. 1 no. 3 of the Insolvency Code. This prohibition applies irrespective of whether or not the Insolvency Representative actually challenged the transaction.

(4) Emergence of a situation giving one party the right to set off after the opening of Insolvency Proceedings

In circumstances where the right to set off emerges after the opening of Insolvency Proceedings, set-off will only be permissible if the mutual claims originated before the opening of Insolvency

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90 SCHWAHN NJW 2005, 473, 475.

91 This provision is generally understood to regulate a question of principle of German insolvency law and, hence, applies to both section 94 of the Insolvency Code and section 95 of the Insolvency Code (HÖHN/KAUFMANN JuS 2003, 751, 753).

Proceedings. If on the date when Insolvency Proceedings are opened one or more of the claims to be set off against each other are conditional, not yet due or do not cover similar types of obligations, such set-off will not be effected before such conditions are met (section 95 para. 1 sent. 1 of the Insolvency Code). Pursuant to section 95 para. 1 sent. 2 of the Insolvency Code, section 41 of the Insolvency Code[92] concerning claims not yet due at the date when Insolvency Proceedings are opened and section 45 of the Insolvency Code[93] concerning the conversion of certain claims do not apply.

(5) Statutory limitation of set-off

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 sent. 3 of the Insolvency Code). With respect to set-off after the opening of Insolvency Proceedings, timing, therefore, is of fundamental importance. Set-off is permissible if the Solvent Party's claim is unconditional and mature prior to the Insolvent 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 sent. 3 of the Insolvency Code would not apply[94].

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92 Section 41 (Unmatured Claims) of the Insolvency Code reads in its non-binding English translation 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.*"

93 Section 45 (Conversion of Claims) of the Insolvency Code reads in its non-binding English translation 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.*"

94 Moreover, section 95 para. 1 sent. 3 of the Insolvency Code has been interpreted restrictively by the *Bundesgerichtshof* in BGH NJW 2005, 3574, 3575 *et seq.*). Pursuant to the *Bundesgerichtshof*, section 95 para. 1 sent. 3 of the Insolvency Code 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.

(6) Prohibition of set-off

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,[95] (iii) a creditor in the Insolvency Proceedings acquired the opportunity to set off his claim by a legal act subject to challenge[96] 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 of the Insolvency Code).

(7) Exceptions for payment systems and the transfer of Financial Collateral

The prohibitions of set-off pursuant to section 95 para. 1 sent. 3 of the Insolvency Code and section 96 para. 1 of the Insolvency Code do neither apply to the transfer of Financial Collateral nor to the set-off of claims and benefits from transfer, payment or settlement agreements introduced into a payment system where set-off is effected at the latest on the day of opening of the Insolvency Proceedings. Payment systems are systems serving to implement transfer, payment or settlement agreements within the meaning of Article 2 (a) of Directive 98/26/EC of the European Parliament and the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (section 1 para. 16 of the Banking Act).

(ii) *Challengeability of the determination of the Final Net Settlement Amount*

In order to be challenged by the Insolvency Representative under sections 129 *et seq.* of the Insolvency Code, the determination of the Final Net

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95 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 of the Insolvency Code 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.

96 This prohibition applies irrespective of whether or not the Insolvency Representative actually challenged the Transaction (HÖHN/KAUFMANN JuS 2003, 751, 753).

Settlement Amount would have to be qualified as legal act (see also under Paragraph 4.1.1(c) on page 19 above).

The agreement on the automatic occurrence of the set-off is contractually agreed between the Parties at the time of entering into of the Master Agreements. Therefore, it may be argued that the determination of the Final Net Settlement Amount merely constitutes a factual determination of an existing claim arising out of a set-off and could, thus, not be challenged separately. Accordingly, the Insolvency Representative could merely deny the amount of the claim determined by the Solvent Party in accordance with section 176 of the Insolvency Code. However, as the determination of the Final Net Settlement Amount stipulates to what extent claims of either party have extinguished by way of set-off (*Tilgungswirkung der Aufrechnung*), one cannot fully exclude that such determination would be considered a legal act itself by an Insolvency Representative and that an Insolvency Court will follow such view.

(o) *Do the laws of Germany recognize that the Close-Out applies to all Individual Contracts? Would we need the single agreement concept (as provided for in § 2.3 of the MNA and, if so selected in Part VIII Section 10.6 of the Commodities Schedule, in the CPMA) in order to preserve the enforceability of the termination right and the ability to calculate a net amount? If the single agreement concept is particularly important in your jurisdiction, please give us your opinion on whether or not, and if so, the degree to which, provisions allowing or providing for the termination of some but not all Netted Agreements and some and not all Individual Contracts thereunder might impact termination and close out rights generally, as well as subsequent rights to terminate transactions remaining under the Master Agreements following a previous Partial Close-Out.*

Regarding the applicability of German law to the Netting Provisions of the Master Agreements, please refer to Paragraph 4.1.1(h)(i) on page 43 above.

Assuming that the Master Agreements, the Netted Agreements and the Individual Contracts entered into thereunder are subject to German substantial insolvency law, in particular sections 103 *et seq.* of the Insolvency Code,[97] where a Close Out Event has occurred in relation to a Party and the date of early termination falls before the opening of the Insolvency Proceeding, the requirements for the single agreement

[97] Whether or not substantial German insolvency laws are applicable in this context depends on the relevant conflict of law provisions, see in more detail in Paragraph 4.2.1 on pages 72 *et seq.* below.

concept as set forth in § 2.3 of the MNA and, if so selected in Part VIII Section 10.6 of the Commodities Schedule, in the CPMA need not be fulfilled to preserve the enforceability of early termination rights and the ability to close out net.

Where the date of early termination falls after the opening of Insolvency Proceedings, the termination rights and the ability to calculate a net amount would also exist under those Master Agreements which provide for the termination of some, but not all, Netted Agreements and Individual Contracts entered into thereunder, provided that the Individual Contracts that are terminated prior to the termination of the Master Agreements qualify as a fixed date transactions (section 104 para. 1 of the Insolvency Code) or as financial transactions (section 104 para. 2 of the Insolvency Code) and provided further that all such contracts are executory contracts (please refer to footnote 60 on page 45 above). If these requirements are fulfilled, such Individual Contracts will not be subject to the Insolvency Representative's "cherry-picking" right under section 103 of the Insolvency Code. However, the single agreement concept is particularly important because section 104 para. 2 sent. 3 of the Insolvency Code extends the scope of section 104 para. 2 sent. 1 and 2 of the Insolvency Code also to such transactions which would normally not fall within the scope of sections 103 and 104 of the Insolvency Code, since they have been fully performed by a party before the opening of Insolvency Proceedings (please refer to Paragraph 4.1.1(h)(iii)(4) on page 58 above).

The early termination and, if applicable, close out netting of some Individual Contracts would not prevent the later termination of the Master Agreements and the termination and close out netting of the remaining Individual Contracts.

(p) *Is the insolvent counterparty's obligation to pay the Final Net Settlement Amount in Euro, USD or GBP (as agreed between the parties in the Election Sheet or the Commodities Schedule) enforceable under the laws of Germany or could the calculation or demand of such amount in a foreign currency be challenged by a liquidator, administrator, receiver or third party?*

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

(q) *Please specify, if and as applicable, the degree to which termination and close-out rights in insolvency in your jurisdiction are dependent upon, or otherwise effected by, the status of one or more of the concerned parties falling within a particular category of classification of entity. Specifically, do these rights differ as the result of* *a party being a financial institution, ordinary corporate entity or any other categorization or regulatory or legal status?*

With respect to close out netting, the Insolvency Code does not contain explicit distinctions between different types of counterparties.

However, there are restrictions applicable to the set-off against claims of certain types of entities. In particular, according to section 31 para. 6 sentence 1 of the Investment Act, claims against an investment management company and claims belonging to the separate assets (*Sondervermögen*, as defined in section 2 para. 2 of the Investment Act), cannot be set off against each other. However, according section 31 para. 6 sentence 2 of the Investment Act, this does not prohibit a set-off of claims under a master agreement.

4.1.2 **Non-insolvency related Close Out Events**

(a) *Please discuss and advise on the issues outlined above under 4.1.1(n) on page 63 et seq., 4.1.1(o) on page 69 et seq. and 4.1.1(p) on page 70 above in the context of non-insolvency related Close Out Events.*

§ 3 (C) of the MNA provides for several Close Out Events which are not directly related to the insolvency of a Party. Such non-insolvency related Close Out Events are - *inter alia* - Non Performance, Cross Default and Acceleration, Failure to Deliver or Accept, *Force Majeure* and breach of a Representation and Warranty.

The CPMA does not enlist certain Close Out Events, it rather refers to the relevant Close Out Events of the Netted Agreements entered into thereunder.

With respect to the termination of the Master Agreements due to non-insolvency related Close Out Events, our advice on the enforceability of § 8 of the MNA and Section 4 of the CPMA set out under Paragraph 4.1.1(n) on page 63 *et seq.* above, on the enforceability of the Netting Provisions, as set out under Paragraph 4.1.1(h)(i) *et seq.* and 4.1.1(h)(iii) *et seq.* above, as well as on the counterparty's obligation to pay the amount of any compensation claim in Euro, USD or GBP, as set out under Paragraph 4.1.1(p) on page 70 above also apply in the context of non-insolvency related Close Out Events.

(b) *Are the rights of the Terminating Party to terminate and close-out the Master Agreements, the Netted Agreements and all Individual Contract entered into thereunder enforceable in accordance with the terms of the Master Agreements, irrespective of the insolvency of Party A?*

As set out in Paragraph 4.1.2(a) on page 71, the Netting Provisions of the Master Agreements are enforceable. This is irrespective of the insolvency of Party A.

4.2 Multibranch Parties

4.2.1 Overview of German international insolvency law

The international scope of application of Insolvency Proceedings and the conflict of law regime relating to German insolvency laws is governed by Article 102 of the Introductory Act to the Insolvency Code (*Einführungsgesetz zur Insolvenzordnung*), the EU Insolvency Regulation, sections 3, 335 *et seq.* of the Insolvency Code, sections 46d to 46f of the Banking Act and sections 88 *et seq.* of the Insurance Supervisory Act.

Whether or not the German insolvency courts have jurisdiction for opening Insolvency Proceedings over the assets of the Insolvent Party depends on whether or not such proceedings fall within the scope of the EU Insolvency Regulation.

(a) Scope of application of the EU Insolvency Regulation

The EU Insolvency Regulation applies to insolvency proceedings as specified in Article 1 para. 1 in conjunction with Annex A of the EU Insolvency Regulation. The EU Insolvency Regulation is not applicable, *inter alia*, to insolvency proceedings concerning European insurance companies, European deposit taking credit institutions, investment undertakings (*Wertpapierfirmen*)[98] which provide services involving the holding of funds or securities for third parties, and collective investment undertakings (*Organismen für gemeinsame Anlagen*)[99] (Article 1 para. 2 of the EU Insolvency Regulation; for purposes of this item any such references are not only references to German entities).

Within this scope of application, Article 3 para. 1 of the EU Insolvency Regulation gives the courts of the EU member states (other than Denmark[100]) within the territory of which the "centre of main interests" of a debtor is situated, the ability to open main insolvency proceedings (as specified in Annex A to the EU Insolvency Regulation). In case of a legal entity, the place of the registered office is presumed to

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98 Regarding the definition of "investment undertaking", please refer to footnote 10 on page 8 above.

99 Regarding the definition of the term "collective investment undertaking", please refer to footnote 11 on page 8 above.

100 As regards Denmark, the autonomous German international insolvency law pursuant to sections 335 *et seq.* of the Insolvency Code applies.

be the centre of its main interests in the absence of proof to the contrary (Article 3 para. 1 of the EU Insolvency Regulation). These proceedings are, generally speaking governed by the law of the EU member state where such proceedings are opened. They are, with regard to other EU member states, international in scope being effective in all EU member states unless secondary proceedings are opened in another EU member state. The only main insolvency proceedings permitted under Annex A of the EU Insolvency Regulation under the laws of Germany would be procedures under the Insolvency Code.

If the "centre of main interests" of a debtor is in one EU member state (other than Denmark), under Article 3 para. 2 of the EU Insolvency Regulation, the courts of another EU 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 (please refer to Paragraph 2.5/page 6 above) within the territory of such other EU member state. The applicable law of such territorial or secondary insolvency proceedings will be the law of that other EU member state. However, territorial or secondary insolvency proceedings are limited in scope to the debtor's assets in that EU member state and will, thus, not extend beyond the EU member state where they are opened. Furthermore, under Article 3 para. 3 of the EU Insolvency Regulation, secondary proceedings are limited to winding-up proceedings. Generally, secondary insolvency proceedings will be opened following the opening of the main insolvency proceedings, but there are exceptions to this principle as set out in Article 3 para. 4 of the EU Insolvency Regulation.

The EU Insolvency Regulation applies only insofar as the Insolvency Proceedings have a cross-border effect in an EU member state (other than Denmark).[101]

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101 See LIERSCH, in: Braun, Insolvenzordnung, 4th ed. (2010), before §§ 335-358 no. 23; KINDLER, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch, 4th ed. (2006), IntInsR, VO (EG) 1346/2000 Article 1 no. 77; VIRGOS/SCHMIT, Report on the Convention on Insolvency Proceedings, no. 11.

However, the EU Insolvency Regulation does not define as to when a cross-border effect in another EU member state (other than Denmark) is given. According to legal commentators (REINHART, in: Münchener Kommentar zur Insolvenzordnung Vol. 3, 2nd ed. (2008), VO (EG) 1346/2000 Article 1. no. 14) and certain case law (AG Hamburg NZI 2006, 652 *et seq.*) any cross-border effect which is regulated in the EU Insolvency Regulation, in the specific decisions, the existence of a creditor with registered seat in another EU member state (Article 39 of the EU Insolvency Regulation) is sufficient.

Moreover, it is still disputed in German legal literature as to whether Article 3 para. 1 of the EU Insolvency Regulation 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

As a result of the implementation of the European Council Directive (EC) No. 2001/24 dated 4 April 2001 on the Reorganisation and Winding-Up of Credit Institutions (the "**Bank Winding-Up Directive**"), the opening of secondary or territorial insolvency proceedings is excluded in respect of European deposit taking credit institution and European e-money institutions (section 46e of the Banking Act). Insolvency proceeding may only be opened by the competent authorities of the home state (*Herkunftsmitgliedsstaat*). Likewise, as a result of the implementation of 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, the opening of secondary or territorial insolvency proceedings is excluded in respect of EU Insurance Companies (section 88 para. 1b of the Insurance Supervisory Act). Insolvency proceeding may only be opened by the competent authorities of the home state (*Herkunftsmitgliedsstaat*).

