MEMORANDUM OF LAW

**FOR THE EUROPEAN FEDERATION OF ENERGY TRADERS
GENERAL AGREEMENT CONCERNING THE
DELIVERY AND ACCEPTANCE OF ELECTRICITY**

*Enforceability of the Early Termination and
Close-Out Netting Provisions of the
2007 Form of EFET Master Electricity Agreement*

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As of June 30, 2017

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FisherBroyles LLP
445 Park Avenue
New York, New York 10022
Tel: (917) 365-4871
Fax: (212) 432-0618

MEMORANDUM OF LAW FOR THE EUROPEAN
FEDERATION OF ENERGY TRADERS

Enforceability of Early Termination and
Close-Out Netting under the Code,
the FDIA, the NYBL, FDICIA, SIPA and the OLA

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Discussion of Parent Company Guarantee

As of June 30, 2017

This memorandum of law (this "**Memorandum**") examines the general enforceability of the early termination and close-out netting provisions of the 2007 Version 2.1(a)/September 21, 2007 of the EFET General Agreement Concerning the Delivery and Acceptance of Electricity (the "**General Agreement**") under the United States Bankruptcy Code (the "**Code**"),[1] the Federal Deposit Insurance Act (the "**FDIA**"),[2] the New York Banking Law (the "**NYBL**"),[3] the Federal Deposit Insurance Corporation Improvement Act of 1991 ("**FDICIA**"),[4] the Securities Investor Protection Act of 1970 ("**SIPA**")[5] and Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**") entitled Orderly Liquidation Authority (the "**OLA**").[6] This Memorandum also discusses certain issues relating to a Credit Support

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[1] 11 U.S.C. §§ 101 et seq. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which was signed into law in April, 2005 (the "**2005 Act**"), amended the Code, the FDIA, FDICIA, SIPA and related statutes in certain respects, to take effect (as pertinent to this Memorandum) on October 17, 2005. The provisions of the Code, the FDIA, FDICIA and related statutes were further amended in certain respects by The Financial Netting Improvements Act of 2006 (the "**2006 Act**"), which was enacted and became effective on December 12, 2006. The provisions of the 2005 Act that are discussed in this Memorandum apply only to proceedings commenced under the Code, the FDIA, SIPA or related statutes on or after October 17, 2005. The amendments enacted under the 2006 Act only apply to proceedings commenced under the Code, the FDIA or related statutes on or after December 12, 2006. In this Memorandum, references to the Code, the FDIA, FDICIA and SIPA as in effect on the date of this Memorandum include the amendments made by the 2005 Act and the 2006 Act.

[2] 12 U.S.C. §§ 1811 et seq.

[3] N.Y. Banking Law §§ 1 et seq.

[4] Pub. L. No. 102-242, 105 Stat 2236 (1991).

[5] 15 U.S.C. §§ 78aaa et seq.

[6] 12 U.S.C. §§ 5381, et seq. The OLA provides an alternate insolvency regime for systemically significant financial companies that are determined under the Dodd-Frank Act to pose risk to the financial stability of the

Document (as defined in the General Agreement) in the nature of a parent company guarantee of the obligations of a subsidiary entity that is a Party (as defined below) to the General Agreement; and we refer to that Credit Support Document as a "**Parent Company Guarantee**".

This Memorandum is intended solely for the information of the European Federation of Energy Traders ("**EFET**") and its members in considering the questions posed by EFET and addressed in this Memorandum relating to (i) the enforceability of the early termination and close-out netting provisions of the General Agreement upon the occurrence of a certain Event of Default under the General Agreement and (ii) factors that may impact the enforceability of a Parent Company Guarantee, and no part of this Memorandum may be relied upon by any other person or for any other purpose. This Memorandum may not be quoted, filed with any governmental authority or regulatory agency or circulated without this Firm's written consent; provided, however, that regulated members of EFET may present this Memorandum to banking regulators or comparable regulatory authorities with oversight responsibility with respect to such members upon the understanding that only members of EFET may rely on this Memorandum for the purpose stated in the immediately preceding sentence. This Memorandum is not intended and cannot be deemed or construed to be a legal opinion of this Firm, as we would require actual and specific parties, transactions, documents and facts and circumstances to endeavor to render a legal opinion. In all cases, use of or reliance upon this Memorandum is conditioned upon acceptance of all of the qualifications, exceptions, assumptions, definitions, exclusions, limitations and other provisions (collectively, the "**Qualifications**") set forth in this Memorandum.

1. Structure of this Memorandum

This prefatory part of this Memorandum introduces the laws and entities covered by this Memorandum and includes an Executive Summary of the analysis which follows. The balance of this Memorandum is structured as follows: Section I sets forth some background information and certain assumptions; Section II analyzes the treatment of a "forward contract", "swap agreement" (as it may apply to certain transactions in electricity) and "master netting agreement" under the Code, the FDIA, the NYBL, and the OLA, as well as the provisions of SIPA and FDICIA relevant to the enforceability of the early termination and close-out netting provisions of the General Agreement; Section III sets forth the questions presented by EFET relating to enforceability, and our responses thereto; and Section IV addresses factors that may impact the enforceability of a Parent Company Guarantee in the case that a Default (as hereinafter defined) occurs and is continuing.

2. Certain U.S. entities who may be a Debtor under the Code or SIPA

United States ("U.S.") and come within the definition of "covered financial company," "covered broker or dealer" or "covered subsidiary" under section 201 of the Dodd-Frank Act, 12 U.S.C. § 5381(a)(7), (8) and (9). See discussion below. The Dodd-Frank Act in Article VII mandates that certain swaps must be cleared through a clearing broker. The treatment of cleared derivative transactions upon the insolvency of a clearing broker or clearinghouse is beyond the scope of this Memorandum.

For purposes of this Memorandum, U.S. entities subject to the Code or SIPA, as applicable, include:

(i) corporations[7] that are incorporated under the laws of any of the fifty states of the United States, the District of Columbia or Puerto Rico;

(ii) partnerships[8] that are organized under the laws of any of the fifty states of the United States, the District of Columbia or Puerto Rico;[9]

(iii) business trusts (as referred to in section 101(9)(A)(v) of the Code) that are organized under the laws of any of the fifty states of the United States, the District of Columbia or Puerto Rico. Business trusts are trusts with the primary purpose of transacting business for the benefit of investors and sharing of gains with those investors (unlike ordinary trusts, whose purpose typically is to hold and conserve particular property). Although the Code does not define the term "business trust", courts have adopted several different interpretations of the term, all of which could include a trust that enters into forward contracts, swap agreements or master netting agreements, depending on the trust's structure;[10]

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7 The definition of "corporation" in section 101(9)(A) of the Code includes partnerships, except that limited partnerships are expressly excluded by section 101(9)(B). The term "corporation" has been held to include limited liability companies.

8 Partnerships include general partnerships and limited partnerships.

9 Hedge funds and mutual funds domiciled in the U.S. are typically organized as corporations, partnerships or business trusts and to that extent are covered by this Memorandum.

10 The term "business trust" is one form of corporation. See 11 U.S.C. § 101(9)(A)(v). There is conflicting case law as to whether a business trust is defined by state law or federal law. See, e.g., Brady-Morris v. Schilling (In re Knight Trust) 303 F.3d 671 (6th Cir. 2002) (whether a trust is a "business trust" properly belongs to federal law, not state law); In re Heritage N. Dunlap Trust, 120 B.R. 252, 254 (Bankr. D. Mass. 1990) (whether a trust is a "business trust" is determined by looking to applicable state law (including filing and registration requirements)).

Courts have taken varying approaches in determining whether a trust is a "business trust." In Knight Trust, the United States Court of Appeals for the Sixth Circuit adopted a test that rejected two requirements imposed by some cases, namely, that to be a business trust, the trust must have transferable certificates of ownership and the trust's business must be "for profit." The test consists of two propositions, "first, 'trusts created with the primary purpose of transacting business or carrying on commercial activity for the benefit of investors qualify as business trusts, while trusts designed merely to preserve the trust res for beneficiaries generally are not business trusts'; and second, 'the determination is fact-specific, and it is imperative that bankruptcy courts make thorough and specific findings of fact to support their conclusion'—findings, that is, regarding what was the intention of the parties, and how the trust operated." Knight Trust, 303 F.3d at 676-77 (citing Brady v. Schilling (In re Knight Trust), 121 F.3d 708 (6th Cir. 1997) (unpublished)); see also, In re Estate of Assignment for the Benefit of Creditors of May, 405 B.R. 443, 450 (Bankr. E.D. Mich. 2008); see, e.g., In re Michigan Real Estate Ins. Trust, 87 B.R. 447, 449 (Bankr. E.D. Mich. 1988) ("[a] business trust is 'an unincorporated business organization ... by which property is to be held and managed by trustees for the benefit and profit of such persons as may be or may become the holders of transferable certificates evidencing the beneficial interests in the trust's estate")

(iv) registered[11] broker-dealers that carry customer accounts insured by the Securities Investor Protection Corporation ("**SIPC**") ("stockbrokers with insured accounts") and whose liquidation proceedings are subject to SIPA[12] as well as stockbrokers that are subject to subchapter III of chapter 7 of the Code; and

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(citing 13 AM. JUR. 2D *Business Trusts* § 1); In re Mosby, 61 B.R. 636, 638 (E.D. Mo. 1985), aff'd, 791 F.2d 628 (8th Cir. 1986), (relied on cases with respect to business trusts in the Federal tax context); In re Universal Clearing House Co., 60 B.R. 985, 992 (Bankr. D. Utah 1986) (debtor found to be a business trust because its express purpose was principally making profit rather than protecting the trust assets). But see, Shawmut Bank Conn. v. First Fid. Bank (In re Secured Equip. Trust of Eastern Airlines, Inc.), 38 F.3d 86 (2d Cir. 1994) (where a trust established to secure the repayment of the certificateholders' loans to an airline was held not to be a business trust since its purpose was to preserve the interest that the certificateholders had already been guaranteed, not to generate it); In re Estate of Assignment for the Benefit of Creditors of May, 405 B.R. 443 (holding that the trust was not a "business trust" and thus was not a "person" eligible to be a debtor in bankruptcy because the primary purpose of the trust was not transacting business or commercial activity for the benefit of investors).

In addition, when defining a "corporation" the drafters of the Code inserted the term "business trust" in place of the following language used in the Bankruptcy Act of 1898: "any business conducted by a trustee or trustees wherein beneficial interest or ownership is evidenced by a certificate or other written instrument." As at least one court has noted, this change was intended by Congress to broaden the variety of trusts eligible to obtain relief in the bankruptcy courts, thus, it is quite possible that a trust entering into a General Agreement would be considered a "business trust". See Cutler v. 65 Sec. Plan, 831 F. Supp. 1008, 1014 (E.D.N.Y. 1993) (citing In re Treasure Island Land Trust, 2 B.R. 332, 334 (Bankr. M.D. Fla. 1980); In re Tru Block Concrete Prods., Inc., 27 B.R 486, 490-91 (Bankr. S.D. Cal. 1983). See also Hecht v. Malley, 265 U.S. 144, 159-62 (1924); 16A W. FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 8267 (perm. ed., rev. vol. 1988).

[11] For the registration and regulation requirements for broker-dealers, see section 15(b) of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"). 15 U.S.C. §§ 78o et seq. In that regard, we note that the broker-dealer registration requirements of section 15(b) of the Exchange Act might apply as well to non-U.S. parties that conduct certain activities that exceed the scope of Rule 15a-6 which is a safe harbor provision promulgated in 1989 under the Exchange Act that exempts non-U.S. brokers and dealers conducting only certain limited activities in the U.S. from the registration requirements of section 15 of the Exchange Act. Non-U.S. brokers or dealers should consult with counsel as to whether their activities involving the U.S. market are covered by Rule l5a-6.

[12] See 15 U.S.C. §§ 78aaa et seq. In addition to certain provisions of the Code, stockbrokers with accounts insured by SIPA are subject to the special provisions of the SIPA, to the extent that liquidation proceedings are carried out under the SIPA, and stockbrokers who are not registered under SIPA are subject to the provisions of subchapter III of chapter 7 of the Code. See discussion in Section II.F below concerning the application of chapters 1, 3 and 5 and subchapters I and II of chapter 7 of the Code to SIPA liquidations to the extent not inconsistent with the provisions of SIPA. Affiliates of registered broker-dealers that are not themselves so registered but that are the type of entities covered by this Memorandum are also covered by this Memorandum. As amended by the 2005 Act, neither the stay applicable upon the filing with the court of an application for a protective decree nor any order or decree obtained by SIPC shall operate as a stay of a creditor's "contractual right" (broadly defined) to liquidate, terminate, accelerate or net obligations arising under or in connection with, a securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, or master netting agreement, each as defined in the Code and collectively, sometimes referred to as "financial contracts", or to foreclose on cash collateral pledged by the debtor. 15 U.S.C. § 78eee(b)(2)(C). Special rules apply to disposition of "securities collateral" in the SIPA context and limits may be set on the right to realize on collateral

(v) commodity brokers.[13]

In this Memorandum, we refer to such corporations, partnerships and business trusts individually as an "**Included Code Entity**", and we refer to the Included Code Entities and the Insured Institutions (defined below), including certain New York State chartered banking institutions, individually as a "**U.S. Party**". Since certain provisions of the Code apply to the liquidation proceedings of registered broker-dealers under SIPA and special provisions of the Code apply to stockbrokers in proceedings under subchapter III of chapter 7 of the Code and to commodity brokers under subchapter IV of chapter 7 of the Code, those entities are not included within the definition of Included Code Entity or U.S. Party. We instead will refer to registered broker-dealers subject to SIPA or the OLA and stockbrokers subject to subchapter III of chapter 7 of the Code or the OLA as "**U.S. Stockbrokers**". Although the term "commodity broker" as defined in the Code includes certain foreign entities, for the purpose of this Memorandum, we will consider only debtors that are U.S. commodity brokers ("**U.S. Commodity Brokers**"). Although an entity may be both a U.S. Stockbroker and a U.S. Commodity Broker, for the purpose of this Memorandum, we have assumed that the applicable U.S. Stockbroker or U.S. Commodity Broker will only act in one such capacity.

Excluded from the scope of this Memorandum are certain other entities, some of which are covered by the Code, in particular:

(i) municipalities;[14]

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that validly secures a financial contract. Id. See discussion below with respect to the applicability of provisions of the OLA relating to financial contracts in the event that a registered broker or dealer that is a member of SIPC is determined to be a covered broker or dealer (as defined under the OLA) ("**Covered Broker or Dealer**").

13 "Commodity broker" is defined in 11 U.S.C. §101(6) of the Code to include a range of intermediaries in commodity contracts. Commodity brokers in insolvency may be subject to special provisions of the Code, the Commodity Exchange Act (7 U.S.C. §§ 1 et. seq.) and certain Commodity Futures Trading Commission rules. See Sections 761-767 of the Code and 17 C.F.R. § 190. It should be noted that federal bankruptcy proceedings are not the only means of administering the affairs of a failed commodity broker. Commodity broker failures are often administered by means of federal equity receivership proceedings at the instance of the Commodity Futures Trading Commission. See COLLIER ON BANKRUPTCY P 760.01 note 5 (Alan N. Resnick & Henry J. Sommer eds. 15th ed. 2001). This Memorandum will be limited to the provisions of the Code relevant to proceedings under subchapter IV of chapter 7 of the Code and provisions of the OLA with respect to commodity brokers. Sections 561(b)(2) and (3) of the Code limit, in certain respects, the application of netting in the case of a U.S. Commodity Broker (as hereinafter defined) subject to subchapter IV of chapter 7 of the Code. See 11 U.S.C. § 561(b)(2), (3).

14 11 U.S.C. § 101(40). "Municipality" means political subdivision or public agency or instrumentality of any "State", which term is defined in 11 U.S.C. § 101(52) as including the fifty states of the United States as well as the District of Columbia and Puerto Rico, except that, the term "State" does not include the District of Columbia or Puerto Rico for the purposes of Chapter 9 of the Code. As a result of the 2005 Act, proceedings regarding municipalities under Chapter 9 of the Code now have the benefit of Code sections 555, 556, 559, 560, 561 and 562 relating to financial contracts, some of which sections are discussed in this Memorandum with respect to Included Code Entities, U.S. Stockbrokers and U.S. Commodity Brokers, as applicable.

(ii) pension funds that are subject to a special insolvency regime administered by the Pension Benefit Guaranty Corporation;[15]

(iii) ordinary private trusts that are not eligible for insolvency under the Code; and

(iv) clearing banks.[16]

3. Certain U.S. Banking Institutions

For purposes of this Memorandum, U.S. banking institutions ("**U.S. Banking Institutions**") include nationally chartered banking institutions that take Federally-insured deposits, New York State chartered banking institutions whether or not they take Federally-insured deposits and Federal savings associations that take Federally-insured deposits. We refer to those U.S. Banking Institutions that take Federally-insured deposits as "**Insured Institutions**" and to New York State chartered banking institutions that do not take Federally-insured deposits as "**Uninsured N.Y. Institutions**".

4. Certain U.S. Systemically Significant Financial Companies

For the purposes of this Memorandum, the term "**Covered Financial Company**" has the meaning assigned to it in section 201(a)(8) of the OLA[17] and may include an Included Code Entity, an Uninsured N.Y. Institution, a U.S. Stockbroker that is not a member of SIPC or a U.S. Commodity Broker for which the FDIC is appointed as a receiver under the OLA. A U.S. Stockbroker that is a registered broker dealer and a member of SIPC is a "Covered Broker or Dealer" under the OLA.

5. Non-U.S. Banks

For purposes of this Memorandum, we refer to banks incorporated or organized outside the United States (each with its New York State branch or agency as a single entity) or only the non-U.S. bank parent of a branch or agency, as appropriate and relevant to the context.

6. Certain U.S. Branches of Non-U.S. Banking Institutions

For purposes of this Memorandum, U.S. branches of non-U.S. banking institutions ("**Branches**") include branches and agencies of banks incorporated or organized outside the United States that are (i) Federally-licensed[18] branches or agencies whether or not they take

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15 See Subchapter III on Plan Termination Insurance of the Employee Retirement Income Security Act ("**ERISA**") of 1974 (29 U.S.C. §§ 1301 et seq.)

16 "Clearing bank" is defined in Section 781(3) of the Code as "an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the FDICIA." 11 U.S.C. § 781(3). The Consolidated Appropriations Act of 2001 added a new subchapter V of chapter 7 to the Code for clearing bank liquidations.

17 12 U.S.C. § 5381(a)(8).

18 Under the International Banking Act of 1978 (the "**IBA**"), a Federal Branch must be licensed to take deposits

Federally-insured deposits ("**Federal Branches**"), or (ii) New York State licensed branches[19] or agencies that do not take Federally-insured deposits ("**New York Branches**").

7. Entities Not Covered by this Memorandum

Excluded from the scope of this Memorandum (in addition to those described in (2) above) are certain other categories of U.S. entities, in particular:

(i) insurance companies;[20]

(ii) credit unions;[21] and

(iii) governmental entities, such as the Federal Reserve Banks, government-sponsored agencies, such as the Federal Home Loan Banks,[22] the Federal National Mortgage Association ("**Fannie Mae**"),[23] the Federal Home Loan Mortgage Corporation ("**Freddie Mac**"),[24] the Financing Corporation,[25] the Resolution Funding

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and do banking business in the United States (12 U.S.C. § 3102).

19 A New York Branch of a non-U.S. banking institution must be licensed to take deposits or do business in New York (N.Y. Banking Law § 200).

20 U.S. insurance companies are subject to various state insolvency laws and also may become subject to the OLA if a U.S. insurance company is determined to be a "Covered Financial Company." Parties should consider carefully entering into the General Agreement with U.S. insurance companies because the enforceability of the termination and close-out netting provisions of the General Agreement may be uncertain under state insurance company insolvency laws.

21 Credit unions are subject to a special insolvency regime governed by the Federal Credit Union Act (12 U.S.C. §§ 1751-1795k). The 2005 Act and 2006 Act include amendments to the Federal Credit Union Act with respect to the treatment of certain financial contracts.

22 See Federal Home Loan Bank Act of 1932 (12. U.S.C. §§ 1421-1449). The Federal Home Loan Banks have become subject to conservatorship and receivership provisions provided in the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

23 See National Housing Act of 1934 (12 U.S.C. §§ 1716 et seq.)

24 See Federal Home Loan Mortgage Corporation Act (12 U.S.C. §§ 1451-1459).

25 See Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987 (12 U.S.C. § 1461).

Corporation,[26] the Banks for Cooperatives,[27] the Farm Credit Banks,[28] and the Government National Mortgage Association ("**Ginnie Mae**");[29] [30]

(iv) international organizations; and

(v) sovereigns and states of federal sovereigns.

In addition to the Code, the FDIA, the NYBL and the OLA, this Memorandum covers FDICIA, which supplements the Code and the FDIA and provides for the enforceability of netting provisions contained in a "netting contract" between two or more "financial institutions" notwithstanding any other provision of law as it relates to insolvency of an Insured Institution.[31] This Memorandum also covers SIPA as it relates to the enforceability of the early termination and close-out netting provisions of the General Agreement.

8. Parent Company Guarantee

Section 16 of the General Agreement ("Guarantee and Credit Support") provides: "To address each Party's risk relating to the creditworthiness of the other Party, and to secure the prompt fulfillment of all obligations resulting from this General Agreement and Individual Contracts, the Parties may agree, on or at any time after the Effective Date, or at the time of the concluding of each Individual Contract, upon the circumstances in which Credit Support documents may be required to be provided for the benefit of a party, including, the form of Credit Support Documents, the amount of credit support, and the identify of one or more acceptable Credit Support Providers." For the purposes of this Memorandum, we assume that the Election

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26 See Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (Pub L. 101-73, 103 Stat. 183 (1989)).

27 See Farm Credit Act of 1971 (12 U.S.C. § 2121).

28 See Farm Credit Act of 1971 (12 U.S.C. § 2011).

29 Ginnie Mae was created on September 1, 1968, as one of two corporations resulting from the partition of the former Federal National Mortgage Association. Ginnie Mae is a tax-exempt corporate instrumentality of the U.S., chartered under 12 U.S.C. §§ 1716b-l723i.

30 The Government-sponsored enterprises are subject to a variety of insolvency regimes. Fannie Mae and Freddie Mac as well as the Federal Home Loan Banks are subject to conservatorship and receivership provisions provided in the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2684 (2008). Some of these insolvency regimes are contained in the statutes establishing those government-sponsored entities; however, for some enterprises, such as Ginnie Mae, and Sallie Mae, there are no specific statutory provisions addressing the liquidation, reorganization, conservatorship, or receivership. The Federal Housing Finance Agency ("**FHFA**") has certain powers as conservator or receiver for Fannie Mae, Freddie Mac and the Federal Home Loan Banks under the Housing and Economic Recovery Act of 2008 ("**HERA**"). Public Law 110-289, 122 Stat. 2654. The qualified financial contract provisions of HERA (not within the scope of this Memorandum) share many features with the FDIA. We note that Freddie Mac and Fannie Mac were placed into conservatorship by the FHFA on September 7, 2008. We also note that on December 29, 2004, the Student Loan Marketing Association, a former government-sponsored enterprise, was dissolved in connection with its privatization as SLM Corporation.

31 See in particular the discussion under Section II below.

Sheet will identify the Parent Company Guarantee and name of the applicable Credit Support Provider as the parent company of the applicable party; and we further assume such parent company will satisfy the criteria set forth in Section IV of this Memorandum for the "Parent Company Guarantor" (as defined in Section IV).

9. New York and U.S. Law Covered by this Memorandum

For the purpose of this Memorandum our analysis is limited to the applicable laws of the State of New York (other than county, municipality or other local law) and the Federal laws of the U.S. enumerated in the first paragraph of this Memorandum. Furthermore, we have examined and addressed only those statutes and regulations expressly noted below.[32]

Notwithstanding the preceding paragraph, for purposes of Section IV of this Memorandum regarding the Parent Company Guarantee, our analysis and discussion is limited solely to the applicable laws of the State of New York (other than county, municipality or other local law), including applicable case law determined at the appellate level and we have assumed that the Parent Company Guarantee provides that it will be governed by the laws of the State of New York. Our references in Section IV to certain Federal laws, or to laws of other States, that may be applicable to the enforceability of the Parent Company Guarantee are made for illustrative purposes only and constitute neither an exhaustive survey of other potentially applicable laws nor a thorough analysis of those so identified.

10. Expressions of Professional Judgment

The views contained in this Memorandum are expressions of our professional judgment regarding the legal matters addressed and are not guaranties or warranties that a court or other authority will reach any particular result.

11. Views Limited to the Date Hereof

The views contained in this Memorandum are limited to and as of the date of this Memorandum as first set forth above.[33]

As we are not considering actual, specific contracts, we instead are assuming, as more fully described in Section I below, the Parties to the General Agreement (each, a "**Party**" and collectively, the "**Parties**") have entered into a General Agreement (including its Annexes and the completed Election Sheet) effective as of the Effective Date of the General Agreement, and one or more Individual Contracts (as defined below) thereunder, and that the documentation and agreements entered into by them in connection therewith conform to the other assumptions outlined in Section I. In the case of the Parent Company Guarantee, we are assuming (as more

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32 In Section I below, we assume the parties to the General Agreement have elected that it be governed and construed under German law, excluding any application of the "United Nations Convention on Contracts for the International Sale of Goods of April 11, 1980". As we are not expert in German law, this Memorandum instead applies New York law legal concepts and terminology in lieu of that foreign law.

33 In certain specific instances we reference court decisions subsequent to the date of this Memorandum, but we have not undertaken a comprehensive updating of this Memorandum to any date subsequent to the date of this Memorandum.

fully described in Section IV below) that the Parent Company Guarantor has entered into the Parent Company Guarantee contemporaneously with the effectiveness of the General Agreement, in documentation conforming to the other assumptions outlined in Section I (insofar as applicable for the purposes of our discussion and analysis in Section IV).

We also assume, whether or not already entered into as of the date of this Memorandum, that such documentation and agreements are fully consistent with the General Agreement and other documentation we have reviewed for purposes of this Memorandum, and that such documentation and agreements are not and will not be otherwise modified or supplemented by any special provisions, addenda or other documentation or agreement, any trade usage or course of dealing or course of performance, or any other facts and circumstances (whether or not otherwise contemplated by or permissible under the General Agreement), that could define, conflict with, supplement, vary, qualify or otherwise affect the same, including some other master netting agreement, in a way that is material to our analysis in this Memorandum (the "**Consistency Assumption**"). We further assume that the Parties do not specify in the Election Sheet with respect to § 1.2 of the General Agreement that each transaction between the Parties regarding the purchase, sale, delivery and acceptance of Electricity, including Options on transactions, entered into before the Effective Date but which remain either not yet fully or partially performed by one or both Parties is deemed to be an Individual Contract under the General Agreement. We further assume no change in applicable law after the date hereof (whether or not the same could have possible retroactive effect). In any event, we expressly disclaim any obligation or undertaking to advise you of any such item or change occurring or coming to our attention subsequent to the date of this Memorandum (whether or not contrary to the Consistency Assumption), or to update this Memorandum in order to take such item or change into account.

12. Definitions and Interpretation

Capitalized terms used and not otherwise defined in this Memorandum shall have the meanings respectively assigned to them in the General Agreement. The meaning of each capitalized term or other word or phrase defined in singular form also shall apply to the plural form of such term, word or phrase, and vice versa; each singular pronoun shall be deemed to include the plural variation thereof, and vice versa; and each gender specific pronoun shall be deemed to include the neuter, masculine and feminine; in each case as the context may permit or require. Each caption, section or other heading in this Memorandum are for reference purposes only. The words "include", "includes" and "including" (other than as quoted from a statute) shall be deemed to be followed by the phrase "(without limitation)", whether or not so stated, and in any event shall not in any way limit the generality of the term or description preceding such word or preclude any other applicable item encompassed by such general term or description.

I. BACKGROUND AND ASSUMPTIONS

A. Background

In this part, we describe how we believe the noted provisions of the General Agreement relevant to early termination and close-out netting are intended to operate (and we assume would be enforced as a purely contractual matter) upon the occurrence of a Material Reason specified in § 10.5(c)(iv) of the General Agreement when a Party that is a U.S. Party institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other similar relief under the Code, the FDIA, the NYBL or the OLA. We separately consider the enforcement of early termination and close-out netting as applied (i) to a U.S. Stockbroker, in the case of the commencement of a SIPA liquidation, a stockbroker liquidation proceeding under subchapter III of chapter 7 of the Code or a proceeding under the OLA or (ii) to a U.S. Commodity Broker, in the case of a commodity broker liquidation proceeding under subchapter IV of chapter 7 of the Code or a proceeding under the OLA.

The General Agreement states that, unless otherwise specified in the Election Sheet, the General Agreement (which includes all Annexes and the Election Sheet) governs all transactions the Parties enter into for the purchase, sale, delivery and acceptance of electricity, including Options on the purchase, sale, delivery and acceptance of electricity (each such transaction being an "**Individual Contract**"). (General Agreement § 1.1)

The General Agreement also states that the Parties agree that the General Agreement and Individual Contracts relating thereto form a single agreement between the Parties and the Parties would not otherwise enter into Individual Contracts if that were not the case. The General Agreement provides that the provisions of the General Agreement constitute an integral part of, [but may be supplemented by,] the terms of each Individual Contact. (General Agreement § 1.1)

Under § 10.3(a) of the General Agreement, the General Agreement may be terminated ("**Early Termination**") by a Party (the "**Terminating Party**") giving notice to the other Party if a Material Reason with respect to the other Party has occurred and is continuing. Under §10.5(c)(iv) of the General Agreement, a Material Reason will occur if any Party institutes (or has instituted against it) a proceeding seeking a judgment of insolvency or bankruptcy or other relief under any bankruptcy or insolvency law or other similar law affecting creditors rights, or a Party files (or has filed against it) a petition for such proceeding, and with respect to those proceedings instituted or filed against it, if a "cure" period is specified in the Election Sheet, the same are not withdrawn, dismissed, discharged, stayed or restrained within the period specified in the Election Sheet.

For the purpose of this Memorandum we will assume that the Material Reason that gives rise to Early Termination occurs under § 10.5(c)(iv) of the General Agreement as the result of the institution of a proceeding by or against (a) an Included Code Entity under the Code, (b) an Insured Institution under the FDIA, (c) a banking corporation organized under the laws of the State of New York under the NYBL, (d) a Covered Financial Company under the OLA, (e) a U.S. Stockbroker under SIPA, subchapter III of chapter 7 of the Code, or the OLA or (f) a U.S. Commodity Broker that is subject to proceedings under subchapter IV of chapter 7 of the Code or the OLA, as applicable.[34]

A notice of Early Termination pursuant to § 10.3(a) may designate an Early Termination Date that is no earlier than the day the notice is deemed received under the General Agreement nor later than 20 days after such date. From the Early Termination Date all further payments and performance in respect of all Individual Contracts will be released and obligations of the Parties under the General Agreement will be replaced by the obligation of one Party to pay the Termination Amount to the other Party calculated in accordance with § 11 of the General Agreement. The General Agreement further provides that if the Termination Amount is negative it shall be payable to the Terminating Party by the other Party and that if the Termination Amount is positive it shall be payable by the Terminating Party to the other Party. The Terminating Party may take into account any Performance Assurance or credit support available pursuant to the General Agreement or any Credit Support Document, including a Parent Company Guarantee.

If notice of Early Termination is given, the Terminating Party shall calculate and shall notify the other Party of, the Termination Amount (if any) to be recovered or paid by it by deriving the Termination Amount from aggregating all Settlement Amounts of Individual Contracts as calculated in § 11 of the General Agreement.

Pursuant to § 10.4 of the General Agreement, if Automatic Termination is specified in the Election Sheet, then upon occurrence of a Material Reason specified in § 10.5(c)(iv) based on Winding up/Insolvency/Attachment, the Terminating Party need not send the other Party any notice of designation of an Early Termination Date and the Early Termination Date will be as specified in the Election Sheet.