(b) Jurisdiction of German insolvency courts within the scope of application of the EU Insolvency Regulation

As to the jurisdiction of German insolvency courts within the scope of application of the EU Insolvency Regulation the following distinctions have to be made:

(i) The centre of main interests of the Insolvent Party is in Germany

If the centre of main interests of the Insolvent Party is in Germany, an Insolvency Proceeding is instituted 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. An Insolvency Representative appointed in Germany in relation to an Insolvent Party would include transactions (regardless of the branch from which they were entered into) in the calculation of amounts owed to and from the Insolvent Party and would recognise the Netting Provisions, subject to sections 109 and 104 of the Insolvency Code (see Paragraph 4.1.1(h)(iii) on page 51 above).

Denmark). Numerous authors argue that such effect is sufficient (HUBER, in: Haß et al., EU-Insolvenzverordnung (2005), Article 1 no. 19 with further references; REINHART, in: Münchener Kommentar zur Insolvenzordnung Vol. 3, 2nd ed. (2008) VO (EG) 1346/2000 Article 1. no. 16), while court decisions and the majority of legal commentators require that the cross-border effect must take place within another member state (other than Denmark) (AG Köln NZI 2008, 390 *et seq.*), KINDLER, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch, 4th ed. (2006), IntInsR VO (EG) 1346/2000 Article 1 nos. 79 *et seq.* with further references).

(ii) The centre of main interests of the Insolvent Party is in an EU member state other than Germany or Denmark and the Insolvent Party has an establishment in Germany

Where the centre of main interests of the Insolvent Party is in an EU member state other than Germany or Denmark and the Insolvent Party has an establishment (within the meaning of the EU Insolvency Regulation) in Germany, the German insolvency courts will have jurisdiction in respect of such assets of the Insolvent Party which are situated in Germany. An establishment is defined 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) (Article 2 (h) of the EU Insolvency Regulation).

(iii) The centre of main interests of the Insolvent Party is in an EU member state other than Germany or Denmark and the Insolvent Party has no establishment in Germany

Where the centre of main interests of the Insolvent Party is in an EU member state other than Germany or Denmark and the Insolvent Party has no establishment (within the meaning of the EU Insolvency Regulation) in Germany, the German insolvency courts will have no jurisdiction in respect of such Insolvent Party.

(iv) Situation of payment claims

Payment claims are deemed to be situated in the country in which the debtor of such claim has the centre of its main interests (Article 2 (g) of the EU Insolvency Regulation). Therefore, if the centre of main interests of the Solvent Party is in another EU member state (other than Denmark), and there are secondary proceedings under the EU Insolvency Regulation in respect of the Insolvent Party in that EU member state, then the claims of such Insolvent Party against the Solvent Party would be deemed under the EU Insolvency Regulation 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 EU member state in relation to such claims (to the extent they have not been extinguished at the time of opening of Insolvency Proceedings).

(c) Jurisdiction of German insolvency courts outside the scope of application of the EU Insolvency Regulation

As to the jurisdiction of German insolvency courts outside the scope of application of the EU Insolvency Regulation the following distinctions have to be made:

(i) The Insolvent Party is not a European deposit taking credit institution, an European e-money institution or an European insurance company

In case the Insolvent Party is not an European deposit taking credit institution, an European e-money institution or an European insurance company having 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 different to the registered seat) such place determines the competent insolvency court (section 3 of the Insolvency Code). Therefore, if the centre of an independent business activity of the Insolvent Party is located outside Germany, the German insolvency courts have no jurisdiction except for the opening of (separate) insolvency proceeding (which is limited in its scope to the assets of the Insolvent Party situated in Germany).

(ii) The Insolvent Party is an European deposit taking credit institution, an European e-money institution or an European insurance company

In case the Insolvent Party is an European deposit taking credit institution, an European e-money institution or an European insurance company, the opening of secondary or territorial insolvency proceedings is excluded (section 46e of the Banking Act, section 88 para. 1b of the Insurance Supervisory Act). Insolvency Proceedings may be opened in Germany only if Germany is considered to be the home member state, which is the case if the main office (*Hauptniederlassung*) is located in Germany (section 1 para. 4 of the Banking Act (which implements Article 2 of the Bank Winding-Up Directive in connection with Article 1, point (6) of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions); section 6 para. 1 of the Insurance Supervisory Act (which implements Article 1 sentence 1 lit. c) and Article 6 sentence 2 of Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance (third non-life insurance Directive) and Article 1 lit. e) and Article 4 of the Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance).

(iii) Secondary or territorial insolvency proceedings

Secondary or territorial insolvency proceedings can be commenced in Germany under section 354 para. 1 of the Insolvency Code if the debtor has an establishment in Germany (with respect to the exception for deposit taking credit institutions or electronic money institutions see the preceding item 4.2.1(c)(ii) on page 76 on page 76). Where the Insolvent Party has no establishment in Germany, a sufficient basis for separate proceedings in Germany under the Insolvency Code 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 of the Insolvency Code)[102].

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 situated in Germany. Such territorial or secondary insolvency proceedings and, thus, the applicability of the German insolvency law rules set out above are, however, limited in scope to the debtor's assets in Germany.

(iv) Situation of payment claims

Payment obligations are assets deemed to be located in Germany if they are payable by the debtor out of Germany to the Insolvent Party. Therefore, only payment obligations which are payable by the Solvent Party out of Germany are assets deemed to be located in Germany and could provide a sufficient basis for separate Insolvency Proceedings in relation to such Insolvent Party.

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[102] According to legal commentators this provision has to be applied restrictively (WENNER, in: Mohrbutter/Ringstmeier, Handbuch der Insolvenzverwaltung, 8th ed. (2007), § 20 no. 71.

(d) Netting under German international insolvency law

As to the netting under German international insolvency law the following distinctions have to be made:

(i) With respect to netting under German international insolvency law within the scope of the EU Insolvency Regulation the following applies:

(1) Scope of the *lex fori concursus* rule (Article 4 of the EU Insolvency Regulation)

When applicable, Article 4 of the EU Insolvency Regulation provides that the law applicable to insolvency proceedings and their effects shall be that of the EU member state in which the proceedings are opened, this will be the centre of main interests of the Insolvent Party except where there is another, more specific, provision within the EU Insolvency Regulation itself – subject to any secondary proceedings. Secondary proceedings will be governed by the law of the EU member state (other than Denmark) in which they are opened (Article 3 para. 2, 28 of the EU Insolvency Regulation).

Cases where rights may be immunised from the effects of insolvency law are, for example, "rights *in rem*" over assets outside the jurisdiction where the insolvency proceedings are conducted (Article 5 of the EU Insolvency Regulation) and rights of set-off permitted by the law applicable to the insolvent debtor's claim (Article 6 of the EU Insolvency Regulation). Insolvency law is subordinated to some other system of law where the rules of payment systems and financial markets (Article 9 of the EU Insolvency Regulation) apply.

(2) Conflict of law rule regarding insolvency set-off

Under the EU Insolvency Regulation set-off is permitted in each of the two following situations:

(A) if it is permitted under the insolvency[103] laws of the jurisdiction in which insolvency proceedings have been

[103] According to many legal commentators in Germany (REINHART, in: Münchener Kommentar zur Insolvenzordnung Vol. 3, 2nd ed. (2008), Article 4 EuInsVO no. 3; HAß/HERWEG, in: Haß *et al.*, EU-Insolvenzverordnung (2005), Article 4 no. 32; GOTTWALD, in: Insolvenzrechtshandbuch, 3rd ed. (2006), § 131 no. 66; BORK ZIP 2002, 690, 692),

opened in relation to the insolvent debtor (Article 4 para. 2 (d) of the EU Insolvency Regulation) or

(B) if it is permitted by the law applicable to the insolvent debtor's claim (Article 6 para. 1 of the EU Insolvency Regulation) [104].

Article 6 para. 1 of the EU Insolvency Regulation is establishing an insolvency conflict of law rule regarding insolvency set-off as an exception to the *lex fori concursus* rule as set forth by Article 4 para. 1 of the EU Insolvency Regulation. In relation to (A), the laws of Germany would be applicable in the case of Insolvency Proceedings being opened by a court in Germany. In relation to the situation mentioned under (B), set-off will be allowed if it is permitted under the laws[105] governing the Netted Agreements and the relevant Individual Contracts.

In this respect, it is disputed in Germany (and, as it appears, also in other EU jurisdictions) whether or not close-out netting arrangements fall within the scope of application of Article 6 para. 1 of the EU Insolvency Regulation.

From its wording, it appears that Article 6 para. 1 of the EU Insolvency Regulation does not include close-out netting arrangements 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

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Article 4 para. 2 (d) of the EU Insolvency Regulation only concerns set-off restrictions that stem from the insolvency law of the jurisdiction in which insolvency proceedings have been opened. The scope of the *lex fori concursus* thus would be limited to such laws. The general legal requirements relating to set-off (e.g. in Germany sections 387 *et seq.* of the Civil Code), however, shall be determined according to the usual conflict of law rules (e.g. the Rome I Regulation with respect to contracts entered into after 17 December 2009 or Article 32 para. 1 no. 4 of the Introductory Code to the German Civil Code regarding claims having come into existence prior to such date, which shall be applicable as if there were no insolvency proceedings).

104 Article 6 of the EU Insolvency Regulation reads as follows: "*The opening of insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim.*"

105 This includes insolvency law, e.g. in Germany sections 94 *et seq.* of the Insolvency Code (see Paragraph 4.1.1(n)(i)/page 63 above) (KINDLER, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch, 4th ed. (2006), IntInsR no. 287, GRUBER, in: Haß *et al.*, EU-Insolvenzverordnung (2005), Article 6 no. 9; REINHART, in: Münchener Kommentar zur Insolvenzverordnung, Vol. 3, 2nd ed. (2008), Article 6 EuInsVO no. 9).

conversion of the terminated transactions into claims which are eligible for being set off.

In discussing the purpose of Article 6 para. 1 of the EU Insolvency Regulation, it is, however, argued that such article shall be interpreted broadly to include close-out netting arrangements. Such interpretation is largely justified by the needs of financial market participants to choose the insolvency law applicable to close-out netting.[106]

However, besides the broad interpretation of Article 6 para. 1 of the EU Insolvency Regulation to cover such need, a systematic interpretation of such article argues against the inclusion of close-out netting arrangements.

Recital 27 of the EU Insolvency Regulation in connection with Article 9 of the EU Insolvency Regulation clarify that the European legislator distinguishes between set-off and netting agreements and that the latter shall only be exempted from the *lex fori concursus* rule of Article 4 para. 1 of the EU Insolvency Regulation if agreed in the context of a payment system.[107] Moreover, the European legislator uses the terms set-off and netting agreements differently in other relevant EC legal acts as well.[108]

To summarise, following the wording of Article 6 para. 1 of the EU Insolvency Regulation and the use of terminology by the European legislator, the proper interpretation of Article 6 para. 1 of the EU Insolvency Regulation 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 of the EU Insolvency

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106 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.*

107 Recital 27 and Article 9 of the EU Insolvency Regulation refer to payment systems and financial markets rather than to contractually agreed close-out netting arrangements. Furthermore, Article 25 of the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganisation and Winding Up of Credit Institutions refers to netting agreements rather than to set-off arrangements.

108 The European Council Directive (EC) No. 2001/24 dated 4 April 2001 on the Reorganisation and Winding Up of Credit Institutions contains, in addition to the general rule regarding set-off (Article 23 para. 1), a specific rule in respect of "netting agreements" (Article 25).

Regulation, *i.e.* are governed by the law applicable to insolvency proceedings of the EU member state in which the proceedings are opened.

(3) Effects of Articles 6 para. 2 and 4 para. 2 (m) of the EU Insolvency Regulation

According to Article 4 para. 2 (m) of the EU Insolvency Regulation, the law of the member state opening the insolvency proceedings (*lex fori concursus*) will determine the rules relating to the voidness, voidability or unenforceability of legal acts which are detrimental to all creditors. Article 6 para. 2 of the EU Insolvency Regulation provides that the protection for set-off pursuant to Article 6 para. 1 of the EU Insolvency Regulation does not preclude actions for voidness, voidability or unenforceability as referred to in Article 4 para. 2 (m) of the EU Insolvency Regulation. Consequently, Article 6 para. 2 of the EU Insolvency Regulation preserves the ability of the *lex fori concursus* to declare the provision void despite the protection in Article 6 para. 1 of the EU Insolvency Regulation[109].

(4) Article 13 of the EU Insolvency Regulation

According to Article 13 of the EU Insolvency Regulation, the rules relating to voidness, voidability or unenforceability of the EU member state in which the proceedings have been opened would not apply where the person who benefited from an act detrimental to all the creditors provides proof that (i) the said act is subject to the law of an EU member state other than that of the EU member state of the opening of proceedings, and (ii) that that law does not allow any means of challenging that act in the relevant case.

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109 Contrary to the explicit wording of Article 6 para. 2 of the EU Insolvency Regulation, it is, however, argued that the set-off of claims has absolute protection under Article 6 para. 1 of the EU Insolvency Regulation even where the agreement creating the right to set off was itself vulnerable as a preference (see European Financial Markets Lawyers Group, Protection for Bilateral Insolvency Set-off and Netting Agreements under EC Law, A report by the European Financial Market Lawyers Group (EFMLG), October 2004, pages 27 *et seq.* (nos. 84 *et seq.*).

(ii) With respect to netting under German international insolvency law outside the scope of the EU Insolvency Regulation the following applies:

(1) Principles of German international insolvency law

Under German international insolvency laws, section 335 of the Insolvency Code provides that insolvency proceedings and their effects are, in general, governed by the laws of the jurisdiction in which the proceedings have been opened (this principle is also provided by Article 4 of the EU Insolvency Regulation). However, the Insolvency Code provides for some exceptions to this principle.

With respect to insolvency proceedings instituted in a jurisdiction other than Germany, section 351 of the Insolvency Code (see also Article 5 of the EU Insolvency Regulation) 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 situated 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*).