The General Agreement provides in § 11 for netting of the Settlement Amounts for all Individual Contracts (commonly referred to as "close-out netting") taking into account any or all other amounts payable between the Parties under or in connection with the General Agreement. The Settlement Amount for each Individual Contract is the Gains less the aggregate of the Losses and Costs which the Terminating Party incurs as a result of the termination of the Individual Contract. The calculation is made by the Terminating Party. If the Termination Amount is negative, an amount equal to the absolute value of the Termination Amount will be payable to the Terminating Party by the other Party. If the Termination Amount is positive, the Termination Amount will be payable by the Terminating Party.

The background and assumptions set forth in this Section I apply to our analysis in Sections II and III below. Aspects also apply for purposes of our discussion and analysis in Section IV below. For the sake of clarity, and cognizant that additional background and assumptions are

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34 We further note that the appointment of the FDIC as conservator or receiver under the FDIA or as receiver of a Covered Financial Company under the OLA, or of a SIPA trustee under SIPA or the OLA, or a chapter 7 trustee in a stockbroker liquidation or a commodity broker liquidation under the Code would also qualify as a Material Reason under § 10.5(c)(vi).

needed solely for purposes of Section IV, we set out the background and assumptions applicable to our discussion of the Parent Company Guarantee in one central location, within Section IV.

B. Assumptions and other Qualifications

The views we express in this Memorandum (however expressed) are each subject to all of the Qualifications, and other provisions of this Memorandum, including (without limitation) the following assumptions. For purposes of this Memorandum, we have assumed that:

(a) Two entities "**Parties**" have entered into a General Agreement, and one of the Parties is (i) a U.S. Party that is either (x) an Included Code Entity that is the debtor in a proceeding under either chapter 11 or chapter 7 of the Code or (y) an Insured Institution that is subject to the FDIA, NYBL or FDICIA, as applicable, (ii) a U.S. Stockbroker that is (A) either subject to proceedings under SIPA, (B) subchapter III of chapter 7 of the Code, or (C) determined to be a "Covered Broker or Dealer" subject to the OLA, (iii) a U.S. Commodity Broker that is (A) subject to proceedings under subchapter IV of chapter 7 of the Code or (B) if determined to be a Covered Financial Company or (C) a Covered Subsidiary under the OLA.

(b) Pursuant and subject to the provisions of the General Agreement, and acting in a manner consistent with the intentions stated in the General Agreement, the Parties over time enter into a number of Individual Contracts and may enter into one or more Credit Support Documents that reference and are intended to be governed by the General Agreement (each a "**Transaction Document**").

(c) The provisions of the form of the General Agreement in §§ 1.1, 2.1, 4, 5, 10.3, 10.4 (if applicable), 10.5(c), and 11.1, the related definitions contained in Annex 1 of the General Agreement (the "**Core Provisions**") and the assumed choices in the Election Sheet have not been altered or otherwise affected in a manner contrary to the Consistency Assumption in any substantive respect,[35] whether in an Individual Contract, a Credit Support Document or otherwise.

(d) The Parties have selected that the General Agreement be construed and governed by the substantive law of the Federal Republic of Germany, (notwithstanding that the Election Sheet would allow the Parties to select

35 We believe that any election contemplated by §§ 10.3 and 10.4 of the General Agreement and made pursuant to an Election Sheet to a General Agreement, or in an Individual Contract for a Transaction, is not a material alteration. Although we rely on the Core Provisions for purposes of our analysis, we do not separately consider their enforceability under applicable law beyond our analysis and conclusions regarding early termination and close-out netting.

the law of another country as the governing law); any exclusion for conflict of law rules thereunder does not apply to those rules that permit selection of that jurisdiction's law; and that selection would be enforceable in all relevant jurisdictions to the same extent as if the Parties had selected New York law.[36]

(e) Each Party to a Transaction Document (i) is duly organized, validly existing and in good standing in its jurisdiction of organization and is qualified to do business and licensed in each other jurisdiction necessary to its performance or enforcement thereunder, (ii) has full and unrestricted power, authority and legal capacity and has been duly authorized and empowered to the extent necessary to make each such document enforceable by or against it, (iii) has obtained all required foreign qualifications, authorizations, approvals and waivers and satisfied all other applicable legal, governance and contractual requirements to the extent necessary to make each such document enforceable by or against it, (iv) is acting on behalf of itself as principal unless some other capacity is expressly stated, (v) is properly identified with its true, complete and correct legal name, and (to the extent referenced) its jurisdiction of organization and principal place of business, and (vi) has duly authorized and empowered each person signing, authenticating or approving each such document on its behalf to do so.

(f) Each Transaction Document has been duly executed and delivered by each Party thereto, or in the case of each Transaction Document signed only by a single Party, such Transaction Document has been duly accepted and agreed to by each other Party in whose favor or for whose benefit such Transaction Document has been made or given, and each condition precedent to the effectiveness of the Transaction Documents has been duly satisfied or waived.

(g) Each Transaction Document is the legal, valid and binding obligation of each Party, and is enforceable and would be enforced as written against each such Party in accordance with the plain meaning of its provisions (other than as enforceability may be limited by the Code, FDIA, NYBL, OLA, SIPA or FDICIA as noted below), under both the applicable law of the jurisdiction whose law the Parties choose to have govern the Transaction Documents and (were it instead to be applied) New York law.[37]

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36 The Parties have excluded any application of the "United Nations Convention on Contracts for the International Sale of Goods of 11 April 1980."

37 While we have assumed enforceability for the purposes of this Memorandum (other than as enforceability may be limited by the Code, FDIA, OLA, NYBL, SIPA or FDICIA), please note that in practice enforceability may be limited by (among other things): (i) applicable bankruptcy, insolvency, fraudulent conveyance or transfer,

(h) There has not been any mutual mistake of fact, misunderstanding, duress, undue influence or fraud or other criminal activity, and any requirement of good faith, fair dealing and conscionability has been met, in the execution and delivery of the Transaction Documents.

(i) The Transaction Documents contain all of the provisions intended by the Parties and the entire agreement of the parties thereto with respect to the subject matter thereof, the rights and remedies thereunder are cumulative (unless, and then only to the extent, otherwise provided in the General Agreement) and there are no written or oral agreements or understandings among the Parties, no usage of trade or course of dealing among the Parties, and no other extrinsic evidence, that in any case could define, conflict with, supplement or qualify any provision of any Transaction Document or otherwise would be contrary to the Consistency Assumption.

(j) In the event that any security agreement or arrangement or other credit enhancement related thereto has been given as "**Credit Support**" under a Credit Support Document, (i) such Credit Support was given by the U.S. Party, U.S. Stockbroker or U.S. Commodity Broker, as applicable (a "**Credit Support Provider**"), (ii) such Credit Support was duly granted by the Credit Support Provider to a counterparty under the General Agreement as secured party in a written agreement or document constituting a "**Credit Support Document**" under (and as defined in) the General Agreement, (iii) each intended security interest or other lien in any asset or property of such Credit Support Provider has been duly created in a Credit Support Document, has been duly perfected under applicable law, and would be recognized as a duly created and perfected security interest, and would not be subject to avoidance, under the Code, the FDIA, the NYBL or OLA, as applicable (each such interest may be referred to as a "**Perfected Security Interest**", and each such asset or property that is subject to a Credit Support Document and a Perfected Security Interest may be referred to as "**Collateral**"), (iv) the secured party is the non-defaulting party under the Transaction Documents, (v) any set off against, foreclosure of or other sale or disposition of any Collateral will be made or other action will be taken

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reorganization, arrangement, moratorium or other laws affecting or respecting any rights, powers, privileges, remedies or interests of creditors, obligees or sureties generally (including any provision for post-petition interest or rights), (ii) rules or principles (of equity, public policy or otherwise) affecting the enforcement of obligations generally, whether considered at law, in equity or otherwise, including those pertaining to materiality, good faith, fair dealing, diligence, reasonableness, unconscionability, impossibility of performance, redemption or other cure, suretyship rights or defenses, waivers, releases, laches, estoppel, or judicial deference, or (iii) the exercise of the discretionary powers of any court or other authority before which may be brought any proceeding seeking equitable, legal or other remedies, including specific performance, injunctive relief, contribution, subrogation, indemnification, determinations of damages and mitigations, and determinations and awards of attorney and other professional fees and expenses. We also assume that each Transaction Document is severable.

by the secured party as permitted by and in accordance with the applicable procedural requirements and other provisions of the applicable Transaction Documents and applicable law (including the Uniform Commercial Code of any relevant jurisdiction as and to the extent applicable) in acting to exercise or enforce any right respecting such Credit Support or otherwise utilizing any margin or other Collateral, (vi) such action would not adversely affect any right or remedy otherwise available under the General Agreement,[38] and (vii) such Credit Support Provider, Collateral and secured party's action are not subject to, or such secured party's action is exempt under the circumstances from, the automatic stay under Section 362 of the Code or any comparable provision of the FDIA, SIPA, the NYBL or the OLA, as applicable.

(k) In the event that any guaranty or similar credit enhancement related thereto has been given as Credit Support under a Credit Support Document, (i) the U.S. Party, U.S. Stockbroker or U.S. Commodity Broker, as applicable, gave such Credit Support or caused it to be given (in doing so, each such person also is a "Credit Support Provider"), (ii) such Credit Support was duly granted or required to be provided by a Credit Support Provider in favor of a counterparty under the General Agreement (as beneficiary of such support) in a written agreement or document constituting a Credit Support Document, (iii) the beneficiary is the non-defaulting party under the Transaction Documents, (iv) any demand for payment will be made or other action will be taken by the beneficiary as permitted by and in accordance with the applicable procedural requirements and other provisions of the applicable Transaction Documents and applicable law (including the Uniform Commercial Code of any relevant jurisdiction as and to the extent applicable) in acting to exercise or enforce any right respecting such Credit Support, (v) such action would not adversely affect any right or remedy otherwise available under the General Agreement, and (vi) such Credit Support Provider and beneficiary's action are not subject to, or such beneficiary's action is exempt under the circumstances from, the automatic stay under Section 362 of the Code or any comparable provision of the FDIA, SIPA, NYBL or OLA, as applicable.

(l) Each party to a Transaction Document (including any Credit Support Document) has received sufficient consideration and value in return for its execution and delivery thereof and its obligations undertaken and security

38 For example, application of any applicable election of remedies rule, or single action rule, may impair or invalidate any right the secured party otherwise may have had to exercise any close-out netting right. Where the Credit Support Provider is other than the counterparty to the General Agreement, the enforceability of a guaranty, or security interest or lien on Collateral posted by such Credit Support Provider may be subject to defenses based on principles of suretyship and, in certain cases, among other things, applicable fraudulent conveyance laws. Other than as set forth in Section IV of this Memorandum with respect to a Parent Company Guarantee, discussions of those topics is beyond the scope of this Memorandum.

interests, if any, granted in connection therewith and was not rendered insolvent thereby.

(m) The Transaction Documents were not entered into by one Party, and any payments made by or any security interest granted to one Party in any of the assets of the other Party were not taken by the Party, in contemplation or anticipation of the other Party's insolvency or with the intent to hinder, delay, or defraud that Party or the creditors of that Party.

(n) Each Transaction Document was entered into prior to the formal commencement of insolvency proceedings against either Party and at the time when neither Party had actual notice of the insolvency of the other Party.

(o) After entering into the Transaction Documents and prior to the maturity thereof, (i) the U.S. Party becomes the debtor in and subject to a voluntary or involuntary case under the Code, or a proceeding under the FDIA, the NYBL or the OLA, as the case may be, (ii) a U.S. Stockbroker becomes subject to liquidation proceedings under SIPA, subchapter III of chapter 7 of the Code or the OLA if it is determined to be a Covered Broker or Dealer, or (iii) a U.S. Commodity Broker becomes the debtor subject to liquidation proceedings under subchapter IV of chapter 7 of the Code or the OLA if it is determined to be a Covered Financial Company or a "covered subsidiary".

(p) Upon the occurrence of a Material Reason as described in § 10.5(c)(iv) of the General Agreement in respect of a Party, the Terminating Party will act in good faith and in a commercially reasonable manner in the exercise of its rights under the Transaction Documents, including (without limitation) those granted to it under §§ 10.3 or 10.4, as applicable, and §11 of the General Agreement.

(q) With respect to an Insured Institution subject to the FDIA, the written agreement requirements of sections 11(d)(9), 11(n)(4)(I) and 13(e) of the FDIA, as interpreted in the Policy Statement Regarding Qualified Financial Contracts issued by the Board of Directors of the Federal Deposit Insurance Corporation (the "**FDIC**") on December 12, 1989 (the "**FDIC Policy Statement**"), are satisfied[39]; and with respect to a U.S. Banking Institution

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[39] The FDIC Policy Statement provides a safe harbor under these sections of the FDIA where (i) the Individual Contract entered into under the General Agreement is evidenced by a written confirmation issued by one of the parties "reasonably contemporaneously" with the Individual Contract, (ii) the Non-Defaulting Party has relied on a representation or a resolution as to the corporate authority of the Insured Institution and (iii) the Non-Defaulting Party has maintained a copy of the confirmation and evidence of authority. We believe that the Confirmations permitted under section 2 of the General Agreement and the representations given under section

or a New York Branch subject to the NYBL, for purposes of the definition of Qualified Financial Contracts under the NYBL,[40] the General Agreement and Individual Contracts entered into by such Party are reflected in the books, accounts or records of such Party and (iii) with respect to a Covered Financial Company subject to the OLA, the written agreement requirements of 12 U.S.C. § 5390(a)(6) are met.[41]

(r) Neither Party to the relevant Transaction Document will be an "insider" of the other Party as defined in section 101(31) of the Code, an "affiliate" of the other Party as defined in either section 101(2) of the Code or section 23A of the Federal Reserve Act, or an "institution affiliated party" of the other Party as defined in section 3(u) of the FDIA.

(s) The United Nations Convention on Contracts for the International Sale of Goods will not apply to any of the Individual Contracts or the Transaction Documents.

(t) In the case (A) of a commodity broker liquidation under subchapter IV of chapter 7 of the Code, (i) the debtor (x) is a "commodity broker" as defined in section 101(6) of the Code[42] eligible for relief under the commodity broker liquidation provisions of subchapter IV of chapter 7 of the Code and (y) is actively engaged in soliciting or accepting orders for the purchase of commodity contracts as of the petition date, (ii) the Individual Contracts

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21 of the General Agreement should meet the requirements set forth in the FDIC Policy Statement. Sections 11(d)(9) and 11(n)(4)(I), each of which relates to agreements generally, refer to section 13(e) to define aspects of the written agreement requirement. Section 13(e) has been amended by the 2005 Act to eliminate the contemporaneous requirement, but, as written, only with respect to security arrangements for qualified financial contracts. We believe sections 11(d)(9) and 11(n)(4)(1) should be interpreted to be equally subject to the amended language of section 13(e). However, in the absence of precedent, whether or not a court would decide that there remained any contemporaneous requirement in respect of a General Agreement remains unclear.

[40] N.Y. Banking Law § 618-a2(e).

[41] 12 U.S.C. § 5390(a)(6) provides that "[n]o agreement that tends to diminish or defeat the interest of the [FDIC] as receiver in any asset acquired by the receiver under this section shall be valid against the receiver, unless such agreement (A) is in writing; (B) was executed by an authorized officer or representative of the covered financial company, or confirmed in the ordinary course of business by the covered financial company; and (C) has been, since the time of its execution, an official record of the company or the party claiming under the agreement provides documentation, acceptable to the receiver, of such agreement and its authorized execution or confirmation by the covered financial company."

[42] The term "commodity broker" is defined as "future commission merchant, foreign futures commission merchant, clearing organization, leverage transactions merchant, or commodity options dealer, as defined in section 761 of [the Code] with respect to which there is a customer, as defined in section 761 of [the Code]." 11 U.S.C. § 101(6). Although the term "commodity broker" is not limited to commodity brokers organized under U.S. law and may include a foreign futures commission merchant, this Memorandum is limited to U.S. Commodity Brokers.

with the U.S. Commodity Broker under the General Agreement are "forward contracts" or "swap agreements" as those terms are defined in the Code, and (iii) the Non-Defaulting Party is not (x) a "customer" (as defined in section 761(9) of the Code) [43] of the U.S. Commodity Broker or (y) a "commodity broker" (as defined in section 101(6) of the Code) acting on behalf of a customer of the U.S. Commodity Broker[44], or (B) that the U.S. Commodity Broker is a Covered Financial Company, (i) the Individual Contracts with the U.S. Commodity Broker under the General Agreement are "forward contracts" or "swap agreements" (as those terms are defined in section 210(c)(8)(D) of the OLA)[45] and (iii) the Non-Defaulting Party is not (x) a "customer" (as defined in section 210(m)(2)(A) of the OLA[46]) of the U.S. Commodity Broker or (y) a "commodity broker" (as defined in section 210(m) (2)(B) of the OLA) for a customer.[47]

(u) In the case (A) of a liquidation under SIPA (a "**SIPA Liquidation**")[48] (i) the debtor (x) is a member of SIPC with respect to whom an application for a protective decree has been filed under section 5(a)(3) of SIPA[49] or a direct payment procedure has been instituted under section 6-4(b) of SIPA,[50] (y) the Individual Contracts under the General Agreement are "forward contracts" or "swap agreements" (as defined under the Code) and (ii) the Non-Defaulting Party is not a "customer" (as defined in section 12(2) of SIPA), of the U.S. Stockbroker, [51], (B) of a stockbroker liquidation of a U.S. Stockbroker under subchapter III of chapter 7 of the Code, (i) the debtor (x) is a "stockbroker" as defined in section 101(53A) of the Code,[52] and (y) the

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43 11 U.S.C. § 761(9).

44 11 U.S.C. § 101(6).

45 12 U.S.C. § 5390(c)(8)(D).

46 12 U.S.C. § 5390(m)(2)(A) (which has the same meaning as in section 761 of the Code).

47 12 U.S.C. § 5390(m)(2)(B) (which has the same meaning as in section 101 of the Code).

48 If the U.S. Stockbroker is determined to be a Covered Broker or Dealer under the OLA, then certain provisions of the OLA will apply to the SIPA Liquidation as set forth below.

49 15 U.S.C. § 78lll(a)(3).

50 15 U.S.C. § 78fff(4)(b).

51 15 U.S. § 78lll(2).

52 The term "stockbroker" means, person-

(A) with respect to which there is a customer, as defined in section 741 of this title; and
(B) that is engaged in the business of effecting transactions in securities
(i) for the accounts of others; or
(ii) with members of the general public, from or for such person's own account.

11 U.S.C. § 101(53A).

Individual Contracts with the U.S. Stockbroker under the General Agreement are "forward contracts" or "swap agreements" and (ii) the Non-Defaulting Party is not a "customer" (as defined in section 741(2) of the Code) of the U.S. Stockbroker that is in proceedings under subchapter III of chapter 7 of the Code[53], or (C) that the U.S. Stockbroker is either a Covered Broker or Dealer or a Covered Financial Company, (i) the Individual Contracts under the General Agreement are "forward contracts" or "swap agreements" (as defined in section 210(c)(8)(D) of the OLA) and (ii) the Non-Defaulting Party is not a "customer" as (defined in section 210(m)(2)(A) of the OLA) of the U.S. Stockbroker.[54]

(v) Either (i) the U.S. Party in a proceeding under the Code, (ii) a receiver, conservator or Superintendent in a proceeding under the FDIA, the OLA, FDICIA or NYBL, as applicable, (iii) the SIPA trustee in a SIPA Liquidation, (iv) the trustee in a stockbroker liquidation under subchapter III of chapter 7 of the Code or (v) the trustee in a commodity broker liquidation under subchapter IV of chapter 7 of the Code, seeks to assume certain Individual Contracts and not other Individual Contracts.

C. Executive Summary

As a general matter, upon the occurrence of a Material Reason under § 10.5(c)(iv) of the General Agreement, the early termination and close-out netting provisions of the General Agreement (including all Individual Contracts (including Options) entered into under a single General Agreement that qualify as forward contracts or swap agreements) are enforceable under the Code, FDIA, NYBL, FDICIA, SIPA and OLA, subject to the limitations set forth in this Memorandum. A Material Reason under section 10.5(c)(iv) may occur as the result of the institution of a proceeding by or against (a) an Included Code Entity under the Code, (b) an Insured Institution under the FDIA, (c) a banking corporation organized under the laws of the State of New

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Section 763 of the Dodd-Frank Act amends the Securities Exchange Act of 1934 to provide that the term "security" as used in subclause (B) includes a "securities-based swap" (as that term is defined in the Dodd-Frank Act) and to provide for amendments to certain other terms used in Section 741 of the Code.

53 The term "customer" is defined in 741(2) in relevant part as including

(A) entity with whom a person deals as principal or agent that has a claim against such person on account of a <u>security</u> received, acquired, or held by such person in the ordinary course of such person's business as a stockbroker, from or for the securities account or accounts of such entity…; and

(B) entity that has a claim against a person arising out of

(i) a sale or conversion of a <u>security</u> received, acquired or held as specified in subparagraph (A) of this paragraph; or

(ii) a deposit of cash, a security, or other property with such person for the purpose of purchasing or selling a <u>security</u>;

11 U.S.C. § 741(2). (emphasis added).

The term "security" is defined in 101(49) of the Code and expressly excludes in (B)(iii) "forward contract". However, the term does not exclude a "swap agreement".

54 11 U.S.C. §5390(m)(2)(A) (which has the same meaning as in section 741 of the Code).

York under the NYBL, (d) a Covered Financial Company under the OLA, (e) a U.S. Stockbroker under SIPA, subchapter III of chapter 7 of the Code, or under the OLA (if the U.S. Stockbroker is determined to be a Covered Broker or Dealer, or (f) a U.S. Commodity Broker under subchapter IV of chapter 7 of the Code or the OLA, as applicable.

Both Automatic Termination under § 10.4 of the General Agreement (assuming the Election Sheet provides for Automatic Termination upon the occurrence of a Material Reason under § 10.5(c)(iv) of the General Agreement) and discretionary Early Termination under § 10.3 of the General Agreement will be enforceable under the Code, NYBL and SIPA as of the applicable Early Termination Date as defined in the General Agreement. However, in the case of a conservatorship under the FDIA, Early Termination will not be enforceable upon the occurrence of a Material Reason under section 10.5(c)(iv) that is based solely upon the appointment of the conservator, the exercise of the rights or powers of the conservator or the insolvency underlying the existence of such powers, but will be given effect if another Material Reason exists. Moreover, in the case of the appointment of the FDIC as receiver under the FDIA or OLA, the contractual right of a party to the General Agreement to terminate, liquidate or close-out net under the General Agreement based solely upon the appointment of the receiver or the insolvency or financial condition of the Insured Institution or Covered Financial Company, as applicable, may not be exercised (i) until 5:00 pm (eastern time) on the business day after the appointment of the receiver, or (ii) after the Non-Defaulting Party has received notice that the General Agreement has been transferred pursuant to section 11(e)(9)(A) of the FDIA or section 210(c)(9)(A) of the OLA, respectively.

In the case that FDICIA is applicable, the enforceability of the early termination provisions of the General Agreement under FDICIA is limited by the rights of a receiver or conservator of an insolvent Federally insured depository institution under the FDIA and the rights of a receiver of an insolvent Covered Financial Company under the OLA.

It is not necessary to have the single agreement concept in § 1.1 of the General Agreement to preserve enforceability of the early termination and close-out netting rights with respect to the General Agreement and the Individual Contracts under the General Agreement since each of the Code, FDIA, FDICIA, SIPA (by incorporation of the provisions of the Code or OLA relating to qualified financial contracts, as applicable), NYBL and OLA recognizes the enforceability of all Individual Contracts (including Options) that qualify as forward contracts or swap agreements that are governed by a single General Agreement. Under these statutes, selective termination of Individual Contracts governed by the same General Agreement is not permitted. Similarly, selective rejection or repudiation of Individual Contracts that qualify as forward contracts or swap agreements under a single General Agreement is not permitted. The definition of swap agreement under the Code, FDIA, and OLA would include spot trades. Spot trades are included in the definition of forward contract under the NYBL. Spot trades are also included in the definition of forward contract as applicable to FDICIA.

Under section 562 of the Code, so long as notice of Early Termination is given by the Non-Defaulting Party prior to rejection of the General Agreement by the debtor (or trustee) the Terminating Party has the right to calculate the Termination Amount since under section 562 damages will be measured as of the earlier of the date of rejection of the General Agreement by the debtor (or trustee) or the date or dates of liquidation, termination or acceleration. However, if there are no commercially reasonable determinants of value on the applicable date for measurement of damages, damages may be measured at the earliest subsequent date or dates on which values can be determined in a commercially reasonable manner. In such event, the Party that has not determined the Termination Amount may object to the measurement of damages and will have the burden of proving that there were no commercially reasonable determinants of value on such date or dates. This provision may apply in the case of a SIPA proceeding and will not apply if the U.S. Stockbroker is a Covered Broker or Dealer under the OLA.

Under both the FDIA and OLA, if a contract is repudiated by the receiver, the liability of the FDIC is generally limited to "actual direct compensatory damages" of the parties to the contract as of the date on which the FDIC took possession of the Insured Institution, if the FDIA applies, or the date the receiver was appointed, if the OLA applies. However, under the FDIA and OLA, the compensatory damages arising in respect of the FDIC's repudiation of any qualified financial contract is deemed to include normal and reasonable costs of cover or other reasonable measures of damages utilized in the industries for such contract and agreement claims calculated as of the date of disaffirmance or repudiation of such contract or agreement. Under the NYBL, the liability of the Superintendent in respect of a repudiated contract is generally limited to "actual direct compensatory damages" which are deemed to include normal and reasonable costs of cover or other reasonable measures of damages utilized among participants in the market for qualified financial contract claims, calculated as of the date of repudiation or termination of such qualified financial contract.

In the case that the Non-Defaulting Party owes the Termination Amount to the debtor it must pay such amount in accordance with the terms of the General Agreement. In the case that the Non-Defaulting Party is owed the Termination Amount, the Non-Defaulting Party will have a claim which it must timely prove in accordance with the provisions of the applicable statute. The timing of distributions on allowed claims will be subject to the provisions of the applicable statute relating thereto. In the case of the Code, SIPA, FDIA, NYBL or the OLA, any claim of the Non-Defaulting Party must be stated in U.S. dollars.

This summary is qualified in its entirety by reference to the more complete discussion of the enforceability of the early termination and close-out netting provisions of the General Agreement which follows in Sections II and III.

II. TREATMENT OF "FORWARD CONTRACTS" AND "SWAP AGREEMENTS" <u>UNDER THE CODE, THE FDIA, THE OLA, THE NYBL, FDICIA AND SIPA</u>

A. Code[55]

1. Background; Definitions

[55] Throughout this Section II.A, we assume that the insolvent U.S. Party is an Included Code Entity and thus the debtor is neither a U.S. Stockbroker nor U.S. Commodity Broker.

(a) Code Insolvency Proceedings

Under the Code, cases may be commenced either voluntarily by the debtor or involuntarily by the debtor's creditors. A voluntary case commences when an Included Code Entity files with the bankruptcy court a petition under the relevant chapter of the Code. An involuntary case may be commenced under the Code against an Included Code Entity by the filing with the bankruptcy court of a petition by one or more (as applicable) of the persons permitted to file an involuntary case under section 303(b)(1), (2), or (3) of the Code.[56] As a general rule, the Code offers two types of insolvency proceedings for Included Code Entities, one under chapter 7 (liquidation)[57] and one under chapter 11 (reorganization). A trustee is appointed in a chapter 7 case and is authorized to wind down the operations of the debtor. In a chapter 11 case, the debtor will remain in possession and operate the business unless after notice and a hearing a chapter 11 trustee is appointed. Where the debtor remains in possession, references in the Code to trustee apply to the debtor-in-possession.

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[56] Section 303(b)(4) of the Code permits a foreign representative (as defined in section 101(24) of the Code) of the estate in a foreign proceeding (as defined in section 101(23) of the Code) concerning such person to file an involuntary case and chapter 15 has been added by the 2005 Act to permit ancillary and other cross border cases with respect to an entity that is the subject of a foreign proceeding.

However, with the exception of New York Branches, this Memorandum as it relates to the Code is limited to U.S. Parties (that are Included Code Entities; Insured Institutions or certain New York State chartered banking institutions), U.S. Stockbrokers and U.S. Commodity Brokers.

[57] In the case that a debtor is a stockbroker not subject to a liquidation under SIPA, the provisions of subchapter III of chapter 7 of the Code relating to stockbroker liquidations will apply. In the case that a debtor is a commodity broker, it is assumed that the provisions of subchapter IV of chapter 7 of the Code relating to commodity broker liquidations will apply. A stockbroker or a commodity broker may not be the subject of a case under chapter 11 of the Code. See 11 U.S.C. § 109(d).

(b) Special Provisions Relating to Forward Contracts, Swap Agreements, and Master Netting Agreements under the Code

As a general matter, upon the commencement of a case under chapter 11 or chapter 7 of the Code, the automatic stay provided under section 362 of the Code[58] goes into effect and creditors of a debtor are prohibited from taking action to collect on their claims, to realize on any collateral securing the claims and to exercise contractual rights of set-off, unless in each instance they seek the specific approval of the bankruptcy court to lift the automatic stay. The Code also contains provisions that prohibit the non-debtor party to an executory contract (a contract under which a debtor and non-debtor each have unperformed obligations, and the debtor, if it ceased further performance, would have no right to the other party's continued performance) from terminating such a contract based upon, among other things, the commencement of a case under the Code[59] but permit the debtor-in-possession to reject the executory contract.[60] The General Agreement and Individual Contracts will be considered executory contracts under the Code if upon the occurrence of a Material Reason under §10.5(c)(iv) each of the Parties has unperformed obligations and where upon the debtor's ceasing to perform under the General Agreement, the Non-Defaulting Party would not have any further obligations to perform thereunder.

However, the Code contains specific provisions that provide so-called "safe harbors" for specified types of financial contracts, including forward contracts, commodities contracts, securities contracts, repurchase agreements, and swap agreements as well as master netting agreements for any of the foregoing financial contracts. [61] These safe harbors are only available to specified categories of entities. These entities include "forward contract merchants"[62], financial participants",[63] "swap participants"[64], and "master netting agreement participants"[65]. For example, the Code provides an express exception from the automatic stay contained in section 362(b)(6) of

58 11 U.S.C. § 362(a).

59 See 11 U.S.C. § 365(e)(1).

60 See section 365(a) of the Code which allows the trustee, except as provided in sections 765 and 766 of the Code and subsections (b), (c) and (d) of section 365, subject to the court's approval, to assume or reject any executory contract. See also, 11 U.S.C. § 562, which acknowledges the right of the trustee or debtor-in-possession to reject financial contracts listed in § 561, and 11 U.S.C. § 502(g), which treats the claim for damages determined under section 562 upon such rejection as a prepetition claim, in the same manner as damages arising as a result of rejection of a non-financial executory contract are treated as prepetition claims. Subsection 502(g) was added by the 2005 Act and provides that "[a] claim for damages calculated in accordance with Section 562 shall be allowed . . . or disallowed . . . as if such claim had arisen before the date of the filing of the petition."

61 11 U.S.C. § 561 (relating to master netting agreements). These so-called "safe harbors" except financial contracts from certain provisions of the Code including section 362 (automatic stay) and section 365(e)(1).

62 See 11 U.S.C. § 101(26). See II.A(1)(b)(v) below.

63 See 11 U.S.C. § 101(22A). See II.A(1)(b)(v) below.

64 See 11 U.S.C. § 101(53C). See II.A(1)(b)(v) below.

65 See 11 U.S.C. § 101(38B). See II.A(1)(b)(v) below.

the Code[66] for the exercise by, among others, forward contract merchants and financial participants of any contractual right (as defined in section 556 of the Code[67]) under any security agreement or arrangement or other credit enhancement forming part of or related to any forward contract, or of any contractual right (as defined in section 556 of the Code) to offset or net out any termination value, payment amount or other transfer obligation arising under one or more such contracts, including any master agreement for such contracts. Section 362(b)(17)[68] provides a similar exception for the exercise by swap participants or financial participants of any contractual right (as defined in section 560 of the Code[69]) under any security agreement or arrangement or other credit enhancement forming a part of or related to any swap agreement, or any contractual right (as defined in section 560) to offset or net out any termination value, payment amount or other transfer obligation arising under one or more such contracts, including any master agreement for such contracts. Section 362(b)(27)[70] provides a similar exception for master netting agreement participants to exercise any contractual right (as defined in section 555, 556, 559 or 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any master netting agreement, or any contractual right (as defined in section 555, 556, 559 or 560) to offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with one or more master agreements to the extent that such participant is eligible to exercise such rights under section 362(b)(6), 362(b)(7) (repurchase agreements) or 362(b)(17) for each individual contract covered by the master agreement.