Section 338 of the Insolvency Code[110] provides that any right to declare a set-off shall 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 Party at the time the Insolvency Proceedings are instituted, and section 339 of the Insolvency Code provides that the validity of specific legal acts may be challenged if the requirements for doing this in insolvency proceedings are met in accordance with the law governing the

[110] Section 338 of the Insolvency Code reads in its non-binding English translation as follows: "*The right of a creditor of an insolvent party to exercise a set off right shall not be affected by the opening of insolvency proceedings if under the laws of the jurisdiction governing the claim of the insolvency debtor the creditor is entitled to the set off at the time the insolvency proceedings are opened.*" Section 339 of the Insolvency Code reads in its non-binding English translation as follows: "*The validity of legal acts may be challenged if the requirements for insolvency avoidance 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 evidence that the relevant act is governed by the laws of another jurisdiction and such act can in no ways be challenged under the laws of such jurisdiction.*"

insolvency proceedings, unless the party whose acts are to be challenged provides conclusive evidence that the relevant act is governed by the laws of another state and cannot be challenged thereunder.

(2) Effect of section 340 para. 2 of the Insolvency Code on the Netting Provisions

Where the conflict of law rules of sections 335 *et seq.* of the Insolvency Code apply, section 340 para. 2 of the Insolvency Code provides for an insolvency conflict of law rule for "netting agreements". According to our interpretation of section 340 para. 2 of the Insolvency Code, the Netting Provisions take effect in accordance with the substantive insolvency laws of the country the laws of which have been chosen by the parties to govern the Master Agreements.

Section 340 para. 2 of the Insolvency Code provides for the effects of Insolvency Proceedings on repurchase agreements (*Pensionsgeschäfte*) within the meaning of section 340b of the Commercial Code as well as on netting agreements (*Schuldumwandlungsverträge und Aufrechnungsvereinbarungen*) to be governed by the law applicable to that agreement[111]. Even though section 340 para. 2 of the Insolvency Code does not provide any guidance on the interpretation of the term "netting agreement"[112], the legislative history reveals that master agreements within the meaning of section 104 para. 2 sent. 3 of the Insolvency Code fall within the scope of section 340 para. 2 of the Insolvency Code[113].

However, 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 of the Insolvency Code could refer to (i) the substantive insolvency laws of the jurisdiction that has been chosen

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111 Section 340 para. 2 of the Insolvency Code implements Article 25 of Directive 2001/24/EEC on the Winding up of Credit Institutions (*"Netting agreements shall be governed solely by the law of the contract which governs such agreement."*) into German law.

112 With respect to the German terminology please see item 4.1.1(g)/page 26 and BT-Drucksache 15/16, page 20.

113 BT-Drucksache 15/16, page 20; see also GOTTWALD, in: Insolvenzrechtshandbuch, 3rd ed. (2006), § 131 no. 64.

by the parties to govern the relevant agreement[114], (ii) the substantive contract law of the jurisdiction that has been chosen by the parties to govern the relevant agreement[115] or (iii) directly to the terms of the relevant agreement without any regard to the substantive insolvency or contract laws.[116]

Since the wording of section 340 para. 2 of the Insolvency Code 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 of the Insolvency Code implements Article 25 and 26 of the Bank Winding-Up Directive into German law. However, the wording of the Bank Winding-Up Directive is not precise either. With respect to the relevant context of the Bank Winding-Up Directive, in particular European Council Directive (EC) 2002/47 on Financial Collateral Arrangements, 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 Bank Winding-Up Directive into German law, the German legislator expressly referred to this intention behind the Bank Winding-Up Directive and emphasised the necessity to ensure predictability[117] regarding the applicable laws.

However, the realisation of this purpose does not require an extension of the parties' freedom of contract in a way that conflicts with the principles of insolvency law. Moreover, the wording of section 340 para. 2 of the Insolvency Code refers to the laws of the country instead of merely referring to the provisions of the contract. Therefore, the effectiveness of close-out netting arrangements in netting agreements would not only be a matter of the terms of the

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114 LIERSCH/TASHIRO, in: Braun, Insolvenzordnung, 4th ed. (2010), § 340 no. 4; JAHN, in: Münchener Kommentar zur Insolvenzordnung, Vol. 2, 2nd ed. (2008) § 340 no. 6.

115 KINDLER, in: Münchener Kommentar zum Bürgerlichen Gesetzbuch, 4th ed. (2006), IntInsR no. 989 (*lex causae*); STEPHAN, in: Heidelberger Kommentar zur Insolvenzordnung, 5th ed. (2008), § 340 nos. 4, 5.

116 This interpretation is supported by SCHNEIDER, in: Kohler/Obermüller/Wittig, Kapitalmarkt – Recht und Praxis, Gedächtnisschrift für Ulrich Bosch (2006), page 211.

117 BT-Drucksache 15/16, pages 19 *et seq.*

netting agreement as agreed between the parties (without any reference to substantive insolvency laws)

An interpretation according to which section 340 para. 2 of the Insolvency Code would refer to the contract law of the jurisdiction that has been chosen by the parties to govern the relevant agreement is not convincing. As section 340 para. 2 of the Insolvency Code 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.

In the context of insolvency, the realisation of legal certainty and predictability not only is in the interest of the parties to a contractual agreement, but also in the interest of all insolvency creditors. Therefore, we think section 340 para. 2 of the Insolvency Code should be interpreted as referring to the substantive insolvency laws of the country the laws of which have been chosen by the parties to govern the relevant agreement. This interpretation of section 340 para. 2 of the Insolvency Code is in accordance with its wording, its context and its purpose without conflicting with the general principles of insolvency law.

However, we note that, as far as we are aware, the interpretation of section 340 para. 2 of the Insolvency Code has not been the subject of any court decision yet.

4.2.2 German Multibranch Party

(a) *Additional assumptions*

For the purposes of Paragraph 4.2.2, we assume that one party (Party A) has entered into Individual Contracts under the Netted Agreements through offices in Germany as well as through one or more branches located abroad. After entering into these Individual Contracts and prior to the maturity thereof, Party A becomes the subject of a voluntary or involuntary proceeding under the insolvency laws of Germany.

(b) *Would there be any change in your conclusions reached under Paragraphs 4.1.1 or 4.1.2 above based upon the fact that Party A has conducted business under some or all of the Netted Agreements on a multibranch basis prior to its insolvency?*

If the main Insolvency Proceedings are opened in Germany, such main Insolvency Proceedings in Germany would be universal, which means that the Individual

Contracts entered into by non-German branches of Party A are included in the Insolvency Proceedings. Therefore, a single compensation claim will be calculated in the main Insolvency Proceedings in Germany, provided, however, that German law cannot prevent that under the insolvency laws of another jurisdiction secondary insolvency proceedings are opened.

(i) Opening of main Insolvency Proceedings in Germany

(1) In case the EU Insolvency Regulation is applicable

If the EU Insolvency Regulation applies (please refer to Paragraph 4.2.1(a) on page 72 above), Insolvency Proceedings are instituted in Germany with respect to Party A, because Party A has its centre of main interest in Germany (Paragraph 4.2.1(b)(i) on page 74 *et seq.* above).[118] This applies 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. An Insolvency Representative appointed in Germany in relation to Party A would include all Individual Contracts entered into under the Netted Agreement (regardless of the branch from which they were entered into) in the calculation of amounts owed to and from the Insolvent Party and would recognise the Netting Provisions and section 104 of the Insolvency Code (see item 4.1.1(h)(iii) on page 22 above).

(2) In case Party A is a German deposit taking credit institution, a German e-money institution or a German insurance company

In case Party A is a German deposit taking credit institution, a German e-money institution or a German insurance company, the main insolvency proceedings are also opened in Germany (please refer to Paragraphs 4.2.1(a) on page 72 *et seq.* 4.2.1(c)(ii) on page 76 above).

(3) In case the EU Insolvency Regulation is not applicable and Party A is not an European deposit taking credit institution, an European e-money institution or an European insurance company

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118 Please refer to the general assumption set out in Paragraph 3.1(a) on page 10 above.

If the EU Insolvency Regulation does not apply and Party A is not an European deposit taking credit institution, an European e-money institution or an European insurance company, insolvency proceedings are instituted with respect to Party A in the jurisdiction where Party A has its general place of jurisdiction. This applies 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 (please refer to Paragraph 4.2.1(c)(i) on page 76 above). In case of a legal entity, the place of general jurisdiction is the registered seat, except that if the centre of that legal entity's independent business activity is located elsewhere (for example, if the management is located at a place different to the registered seat) such place determines the competent insolvency court (section 3 para. 1 sent. 2 of the Insolvency Code). Therefore, as the centre of main interest of Party A is in Germany (please refer to the assumption in Paragraph 3.1(a) on page 10 above), the main insolvency proceedings will be opened in Germany.

(ii) Recognition of foreign secondary insolvency proceedings

If payment claims of Party A are deemed to be situated in a jurisdiction other than Germany (please refer to Paragraphs 4.2.1(b)(iv) on page 75 and 4.2.1(c)(iv) on page 77 above), the secondary insolvency proceeding opened in such other jurisdiction will be recognised in Germany within the limits of section 343 para. 1 sentence 2 of the Insolvency Code[119] and Article 16 of the European Insolvency Regulation, which require the recognition of such proceedings only if the relevant court had jurisdiction. If under the insolvency proceeding in such other jurisdiction, the Netting Provisions of the relevant Master Agreement are not enforceable, then, even if such master Agreement has been terminated prior to the opening of the main Insolvency Proceeding in Germany, the Insolvency Representative will not enforce the

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[119] Section 343 para. 1 of the Insolvency Code reads, in its non-binding English translation:

"*(1) The opening of foreign insolvency proceedings shall be recognised. This shall not apply*

1. *if the courts of the state of the opening of proceedings do not have jurisdiction in accordance with German law;*
2. *where recognition leads to a result which is manifestly incompatible with major principles of German law, in particular where it is incompatible with basic rights.*"

payment claims that are situated in such other jurisdiction. The net payment claim of Party A under the relevant Master Agreement, if any, will be decreased accordingly.

(c) *Would the MNA and, if so selected in Part VIII Section 10.6 of the Commodities Schedule, the CPMA be treated as a single unified agreement by the German receiver under the laws of Germany, regardless of the treatment of the MNA or CPMA or transactions thereunder by an insolvency official in a country where close-out netting may be unenforceable?*

If claims under the Individual Contracts become the subject of a secondary insolvency proceeding, and the single agreement concept is not recognised in such proceeding, the relevant Master Agreement would not be treated as a single unified agreement by the German Insolvency Representative, because such secondary insolvency agreements will be recognised in Germany.

4.2.3 Foreign Multibranch Party

(a) *Additional assumptions*

We assume that a company, a credit institution, a financial services institution, an insurance company, an investment fund management company or any other similar financial institution ("**Party F**") incorporated, organised or having its centre of main interest in a country ("**Country H**") other than Germany has entered under some or all Netted Agreements into Individual Contracts both through its home office and through one or more branches located in other countries including in each case a branch of Party F located in and subject to the laws of Germany (the "**German Branch**").

After entering into these Individual Contracts and prior to the maturity thereof, Party F becomes the subject of voluntary or involuntary proceedings under the insolvency laws of Country H.

(b) *Would there be separate proceedings in Germany with respect to the assets and liabilities of the German Branch upon the start of the insolvency proceeding for Party F in Country H? Or would the relevant authorities in Germany defer to the proceedings in Country H, so that the assets and liabilities of the German Branch would be handled as part of the proceedings for Party F in Country H? Could local creditors of the German Branch initiate separate proceedings in Germany even if the relevant authorities in Germany did not do so?*

(i) In case the EU Insolvency Regulation is applicable

If the EU Insolvency Regulation is applicable to the insolvency of Party F (please refer to Paragraph 4.2.1(a) on page 72 above), the German Branch would qualify as an "establishment" of Party F in Germany (please refer to Paragraph 2.5 on page 6. Hence, a secondary insolvency proceeding (Article 3 para. 3 of the EU Insolvency Regulation) may be opened by a German insolvency court after the opening of the main insolvency proceeding in Country H, or a territorial insolvency proceeding may be opened absent a main insolvency proceeding in Country H (Article 3 para. 2 of the EU Insolvency Regulation). Such secondary insolvency or territorial insolvency proceeding will be limited to the assets of Party F which are situated in Germany (please refer to Paragraph 4.2.1(b)(ii) on page 75 above). Claims of Party F are deemed to be situated in Germany if the debtor of such claim has the centre of its main interests in Germany, as determined in Article 3 para. 1 of the EU Insolvency Regulation. In case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary (please refer to Paragraph 4.2.1(b)(iv) on page 75 above). This applies irrespective of whether or not such claims arise from transactions which were entered into by an establishment of Party F in Germany. Local creditors of the German Branch are generally entitled to initiate separate proceedings in Germany even if the relevant authorities in Germany did not do so.

(ii) In case Party F is an European deposit taking credit institution, an European e-money institution or an European insurance company

In case Party F is an European deposit taking credit institution, an European e-money institution or an European insurance company, the EU Insolvency Regulation is not applicable (please refer to Paragraph 4.2.1(a) on page 72 above). Only the insolvency courts or other relevant authorities in the home member state of such European deposit taking credit institution, European e-money institution or European insurance company may open an insolvency proceeding (section 46e para. 1 sentence 1 of the Banking Act; please refer to Paragraph 4.2.1(c)(ii) on page 76 above). Therefore, even though Party F has an establishment in Germany, no secondary insolvency proceeding will take place in Germany.

(iii) In case the EU Insolvency Regulation is not applicable and Party F is not an European deposit taking credit institution, an European e-money institution or an European insurance company

In case the EU Insolvency Regulation is not applicable and Party F is not an European deposit taking credit institution, an European e-money institution or an European insurance company, sections 335 to 358 which provide for the conflicts of law rules of the Insolvency Code apply. German insolvency courts may open a secondary insolvency proceeding (section 354 of the Insolvency Code) in addition to the insolvency proceeding in Country H or, absent such insolvency proceeding in Country H, a territorial insolvency proceeding (section 354 para. 1 of the Insolvency Code). Such secondary insolvency or territorial insolvency proceeding will be limited to the assets of Party F which are situated in Germany. Payment claims are deemed to be situated in Germany if Party F as debtor thereunder has its registered office in Germany (in case Party F is a corporation) or if Party F's place of residence is in Germany (please refer to Paragraph 4.2.1(c)(iv) on page 77 above).

(c) *If there were separate proceedings in Germany with respect to the assets and liabilities of the German Branch, would the receiver or liquidator in Germany and the German courts, based on the facts above, include Party F´s position under the Netted Agreement, in whole or in part, among the assets of Germany and, if so, would the receiver or liquidator and the German courts recognise the close-out netting provisions of the Master Agreements in accordance with their terms? The most significant problem arising would be if a German receiver, liquidator or court considering a single Master Agreement were to require a counterparty of the German Branch of Party F to pay the mark-to-market value of Individual Contracts entered into with the German Branch to the liquidator or receiver of the German Branch, while at the same time forcing the counterparty to claim in the proceedings in Country H for its net value from other Individual Contracts with Party F under the same Master Agreement. In considering this issue, please assume that close-out netting under the relevant Master Agreement would be enforced in accordance with its terms in the proceedings for Party F in Country H.*

If, according to the principles set out in Paragraph 4.2.3(b) on page 89 *et seq.* above, separate Insolvency Proceedings are opened in Germany, such separate Insolvency Proceedings cover all assets of the debtor situated in Germany (for the situation of payment claims, please refer to Paragraphs 4.2.1(b)(iv) on page 75 and 4.2.1(c)(iv) on page 77 above). Therefore, separate insolvency estates are created, despite of the single agreement concept provided for in § 2.3 of the MNA and, if so selected in Part VIII Section 10.6 of the Commodities Schedule, in the CPMA.

Potentially, an Insolvency Representative considering a single Master Agreement might require a counterparty of the German Branch of Party F to pay the market value of Individual Contracts entered into under such Master Agreement with the German Branch to the insolvency estate in Germany, while at the same time forcing the counterparty to claim in the proceedings in Country H for its residual net value from other Individual Contracts with Party F under the same Master Agreement. However, this risk does not exist if at the time the secondary Insolvency Proceeding in Germany is opened, the relevant Master Agreement has been closed out already (and no claims under the Individual Contracts exist anymore) and such close-out netting is recognised under German conflicts of law rules (please refer to Paragraph 4.2.1(d) on page 78 above).

(d) *Would it make any difference if Party F has no branch located in Germany, but has assets in Germany?*

If Party F does not have an establishment in Germany[120], but has assets in Germany, a secondary Insolvency Proceeding may be opened in Germany, if a creditor has a

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120 For a discussion of the term "establishment" see REINHART, in: Münchener Kommentar zur Insolvenzordnung, Vol. 3 2nd ed. (2008), § 354 no. 7. According to Article 2 lit h) of the EU Insolvency Regulation, "establishment" shall mean any place of operations where the debtor carries out a non-transitory economic activity with human means and goods. This has to be distinguished from the question of how Individual Contracts can be attributed to an establishment that is not a legal person. If the establishment is not a legal person of its own, the head office becomes party to the Individual Contract. However, if this meant that such Individual Contract will be attributed to the head office, Article 3 para. 4 lit b) of the EU Insolvency Regulation would be meaningless, as it provides that a territorial insolvency proceeding may be opened "*where the opening of territorial insolvency proceeding is requested by a creditor ... whose claim arises from the operation of that establishment*". Therefore, in our view, a transaction can be attributed to an establishment if such establishment has acted, i.e. where the Individual Contract was entered into by representatives of such establishment or the correspondence which led to the entering into such Individual Contract took place via such establishment (please also refer to ECJ, 22 November 1978, Case 33/78, Somafer SA v. Soar-Ferngas AG, [1978] ECR 2183 (on Article 5 para. 5 of the Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters (in the meantime superseded by Council Regulation (EC) No 44/2001of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters).

particular interest in the opening of such Insolvency Proceeding, in particular, if such creditor will be in substantially worse position if no secondary Insolvency Proceedings were opened. The opening of secondary Insolvency Proceedings in Germany on the basis of assets of the debtor in Germany has been controversially discussed[121]. However, the mere fact that a claim is situated in Germany, may already allow the opening of a secondary Insolvency Proceeding in Germany.

4.3 Collateral under the Credit Support Annexes

4.3.1 Additional assumptions

In this Paragraph 4.3, we assume that at least one of the counterparties entering into the Credit Support Annexes is incorporated or organised or has its centre of main interest in Germany ("**Party A**"). Although the Credit Support Annexes are bilateral forms in that they contemplate that each party may be required to post collateral to the other, we assume that (i) Party A is at all times transferor (the "**Transferor**") and Party B the transferee (the "**Transferee**") under the Credit Support Annexes and (ii) that under the Credit Support Annexes, the collateral is owned by Party A or that Party A is authorised and empowered to transfer ownership in the collateral.

The counterparties agree that Eligible Credit Support will include Cash and Letters of Credit (as defined in the Credit Support Annexes). Cash is denominated in a freely convertible currency (specified as "Base Currency" in Section 14.13 of the 2003 CSA and in Section 15.13 of the 2011 CSA or "Eligible Currency" in section 14.10 of the 2003 CSA and in section 15.10 of the 2011 CSA) and is held in an account under the control of Party B.

4.3.2 Questions to be opined on

(a) *Under the laws of Germany, what law governs the transfer of ownership in the various forms of Eligible Credit Support deliverable under the Credit Support Annexes?*

Under German conflict of law rules regarding the transfer of Cash, one has to distinguish between Cash held in a bank account and Cash in the form of money bills or coins: Where the ownership in Cash is transferred or where a security interest is created in Cash and such Cash is held in a bank account, German conflict of law

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121 Pursuant to Article 3 para. 2 of the EU Insolvency Regulation, a secondary insolvency proceeding can be opened only for an establishment; the EU Insolvency Regulation does not provide for jurisdiction based on the situation of assets. However, section 354 para. 2 of the Insolvency Code recognises that a secondary Insolvency Proceeding may be opened in Germany due to the location of assets in Germany (PAULUS DStr 2005, 334, 339; for a criticism of this position see WENNER, in Mohrbutter/Ringstmeier, Handbuch der Insolvenzordnung, 8th ed. (2007), § 20 no. 71.

rules refer to the law governing the account relationship between the bank and the payee (in this event the Cash is represented by the payee's claim against the bank maintaining his account in regard of the Cash transferred).

Last but not least, the assignment of claims for the payment of money and the creation of a security interest in such claims, as well as the effects of such assignment or creation, are governed by the law which governs such claims.

(b) *Would the laws of Germany characterize each transfer of collateral as effecting an unconditional transfer of ownership in the assets transferred? Is there any risk that any such transfer would be re-characterized as creating a security interest? If so, is there any way to minimize such risk? What would be the consequences of such a re-characterisation?*

In the case of a Letter of Credit, no assets will be transferred. Therefore, the following paragraphs consider the situation where Cash is given as Eligible Credit Support. For Cash, we assume that the Eligible Credit Support is transferred to the account of the Transferee and not of any third party.

It should be noted that the Credit Support Annexes provide only for an obligation to transfer the title but not for the actual transfer of title. Therefore, both Parties need to ensure that all necessary steps will be taken separately so that the title in the relevant assets will pass. The transfer of title itself is subject to mandatory conflict of law provisions (see the respective German conflict of law provisions outlined in Paragraph 4.3.2(a) on page 92 above).

According to section 3 of the Credit Support Annexes, the Transferor (as defined in section 3 para. 1 of the Credit Support Annexes) is obliged to transfer cash into the account of the Transferee (as defined in section 3 para. 1 of the Credit Support Annexes) specified in section 13 of the 2003 CSA and in section 14 of the 2011 CSA and any Excess Credit Support (as defined in section 4 para. 1 of the Credit Support Annexes) shall be retransferred by the Transferee to the Transferor in accordance with section 4 of the Credit Support Annexes. Section 7 para. 1 of the Credit Support Annexes provides that all right, title and interest in and to any Eligible Credit Support shall be transferred from the Transferor to the Transferee.

In principle, different types of security interest in Cash such as a pledge (*Pfandrecht*)[122], a transfer for security purposes (*Sicherungsübereignung*) and a

[122] Pledges of rights are subject to sections 1273 *et seq.* of the German Civil Code.

transfer of "ownership" (*Vollrechtsübertragung*)[123] can be created under German law. Section 7 of the Credit Support Annexes indicates that the parties have no intention of establishing a pledge, but to transfer Cash by way of outright transfer.

Thus, the payment of Cash by the Transferor into an account of the Transferee under the Credit Support Annexes should neither qualify as a pledge nor as a transfer for security purposes but as a transfer of "ownership" (*Vollrechtsübertragung*) in the Cash.

In the unlikely event that the courts of Germany would re-characterise the transfer of Cash under the Credit Support Annexes as a creation of a security right other than a transfer of "ownership" the transfer of the Cash would not be void due to a lack of registration since there is no such requirement under German law.

However, if the account to which the Cash has been transferred is maintained in a jurisdiction other than Germany the laws of that other jurisdiction should be checked to ensure that the transfer would not be re-characterised with possibly adverse effect (please see Paragraph 4.3.2(a) on page 92 above.

(c) *Assuming that Party B receives absolute ownership in the collateral, will it need to take any action thereafter to ensure that its title therein continues? Are there any requirements in Germany necessary or advisable, including any filing, registration, notification, stamping, notarisation or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval? Are there any other procedures that must be followed or consents or other governmental or regulatory approvals that must be obtained or established, to enforce, or continue such ownership interest?*

Under the laws of Germany, no further action such as, for instance, filing a registration, a notification, stamping, or notarisation is required to enforce or continue such ownership.

However, if the account to which the Cash has been transferred is maintained in another jurisdiction the laws of that jurisdiction should be checked to verify that

123 Transfer of ownership arrangements as a security has been recognised by German statutory law (section 1 para. 17 of the Banking Act) following the implementation of the Financial Collateral Directive. Even before the implementation of the Financial Collateral Directive, commercial parties and their legal advisors have developed different types of title transfer arrangements over the years which have been enforced by the German courts and which therefore can be considered as valid and enforceable instruments under German law.

there are no procedures that must be followed to enforce or continue such ownership interest.

(d) *What is the effect, if any, under the laws of Germany of the right to substitute collateral pursuant to section 6 of the Credit Support Annexes? Does the presence or absence of consent to substitution by the counterparty have any bearing on this question?*

Subject to the approval of the Transferee, under section 6 of the Credit Support Annexes the Transferor is entitled to replace, in whole or in part, any Eligible Credit Support provided under the Credit Support Annexes by other Eligible Credit Support of the same or higher value.

Under German law, the contractual right to the re-transfer of title has to be distinguished from the actual re-transfer of such title.

The right of the Transferor to exchange Eligible Credit Support (for example, by swapping Euros for United States Dollars) pursuant to section 6 of the Credit Support Annexes is a contractual right only. The substitution of Eligible Credit Support would require the re-transfer of the relevant assets to be replaced by the Transferee to the Transferor and a transfer of the assets newly provided as Eligible Credit Support by the Transferor to the Transferee. Hence, each of such transfers needs to be made in compliance with the applicable requirements to validly transfer title to such asset. Thus, in case of a refusal by the Transferee to re-transfer assets to the Transferor, the title to the relevant assets will not be transferred to the Transferor, even if the Transferee is under a contractual obligation pursuant to section 6 of the Credit Support Annexes to re-transfer such asset.

(e) *Party B's right in relation to the transferred collateral upon termination of the relevant master agreement will be governed by Section 4 of the CPMA or section 4 and 5 of the MNA, together with section 11 of the 2003 CSA or section 12 of the 2011 CSA. Assuming that Sections 4 of the CPMA and Section 4 and 5 of the MNA are valid and enforceable in Germany insofar as it relates to the determination of a Final Net Settlement Amount payable by either Party on the termination of transactions, are section 11 of the 2003 CSA and section 12 of the 2011 CSA also valid to the extent that it provides for the value of the collateral provided and not yet transferred to be included in the calculation of the Final Net Settlement Amount under Section 4 of the CPMA or section 8 of the MNA?*

According to section 11 of the Credit Support Annexes, the value of all Eligible Credit Support provided under the Credit Support Annexes shall be included in the

Final Net Settlement Amount to be determined pursuant to Section 4 of the CPMA as "an amount payable" by the Transferee. The inclusion of such Eligible Credit Support in the calculation of the net amount payable under section 11 of the Credit Support Annexes as "*an amount payable*" upon early termination will be recognised, because under the principle of freedom of contract, the parties are generally free to agree on which claims shall be included in the netting arrangement, subject to general limitations on contractual netting and set-off.

The provision of section 11 of the Credit Support Annexes, according to which Eligible Credit Support is applied to a Final Net Settlement Amount by way of contractual set-off, will be recognised, subject to restrictions to the right to set off after the opening of Insolvency Proceedings see Paragraph 4.1.1(h)(iii) on page 51 above.

(f) *Are the rights of Party B enforceable in accordance with the terms of the CPMA and the Credit Support Annexes, irrespective of the insolvency of Party A?*

If Party A has provided Cash Collateral in the form of a full title transfer prior to the commencement of Insolvency Proceedings, Party B will be regarded as the person entitled to such Cash Collateral. As set out above, it is unlikely that the courts of Germany would re-characterise the transfer of Cash under the Credit Support Annexes as a creation of a security right other than a transfer of "ownership" (please refer to Paragraph 4.3.2(b) on page 93 above).

However, such transfers of Cash Collateral will be subject to the general avoidance rules, subject to an exception for margin collateral (please refer to Paragraph 4.1.1(c) on page 19 above).

Upon the opening of the Insolvency Proceedings the Insolvency Representative shall be vested with Party A's right to manage and transfer the insolvency estate (section 80 para. 1 of the Insolvency Code). Therefore, if following the commencement of Insolvency Proceedings, Party A transfers an object forming part of the insolvency estate, such transfer shall be legally invalid (section 81 para. 1 sentence 1 of the Insolvency Code).

If the debtor transferred an object forming part of the insolvency estate on the day on which the Insolvency Proceedings were opened, such transfer shall be presumed to have been effected after the opening of the insolvency proceedings. However, provided that at least Party B qualifies as a credit or financial services institution, including (without limitation) financial institutions within the meaning of Art. 1 para. 2 (d) of the Financial Collateral Directive, any transfer by the debtor in respect of financial collateral (*Finanzsicherheiten*) within the meaning of section 1 para. 17 of the Banking Act (please refer to footnote 12 on page 8 above) following the opening of insolvency proceedings shall, subject to general avoidance rules (please refer to Paragraph 4.1.1(c) on page 19 above), be legally valid if it occurred on the day of the opening and the other party proves that he was neither aware of nor had to be aware of the opening of the proceedings (section 81 para. 3 of the Insolvency Code).