(i) Contracts Constituting Forward Contracts, Swap Agreements and Master Netting Agreements

With certain exceptions, transactions in electricity that are subject to the General Agreement come within the definition of "forward contract" found in Section 101(25) of the Code. Section 101(25) provides:

> "The term 'forward contract' means —
>
> (A) a contract (other than a commodity contract as defined in section 761) for the purchase, sale, or transfer of a commodity,[71] as defined in section 761(8)

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66 See 11 U.S.C. § 362(b)(6). While Section 553 of the Code restricts set off under certain circumstances, it expressly allows setoff of a kind referred to in section 362(b)(6) and section 556 of the Code. 11 U.S.C. § 553.

67 11 U.S.C. § 556. See II.A(1)(b)(ii) below.

68 11 U.S.C. § 362(b)(17). While section 553 of the Code restricts set off under certain circumstances, it expressly allows set off of a kind referred to in section 362(b)(17) and section 560 of the Code.

69 11 U.S.C. § 560. See II.A(1)(b)(ii) below.

70 11 U.S.C. § 362(b)(27). While section 553 of the Code restricts set off under certain circumstances, it expressly allows setoff of a kind referred to in section 362(b)(27) of the Code.

71 11 U.S.C. § 101(25). The term "commodity" is defined in section 761(8) of the Code by reference to the definition of that term in the Commodity Exchange Act. See 7 U.S.C. §§ 1 et seq. "Commodity" is defined in the Commodity Exchange Act as follows:

of this title, or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, <u>with a maturity date more than two days</u> after the date the contract is entered into, including, but not limited to, a repurchase or reverse repurchase transaction (whether or not such repurchase or reverse repurchase transaction is a "repurchase agreement" as defined in this Section), consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any other similar agreement;

(B) any combination of agreements or transactions referred to in subparagraphs (A) and (C);

(C) any option to enter into an agreement or transaction referred to in subparagraph (A) or (B);

(D) a master agreement that provides for an agreement or transaction referred to in subparagraph (A), (B), or (C), together with all supplements to any such master agreement, without regard to whether such master agreement provides for an agreement or transaction that is not a forward contract under this paragraph, except that such master agreement shall be considered to be a forward contract under this paragraph only with respect to each agreement or transaction under such master agreement that is referred to in subparagraph (A), (B), or (C); or

(E) any security agreement or arrangement, or other credit enhancement related to any agreement or transaction referred to in subparagraph (A), (B), (C), or (D), including any guarantee or reimbursement obligation by or to a forward contract merchant or financial participant in connection with any agreement or transaction referred to in any such subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562." (emphasis added)

> The term "commodity" means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by the first section of Public Law 85-839, 72 Stat. 1013 (1958) (7 U.S.C. 13-1)) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.

See 7 U.S.C. § 1a(9).

An Option, as used in the General Agreement, will come within the definition of "forward contract" under subparagraph (C) of section 101(25) of the Code so long as it relates to a transaction that would qualify as a forward contract under subparagraph (A) or (B) of the definition.

While the term "commodity contract" as defined in section 761(4) of the Code[72] is not restricted to transactions in which the specified price is due more than two days after the transaction is entered into, the transactions under the General Agreement and the Individual Contracts would not come under the definition of "commodity contract" because only contracts for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade (whether U.S. or foreign) will qualify. See Williams v. Morgan Stanley Capital Grp. (In re Olympic Natural Gas Co.), 294 F.3d 737, 741 (5th Cir. 2002) where the court held that "'forward contracts' are contracts for the future purchase or sale of commodities that are not subject to the rules of a contract market or board of trade"; aff'g 258 B.R. 161, 165 (Bankr. S.D. Tex. 2001). See also, Hutson v. E.I. du Pont de Nemours & Co. (In re Nat'l Gas Distribs., LLC), 556 F.3d 247 (4th Cir. 2009) (a case which arose under the Code prior to the 2005 Act reviewing and applying the definition of a "forward agreement" found in the definition of "swap agreement" both prior to and subsequent to the 2005 Act as including physically settled swaps and clarifying the scope and breadth of forward contracts); BCP Liquidating LLC v. Bridgeline Gas Mktg. (In re: Borden Chems. and Plastics Operating Ltd. P'ship), 336 B.R. 214 (Bankr. D. Del. 2006) (holding that a natural gas supply contract was a "forward contract" even though it contemplated actual delivery of gas) and Clear Peak Energy, Inc. v. Cal. Edison Co. (In re Clear Peak Energy, Inc.), 488 B.R. 647,662-663 (Bankr. D. Ariz. 2013) holding that a company's sale agreement with an electricity utility constituted a forward contract and was not subject to the automatic stay under section 362(a) of the Code;[73] Lightfoot v. MXEnergy Elec., Inc., (In re MBS Mgmt Servs. Inc.), 690 F.3d 352 (5th Cir. 2012) (holding that a contract for the supply of electricity need not specify a fixed quantity or delivery date (time for performance) to qualify as a forward contract) and DeGirolamo v. McIntosh Oil Co. (In re Laurel Valley Oil Co.), 2013 Bankr. LEXIS 896 at *8 (Bankr. N.D. Ohio Mar. 5, 2013) (finding maturity date is the date on which the benefit and detriment of the contract will be realized by the parties and that the maturity date for a prepaid supply contract is therefore the delivery date, not the payment date.)

Subsection (D) of the definition of forward contract indicates that more than one "forward contract" may be effected under a master agreement, such as a General Agreement, and that all forward contracts subject to a master agreement taken together will constitute a single forward contract. This provision, together with section 561 of the Code discussed below, should bar a debtor-in-possession or trustee from cherry picking among Individual Contracts that are documented under a single General Agreement. However, under the Code, if there are multiple General Agreements between two Parties, a U.S. Party that is a debtor under the Code may elect

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72 11 U.S.C. § 761(4). See footnote 222 with respect to the amendment under Title VII of the Dodd-Frank Act of the definition of "commodity contract" to include cleared "swaps" (as defined in the Dodd-Frank Act).

73 But see, U.S. Bank v. Plains Mktg. Can. LP (In re Renew Energy LLC), 463 B.R. 475 (Bankr. W.D. Wis. 2011), where certain supply contracts fell outside of the definition because they did not have a maturity date more than two days after the contract was entered into.

to assume fewer than all General Agreements (including the Individual Contracts documented under any such assumed General Agreement), unless a master agreement provides for netting of transactions under all General Agreements.

It is to be further noted, however, that to the extent that payment of a specified price for a "commodity transaction" covered by a General Agreement or an Individual Contract becomes due on the same day as (or within two days after) the transaction is entered into (commonly referred to as spot trades), such transaction will not qualify as a "forward contract." Therefore, the provisions of the Code discussed below which give effect to contractual rights to early termination and close out netting of forward contracts[74] and permit offset or netting of termination values arising under forward contracts under certain circumstances discussed below[75] will not apply to any Individual Contract for such spot trades.

Although "spot" trades or contracts do not come within the definition of forward contract and, therefore, under the safe harbor provisions of the Code for forward contracts, it may be possible to take the position that spot transactions for electricity would qualify as "swap agreements" under the expanded definition of "swap agreement" in section 101(53B) of the Code enacted under the 2005 Act.[76] That is so because section 101(53B) provides in pertinent part:

> "The term 'swap agreement' –
>
> (A) means –
>
> (i) any agreement, including the terms and conditions incorporated by reference in such agreement, which is – …
>
> (II) a spot, same day-tomorrow, tomorrow-next, forward or other foreign exchange, precious metals, or other commodity agreement; …
>
> (IX) an emissions swap, option, future or forward agreement;…
>
> (ii) any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph and that –
>
> (I) is a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap or other derivatives markets (including terms and conditions incorporated by reference therein); and
>
> (II) is a forward, swap, future, option, or spot transaction on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or contingency

74 11 U.S.C. §§ 556 and 561.

75 See 11 U.S.C. §§ 362(b)(6) and 362(b)(27).

76 11 U.S.C. § 101(53B).

> associated with a financial, commercial, or economic consequence, or economic or financial indices or measures of economic or financial risk or value;" (emphasis added)

Not only does subsection (A)(i)(II) refer to a "spot" or "other commodity agreement" but subsection (A)(i)(IX) refers to emissions forward agreements (which would appear to encompass Emission Allowances). Moreover, subsection (A)(ii)(I) also refers to transactions that are "the subject of recurrent dealings in the swap or other derivatives market" and subsection (A)(ii)(II) refers to a transaction that "is a forward, swap, future, option or spot transaction on one or more…commodities." It would appear that the forward contracts market is covered by the words "other derivatives markets" in subsection (A)(ii)(I).

As in the case of "forward contract", the term "swap agreement" includes options and master agreements with respect thereto as well as any security agreement or arrangement or other credit enhancement related thereto.[77]

Accordingly, the non-debtor Party (herein sometimes referred to as the "**Counterparty**") would be entitled to exercise rights to close-out net "spot trades" under the close-out netting provisions of the General Agreement that contractually permit netting of all Individual Contracts because the General Agreement qualifies as a master netting agreement, and cross product netting would be permitted under section 362(b)(27)[78] and section 561 of the Code[79] discussed below.

Even if a spot transaction for electricity were to be viewed as not within the definition of swap agreement and therefore not qualifying for the safe harbor for close-out netting, the Counterparty should be entitled to assert and file a proof of claim against the U.S. Party as to any General Agreement or Individual Contracts that do not qualify as forward contracts or swap agreements and are rejected by the U.S. Party or terminated by the Counterparty. To the extent that the value of the Collateral, if any, that validly secures the General Agreement exceeds the amount necessary to satisfy the Individual Contracts that qualify as forward contracts or swap agreements and as such have the benefit of the safe harbor provisions permitting close-out netting, any non-qualifying Individual Contracts should be entitled to the benefit of the value of the remaining Collateral in accordance with its contractual rights and applicable law. However, the Counterparty will not be able to foreclose on the Collateral in which it has a Perfected Security Interest as to any claims arising under any non-qualifying Individual Contracts unless the Counterparty moves for relief from the automatic stay to realize (i.e., foreclose) on the Collateral and such relief is granted.

Since the General Agreement provides for the exercise of rights of netting, setoff, liquidation, termination, acceleration and close-out of one or more Individual Contracts it will also

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77 See generally, 11 U.S.C. § 101(53B)(A)(iv), (v) and (vi).

78 11 U.S.C. § 362(b)(27).

79 11 U.S.C. § 561.

qualify as a "master netting agreement" as that term is defined in the Code. Section 101(38A) of the Code provides as follows:

> "The term 'master netting agreement' —
>
> > (A) means an agreement providing for the exercise of rights, including rights of netting, setoff, liquidation, termination, acceleration, or close out, under or in connection with one or more contracts that are described in any one or more of paragraphs (1) through (5) of section 561(a), or any security agreement or arrangement or other credit enhancement related to one or more of the foregoing, including any guarantee or reimbursement obligation related to 1 or more of the foregoing; and
> >
> > (B) if the agreement contains provisions relating to agreements or transactions that are not contracts described in paragraphs (1) through (5) of section 561(a), [it] shall be deemed to be a master netting agreement only with respect to those agreements or transactions that are described in any one or more of paragraphs (1) through (5) of section 561(a)." [80]

Subparagraph (B) of section 101(38A) makes clear that to the extent that some, but not all, of the Individual Contracts under the General Agreement are included within the definition of (i) forward contract in section 101(25) of the Code or (ii) swap agreement in section 101(53B) of the Code, the General Agreement will be a master netting agreement only with respect to those included Individual Contracts.[81]

(ii) Contractual Right to Liquidate, Terminate or Accelerate a Forward Contract or Swap Agreement

As a general matter, section 365(e)(1)[82] prohibits the termination or modification of an executory contract based upon any of the following conditions (each an "**<u>ipso facto</u> default**"):

> "(A) the insolvency or financial condition of the debtor at any time before the closing of the case;
>
> (B) the commencement of a case under . . . [the Code]; or

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80 11 U.S.C. § 101(38A).

81 It is to be noted that while section 561 of the Code permits cross product netting (<u>i.e.</u>, netting of other financial contracts referenced in section 561 of the Code), it permits cross product netting only where the master netting agreement so provides. In the case of the General Agreement, there is a contractual right to net multiple Individual Contracts for the sale of electricity and, therefore, to the extent that one or more Individual Contracts are forward contracts and one or more Individual Contracts are swap agreements, cross product netting will be permitted.

82 11 U.S.C. § 365(e)(1).

(C) the appointment or taking possession by a trustee in a case under . . . [the Code] or a custodian before such commencement."[83]

However, section 556 of the Code overrides the provision in section 365(e)(1) that would prevent a Non-Defaulting Party (that is either a financial participant or forward contract merchant) to a General Agreement from using the commencement of a bankruptcy case under the Code or other ipso facto default as a basis for exercising its rights under the General Agreement upon the occurrence of such ipso facto default to liquidate, terminate or accelerate a forward contract. Section 556 of the Code provides in pertinent part:

> "[T]he contractual right of a commodity broker, financial participant or forward contract merchant to cause the liquidation, termination or acceleration of a…forward contract because of a condition specified in section 365(e)(1) of . . . [the Code] . . . shall not be stayed or avoided, or otherwise limited by operation of any provision of. . . [the Code] or by order of a court in any proceeding under . . . [the Code]."[84]

To the extent that a "spot" transaction or emission forward is a swap agreement, section 560 of the Code similarly overrides the provision in section 365(e)(1) and would permit a swap participant or financial participant to liquidate, terminate or accelerate a swap agreement. Section 560 of the Code provides in pertinent part:

> "The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of . . . [the Code] or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by

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83 Except as provided in sections 555, 556, 559 or 560 of the Code, the termination of an executory contract is prohibited under the bases enumerated in (A), (B) and (C) of section 365(e)(1) of the Code.

84 11 U.S.C. § 556. The case law indicates that early termination may only occur under the safe harbor provisions when based upon an ipso facto default enumerated in section 365(e)(1) of the Code. See e.g., In re Enron, 306 B.R. 465, 473 (Bankr. S.D.N.Y. 2004). See also, In re Louisiana Pellets, Inc., 2016 Bankr. LEXIS 2679 (Bankr. W.D. La., July 22, 2016) in which a provision in a contract which allowed the nondebtor counterparty to terminate a forward contract on the basis of contractual nonperformance was held not to be "a condition of the kind specified in Section 365(e)(1) of the Code" and, therefore, the bankruptcy court held that such termination did not fall within the safe harbor under section 556 of the Code; and Calpine Energy Servs., L.P. v. Reliant Energy Elec. Solutions. L.L.C. (In re Calpine Corp.) 2009 Bankr. LEXIS 1041 (Bankr. S.D.N.Y. May 7, 2009) which held that section 556 only protects the right to terminate based on a condition of the kind specified in section 365(e)(1) and that a provision requiring a debtor to give timely notice that it disputes the non-defaulting party's calculation of a termination payment was not enforceable against the debtor. See also footnote 85 below.

operation of any provision of . . . [the Code] or by order of a court or administrative agency in any proceeding under [the Code]."[85]

As set forth below, section 561 of the Code also makes clear that in the case of a General Agreement for which there are multiple Individual Contracts that qualify as forward contracts or swap agreements, a forward contract merchant, financial participant, swap participant or master netting agreement participant may terminate, accelerate or liquidate such contract as well as net out any termination values or payment amounts as to such forward contracts or swap agreements, notwithstanding the automatic stay provided under section 362(a) of the Code.