(g) *Will Party A (or its receiver or other similar official) be able to recover any transfer of collateral provided to Party B during a certain "suspect period" preceding the date of the insolvency? If so, how long before the insolvency does the suspect period begin? If such a period exists, does the substitution of collateral by a counterparty during this period invalidate an otherwise valid transfer, assuming the substitute assets are of no greater value than the assets they are replacing? Is the transfer of additional collateral pursuant to the mark-to-market provisions of the Credit Support Annexes during the suspect period subject to avoidance, either because it was considered to relate to an antecedent or pre-existing obligation or for some other reason?*

Following the commencement of Insolvency Proceedings, the transfer of Cash Collateral will be invalid, subject to an exception applicable to financial collateral which is transferred on the day on which the Insolvency Proceeding is opened (please refer to Paragraph 4.3.2(f) on page 96 above).

As further set out in Paragraph 4.3.2(f) on page 96 above, the transfer of Cash Collateral prior to the commencement of Insolvency Proceedings is subject to the general avoidance rules as the transfer is to be considered a legal act, subject to an exception for margin collateral. Thus, transfer of Eligible Credit Support under the provisions of the Credit Support Annexes could be challenged by an Insolvency Representative during suspect periods (please see Paragraph 4.1.1(c) on page 19 above for a discussion of the relevant suspect periods and for an exception for margin collateral).

Under German law, substitution of collateral whereby the collateral provider can re-claim particular securities and replace them with other securities of equivalent value is considered as a transaction consisting of various legal acts based on the declared intention of the security provider such as the conclusion of the collateral agreement providing for collateral substitution, each withdrawal of particular securities and each replacement of securities with other securities of equivalent value each of which is principally voidable under German insolvency law. Hence, each substitution is deemed to consist of two transfers that need to be made in compliance with the applicable requirements to validly transfer title to such asset and principally is subject to new suspect periods.

(h) *Are the Credit Support Annexes in an appropriate form to create the intended outright transfer of ownership in the collateral to Party B? Are there any other requirements to be observed in Germany in order to ensure validity of such transfer in each type of Eligible Credit Support created by Party A under the Credit Support Annexes? For example, are there any other requirements such as those mentioned under Paragraph 4.3.2(b) on page 93?*

As set out in Paragraph 4.3.2(a) on page 92 above, we understand that under the terms of the Credit Support Annexes, only Cash or Letters of Credit will qualify as Eligible Security.

In the case of a Letter of Credit, no assets will be transferred.

The transfer of collateral for security purposes (*Sicherungsübereignung*) is not explicitly provided for as a form of security in the German Civil Code, but is generally recognised and reflected in several statutes.

In case of the transfer of Cash Collateral, the Credit Support Annexes are in an appropriate form to effect a transfer of "ownership" (*Vollrechtsübertragung*) (please refer to Paragraph 4.3.2(b) on page 93 above), if the parties have the intention that such form of security shall be created.

(i) *Do you have other specific recommendations on the subject of collateral that you would like the EFET members to consider?*

We do not have other specific recommendations on the subject of collateral.

4.4 General enforceability

4.4.1 *Are the MNA, the CPMA and the Credit Support Annexes enforceable under the laws of Germany in accordance with its own terms? We are especially interested in provisions that you may believe infringe upon the ordre public in Germany and that may be challenged by the courts in Germany irrespective of the law that governs the MNA, the CPMA and the Credit Support Annexes.*

Subject to the reservations under Paragraph 5, the MNA, the CPMA and the Credit Support Annexes once executed between Parties will be legal, valid and binding under the laws of Germany.

There is a general risk that the provisions of the MNA, the CPMA and the Credit Support Annexes may qualify as standard business conditions and may be invalidated due to Sections 305 to 310 of the German Civil Code if governed by German law.

These provisions apply to contractual terms which have not been negotiated individually but are applied by one of the contracting parties as standard business conditions. The term "standard business conditions" means pre-formulated contractual conditions imposed by one party on another. In general terms, the restrictive statutory provisions on the use of standard business conditions would apply if one party incorporates general terms and conditions which have not been negotiated, for example, where one party uses standardised contracts such as the Master Agreements.

However, if both parties respectively use the same master agreement, for example the MNA and the CPMA, as their respective standard terms, the risk that the provisions of the German Civil Code on standard business conditions are applicable is significantly reduced. The majority of commentators in legal literature holds that if both parties to an agreement mutually refer to the same standard business conditions and request their introduction into the contract, sections 305 to 310 of the German Civil Code do not apply to such terms and conditions[124]. Although we generally share this view, it is also important to note that there is some uncertainty whether the courts will follow this argument with regard to the Master Agreements as well, because there is no established case law regarding this question[125], and because some legal commentators suggest that sections 305 to 310 of the German Civil Code also apply to standard business conditions which are commonly used by both parties to a contract[126]. In particular where the counterparty to a master agreement is a new and inexperienced market participant, there is a risk that German courts will argue that such party deserves protection under sections 305 to 310 of the German Civil Code.

Notwithstanding the afore-mentioned exemption, to the extent that agreements will only be concluded with a person pursuing its commercial or independent professional activities as entrepreneur (*Unternehmer*) within the meaning of section 14 of the German Civil Code or with private or public law legal entities, sections 305 to 310 of the German Civil Code apply

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124 GRÜNEBERG, in: Palandt Bürgerliches Gesetzbuch, 69th ed. (2010), § 305 no. 13; ULMER, in: Ulmer/Brandner/Hensen, AGB-Gesetz, 9th ed. (2001), § 1 no. 29; WOLF, in: Wolf/Horn/Lindacher, AGB-Gesetz, 4th ed. (1999), § 1 no. 29.

125 The *Oberlandesgericht Düsseldorf* subscribes to the majority view in legal literature, OLG Düsseldorf NJW 1994, 59.

126 This has been discussed in particular with regard to standard business conditions in the construction business, but the same argument might be applied to master agreements such as the Master Agreements. Please refer to: STAUDINGER/SCHLOSSER (2006) § 305 no. 31; SCHLECHTRIEM, in: Festschrift für Konrad Duden (1977), pp. 576-577; SONNENSCHEIN NJW 1980, 1489, 1491 *et seq.*

to a limited extent. If the MNA, the CPMA or the Credit Support Annexes are entered into with one of the afore-mentioned type of counterparties, sections 308 and 309 of the German Civil Code specifying certain generally prohibited clauses will not apply. Nevertheless, the agreement must not alter substantial principles of German law or lead to consequences that are either surprising, overly disadvantageous or expressed in an unclear way (sections 305c and 307 of the German Civil Code)[127]. In this respect, the legal principles expressed in the prohibition of certain clauses according to sections 308 and 309 of the German Civil Code must still be taken into account. If the relatively strict requirements of such provisions are not met, the standard business conditions concerned are null and void and the rules of statutory law apply. A severability clause replacing the invalid contractual provision with a contractual provision achieving an effect coming as close a legally possible to the effect of the invalid provision would be equally void.

However, such risk generally exists with respect to clauses qualifying as standard business conditions and it is not uncommon to see such or comparable provisions applied by parties.

If the result of the application of a foreign law (e.g. as governing the relevant agreements) contradicts the fundamental idea of the corresponding German legal provisions and the understanding of righteousness of the German public in a way that the application of such foreign law is to be considered unbearable, a German court would not apply such foreign law contravening the so-called *ordre public*.[128] This principle of *ordre public* is, however, only applied in very severe cases[129] and, if governed by a law different from German law, the provisions of the MNA, CPMA and the Credit Support Annexes should regularly not qualify as contravening the German *ordre public*.

However, whether or not the *ordre public* is infringed depends on the circumstances of the specific case with a view to all aspects of the relevant foreign law, the application of which is to be considered.

4.4.2 *Do you have other recommendations going to the topic of general legal enforceability that you would like EFET members to consider?*

We recommend to conduct authority and capacity checks for each counterparty to ensure that the counterparty has obtained all authorisations required to enter into the relevant transaction (for example, board resolutions) and that the signatory is authorised to sign the relevant transaction on behalf of the counterparty. If an advisory relationship exists with the

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127 BGH NJW 2007, 3774; BGHZ 89, 363; BGHZ 90, 273.

128 BGHZ 50, 370, 375; BGH ZIP 1992, 1256, 1264.

129 See for example OLG Köln, VersR 2007, 553 *et seq* on an exclusion of liability under the laws of Taiwan even for cases of gross negligence not contravening the German *ordre public*.

relevant counterparty, it is necessary to observe the general regulatory requirements applicable to investment advice and the obligations applicable in case of an advisory relationship (*anleger- und objektgerechte Beratung*).

4.5 Confirmation practice

4.5.1 Additional assumptions

In this Paragraph 4.5, we furthermore assume that as far as the confirmation practice is concerned, when entering into an Individual Contract, the counterparties in each case (i) make oral reference to a Netted Agreement when concluding the relevant Individual Contract over the phone and (ii) refer to a Netted Agreement when subsequently exchanging confirmations or similar electronic, written or non-verbal means of entering into or confirming Individual Contracts (in whichever form, including telex, telefax, SWIFT, electronic confirmation or position matching service or other means of electronic transmission).

Parties may or may not use matching systems (like EFET eCM, MarkitWire or DTTC DS Match) to electronically match and exchange confirmations.

4.5.2 Binding individual contract

(a) *Does the formation of a legally binding and enforceable Individual Contract require any formal act (e.g., execution in writing, signature, registration or notarization)?*

If governed by German law, Individual Contracts may be concluded in any form in accordance with the form provisions of the relevant Netted Agreement unless otherwise agreed between the Parties. According to German law, no specific formal requirements, such as a notarisation requirement, do generally apply.

In case the relevant Individual Contract is concluded orally, the Parties may agree on producing a written document for merely evidentiary purposes. Such Confirmation sets out in writing the contents of an Individual Contract that has already (i.e. prior to the drafting of the Confirmation) been concluded orally. For merely evidentiary purposes, however, any conceivable text version that is suitable for documentary evidence and that can be permanently stored – including e-mails and telefaxes would suffice.

The parties may agree on the use of certain communication standards to be used for the electronic matching of confirmations. No specific German law provision objects the use of electronic matching systems.

Unless otherwise agreed between the Parties, there is no general requirement under German civil law to sign documents in written form. However, in case a Party is a German entity established under public law, such party may be obliged under applicable law, to enter into the Netted Agreements and the Individual Contracts entered into thereunder in written form. If the entering into the Netted Agreements, the Individual Contracts thereunder or the Confirmation qualifies as a contract under public law (*öffentlich-rechtlicher Vertrag*), the relevant Netted Agreements, the Individual Contracts thereunder or the Confirmation also have to be entered into in writing[130].

If the Parties would only be satisfied with a Confirmation that complies with the more stringent written signature requirements, it would be recommendable to specify the agreed-upon formal requirements in more detail and, in particular, to include an explicit reference to a (handwritten) signature. It is further recommendable to include in the relevant form provision ot the relevant Netted Agreement a reference to the EFET Electronic Confirmation Matching System and the EFET Electronic Confirmation Agreement as a means of confirming a transaction.

(b) *At what point in time does an Individual Contract agreed upon orally become legally binding or enforceable?*

An Individual Contract will become legally enforceable once agreed upon orally. However, the Parties may be required to provide documents in writing following the conclusion of the contract for evidential purposes (see our answer under Paragraph 4.5.2(c)/page 102 below.)

(c) *Does failure to object to incorrect terms in a received Confirmation constitute "acceptance" of those terms? If so, is there a relevant time period?*

Since the Parties will have entered into the Confirmation already orally, a written Confirmation sent to either counterparty after the oral conclusion of the agreement will in principle not alter or amend such agreement and will merely be of declaratory nature.

However, pursuant to the German law doctrine of a commercial letter of confirmation *(kaufmännisches Bestätigungsschreiben)* – which, in the absence of a

130 In most cases, even a party which is an entity established under public law will enter into the Netted Agreement and any Individual Contract and the Confirmations thereunder under private law and such contracts will not qualify as contracts under public law.

deviating agreement between the Parties or a different commercial practice in power trading, would most likely also apply here – the terms stipulated in such commercial letter of confirmation will prevail. The Confirmation will qualify as a commercial letter of confirmation if it states that an agreement has been reached orally and that the terms of such agreement are confirmed in such letter.

If such Confirmation qualifies as a commercial letter of confirmations and its terms deviate from the content of the terms agreed orally, the provisions contained in the Confirmation will generally prevail if the recipient remains silent[131], *i.e.* does not object immediately.

This may apply even if the party which sends the Confirmation requests the recipient to countersign, because the sender of the Confirmation may request the countersignature only for evidentiary purposes[132].

Thus, the terms of the Confirmation will be deemed to be accepted, unless the recipient objects immediately, that is without undue delay (*unverzüglich*) within the meaning of section 121 of the German Civil Code. The time frame allowed thereunder depends on the usual time in which a counterparty can be expected to review and react to a confirmation. General case law – which, however, does not specifically deal with contracts in electricity trading – allows for one to three business days[133]; however, an objection within an even shorter period of time might be required in the specific context of power trading, in particular where performance under the contract shall commence within a short period of time.

The afore-mentioned principles do not apply if the party sending the Confirmation knows that the Confirmation is incorrect[134], or if the Confirmation deviates from the orally agreed terms to such an extent that the silence on behalf of the recipient cannot reasonably be construed as a consent to such terms[135].

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131 BGHZ 7, 187, 189; BGH, WM 2007, 303, 305.

132 BGH WM 2007, 303, 305; BGH NJW 1964, 1269, 1270.

133 BGH NJW 1962, 246, 247; BGHZ 70, 232, 234.

134 SCHMIDT, Münchener Kommentar zum Handelsgesetzbuch, 2nd ed. (2009), § 346 no. 162; BGH WM 1955, 1284.

135 SCHMIDT, Münchener Kommentar zum Handelsgesetzbuch, 2nd ed. (2009), § 346 no. 163; BGH NJW 1954, 105, 105; BGHZ 40, 42, 45; BGHZ 101, 357, 365 = NJW 1988, 55, 57; BGH NJW-RR 2001, 680, 681; BGH NJW 1994, 1288.

(d) *Is the reference to a Netted Agreement sufficient for the inclusion of the Individual Contract in the Netted Agreement?*

In the event the Parties enter into an Individual Contract orally, such as over the telephone, or otherwise, e.g., through a electronic trading or matching system, and make reference to it being an Individual Contract for the purpose of the Netted Agreements between the Parties and assuming that the Individual Contract is governed by German law, such Individual Contract would be validly included in the relevant Netted Agreement.

Assuming the Individual Contract is not governed by German law, under German conflict of law rules, the law governing the relevant Individual Contract would also determine the circumstances under which such Individual Contract may be included in the relevant Netted Agreement.

An Individual Contract is also validly included in the relevant Netted Agreement if the Parties orally enter into such Individual Contract without any reference to the Netted Agreement between them, but subsequently confirm the Individual Contract in writing, via telex, facsimile, SWIFT, or other means of electronic transmission by using one of the sample Confirmations attached to the Netted Agreement or by otherwise referring to the Individual Contract as a Individual Contract for the purposes of the Netted Agreement between the Parties.

The same even applies in the event the Parties orally enter into an Individual Contract and subsequently confirm the Individual Contract in writing, via telex, facsimile, SWIFT, or other means of electronic transmission, but without referring to the Netted Agreement or stating anything negative concerning the applicability of the Netted Agreement.

4.5.3 **Means of Evidence**

Assuming there is a dispute with respect to the existence or the terms or conditions of an Individual Contract, would any or all of the following be eligible for rendering or otherwise properly introducing evidence of the agreed terms of the Individual Contract in court: (i) taped recording; (ii) witness' statement; (iii) e-mail or other electronic message or transaction entry system; and/or (iv) facsimile? Are there any local requirements or other considerations that are relevant to each form of evidence?

(i) *Taped recording*

Under German law, the recording of telephone conversations is generally not permissible without the consent of the all participants of the conversation.

According to section 201 of the German Criminal Code (*Strafgesetzbuch*), it is a criminal offence to illicitly record conversations, to use such recordings or to make such recordings available to third parties. Punishment shall be imprisonment for not more than five years or a fine. Furthermore, such recordings may also constitute a breach of contractual obligations and duties and may constitute a breach of the obligations assumed as an employer vis-à-vis the employees who have not consented to the recording. Subject to narrow exceptions, recordings which have been illegally obtained without the consent of the other participants of the conversation, may not be produced as evidence in civil actions[136].

However, it is permissible to seek and obtain prior consent to the recording of telephone conversations. In such case, each participant to the conversation has to consent to the recording of the conversation, as well as to the use of the recording for evidentiary purposes and to distributing the recording to third parties. The Parties may represent that their employees have given their consent[137]. In such case, the recording Party may generally rely on such representation. In this context it is recommended that the representation is obtained in writing.

From a technical point of view, in order to comply with the restrictions under German law, *i.e.* to record only those conversations for which a consent has been given, a telephone system would be required that identifies incoming calls and routes them depending on whether the caller is identified as having

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136 BGHZ 27, 284; BGH NJW 1982, 277, 278; BGH NJW 1988, 1016; OLG Hamm NJW-RR 1996, 735. Similar principles have been developed in connection with witness evidence which was obtained by listening to telephone conversations without the consent of all participants, please refer to BVerfG NJW 2002, 3619, 3622 *et seq.*; BGH NJW 2003, 1727, 1729.

137 The German Central Credit Committee (*Zentraler Kreditausschuss*) has agreed with the BaFin, the *Deutsche Bundesbank* and the German Association of Employers in the Private Banking Industry (*Arbeitgeberverband des privaten Bankgewerbes*) on a concept which serves as a framework for the recording of telephone conversation in the interbank trading business. Based on this concept, the so-called *Grundsatzvereinbarung* dated February/March 1993 for interbank business on the recording of telephone conversations relating to cash, foreign exchange, securities and derivatives trading has been signed. Under this *Grundsatzvereinbarung*, German credit institutions, on the one hand, have obliged themselves to inform their counterparties about the intended recording and, on the other hand, to obtain consent from all employees of their trading departments. After such consent has been given, telephone conversations can be recorded. This *Grundsatzvereinbarung* is, however, limited in its scope. It applies only to the banks which are members of the said associations. So far, it has not been extended in scope by an agreement with other counterparties. Furthermore, it applies only to telephone conversations in the trading area of a bank.

consented to the recording of its conversations or not, to recording in the first alternative and not recording in the absence of a consent.

(ii) *Witness statement; e-mail or other electronic message or transaction entry system; facsimile*

Witness statements, e-mails or other messages derived from electronic message or transaction entry systems and facsimiles are eligible for rendering or otherwise properly introducing evidence of the agreed terms of the Individual Contract in court.

In order to minimise the risk that German law enforcement authorities rise allegations according to section 202a (data espionage) and 206 (violation of the postal and telecommunications secret) of the German Criminal Code, employees should be asked to give their written consent in advance to have the e-mails sent to and from their company e-mail address overseen and – if necessary – be utilised as forensic evidence. However, this cannot prevent criminal accusations under section 206 of the German Criminal Code should a third party (i.e. not a contracting party of the employment agreement) have been involved in the e-mail communication without agreeing to this data use previously[138].

The court has to assess, based on the entire content of the court proceeding and all evidence taken, whether a statement by a party regarding the agreed terms of the Individual Contract is true or not. This decision is up to the unfettered discretion of the court (*Grundsatz der freien Beweiswürdigung*, section 286 of the German Code of Civil Procedure).

There is no rule according to which one means of evidence is more reliable than the other[139].

4.6 Core Provisions

4.6.1 *Would any of the elections contemplated by the MNA, the CPMA or the Credit Support Annexes change the substance of your conclusions reached under Paragraph 4.1 and Paragraph 4.2.? As far as the Credit Support Annexes are concerned, you should in particular discuss the effect of electing to allow substitution with or without consent.*

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138 LENCKNER, in: Schönke/Schröder, Strafgesetzbuch, Kommentar, 27th ed. (2006), § 206 no. 12.

139 PRÜTTING, in: Münchener Kommentar zur Zivilprozessordnung, 3rd ed. (2008), § 286 no. 13.

In the Election Sheet to the MNA and in the Schedule to the CPMA the Parties may agree on a customisation of provisions in the Master Agreements and include additional provisions to the Master Agreements. If the relevant Master Agreement is governed by German law (please refer to Paragraph 4.2.1 on page 72 above), whether such elections and additional provisions change the substance of our conclusions reached under Paragraph 4.1.1 on page 15 and Paragraph 4.1.2 on page 71 above, depends on the contents of such elections and additional provisions. Generally, such elections and additional provisions should not affect the conclusions reached under Paragraph 4.1.1 on page 15 and Paragraph 4.1.2 on page 71 above regarding the enforceability of close-out netting provided that such inclusion would not have the effect of modifying or affecting the operation or implementation of any Core Provision (as defined in Paragraph 4.6.2 below below).

Clause 6 of the Credit Support Annexes provides that "Subject to the approval of the Transferee (not unreasonably to be withheld), the Transferor may replace, in whole or in part, any Eligible Credit Support provided under this Annex by Eligible Credit Support of the same or higher Value. The Transferee shall have no obligation to transfer the Eligible Credit Support which it holds until it has received the replacement Eligible Credit Support."

If the parties agree to modify this provision and to allow an exchange of Eligible Credit Support without the approval of the Transferee (such modification may be implemented in section 14(14) (Additional Provisions) of the 2003 CSA and section 15(14) of the 2011 CSA), the substance of our conclusions reached under Paragraph 4.1 on page 15 and Paragraph 4.2 on page 72 above would not change.

4.6.2 *Considering your conclusions reached under Paragraph 4.1.1 on page 15 and Paragraph 4.1.2 on page 71 above, what are the provisions of the Master Agreements that you regard as so essential that a material alteration thereof could affect the conclusions reached in that Paragraph 4.1.1 on page 15 and Paragraph 4.1.2 on page 71 above (each such provision a "**Core Provision**")?*

We understand that "**Core Provisions**" are such provisions of the Master Agreements which are so essential that a material alteration thereof could affect the enforceability of the contractual close-out netting as achieved by the Netting Provisions.

(a) Core Provisions of the MNA

Following such understanding and based on the opinions given in Paragraph 4.1.1(c) on page 19 above, the assumptions set out under Paragraph 3 on page 10 above and the reservations set out under Paragraph 5 on page 111 below, we identify the following provisions of the MNA as Core Provisions:

(i) § 3.1 (C)(III)(d) of the MNA; and

(ii) all defined terms contained in Annex 1 to the MNA and related to the sections of the MNA as set out under Paragraph 4.1.1 on page 15 et seq. through Paragraph 4.1.2 on page 71 above.

A modification to any provision of the MNA that is not a Core Provision would not affect the conclusions reached in Paragraph 4.1.1(c) on page 19 *et seq.* above regarding the enforceability of close-out netting provided that such modification would not have the effect of modifying or affecting the operation or implementation of any Core Provision.

It is our understanding that certain changes are commonly made to Core Provision of § 3.1 (C)(III)(d) of the MNA. Changes which seem to be commonly made in the markets to the effect that Automatic Termination as provided in § 6 of the MNA shall only apply in respect of an event specified in § 3.1 (C)(III)(d) of the MNA, if the relevant proceeding is instituted by, or the relevant petition is presented to, a court or authority in the jurisdiction where the party is incorporated or in certain other jurisdictions, would not affect the conclusions reached in Paragraph 4.1.1(c) on page 19 *et seq.* above, provided that the Early Termination Date lies before the opening of Insolvency Proceedings. Furthermore, any change replacing § 3.1 (C)(III)(d) of the MNA with an altered wording describing the events intended to be covered as "Winding-up/Insolvency/Attachment" differently would not affect the conclusions reached in Paragraph 4.1.1(c) on page 19 *et seq.* and Paragraph 4.1.1(h) on page 42 *et seq.* above, provided that the following events are included: "(i) a party becomes insolvent or becomes unable to pay its debts, when they fall due, (ii) a party makes a general assignment, arrangement or composition with or for the benefit of its creditors, and (iii) a petition is filed with respect to a party for (a) seeking a judgment of insolvency, bankruptcy or other similar proceeding or (b) appointing an administrator, liquidator, receiver or other similar officer its assets or substantially all its assets."

An inclusion of Additional Provisions in the Election Sheet to the MNA should not affect the conclusions reached in Paragraph 4.1.1(c) on page 19 above regarding the enforceability of close-out netting provided that such inclusion would not have the effect of modifying or affecting the operation or implementation of any Core Provision.

(b) Core Provisions of the CPMA

We identify the following provisions of the CPMA as Core Provisions:

An inclusion of Additional Provisions in the Schedule to the CPMA should not affect the conclusions reached in Paragraph 4.1.1(c) on page 19 above regarding the enforceability of close-out netting provided that such inclusion would not have the effect of modifying or affecting the operation or implementation of any Core Provision.

4.7 **Governing law, arbitration and jurisdiction**

4.7.1 *Would the Parties' agreement on the governing law, submission to arbitration or jurisdiction (Section 12 of the MNA and Section 6 of the CPMA) be upheld in Germany, and what would be the consequence if it were not?*

(a) Governing law

Regarding the Parties' agreement on the governing law, please refer to Paragraph 4.1.1(h)(i) on page 43 above.

(b) Recognition of arbitral award

An arbitral award on a civil matter rendered on the basis of the arbitration clause contained in the Master Agreements will be recognised by a German court in accordance with sections 1059 *et seq.* of the German Code of Civil Procedure (*Zivilprozessordnung*). Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes proof that

(i) the parties to the respective contract were, under the applicable law, under some incapacity, or the arbitration clause under the respective contract was not valid under the law to which the parties have subjected it, or, failing any indication thereof, under German law; or

(ii) the party against whom the award is invoked was not given proper notice of the appointment of the arbitral tribunal or of the arbitration proceedings or was otherwise unable to present its case; or

(iii) the award is about a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognised and enforced; or

(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the arbitration clause under the respective contract, or, failing such agreement, was not in accordance with German law, and it can be assumed that such deficiency influenced the award;

or if the German court finds that

(v) the subject matter of the dispute is not capable of settlement by arbitration under German law; or

(vi) the recognition or enforcement of the award would be contrary to the German *ordre public*; or

(vii) in case of a foreign arbitral award, any grounds for refusal of recognition and enforcement under the United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards apply.

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

4.8 Other Provisions

4.8.1 *Recommendations that you would like EFET member companies to consider (for example to fully optimise the Master Agreements for a specific purpose such as to support limited trading between two entities both organised and doing business solely in Germany).*

(a) If any single section in the Master Agreements were illegal or unenforceable, such unenforceability or illegality would, under the laws of Germany, not undermine the Netting Provisions, unless the unenforceability or illegality was so material that the relevant Master Agreement would not have been entered into if it had not contained these provisions (section 139 of the German Civil Code).

5. RESERVATIONS

5.1 General

In this Opinion "enforceable" or any word of similar import means that an obligation is of a type which the German courts generally enforce. It does not mean that those obligations will be enforced in all circumstances in accordance with the terms of the Master Agreements. In particular the following has to be taken into account:

5.1.1 Any enforcement of the Master Agreements in Germany will be subject to the rules of civil procedure arising by operation of law as applied by the courts or other competent authority of Germany which may, *inter alia*, require the translation of foreign language documents into the German language.

5.1.2 In the event that an enforcement action is initiated in this jurisdiction in respect of a judgment in a foreign currency (including German court judgments rendered in connection with the enforcement of foreign court judgments) the sum claimed in such action may have to be converted in Euro. If a party defaults on a payment obligation which expressly requires such party to make payment in an agreed currency and such requirement is expressed in a certain prescribed manner, the sum claimed in an enforcement action need not be converted into Euro at the time such action is filed; in such case, the claim may be discharged by converting the judgement currency into Euro at the exchange rate prevailing on the date of payment. However, with respect to bankruptcy, insolvency, liquidation, moratorium, reorganisation, reconstruction or similar proceedings, German law may require that all claims or debts are converted into Euro at an exchange rate determined by the court at a date related thereto, such as the date of the opening of Insolvency Proceedings.

5.1.3 A determination, calculation or certificate of any party to each Agreement as to any matter provided for therein might in certain circumstances be held by a German court not to be final, conclusive and binding (for example, if it could be shown to have been incorrect or to have any other unreasonable or arbitrary basis or not to have been made in good faith) notwithstanding the provisions of the relevant document.

5.1.4 The choice of a foreign law to govern each Agreement would not be recognised or upheld if such choice would conflict with the mandatory law of another jurisdiction which is the only jurisdiction with a connection to the relevant Agreement.

5.1.5 A German court may refuse to give effect to any provision of the Master Agreements (a) for the payment of expenses in respect of the costs of enforcement (actual or contemplated) of unsuccessful litigation brought before a German court or where the court has itself made an order for costs, (b) which would constitute an agreement to agree for the purposes of

German law, (c) which would involve the enforcement of foreign tax or criminal laws, or (d) which would be inconsistent with German public policy.