(iii) Contractual Right to Net Termination Amounts and Liquidate Collateral for Forward Contracts and Swap Agreements

As noted above, section 362(b)(6) of the Code excepts from the automatic stay "the exercise by a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency of any contractual right (as defined in section 555 or 556) under any security agreement or arrangement or other credit enhancement forming a part of or related to any commodity contract, forward contract or securities contract, or of any contractual right (as defined in section 555 or 556) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more such contracts, including any master agreement for such contracts".[86]

Section 362(b)(17) excepts from the automatic stay "the exercise by a swap participant or financial participant of any contractual right (as defined in section 560) under any security

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85 11 U.S.C. § 560. This provision does not preempt the statute of frauds or any other provision of law, except for the provisions of the Code, and does not validate any particular method of calculating termination values or damages. See H.R. REP. NO. 101-484 (1990). One bankruptcy court has read the scope of Section 560 protection as confined to contractual rights within the swap master agreement itself, as opposed to related "flip clause" subordination rights within a related indenture. Lehman Bros. Special Fin. Inc. v. BNY Corp. Tr. Servs. (In re Lehman Bros. Holdings Inc.), 422 B.R. 407 (Bankr. S.D.N.Y. 2010). See also Lehman Bros. Special Fin. Inc. v. Ballyrock ABS CDO 2007-Ltd., 452 B.R. 31 (Bankr. S.D.N.Y. 2011) (holding, on motion to dismiss, that an indenture provision assigning a lower distribution priority to termination payments due to defaulting swap counterparty is not within the scope of Section 560, which is "limited exclusively to preserving the right to liquidate, terminate and accelerate a qualifying financial contract"). *Leave to appeal denied* (S.D.N.Y. November 3, 2011). But see, Lehman Bros. Special Fin. Inc. v. Bank of Am., N.A. (In re Lehman Bros. Holdings, Inc.), 553 B.R. 476 (Bankr. S.D.N.Y. 2016), holding that the right to determine upon default "which party is owed how much" falls in the scope of the section 560 safe harbor, distinguishing the facts from those in the earlier flip clause cases referred to above by the fact that the flip clauses affecting priority upon early termination of the swap agreements involved in this case were set forth in the schedules to the ISDA Master Agreement or incorporated by reference under the Indenture.

86 11 U.S.C. § 362(b)(6). Notwithstanding the very broad definition of "contractual right" as defined in sections 556 and 560, in Bank of Am. v. Lehman Bros. Holdings Inc., 439 B.R. 811 (Bankr. S.D.N.Y. 2010), the court held that the exception from the automatic stay under section 362(b)(17) for the exercise of contractual rights does not extend to common-law setoff rights against a "special purpose" deposit account pledged by the debtor exclusively to secure overdrafts arising in its bank accounts.

agreement or arrangement or other credit enhancement forming a part of or related to any swap agreement, or of any contractual right (as defined in section 560) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more such agreements, including any master agreement for such agreements."[87]

These provisions allow any enumerated entity that is the Non-Defaulting Party and that has Perfected Security Interests in Collateral margin, or that has the benefit of a guarantee (from a nondebtor)[88], to utilize such credit support to satisfy the claim against such debtor notwithstanding the bankruptcy filing of the Included Code Entity and the imposition of the automatic stay.

(iv) Contractual Right to Terminate, Liquidate, Accelerate or Offset Under a Master Netting Agreement and Cross Product Netting

Section 362(b)(27) was added to the Code by the 2005 Act to permit the exercise by a master netting agreement participant of any contractual right (as defined in section 555, 556, 559 or 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any master netting agreement, or of any contractual right (as defined in section 555, 556, 559 or 560) to offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with one or more master netting agreements, to the extent that the master netting agreement participant is "eligible to exercise" the offset rights under section 362(b)(6), (7) or (17) of the Code for each individual contract covered by the master netting agreement.[89] These exceptions to the automatic stay (which would apply to Parties to the General Agreement) apply not only to the exercise of rights of netting and offset but they also allow Parties holding Collateral, or entitled to the benefits of a guarantee, to utilize such credit support notwithstanding the filing of a bankruptcy case and the imposition of the automatic stay. In addition, section 553(a) of the Code excepts setoffs allowed, inter alia, under section 362(b)(6), (17) and (27), 556, 560 and 561 of the Code from the restrictions to setoff contained in section 553(a) and (b), including the prohibition against improvement of a creditor's position within 90 days of the commencement of a bankruptcy case, thereby protecting the right of a forward contract merchant, financial participant, swap participant or master netting agreement participant to exercise rights of setoff by exempting such Party from the trustee's power to readjust any setoff that takes place during the 90 day period prior to the filing of a bankruptcy petition.[90]

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87 11 U.S.C. § 362(b)(17).

88 However, if the guarantor is a debtor under the Code then payment may depend on whether notwithstanding the automatic stay the guaranty is viewed as within the safe harbor for forward contracts and if not, action in respect thereof may be limited to filing a proof of claim in the guarantor's case. See discussion regarding enforceability of a Parent Company Guarantee against a nondebtor guarantor, in Section IV of this Memorandum.

89 11 U.S.C. § 362(b)(27). Section 555 applies to securities contracts and Section 559 applies to repurchase agreements. 11 U.S.C. § 362(b)(7) applies to repurchase agreements.

90 The extent to which the exemption from Section 553 applies is unclear. See e.g., Sass v. Barclays Bank PLC (In re Am. Home Mortgage Holdings, Inc.), 501 B.R. 44 (Bankr. D. Del. 2013) holding company was precluded from setting off amounts owed to bankruptcy debtor under swap agreement against amounts debtor owed to

If the applicable Party has the contractual right to do so under its master netting agreement, section 561(a) of the Code[91] provides for both netting of multiple contracts of a single type enumerated in paragraphs (1) through (5) of section 561(a) of the Code as well as cross product netting of any and all of such financial contracts.[92] Section 561(a) of the Code provides in pertinent part:

> "§ 561. Contractual right to terminate, liquidate, accelerate, or offset under a master netting agreement and across contracts; proceedings under chapter 15.
>
> (a) Subject to subsection (b), the exercise of any contractual right, because of a condition of the kind specified in section 365(e)(1), to cause the termination, liquidation, or acceleration of or to offset or net termination values, payment amounts, or other transfer obligations arising under or in connection with one or more (or the termination, liquidation, or acceleration of one or more) —
>
> (1) securities contracts, as defined in section 741(7);
> (2) commodity contracts, as defined in section 761(4);
> (3) forward contracts;
> (4) repurchase agreements;
> (5) swap agreements; or
> (6) master netting agreements,
>
> shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by any order of a court or administrative agency in any proceeding under this title."

Subparagraph (b)(1) of section 561 of the Code further provides:

> "(b)(1) A party may exercise a contractual right described in subsection (a) to terminate, liquidate, or accelerate only to the extent that such party could exercise

affiliated company of the counterparty under related reimbursement agreement since safe harbor provisions preserving contractual rights under swap agreements did not implicitly remove statutory requirements of mutual debts for offset; and see, Chevron Prods. Co. v. SemCrude L.P. (In re SemCrude L.P.), 428 B.R. 590 (D. Del. 2010) in which the court rejected the argument that mutuality required under Section 553 could be contractually created with respect to swap agreements, but the court disregarded arguments concerning the potential effects of sections 560 and 561 because they were not raised at the trial court level. See also, Bank of Am., NA v. Lehman Bros. Holdings Inc. (In re Lehman Bros. Holdings Inc.), 439 B.R. 811, 833-37 (Bankr. S.D.N.Y. 2010) and Swedbank AB (PUBL) v. Lehman Bros Holdings Inc. (In re Lehman Bros. Holdings Inc.), 445 B.R. 130 (Bankr. S.D.N.Y. 2011).

[91] 11 U.S.C. § 561.

[92] As discussed below, the General Agreement only permits netting of Individual Contracts, so cross-product netting is only available to the extent that one or more Individual Contracts relate to more than one type of financial contact enumerated in (1)-(5) of Section 561(a) of the Code. For example, if any, EU Emissions Contract entered into pursuant to an Allowance Appendix were determined not to be a forward contract but rather a swap agreement, or if any Individual Contract for a "spot" transaction was a swap agreement, cross-product netting of such Individual Contracts which qualify as forward contracts or swap agreements would be permitted under the General Agreement.

such a right under section 555, 556, 559, or 560 of each individual contract covered by the master netting agreement in issue."

(v) Entities that Qualify as a Forward Contract Merchant, Swap Participant, Financial Participant or Master Netting Agreement Participant

A Party that qualifies as a "forward contract merchant", "master netting agreement participant" or "financial participant" will be entitled to the protections afforded to such entities under section 362(b)(6) (forward contract merchant or financial participant), section 362(b)(17) (swap participant or financial participant), section 362(b)(27) (master netting agreement participant), section 556 (forward contract merchant or financial participant), section 560 (swap participant or financial participant), section 561 (master netting agreement participant), and section 562 of the Code relative to setoff, early termination and close out netting.

The term "forward contract merchant" is defined in section 101(26) of the Code as follows:

"The term 'forward contract merchant' means a Federal reserve bank, or an entity the business of which consists in whole or in part of entering into forward contracts as or with merchants in a commodity (as defined in section 761) or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade."[93]

The term "swap participant" is defined in section 101(53C) of the Code as follows:

"The term 'swap participant' means any entity that, at any time before the filing of the petition, has an outstanding swap agreement with the debtor".[94]

The term "financial participant" is defined in section 101(22A) of the Code as follows:

"The term 'financial participant' means —

(A) an entity that, at the time it enters into a securities contract, commodity contract, swap agreement, repurchase agreement, or forward contract, or at the time of the

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93 11 U.S.C. § 101(26). See discussion in BCP Liquidating LLC v. Bridgeline Gas Mktg., LLC (In re Borden Chem. and Plastics Operating Ltd. P'ship), 336 B.R. at 224-225, citing 5 COLLIER ON BANKRUPTCY P 556.03[2] at 556-6 (15th ed. 2001). See Lightfoot v. MXEnergy, Inc., 2011 U.S. Dist. LEXIS 54546 at *7, aff'd, 690 F.3d 352 (5th Cir. 2012) in which the District Court held that the bankruptcy court correctly concluded that MXEnergy was a forward contract merchant because it "is in the business of buying and selling electricity" and "[i]t does not produce any of the power it markets." In DeGirolamo v. McIntosh Oil Co. (In re Laurel Valley Oil Co.), 2013 Bankr. LEXIS 896 at *10-12 (Bankr. N.D. Ohio March 5, 2013) the bankruptcy court held that the customer, who intended to sell the fuel to end-users at a profit, is a "forward contract merchant" because it was neither a producer nor an end-user of the diesel fuel and had entered into a contract to make a profit.

94 11 U.S.C. § 101(53C).

> date of the filing of the petition, has one or more agreements or transactions described in paragraph (1), (2), (3), (4), (5), or (6) of section 561(a) with the debtor or any other entity (other than an affiliate) of a total gross dollar value of not less than $1,000,000,000 in notional or actual principal amount outstanding (aggregated across counterparties) at such time or on any day during the 15-month period preceding the date of the filing of the petition, or has gross mark-to-market positions of not less than $100,000,000 (aggregated across counterparties) in one or more such agreements or transactions with the debtor or any other entity (other than an affiliate) at such time or on any day during the previous 15-month period preceding the date of the filing of the petition; or
>
> (B) a clearing organization (as defined in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991)."[95]

The term "master netting agreement participant" is defined in section 101(38B) of the Code as follows:

> "The term 'master netting agreement participant' means an entity that, at any time before the date of the filing of the petition, is a party to an outstanding master netting agreement with the debtor."[96]

It would appear that any Party to the General Agreement would qualify as a master netting agreement participant and would also qualify as a forward contract merchant (or a swap participant with respect to spot transactions). Therefore, qualification of a Non-Defaulting Counterparty as a financial participant would not be necessary for such Counterparty to benefit from sections 362(b)(6), 362(b)(17), 362(b)(27), 556, 560 and 561 of the Code.

(vi) Provisions Relating to Timing and Measurement of Damages

Section 562 of the Code sets forth the timing and measurement of damages in connection with the termination of swap agreements, securities contracts, forward contracts, commodity contracts, repurchase agreements and master netting agreements relating to the foregoing financial contracts.[97]

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[95] 11 U.S.C. § 101(22A).

[96] 11 U.S.C. § 101(38B).

[97] If the insolvent Party is a registered stockbroker, SIPA provisions for determining a customer's net equity claim may take precedence over section 562 of the Code in certain circumstances. See Sec. Inv. Prot. Corp. v. Lehman Bros., Inc., 433 B.R. 127 (Bankr. S.D.N.Y. 2010) holding that the SIPA definition of "net equity" under 15 U.S.C. § 78lll(11) rather than section 562 of the Code governed the applicable measurement date for a claim relating to the close-out of short securities positions in a prime brokerage account. Accord, In re MF Global Inc., 2013 Bankr. LEXIS 3863 (Bankr. S.D.N.Y. Sept. 17, 2013).

Section 562 provides in pertinent part:

> "(a) If the trustee rejects a swap agreement…forward contract…or master netting agreement pursuant to section 365(a) or if a forward contract merchant…financial participant, master netting agreement participant or swap participant liquidates, terminates, or accelerates such contract or agreement, damages shall be measured as of the earlier of
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> (1) the date of rejection; or
>
> (2) the date or dates of such liquidation, termination or acceleration." [98]

The 2005 Act also added a new subsection (2) to section 502(g) of the Code to make clear that notwithstanding that the calculation of damages will be made as of the earlier of the date of (i) rejection or (ii) liquidation, termination, or acceleration, the claim will be treated as a prepetition claim since it will be allowed under subsections (a), (b) or (c) of section 502, or disallowed under subsection (d) or (e) of section 502, as if the claim arose before the date of the filing of the petition (the "**Filing Date**").[99]

Under section 562 of the Code, if there are no commercially reasonable determinants of value on the date applicable for determination of damages, damages will be measured at the earliest subsequent date or dates on which values can be determined in a commercially reasonable manner.[100]

If damages are not measured as of the date or dates of rejection, liquidation, termination or acceleration, as applicable, and either the Included Code Entity or the forward contract merchant, swap participant, financial participant or master netting agreement participant objects to the date used for the measurement of damages by the other Party, then that other Party has the burden of proving that there were no commercially reasonable determinants of value on such date or dates.[101]

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98 11 U.S.C. § 562.

99 See also In re Enron Corp., 330 B.R. 387 (Bankr. S.D.N.Y. 2005) aff'd, Tauton Mun. Lighting Plant v. Enron Corp. (In re Enron Corp.), 354 B.R. 652 (S.D.N.Y. 2006), a case arising under the Code prior to the effective date of the 2005 Act, in which the District Court for the Southern District of New York held that although the rejection of a forward contract occurred after the Filing Date, damages would be measured in the same manner as for other executory contracts as if the rejection took place immediately prior to the Filing Date. On appeal, the District Court in dicta concluded that under § 562 (which was added by the 2005 Act), if the date of rejection [or termination] is the earlier date, that date (rather than the date preceding the Filing Date) will be used for the purpose of calculation of damages and that new section 502(g)(2) merely makes it clear that the claim arising from rejection or termination is intended to be treated as a prepetition claim rather than an administrative expense which would have priority over unsecured prepetition claims.

100 11 U.S.C. § 562(b).

101 11 U.S.C. § 562(c).