5.1.6 In some circumstances, a German court will not give effect to a provision of an agreement which provides that, in the event of any invalidity, illegality or unenforceability of any provision of such agreement or omission therein the remaining provisions thereof shall not be affected or impaired or the omission shall be corrected, particularly if to do so would not accord with public policy or would require that the German court make a new contract for the parties or would contravene the intention of the parties to such agreement (i.e. the relevant German court establishes that the parties would not have entered into such agreement without the illegal provision being agreed between them which may be found to be the case by the German court under circumstances where the invalid, illegal or unenforceable provision is a material provision).

5.1.7 Any action brought against any person in the German courts will be subject to the rules and procedures of the German courts, including the power of a German court to order a plaintiff in an action, being a party not ordinarily resident in Germany, to provide security for costs and to appoint a process agent (*Zustellungsbevollmächtigten*) in Germany.

5.1.8 There is no final judicial precedent in Germany for holding facsimile or e-mail communications legal, valid and binding in all circumstances (in particular where there is a statutory requirement for written form, a signature by way of a facsimile signing has been held insufficient to satisfy such requirement). Notwithstanding this, where there are no particular statutory or contractual requirements as to the form of communication (unless - in the latter case - the requirement of actual receipt has been validly waived), any communication actually received by the addressee will be deemed validly given (*widerlegbare Vermutung*).

5.1.9 The authenticity or completeness, and therefore the value as evidence, of any message or data in electronic form (even if saved on a medium of data storage) is in principle capable of being challenged as evidence in German courts on *inter alia* the grounds that (i) it may be altered and/or (ii) the sender thereof cannot be certified, and/or (iii) the date and time of its issue can be manipulated.

5.1.10 On the basis of section 2(b) of Article VIII of the International Monetary Fund Agreement, as interpreted 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.

5.1.11 Any transfer of rights or payment in respect, or other performance, of an obligation under the Master Agreements, any Netted Agreement or any Individual Contract 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.

In respect of cross-border cash payments the notification requirements under the Foreign Trade Act (*Außenwirtschaftsgesetz*) and the Foreign Trade Regulation (*Außenwirtschaftsverordnung*, "**AWV**") need to be observed. The reports have to be submitted to the Deutsche Bundesbank using the applicable notification forms. With regard to payments this is usually done via the banks involved in the execution of such payments. A failure to do so would, however, by no means endanger the validity of the respective transaction. From 31 December 2009, starting with the position held on 31 December 2010, entities resident in Germany are subject to a new reporting requirement under the AWV. Pursuant to section 62 para. 1 and 4 of the AWV outstanding accounts or accounts payable vis-à-vis foreign business partners exceeding EUR 500,000,000 have to be reported to the Deutsche Bundesbank on an annual basis by 20 February of the following year by using the printed form "Z 5b".

5.1.12 Pursuant to section 395 of the German Civil Code, a set-off against a claim of the Federal Republic, a German Federal State, a municipality or an association of municipalities (*Kommunalverband*) is only permissible if the performance is to be effected to the same fund (*Kasse*) from which the claim of the party which declares the set-off is to be paid.

5.1.13 Any provision of the Master Agreements which constitutes, or purports to constitute, a restriction on the exercise of any statutory power by any Party or any other person may be ineffective.

5.1.14 A German court might hold that any provision in the Master Agreements stating that a representation or communication shall be deemed to have been made or delivered or which reverses the burden of proof is void or voidable.

5.1.15 A provision requiring a Party to represent that a Netted Agreement or Individual Contract is legal, valid and binding may be unenforceable to the extent that it applies to provisions of such Netted Agreement or Individual Contract which are not legal, valid and binding.

5.1.16 A German court might hold that, irrespective of the provisions of the Master Agreements, any waiver of or amendment to the Master Agreements agreed between the respective parties is valid whether or not given or made in writing or orally or implied by subsequent conduct of the relevant parties.

5.1.17 The collection, processing, use and transfer of personal data by any Party to the Master Agreements must comply with the requirements of the applicable data protection laws. In this respect please note that the Federal Data Protection Act (*Bundesdatenschutzgesetz* – "**BDSG**") currently 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 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 individuals) the BDSG does not apply.

5.1.18 With respect to the doctrine of *ultra vires*, the capacity of a legal entity governed by public law to validly enter into a legally binding agreement may be limited under German law. Public law entities may principally only enter into transactions that fall within their scope of competence and functions (*Wirkungskreis*) as defined by a special law or bylaw enacted by a sovereign such as the Federal Republic or a federal state. If a public law entity purports to enter into a contract under private law that is beyond or exceeding its statutorily specified powers, such a contract might be considered as *ultra vires* and therefore null and void. There is a risk that a court may decide that the concept of *ultra vires* is also applicable to municipalities. In contrast, the states or the Federal Republic, when acting under private law, should not be restricted by the principle of *ultra vires*. Provided that the *ultra vires* doctrine is applicable, it applies regardless of the good faith of the counterparty or any representation to the contrary. As a rule, *ultra vires* measures are unenforceable. They may not be ratified. Furthermore, no claims for damages might be raised either (for example, claims based on misrepresentation) and any collateral provided has to be returned.

5.1.19 Under German law, the Federal Republic, the Federal States, municipalities and public law entities in their capacity as party to the Master Agreements do not enjoy an absolute right of sovereign immunity from legal proceedings, the execution of a judgment or an attachment. However, the procedural law provides for special provisions as regards legal proceedings against entities governed by public law and the execution of a judgement against such an entity might either be restricted or be subject to special requirements such as the consent of the supervisory authority.

5.1.20 If any obligation is to be performed in a jurisdiction outside Germany, it may not be enforceable in Germany to the extent that performance would be illegal or contrary to public policy under the laws of the other jurisdiction and a German court may take into account the law of the place of performance in relation to the manner of performance and to the steps to be taken in the event of defective performance.

5.2 **Additional reservations regarding agreements governed by German law**

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

5.2.2 If a German court considers it impossible or unduly burdensome for obligations to be performed the debtor is discharged from performing such obligation; the debtor may however be held liable for damages.

5.2.3 In some circumstances, a German court will not give effect to any provision of the Master Agreements which provides that, in the event of any invalidity, illegality or unenforceability of any provision of such Master Agreement or omission therein the remaining provisions thereof shall not be affected or impaired or the omission shall be corrected, particularly if to do so would not accord with public policy or would require that the court make a new contract for the parties or would contravene the intention of the parties to such Master Agreement (i.e. the relevant court establishes that the parties would not have entered into the Master Agreement without the illegal provision being agreed between them which may be found to be the case by the court under circumstances where the invalid, illegal or unenforceable provision is a material provision).

5.2.4 Claims may become time-barred under the German Civil Code or may be or become subject to the defence of set-off or to counterclaim.

5.2.5 If a party defaults on a payment obligation which expressly requires such party to make payment in an agreed currency and such requirement is expressed in a certain prescribed manner, the sum claimed in an enforcement action need not be converted into Euro at the time such action is filed; in such case, the claim may be discharged by converting the judgement currency into Euro at the exchange rate prevailing on the date of payment. However, with respect to bankruptcy, insolvency, liquidation, moratorium, reorganisation, reconstruction or similar proceedings, German law may require that all claims or debts are converted into Euro at an exchange rate determined by the court at a date related thereto, such as the date of the opening of Insolvency Proceedings.

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

5.2.7 Under section 193 of the Civil Code, unless the parties have agreed otherwise, any obligation which would have to be performed on a day which would be an official holiday at the place where the performance is to take place, is to be performed instead on the next possible business day at such place.

5.2.8 Generally, a claim cannot be validly assigned under German law if the creditor and the debtor of the claim have contractually restricted the assignment of the claim. The assignment of a claim which contravenes a contractually agreed restriction on assignment will be invalid. However, under an exception contained in section 354a of the Commercial Code, the assignment of monetary claims (i.e. claims for the payment of money) governed by German law cannot effectively be contractually excluded if the underlying agreement constitutes a commercial transaction (*Handelsgeschäft*) for both contracting parties or if the debtor is a public law entity or public law fund (section 354a para. 1 of the Commercial Code). However, pursuant to section 354a para. 2 of the Commercial Code, section 354a para. 1 of the Commercial Code is no longer applicable to receivables resulting from a loan agreement which has been entered into after 18 August 2008 by a lender which is a credit institution. Such monetary claims can be validly assigned notwithstanding a contractual restriction on assignment in the underlying contract provided that the debtor under such claim may pay to the original creditor with the effect of discharging the obligation unless the assignment was notified to him. Notwithstanding that German courts would not enforce restrictions on the assignment of monetary claims to the extent to which section 354a of the Commercial Code provides that they are not enforceable, that same section allows the debtor of an assigned claim to pay and discharge its obligations to the original creditor, even if the debtor is notified of the assignment of its debt obligation.

From our point of view, the single agreement concept (contained in § 2.3 of the MNA and, if so selected in Part VIII Section 10.6 of the Commodities Schedule, in the CPMA) would not constitute a statutory prohibition of assignment pursuant to section 399 of the German Civil Code according to which the assignment of contractual rights is prohibited if such an assignment would lead to an alteration of the subject matter of the contract (section 399 alternative 1 of the German Civil Code). This provision applies primarily to contractual obligations the content of which is predominantly influenced by the person of the creditor such as personal claims or claims based on an agreement characterised by an exceptional amount of mutual trust which is not given under derivative transactions.

5.2.9 If any person expressed to be a Party to the Netted Agreement or an Individual Contract knew or should reasonably have known that any representation, warranty or statement in any

Netted Agreement or Individual Contract was incorrect, inaccurate or incomplete or any covenant was or could reasonably be expected to be impossible to fulfil, such person will be limited in enforcing its rights under the Netted Agreement or under the Individual Contract.

5.2.10 Pursuant to section 248 of the German Civil Code (but subject to section 355 of the Commercial Code) any provision obliging a debtor to pay interest on interest (compound interest) is void. This provision renders void compound interest provided for in any Master Agreement and all similar provisions in the Master Agreement relating to default interest and indemnities in respect thereof. However, pursuant to section 289 of the German Civil Code, a debtor may be liable for damages incurred due to its late payment of interest. Such damages would have to be proven.

5.2.11 A German court might hold that any provision in the Master Agreements stating that a representation or communication shall be deemed to have been made or delivered or which reverses the burden of proof is void or voidable.

5.2.12 A provision requiring a Party to represent that a Netted Agreement or Individual Contract is legal, valid and binding may be unenforceable to the extent that it applies to provisions of such Netted Agreement or Individual Contract which are not legal, valid and binding.

5.2.13 **Standard Business Conditions**

The regulations on standard business conditions pursuant to sections 305 to 310 of the German Civil Code may apply in certain circumstances to the Master Agreement, any Netted Agreement or any Individual Contract. We would like to draw your attention in particular to the following specific aspects of these regulations on standard business conditions:

(a) The protection provided by sections 305 *et seq.* of the German Civil Code for the benefit of the counterparty of the user of standard business conditions (the "**Counterparty**") applies not only if the Counterparty is a consumer, but also if such Counterparty is an entrepreneur (*Unternehmer*); however, the standard of protection for entrepreneurs is not as high as the standard of protection provided to consumers;

(b) provisions contained in standard business conditions may be set aside by a court as invalid without a possibility to reduce its content to a valid provision, pursuant to sections 305b to 307 of the German Civil Code, if they are (a) surprising to the Counterparty (section 305c of the German Civil Code), (b) conflicting with a provision specifically negotiated with the Counterparty (section 305b of the German Civil Code), (c) are intended to circumvent any provision contained in sections 305 to 307 of the German Civil Code (section 306a of the German Civil Code) or (d) are contrary to good faith, inappropriately disadvantageous to the detriment of the Counterparty; in this respect the German Civil Code provides for an assumption that a standard business condition is (in particular without limitation) inappropriately disadvantageous to the detriment of the Counterparty if such provision contravenes the fundamental principles of a statutory provision from which it derogates or constrains fundamental rights and obligations which arise out of the specific nature of the respective contract in such a way that the achievement of the purpose of such contract is at danger (section 307 of the German Civil Code). However, although the main provisions on standard business conditions in sections 308 and 309 German Civil Code do not apply directly with respect to entrepreneurs, most infringements of the provisions contained therein count as an infringement of section 307 German Civil Code. Please note that the standard of good faith employed under section 307 of the German Civil Code is higher than the standard of good faith referred to in Paragraph 5.2.1 on page 115 above;

(c) if a provision contained in standard business conditions is unclear, then such lack of clarity will be to the detriment of the user of the standard business conditions and not to the detriment of the Counterparty (section 305c para. 2 of the German Civil Code);

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

(e) where standard business conditions are in a language other than the German language and no German translation has been provided at the time that the Counterparty accepts such standard business conditions or if standard business conditions are otherwise non-transparent, there is a possibility that German courts will set aside provisions which favour the party using such standard business conditions, in particular, on the basis of lack of transparency; and

(f) severability clauses (*salvatorische Klauseln*) in standard business conditions pursuant to which an invalid, illegal or unenforceable provision is to be replaced by the parties with a provision which comes as close as legally possible to the commercial intentions of the invalid, illegal or unenforceable provisions are invalid (section 306 para. 2 of the German Civil Code).

6. ADDRESSEES AND PURPOSE

This Opinion is addressed exclusively to EFET and its members who have subscribed to the EFET Legal Module, is for their sole benefit and may not be relied upon by any other person, entity or corporation whatsoever and may not be disclosed to any other persons without EFET's and Clifford Chance's prior written approval. This opinion may be made available by EFET members who have subscribed to the EFET Legal Module to the appropriate regulatory authorities.

Yours faithfully,

(Marc Benzler)

CLIFFORD CHANCE PARTNERSCHAFTSGESELLSCHAFT

Annex 1

Transactions under the Netted Agreements

1. Basis Swap. A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

2. Bond Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

3. Bullion Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of Bullion in exchange for the strike price or may be cash settled based on the difference between the market price of Bullion on the exercise date and the strike price.

4. Bullion Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the COMEX Division of the New York Mercantile Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

5. Bullion Trade. A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a "spot" or two-day basis or on a specified future date. A Bullion Trade may be cash settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price.

For purposes of Bullion Trades, Bullion Options and Bullion Swaps, "Bullion" means gold, silver, platinum or palladium and "Ounce" means, in the case of gold, a fine troy ounce, (or in the case of reference prices not expressed in Ounces, the relevant Units of silver, platinum or palladium).

6. Buy/Sell-Back Transaction. A transaction in which one party purchases a security (in consideration for a cash payment) and agrees to sell back that security (or in some cases an equivalent security) to the other party (in consideration for the original cash payment plus a premium).

7. Cap Transaction. A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap).

8. Collar Transaction. A collar is a combination of a cap and a floor where one party is the floating rate or floating commodity price payer on the cap and the other party is the floating rate or floating commodity price payer on the floor.

9. Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. The payment calculation is based on the quantity of the commodity and is settled based, among other things, on the difference between the agreed forward price and the prevailing market price at the time of settlement.

10. Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

11. Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g., West Texas Intermediate Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

12. Contingent Credit Default Swap. A Credit Default Swap Transaction in which the credit protection seller pays an amount determined by reference to the value of a hypothetical swap transaction.

13. Credit Default Swap Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to enter into a Credit Default Swap.

14. Credit Default Swap. A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity") upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. A Credit Default Swap may also be physically settled by payment of a specified fixed amount by one party against delivery of specified obligations ("Deliverable Obligations") by the other party. A Credit Default Swap may also refer to a "basket" (typically ten or less) or a "portfolio" (eleven or more) or Reference Entities or may be an index transaction consisting of a series of component Credit Default Swaps.

15. Credit Derivative Transaction on Asset-Backed Securities. A Credit Default Swap for which the Reference Obligation is a cash or synthetic asset-backed security. Such a transaction may, but need not necessarily, include "pay as you go" settlements, meaning that the credit protection seller makes payments relating to interest shortfalls, principal shortfalls and write-downs arising on the Reference Obligation and the credit protection buyer makes additional fixed payments of reimbursements of such shortfalls or write-downs.

16. Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument.

17. Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and/or final exchanges of amounts corresponding to the notional amounts.

18. Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

19. Currency Swap. A transaction in which one party pays fixed periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

20. Economic Statistic Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency by reference to interest rates or other factors and the other party pays or may pay an amount or periodic amounts of a currency based on a specified rate or index pertaining to statistical data on economic conditions, which may include economic growth, retail sales, inflation, consumer prices, consumer sentiment, unemployment and housing.

21. Emissions Allowance Transaction. A transaction in which one party agrees to buy from or sell to the other party a specified quantity of emissions allowances or reductions at a specified price for settlement either on a "spot" basis or on a specified future date. An Emissions Allowance Transaction may also constitute a swap of emissions allowances or reductions or an option whereby one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which the specified quantity of emissions allowances or reductions exceeds or is less than a specified strike. An Emissions Allowance Transaction may be physically settled by delivery of emissions allowances or reductions in exchange for a specified price, differing vintage years or differing emissions products or may be cash settled based on the difference between the market price of emissions allowances or reductions on the settlement date and the specified price.

22. Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity of shares of an issuer to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

23. Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment

equal to the amount by which an equity index either exceeds (in case of a call) or is less than (in case of a put) a specified strike price.

24. Equity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) shares of an issuer or a basket of shares of several issuers at a specified strike price. The option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

25. Equity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor's 500 Index.

26. Floor Transaction. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in case of a commodity floor).

27. Foreign Exchange Transaction. A transaction providing for the purchase of one currency with another currency providing for settlement either on a "spot" or two-day basis or a specified future date.

28. Forward Rate Transaction. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

29. Freight Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency based on a fixed price and the other party pays an amount or periodic amounts of the same currency based on the price of chartering a ship to transport wet or dry freight from one port to another; all calculations are based either on a notional quantity of freight or, in the case of time charter transactions, on a notional number of days.

30. Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment

equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

31. Interest Rate Swap. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

32. Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a commodity, such as coal, electricity or gas, at a fixed or floating price for actual delivery on one or more dates.

33. Property Index Derivative Transaction. A transaction, often structured in the form of a forward, option or total return swap, between two parties in which the underlying value of the transaction is based on a rate or index based on residential or commercial property prices for a specified local, regional and national area.

34. Repurchase Transaction. A transaction in which one party agrees to sell securities to the other party and such party has the right to repurchase those securities (or in some cases equivalent securities) from such other party at a future date.

35. Securities Lending Transaction. A transaction in which one party transfers securities to a party acting as the borrower in exchange for a payment or a series of payments from the borrower and the borrower´s obligation to replace the securities at a defined date with identical securities.

36. Swap Deliverable Contingent Credit Default Swap. A Contingent Credit Default Swap under which one of the Deliverable Obligations is a claim against the Reference Entity under an ISDA Master Agreement with respect to which an Early Termination Date (as defined therein) has occurred.

37. Swap Option. A transaction in which one party grants to the other party the right (in consideration for a premium payment), but not the obligation, to enter into a swap with certain specified terms. In some cases the swap option may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

38. Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity"), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the

other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation. A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

39. Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.

Annex 2

Master Agreements covered by the MNA or the CPMA

Energy Trading Master Agreements

1. European General Agreement Concerning the Delivery and Acceptance of Electricity (version 2007), sponsored by the European Federation of Energy Traders (EFET)

2. European General Agreement Concerning the Delivery and Acceptance of Electricity (version 2000), sponsored by the European Federation of Energy Traders (EFET)

3. European General Agreement Concerning the Delivery and Acceptance of Natural Gas (version 2007), sponsored by the European Federation of Energy Traders (EFET)

4. European General Agreement Concerning the Delivery and Acceptance of Natural Gas (version 2003), sponsored by the European Federation of Energy Traders (EFET)

5. UK Grid Trade Master Agreement (version June 2004), sponsored by the Futures and Options Association (FOA)

6. NBP Amendment Agreement for natural gas settled through the National Balancing Point (NBP) based on the Short Term Flat NBP Trading Terms and Conditions 1997

7. ZBT Amendment Agreement for natural gas settled through the Belgian Zeebruegge hub based on the Zeebruegge Terms and Conditions 2004

8. ZBT Amendment Agreement for natural gas settled through the Belgian Zeebruegge hub based on the Zeebruegge Terms and Conditions 2001

9. International Emissions Trading Master Agreement (version 2010/2011), sponsored by the International Emissions Trading Association (IETA)

10. Emissions Trading Master Agreement for the EU Scheme (version 2008), sponsored by the International Emissions Trading Association (IETA)

11. Emissions Trading Master Agreement for the EU Scheme (version 2005), sponsored by the International Emissions Trading Association (IETA)

12. Emissions Trading Master Agreement for the EU Scheme (version 2002), sponsored by the International Emissions Trading Association (IETA)

13. US Master Power Purchase & Sale Agreement (version 2000), sponsored by the Edison Electric Institute

14. US General Terms and Conditions Base Contract for Sale and Purchase of Natural Gas (version 2002), sponsored by the North American Energy Standards Board, Inc (NAESB)

15. US General Terms and Conditions Base Contract for Sale and Purchase of Natural Gas (version 2006), sponsored by the North American Energy Standards Board, Inc (NAESB)

16. Canadian Base Contract for Short-term Sale and Purchase of Natural Gas (version 2005), sponsored by GasEDI

17. Canadian Base Contract for Short-term Sale and Purchase of Natural Gas (version 2000), sponsored by GasEDI

Derivatives Master Agreements

1. Financial Energy Master Agreement (version 2000), sponsored by the Nordic Association of Energy Traders (NAET)

2. ISDA 2002 Master Agreement, sponsored by the International Swaps and Derivatives Association, Inc.

3. 1992 ISDA Master Agreement (Multicurrency – Cross Border), sponsored by the International Swaps and Derivatives Association, Inc.

4. 1992 ISDA Master Agreement (Local Currency – Single Jurisdiction), sponsored by the International Swaps and Derivatives Association, Inc.

5. 1987 Interest Rate and Currency Exchange Agreement, sponsored by the International Swaps and Derivatives Association, Inc.

6. Australian version of the 1992 ISDA Master Agreement (Multicurrency – Cross Border), sponsored by the Australian Financial Markets Association (AFMA)

7. New Zealand version of the 1992 ISDA Master Agreement (Multicurrency – Cross Border)

8. German Rahmenvertrag für Finanztermingeschäfte (version 2001), sponsored by the German Banker's Association

9. German Rahmenvertrag für Finanztermingeschäfte (version 1994), sponsored by the German Banker's Association

10. Swiss Master Agreement for Over-The-Counter Derivative Instruments (version 2003), sponsored by the Schweizerische Bankiervereinigung

11. Swiss Master Agreement for Over-The-Counter Derivative Instruments (version 1994), sponsored by the Schweizerische Bankiervereinigung

12. French Convention-Cadre FBF Relative Aux Operations Sur Instruments Financiers à Terme (version July 2007), sponsored by the Fédération Bancaire Française (FBF)

13. French Convention-Cadre FBF Relative Aux Operations Sur Instruments Financiers à Terme (version August 2001), sponsored by the Fédération Bancaire Française (FBF)

14. French Convention-Cadre AFB Relative Aux Operations Sur Instruments Financiers à Terme (version), sponsored by the Association Française des Banques (AFB)

15. Spanish Contrato Marco De Operaciones Financieras (versión 1997), sponsored by the Asociación Española de Banca Privada (AEB)

16. Dutch Raamovereenkomst voor Financiële Derivaten (RFD), sponsored by the Nederlandse Vereniging van Banken (NVB)

17. Japanese Bond Option Agreement, sponsored by the Japan Securities Dealers Association (JSDA)

18. Mexican Contrato Marco para Operaciones Financieras Derividas

19. Mexican Contrato Normativo para la realización de las operaciones de Intercambio

20. Mexican Master Agreement for Entering into Dollar against Mexican Peso Forward Transactions

21. US Master Securities Forward Agreement (version 1996), sponsored by The Bond Market Association (TBMA)

22. US Master OTC Options Agreement (version 2000), sponsored by The Bond Market Association (TBMA)

23. US OTC Option Transactions – U.S. Treasury Securities Master Dealer Agreement (version August 1989), sponsored by the Public Securities Association (PSA)

24. UK International Currency Options Market Agreement (ICOM) sponsored by the British Bankers' Association (BBA)

25. UK Foreign Exchange and Options Master Agreement (FEOMA), sponsored by the British Bankers' Association (BBA)

26. UK International Foreign Exchange Master Agreement (IFEMA), sponsored by the British Bankers' Association (BBA)

27. The 1994 International Bullion Master Agreement (IBMA) (version June 1994), sponsored by the London Bullion Market Association and the Foreign Exchange Committee

28. European Master Agreement for Financial Transactions (EMA) (edition January 2004), sponsored by the Banking Federation of the European Union (FBE)

29. European Master Agreement for Financial Transactions (EMA) (edition January 2001), sponsored by the Banking Federation of the European Union (FBE)

Securities Lending Master Agreements

1. Global Master Securities Lending Agreement (GMSLA) (version 2010), sponsored by the International Securities Lending Association (ISLA)

2. Global Master Securities Lending Agreement (GMSLA) (version 2000), sponsored by the International Securities Lending Association (ISLA)

3. Master Equity & Fixed Interest Stock Lending Agreement (MEFISLA) (version 1996), sponsored by the International Securities Lending Association (ISLA)

4. Master Gilt Edged Stock Lending Agreement (GESLA) (version 1996), sponsored by the International Securities Lending Association (ISLA)

5. Overseas Securities Lender's Agreement (OSLA) (version 1995), sponsored by the International Securities Lending Association (ISLA)

6. Overseas Securities Lender's Agreement (OSLA) (version October 1994), sponsored by the International Securities Lending Association (ISLA)

7. Overseas Securities Lender's Agreement (OSLA) (version February 1994), sponsored by the International Securities Lending Association (ISLA)

8. US Master Securities Loan Agreement (version 2000), sponsored by The Bond Market Association (TBMA)

9. US Master Securities Loan Agreement (version May 1993), sponsored by the Public Securities Association (PSA)

10. Canadian Securities Loan Agreement, sponsored by the Investment Dealers Association of Canada (IDAC)

11. German Rahmenvertrag für Wertpapierleihgeschäfte

12. German Rahmenvertrag für Wertpapierdarlehen (version 1999)

13. French Contract Cadre de Prêts des Titres (version 2007), sponsored by the Association Francaise des Professionnels des Titres (AFTI)

14. French Contract Cadre de Prêts des Titres (version), sponsored by the Association Francaise des Professionnels des Titres (AFTI)

15. Australian Master Securities Lending Agreement (version November 2003), sponsored by Australian Securities Lending Association Ltd. (ASLA)

16. Australian Master Securities Lending Agreement (version December 2002), sponsored by Australian Securities Lending Association Ltd. (ASLA)

17. Australian Master Securities Lending Agreement (version April 1997), sponsored by Australian Securities Lending Association Ltd. (ASLA)

18. New Zealand Master Repurchase Securities Lending Agreement

19. Japanese Basis Agreement Concerning Stock Lending Transactions, sponsored by the Japan Securities Dealers Association (JSDA)

Repurchase Master Agreements

1. Global Master Repurchase Agreement (GMRA) (version October 2000), sponsored by The Bond Market Association (TBMA) and the International Securities Market Association (ISMA)

2. Global Master Repurchase Agreement (GMRA) (version 1995), sponsored by the Public Securities Association (PSA) and the International Securities Market Association (ISMA)

3. Global Master Repurchase Agreement (GMRA), sponsored by the Public Securities Association (PSA) and the International Securities Market Association (ISMA) (version November 1992)

4. US Master Repurchase Agreement (MRA) (version September 1996), sponsored by The Bond Market Association (TBMA)

5. US Master Repurchase Agreement (MRA) (version 1987)

6. Canadian Repurchase/Reverse Repurchase Transaction Agreement

7. Australian version of the Global Master Repurchase Agreement (GMRA) (version 1995), sponsored by the Australian Financial Markets Association (AFMA)

8. New Zealand version of Global Master Repurchase Agreement (GMRA) (version 1995)

9. German Rahmenvertrag für Wertpapierpensionsgeschäfte (version 2005)

10. German Rahmenvertrag für Wertpapierpensionsgeschäfte (version 2002)

11. German Rahmenvertrag für echte Pensionsgeschäfte (version 1997)

12. French Convention-cadre FBF Relative Aux Opérations de Pensions Livriée (version 2007), sponsored by the Fédération bancaire française (FBF)

13. French Convention-cadre FBF Relative Aux Opérations de Pensions Livriée (version 2003), sponsored by the Fédération bancaire française (FBF)

14. French Convention-cadre Relative Aux Opérations de Pensions Livriée, sponsored by the Association du Forex et des Trésoriers de Banque (AFTB)

15. Japanese Bond Lending Agreement, sponsored by the Japan Securities Dealers Association (JSDA)

16. Japanese Basic Agreement Concerning Gensaki Transactions of Bonds, Japan Securities Dealers Association (JSDA)