Where Automatic Termination is selected, the Early Termination Date will establish the date for determining damages in respect of Individual Contracts that qualify as forward contracts or swap agreements. However, if Automatic Termination is not selected, the Included Code Entity may reject[102] the General Agreement and Individual Contracts (if the Counterparty has not already terminated the General Agreement), notwithstanding the express terms of §10.3(a) of the General Agreement, which give the contractual right to terminate the General Agreement and Individual Contracts only to the Counterparty that is not subject to insolvency or similar proceedings. Section 365 of the Code gives the trustee (or debtor-in-possession) the right to assume or reject any executory contract at any time before confirmation of a case under chapter 11[103] or within 60 days after the order of relief under chapter 7, subject to certain limitations set forth in subsections (b),(c) and (d) of section 365 of the Code.[104] In a case under chapter 7, if an executory contract is not assumed within 60 days after the order for relief, or within such additional time as the court, for cause, determines within such 60-day period, it is deemed rejected.[105]

As noted, under the General Agreement the Non-Defaulting Party may, by notice to the Included Code Entity, select the Early Termination Date, which may be as much as 20 days after the notice of Termination Date. However, it is unclear whether the giving of notice by the Counterparty under §10.3 before the Included Code Entity seeks rejection of the General Agreement and Individual Contracts is enough to establish the date of termination as the date used for calculation of Termination Amount where the Early Termination Date chosen would be later than a rejection date subsequently chosen by the Included Code Entity. It is possible that an Included Code Entity may give a notice of rejection after the notice of Early Termination is given by the Non-Defaulting Party and prior to the Termination Date specified therein and seek an order of the bankruptcy court approving such rejection effective as of the date of the notice of rejection in an attempt to have the rejection date be the earlier event. As noted above, under section 502(g) of the Code it would appear that if rejection by the Included Code Entity is held to occur first, the rejection date would be the date for determining values and for measurement of damages, i.e., the Termination Amount, but as with other executory contracts, the claim that results would be a

102 Rejection of an executory contract under the Code has been distinguished in many cases from termination, although rejection has much the same effect as termination, in that, once the bankruptcy court approves the rejection by a debtor/trustee of an executory contract, the debtor/trustee ceases to have any obligation to perform under the contract. Rejection constitutes a breach of the contract, hence the creditor is also excused of further performance of its obligations and the breach results in a prepetition general unsecured claim for breach of the contract (unless the creditor's claim is secured).

103 11 U.S.C. § 365(d)(2).

104 See 11 U.S.C. § 365(b), (c) and (d).

105 11 U.S.C. § 365(d)(1). In the case of a stockbroker liquidation under subchapter III of chapter 7 of the Code, executory contracts for the purchase or sale of a security in the ordinary course of the debtor's business must be assumed within a reasonable time not to exceed 30 days after the order for relief or any such executory contract is deemed rejected. See 11 U.S.C. § 744.

prepetition claim. We have found no case dealing with such scenario, but it is at least theoretically possible that a court may approve such earlier date.[106]

B. The FDIA[107]

1. Background; Definitions

(a) FDIA Insolvency Proceedings

Insured Institutions are subject to insolvency proceedings under the FDIA. The FDIC is permitted to act as receiver or conservator for any Insured Institution pursuant to the conservatorship and receivership provisions of the FDIA.

If an Insured Institution is a national banking association, it is also subject to certain provisions of the National Banking Act ("**NBA**").[108] The NBA provides a full-fledged legal regime for national banks, including provisions for voluntary dissolution[109] and receivership.[110] Section 191 of the NBA empowers the Office of the Comptroller of the Currency (the "**OCC**") to appoint a receiver or conservator to take over a national bank, whenever the OCC becomes satisfied that the national bank is insolvent. When the OCC is to appoint a receiver for any Federal depository institution, such as a national bank that takes Federally-insured deposits, it is required to appoint the FDIC as receiver[111] and the insolvency proceedings would be carried out under the FDIA. In addition, the OCC may, but is not required, to appoint the FDIC as conservator for any Federal depository institution,[112] such as a national bank that takes Federally-insured deposits. For

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106 Indeed, there have been instances in which debtors have sought to reject an executory contract retroactive to the date of their notice (even though the motion to reject was approved on a later date), in order to limit the amount of any post-petition damages. See, e.g., Pac. Shores Dev., LLC v. At Home Corp. (In re At Home Corp.), 392 F.3d 1064 (9th Cir. Cal. 2004), cert. denied, 546 U.S. 814 (2005); In re Thinking Macs. Corp., 67 F.3d 1021 (1st Cir. 1995) (finding that rejection under section 365(a) does not take effect until judicial approval is secured, but the court has equitable power, in suitable cases, to order rejection retroactively); Constant Ltd. P'ship v. Jamesway Corp. (In re Jamesway Corp.), 179 B.R. 33 (S.D.N.Y. 1995). That is because the claim for goods or services provided to a debtor after the Filing Date will be entitled to administrative expense treatment for the period from the Filing Date to the date of rejection and would have to be paid in full before any distribution is made in respect of prepetition unsecured claims.

107 Throughout this Section II.B, we assume that the insolvent U.S. Party will be an Insured Institution.

108 12 U.S.C. §§ 38, 91 and 191.

109 12 U.S.C. §§ 181-182.

110 12 U.S.C. §§ 191-194 and §§ 196-203.

111 Under 12 U.S.C. § 1821(c)(2)(A)(ii), the FDIC shall be appointed receiver, and shall accept such appointment, whenever a receiver is appointed for the purpose of liquidation or winding up the affairs of an insured Federal depository institution by the appropriate Federal banking agency, notwithstanding any other provision of Federal law.

112 Under 12 U.S.C. § l813(c)(4), the term "Federal depository institution" means any national bank, any Federal savings association, and any Federal branch.

the purposes of this Memorandum, we assume that the OCC would appoint the FDIC as conservator for a national bank, in which case the insolvency proceedings would be carried out under the FDIA as well.[113]

If the FDIC is appointed as a conservator or receiver of a national bank, the FDIC will have both the powers granted to it by the FDIA and, to the extent not inconsistent with the FDIA, the powers granted to conservators or receivers of national banks.[114] The only provision of the NBA that may be inconsistent with the provisions of the FDIA is section 91 of the NBA which is expressly overridden by the 2005 Act.[115] However, we do not believe that a conservator would invoke the preference provisions of the NBA to avoid a pre-insolvency transfer made under a qualified financial contract if such transfer was made without the intent to hinder, defraud or delay. Therefore, the discussion below of the relevant provisions of the FDIA would also apply to an Insured Institution that is subject to the NBA. FDICIA would also apply to any contract that is a "netting contract" between "financial institutions." Application of FDICIA, discussed in Section II.E. below, would provide additional impetus for netting of financial contracts.

The FDIA would not apply in the case of a bank or savings institution that is neither Federally-chartered nor Federally-insured. The FDIA also would not apply to a proceeding involving the insolvency of a non-U.S. bank's U.S. branch or agency that did not have Federally-insured deposits. Accordingly, the insolvency of a branch of a non-U.S. bank organized under the laws of New York State (i.e., a New York Branch) that does not take Federally-insured deposits would not be covered by the FDIA.

(b) FDIA Receiverships and Conservatorships

Pursuant to the FDIA, in the case of a *receivership*, subject to certain limitations, a party to a "qualified financial contract"[116] will be entitled after 5:00 p.m. (eastern time) on the business day following the appointment of the receiver to:

(i) exercise any contractual right to terminate, liquidate or accelerate a qualified financial contract as a result of the appointment of the FDIC as receiver or the insolvency or financial condition of the depository institution for which the receiver was appointed;[117]

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113 Under 12 U.S.C. § 1821(c)(2)(A)(i), the FDIC may, at the discretion of the supervisory authority, be appointed conservator of any insured Federal depository institution and the FDIC may accept such appointment. As a practical matter we believe that the OCC would appoint the FDIC as conservator for a national bank.

114 12 U.S.C. §§ 203(d) and 1821(c)(2)(B).

115 12 U.S.C. § 91. See Section II.B5 below for an analysis of this provision.

116 As noted below, the term "qualified financial contract" includes all five types of financial contracts.

117 12 U.S.C. § 1821(e)(8)(A)(i), 12 U.S.C. § 1821(e)(10)(B)(i). Such rights may also be exercised after the Party has received notice that the General Agreement (and Individual Contracts) have been transferred pursuant to 12 U.S.C. §1821(e)(9)(A). Notification of transfer must be given by the receiver by 5:00 p.m. (eastern time) on the

(ii) exercise any rights under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts; and

(iii) exercise any right to "offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with 1 or more [qualified financial contracts] . . .including any master agreement for such contracts or agreements"[118]

The FDIA provides that in the case of a *conservatorship*, the above applies except that a party to a qualified financial contract will be able to exercise any contractual right to terminate other than one based solely on the appointment of or the exercise of rights or powers by the conservator or the insolvency underlying the existence of such powers (i.e., a "bankruptcy" default provision).[119]

The FDIA, in the case of both receivership and conservatorship, expressly provides that neither payments made nor collateral transferred by a depository institution prior to its insolvency, nor any legally enforceable or perfected security interest in any of the assets of the institution, may be avoided by the FDIC (subject to certain exceptions), except where the transferee intended to "hinder, delay, or defraud" the creditors or the receiver or conservator of the institution.[120]

The FDIC's powers as a receiver and as a conservator are different. As receiver, the FDIC has the power to liquidate and wind up the affairs of an institution, while as a conservator, the FDIC has the power to operate the insolvent institution as a going concern. The FDIC, when acting as receiver or conservator, generally will have many of the powers of a bankruptcy trustee (or debtor-in-possession) under the Code, including the right to repudiate burdensome contracts, to enforce contracts and to assign contracts to another party.

The FDIA contains significant limitations on the FDIC's powers with respect to financial contracts that meet the definition of "qualified financial contract". "Qualified financial contract" is defined to include securities contracts, commodity contracts, forward contracts, repurchase agreements and swap agreements.[121] In the 2005 Act, each of the definitions of these types of protected transactions was amended to make it substantively identical to the revised Code

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business day following the date of the appointment of the receiver or the business day following such transfer in the case of a conservatorship pursuant to 12 U.S.C. § 1821(e)(10)(A).

118 12 U.S.C. § 1821(e)(8)(A).

119 12 U.S.C. § 1821(e)(8)(E), (e)(13). If there exists a contractual right to terminate based on insolvency or the appointment of a conservator (or the insolvency or financial condition of the depository institution for which the conservator has been appointed) and some other event of default, then a party would be able to terminate a qualified financial contract upon the occurrence of such other event notwithstanding the appointment of the conservator or the insolvency or financial condition of the depository institution.

120 12 U.S.C. § 1821(e)(8)(C)(ii).

121 12 U.S.C. § 1821(e)(8)(D)(i)-(vi). The term also extends to any "similar agreement" that the FDIC determines by regulation, resolution or order to be a qualified financial contract.

definition for the same transaction (other than that the Code definitions specifically reference certain Code parties and damages limits in certain respects).[122] In the 2006 Act the definitions of forward contract, swap agreement and securities contract in the FDIA were revised to make them substantively identical to the revised definitions of those terms in the Code.

The FDIA also specifies that a master agreement (such as a General Agreement) (i) that documents individual contracts that come within the definition of "forward contract" or "swap agreement", together with all supplements to such master agreement, will be treated as a single agreement and a single qualified financial contract, and (ii) that documents individual contracts that are qualified financial contracts will be treated as one qualified financial contract (but only with respect to those individual contracts that are qualified financial contracts).[123]

2. Right to Terminate

In the case of receivership, the FDIA provides that a party to a qualified financial contract will not be entitled to exercise any contractual right to terminate, liquidate or net such a contract as a result of the appointment of the receiver or the insolvency or financial condition of the depository institution for which the receiver has been appointed until 5 p.m. on the business day after such appointment or after receipt of notice that the qualified financial contract has been transferred pursuant to section 11(e)(9)(A) of the FDIA.[124]

However, in the case of a conservatorship, a party to a qualified financial contract may enforce any contractual right to terminate, liquidate or net for any default other than one based solely on the appointment of the conservator or the insolvency or financial condition of the depository institution for which the conservator has been appointed.[125]

A qualified financial contract will continue in effect in accordance with its terms notwithstanding such a conservatorship. The FDIC will succeed to the rights and obligations of the bank or savings institution. A party to a qualified financial contract will not be able to terminate, liquidate or accelerate the contract as a result of the appointment of the FDIC as conservator, but may be able to do so as a result of any other default existing or occurring subsequent to the appointment of the conservator, such as failure to make a payment that is enforceable under applicable non-insolvency law.

The limitations described above on the ability of a party to utilize a bankruptcy or insolvency default provision in the case of a conservatorship do not affect the rights of parties to

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122 12 U.S.C. § 1821(e)(8)(D). See § 1821(e)(3), described in Section II.B1(b)3 below, which indicates how damages will be calculated under the FDIA.

123 12 U.S.C. § 1821(e)(8)(D)(vii).

124 12 U.S.C. § 1821(e)(l0)(B)(i). 12 U.S.C. § 1821(e)(8)(A) refers to the right to "accelerate" in lieu of the right to "net".

125 12 U.S.C. § 1821(e)(8)(E)(i)(iii), (e)(13). 12 U.S.C. § 1821(e)(10)(B)(ii) refers to the right to "net" in lieu of the right to accelerate. 12 U.S.C. § 1821(e)(8)(A) refers to the right to "accelerate" in lieu of the right to "net".

enforce contractual rights to close-out net or set off termination values or payment amounts upon any permitted termination of a General Agreement.

The FDIA further provides that a party to a qualified financial contract will be entitled to enforce any right under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts.[126]

3. Netting

Section 11(e)(8)(A)(iii) of the FDIA protects the rights of parties to forward contracts, swap agreements, and other qualified financial contracts to "offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more [financial] contracts…including any master agreement for such contracts or agreements."[127] Section 11(e)(8)(D)(vii) provides for the treatment of a master agreement for any financial contract (or a master agreement for such master agreement or agreements) together with all supplements to such master agreement (including any security arrangements) as a single agreement and a single master agreement. This provision would prevent cherry picking among Individual Contracts and would appear to be similar to Section 561 of the Code (master netting) in purpose and may permit cross product netting where the master agreement provides such right, subject to the qualification that each Individual Contract qualifies as a qualified financial contract.[128]

Under the FDIA, the liability of the FDIC in respect of a repudiated contract is generally limited to "actual direct compensatory damages" of the parties to the contract as of the date on which the FDIC took possession of the institution.[129] In the case of qualified financial contracts, however, the "actual direct compensatory damages" arising in respect of the FDIC's repudiation of such a contract are deemed to include normal and reasonable costs of cover or other reasonable measures of damages utilized in the industries for such contract and agreement claims, calculated as of the date of the disaffirmance or repudiation of such contract or agreement.[130]

4. No Selective Transfer or Repudiation

The FDIA permits a conservator or receiver to transfer assets or liabilities of an insolvent institution to another financial institution, including qualified financial contracts, subject to certain

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126 12 U.S.C. § 1821(e)(8)(A), (E). The 2006 Act expanded Section 1821(e)(8)(D) in order to define those "person[s]" who many enforce such rights. New Section 1821(e)(8)(D)(ix) defines a person as "any governmental entity in addition to any entity included in the definition of such term in section 1 of Title 1" of the United States Code.

127 12 U.S.C. § 1821(e)(8)(A)(iii).

128 12 U.S.C. § 1821(e)(8)(D)(vii).

129 Actual direct compensatory damages do not include punitive or exemplary damages, damages for lost profits or opportunity, or damages for pain and suffering. (See 12 U.S.C. § 1821(e)(3)(B)).

130 12 U.S.C. § 1821(e)(3).

limitations. The FDIA provides that, in any transfer of assets of an insolvent institution, the receiver or conservator may not "cherry-pick" among qualified financial contracts between the insolvent institution and any particular counterparty or any affiliate of such counterparty.[131] Thus, the FDIA provides protections that go beyond the counterparty to include financial contracts with the counterparty's affiliates. If any qualified financial contract with a given counterparty is transferred, all qualified financial contracts with that counterparty or any affiliate of such counterparty must be transferred to the same financial institution (together with all claims of or against such counterparty or affiliate, and security and credit enhancements relating thereto). Section 11(e)(11) of the FDIA (which was added by the 2005 Act) also makes clear that the receiver or conservator may not "cherry-pick" among qualified financial contracts between the insolvent institution and any particular counterparty or any affiliate of such person for purposes of repudiating or disaffirming any qualified financial contracts.[132]

5. Pre-insolvency Payments

The FDIA expressly provides that neither payments made nor collateral transferred by an institution prior to its insolvency, nor any legally enforceable or perfected security interest in any of the assets of the institution, may be avoided by the FDIC, except where the FDIC determines that "the transferee had actual intent to hinder, delay, or defraud such institution, the creditors of such institution, any conservator or receiver appointed for such institution."[133] These provisions are intended to ensure that qualified financial contracts receive the same treatment under the FDIA and the Code with respect to any preferential and fraudulent transfers.

If the FDIC is appointed as a conservator or receiver of a national bank, the FDIC will have both the powers granted to it by the FDIA and, to the extent not inconsistent with the FDIA, the powers granted to conservators or receivers of national banks. Therefore, pre-insolvency payments made by an insolvent national bank may also be reviewed under section 91 of the NBA.[134] Pursuant to section 91 of the NBA, all transfers by a national bank, including "payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to ... preference of one creditor to another… shall be utterly null and void ...." The 2005 Act amended the FDIA provision described above to clarify that it supersedes section 91 of the NBA. As amended, the FDIA provision applies to "... [section 91 of the NBA or] any other

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131 12 U.S.C. § 1821(e)(9). In addition, a receiver or conservator has an express right to transfer qualified financial contracts netting agreements, security agreements or other credit enhancement related thereto, subject to certain limitations to certain foreign banks or financial institutions. 12 U.S.C. § 1821(e)(9)(B).

132 12 U.S.C. § 1821(e)(11).

133 12 U.S.C. § 1821(e)(8)(C). See also, 12 U.S.C. § 1821(e)(12), which prohibits the avoidance of any legally enforceable or perfected security interest in any of the assets of any depository institution except where such an interest is taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or the creditors of the institution.

134 12 U.S.C. § 91. See Nat'l. Sec. Bank v. Butler, 129 U.S. 223 (1889) pre-insolvency transfers by national banks can be invalidated by Section 91; see also First Nat'l Bank v. Andresen, 57 F.2d 17 (8th Cir. 1932); but see Nelson v. Lewis, 73 F.2d 521 (2d. Cir. 1934); Rucker v. Kokrda, 68 F.2d 73 (10th Cir. 1933).

Federal or State law relating to the avoidance of preferential or fraudulent transfers…."[135] Accordingly, a conservator or receiver should not be able to invoke the preference provisions of the NBA to avoid a pre-insolvency transfer made under a qualified financial contract if such transfer was made without the intent to hinder, defraud, or delay. Furthermore, if FDICIA applies, a court should not void a transfer made pursuant to a security arrangement relating to a "netting contract" if it is to give effect to the broad preemptive language of the new section 403(f) of FDICIA.[136]

6. No Walkaway Clause

The FDIA was amended by the 2005 Act to deny enforcement against a Federally-insured depository institution in default of "walkaway" clauses in qualified financial contracts. In order to clarify the ability of the receiver to enforce contracts, the 2006 Act states that payment or delivery obligations due from a party are suspended until the earlier of the time a party receives notice that such contract has been transferred or 5:00 p.m. on the business day following the date of the appointment of the receiver. A walkaway clause is defined as follows: "any provision in a qualified financial contract that suspends, conditions or extinguishes a payment obligation of a party, in whole or in part, or does not create a payment obligation of a party that would otherwise exist, solely because of [(i)] such party's status as a non-defaulting party in connection with the insolvency of an insured depository institution that is a party to the contract or [(ii)] the appointment of or the exercise of rights or powers by a conservator or receiver of such depository institution, and not as a result of a party's exercise of any right to offset, setoff or net obligations that exist under the contract, any contract between those parties, or applicable law."[137]

This FDIA restriction on walkaway clauses applies also to FDICIA, discussed below.[138] There is a comparable provision in both the OLA and NYBL, discussed below, but no comparable provision in the Code. The General Agreement does not contain a walkaway clause.

C. The OLA[139]

1. Background; Definitions

(a) OLA Insolvency Proceedings.

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135 12 U.S.C. § 1821(e)(8)(C).

136 12 U.S.C. § 4403(f) and Section II.E. below.

137 12 U.S.C. § 1821(e)(8)(G)(iii).

138 12 U.S.C. § 1821(e)(8)(G)(i). The FDIC has been especially concerned to protect its insurance fund and its mandate to manage bank insolvencies in the public interest.

139 Throughout this Section II.C, we assume that the insolvent U.S. Party will be a Covered Financial Company.

Title II of the Dodd-Frank Act establishes the OLA, [140] which authorizes the Secretary of the Treasury to appoint the FDIC as receiver of certain systemically significant financial companies that are not federally-insured depositories[141] following a recommendation, determination and judicial review process set forth in the OLA.[142] The purpose of the OLA is "to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard."[143] The OLA has not yet been used. No attempt has been made to apply the OLA to a failing entity.

As receiver, the FDIC is directed to liquidate and wind up the affairs of a Covered Financial Company in such manner as the FDIC deems appropriate, subject to all legally enforceable and perfected security interests and all legally enforceable security entitlements in respect of assets of the Covered Financial Company.[144] The FDIC's actions under the OLA are subject to certain mandatory terms and conditions, including that the FDIC shall (i) determine that any such action is necessary for purposes of the financial stability of the United States, and not for the purpose of preserving the Covered Financial Company, and (ii) ensure that unsecured creditors bear losses in accordance with the priority of claims provisions of the OLA.[145]

The powers of the FDIC as receiver under the OLA follow closely its powers under the FDIA. In addition, the OLA provides that the FDIC may avoid preferential and fraudulent transfers[146] and preferential set-offs,[147] in each case under provisions similar (but not identical) to

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140 12 U.S.C. §§ 5381-5394.

141 We note that insurance company proceedings may be precipitated by the OLA, but applicable state law will apply. 12 U.S.C. § 5383(e).

142 The required determinations, which are to be made by the Secretary of the Treasury in consultation with the President, include findings that the financial company is in default or danger of default, its failure and resolution under otherwise applicable law would have serious adverse effects on the financial stability of the United States, and no viable private sector alternative is available to prevent the default of the financial company, 12 U.S.C. § 5383(b). If the Covered Financial Company's board of directors (or equivalent body) does not acquiesce to the appointment of the FDIC as receiver, the Secretary of the Treasury's determinations will be subject to judicial review by the District Court for the District of Columbia under an "arbitrary and capricious" standard. 12 U.S.C. § 5382(a)(1). If the determination is not "arbitrary and capricious" then the District Court for the District of Columbia will appoint the FDIC as receiver of the Covered Financial Company. An appeal of the District Court's order to the United States Court of Appeals for the District of Columbia will consider any appeal of the District Court's order on an expedited basis and determine whether that Covered Financial Company is in default or danger of default and that the determination is not arbitrary and capricious. Special provisions of the OLA apply to the appointment of the FDIC as receiver for a Covered Broker or Dealer. See § 5385(d). These provisions are discussed in footnotes 151, 216 and section II.F. below.

143 12 U.S.C. § 5384.

144 12 U.S.C. § 5390(a)(1)(D).

145 12 U.S.C. § 5386.

146 12 U.S.C. § 5390(a)(11).

147 12 U.S.C. § 5390(a)(12).

the corresponding provisions of the Code,[148] and may deviate from the equal treatment of similarly situated creditors in certain circumstances.[149] Further, the FDIC has the power to enforce contracts of subsidiaries and affiliates of the Covered Financial Company, notwithstanding any *ipso facto* contractual rights based solely on the insolvency, financial condition or receivership of the Covered Financial Company, if the obligations of the affiliate or subsidiary under the contract are guaranteed or otherwise supported by or linked to the Covered Financial Company and either: (i) the guarantee or other support and all related assets and liabilities are transferred to a bridge financial company or solvent third party during the time period allowed for the transfer of qualified financial contracts or (ii) the FDIC provides "adequate protection" for the supported obligations.[150]

Like the FDIA, the OLA contains significant limitations on the FDIC's powers with respect to financial contracts meeting the definition of "qualified financial contract."

The OLA applies to "financial companies" for which the Secretary of the Treasury has made a systemic risk determination under Section 203(b) of the OLA and that are not Insured Institutions, (i.e., Covered Financial Companies). A "financial company" is defined as any "company" incorporated or organized under U.S. Federal or State law that is one of the following:

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148 See 11 U.S.C. §§ 547, 548 and 553. The FDIC has issued regulations implementing certain provisions of the OLA, including a rule to conform its avoidance powers with respect to fraudulent and preferential transfers to the corresponding provisions under the Code. 12 C.F.R. § 380.9 (76 Fed. Reg. 41639, July 15, 2011, effective Aug. 15, 2011.) Regulation 380.9 seeks to harmonize the application of the avoidance powers of the FDIC with the analogous provisions of the Code so that transferees of assets will have the same treatment in a liquidation under the OLA that they would have under the Code.

149 See 12 U.S.C. § 5390(b)(4), (d)(4) and (h)(5)(E). Upon appropriate determinations, the FDIC may make additional payments or credit additional amounts to some but not other creditors of the Covered Financial Company with equally ranking claims. Of relevance to derivatives counterparties, such additional amounts may take the form of payments or credits to third-party institutions in order to induce such institutions to accept liability of the creditors' claims. 12 U.S.C. § 5390(d)(4)(C). Such additional payments or credit may be clawed back by the FDIC if necessary to repay obligations issued by the FDIC to the Secretary of the Treasury under the OLA. 12 U.S.C. § 5390(o)(1)(D)(i).

150 12 U.S.C. § 5390(c)(16). On November 15, 2012, Rule § 380.12 entitled "Enforcement of Subsidiary and Affiliate Contracts by the FDIC as Receiver of a Covered Financial Company" became effective. (77 Fed. Reg. 63214, Oct. 16, 2012, effective Nov. 15, 2012). Rule § 380.12 clarifies the power of the FDIC to enforce contracts of subsidiaries and affiliates of the Covered Financial Company (including qualified financial contracts) during the liquidation process. An agreement is "linked to" a Covered Financial Company if it contains a provision that provides a contractual right to "cause the termination, liquidation or acceleration of such contract based solely on the insolvency, financial condition, or receivership of the covered financial company." (Referred to as a "specified financial condition clause.") The term "support" means an undertaking to guarantee, indemnify, or make loan advances or capital contributions or be contractually obligated to provide any other financial assistance to the subsidiary or affiliate for the purpose of supporting its contractual obligations for the benefit of a counterparty to a linked contract. Rule § 380.12 applies to all contracts and not just qualified financial contracts. It does not affect other provisions of the OLA governing qualified financial contracts, such as sections 210(c)(8) and 210(c)(9) (relating to rights of termination, liquidation or acceleration and rights of transfer of qualified financial contracts). 12 U.S.C. § 5390(c)(8), (9).

(i) a bank holding company as defined in section 2(a) of the Bank Holding Company Act of 1956;

(ii) a nonbank financial company supervised by the Board of Governors of the Federal Reserve (the "Board");

(iii) any company that is predominantly engaged in activities the Board has determined are financial in nature or incidental thereto for purposes of Section 4(k) of the Bank Holding Company Act; and

(iv) any subsidiary (other than an insured depository institution or an insurance company) of one of the aforementioned companies that is predominantly engaged in activities the Board has determined are financial in nature or incidental thereto for purposes of Section 4(k) of the Bank Holding Company Act.[151]

In order to be considered to be "predominantly engaged" in the activities described in clauses (iii) or (iv), a company's consolidated revenues from such activities must constitute at least 85% of its total consolidated revenues, as established in regulations promulgated by the FDIC in consultation with the Secretary of the Treasury.[152] The OLA does not apply to federally chartered

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151 12 U.S.C. § 5381(a)(11). If the OLA proceeding is for a Covered Broker or Dealer, the FDIC must appoint SIPC as trustee. 12 U.S.C. § 5385(a). SIPC must apply SIPA generally but not to assets and liabilities transferred by the FDIC, as receiver, to a bridge financial company. 12 U.S.C. § 5385(b)(1). The effect of SIPA on qualified financial contracts is highly limited, since the provisions regarding qualified financial contracts in section 210 of the OLA will apply rather than the provisions of the Code. 12 U.S.C. § 5385(b)(4). For example, Section 210(c)(10)(B) limits the ability of a counterparty to exercise any right to cause the termination, liquidation or acceleration of a qualified financial contract as a result of the appointment of the FDIC as receiver or the insolvency or financial condition of the covered broker or dealer until 5:00 pm (eastern time) on the business day following the appointment of the receiver or after the person has received notice that the contract has been transferred pursuant to section 210(c)(9). Similarly, the provisions relating to repudiation of qualified financial contracts under section 210(c)(11) would apply. See 12 U.S.C. § 5390(c)(10)(B), (c)(11). Any claims for damages under a forward contract or swap agreement are to be paid in accordance with the priorities under section 210(b) of the OLA; provided that SIPC must allocate customer property and deliver customer name securities in accordance with section 8(c) of SIPA. (15 U.S.C. § 78fff-2(c); 12 U.S.C. § 5385(g)). If the OLA proceeding is for a "stockbroker" that is not a member of SIPC, the FDIC must generally apply the provisions of subchapter III of Chapter 7 of the Bankruptcy Code in respect of the distribution to customers of customer name securities, customer property and member property. 12 U.S.C. § 5390(m)(1)(A). In the case of any Covered Financial Company or bridge financial company that is a commodity broker, the FDIC must generally apply the provisions of subchapter IV of chapter 7 of the Bankruptcy Code to customers and customer property. 12 U.S.C. § 5390(m)(1)(B).

152 12 U.S.C. § 5381(b). On June 10, 2013, the FDIC promulgated Rule § 380.8, a regulation with respect to the definition of "predominantly engaged in activities that are financial in nature or incidental thereto" which became effective on July 10, 2015. The final rule largely mirrors the Federal Reserve Board's definition of the same term in a final rule issued in April, 2013 for the purpose of determining which nonbank financial institutions may be potentially subject to designation as systemically significant financial institutions by the Financial Stability Oversight Council. (12 C.F.R. § 380.8. See also 78 Fed. Reg. 34712 (June 10, 2013)).

Farm Credit System institutions, the Fannie Mae, Freddie Mac, any Federal Home Loan Bank or certain other governmental or regulated entities.

In any case where the FDIC is appointed as receiver of a Covered Financial Company under the OLA, it may also appoint itself as receiver of any "covered subsidiary" of the Covered Financial Company if the FDIC and the Secretary of the Treasury jointly determine that (i) the subsidiary is in default or danger of default, (ii) the appointment of the FDIC as receiver would avoid or mitigate serious adverse effects on the financial stability or economic conditions of the United States and (iii) such action would facilitate the orderly liquidation of the Covered Financial Company.[153] A subsidiary of a Covered Financial Company other than (i) an insured depository institution, (ii) an insurance company or (iii) a Covered Broker or Dealer is eligible to be treated as a covered subsidiary.[154] If the FDIC is appointed as receiver, the covered subsidiary is treated as a Covered Financial Company under the OLA.[155]

(b) Qualified Financial Contract Overview.

The OLA provides that, subject to certain limitations, a party to a qualified financial contract will be entitled after 5:00 p.m. (eastern time) on the business day following the appointment of the receiver to:

(i) exercise any right to cause the termination, liquidation or acceleration of a qualified financial contract as a result of the appointment of the FDIC as receiver or the insolvency or financial condition of the Covered Financial Company for which the receiver was appointed;

(ii) exercise any rights under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts; and

(iii) exercise any right to "offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with [one] or more qualified financial contracts.[156]

Further, the OLA expressly provides that neither payments made nor collateral transferred by a Covered Financial Company in connection with a qualified financial contract may be avoided

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153 12 U.S.C. § 5390(a)(1)(E).

154 12 U.S.C. § 5381(a)(9).

155 12. U.S.C. § 5390(a)(1)(E)(ii).

156 12 U.S.C. §§ 5390(c)(8)(A), 10(B)(i). Such rights may also be exercised after the Party has received notice of transfer of a qualified financial contract. Such notice must be given by the receiver no later than 5:00 pm (eastern time) on the business day following the appointment of the receiver. 12 U.S.C. §5390(c)(9)(A) and(10)(A)(ii). The purpose of this provision is to afford the FDIC as receiver the ability (which it similarly has under the FDIA) to transfer qualified financial contracts to a bridge financial company or other transferee and to avoid claims arising from early termination of a qualified financial contract if the FDIC determines that is appropriate.

by the FDIC, except where the transferee intended to "hinder, delay, or defraud" the creditors or the receiver of the Covered Financial Company.[157]

"Qualified financial contract" is defined to include securities contracts, commodity contracts, forward contracts, repurchase agreements and swap agreements.[158] The definition of each of these types of protected transactions is substantially identical to the corresponding definition under the FDIA.

The OLA also specifies that a master agreement (such as the General Agreement) (i) that documents transactions falling within the definition of "forward contract" or "swap agreement", together with all supplements to such master agreement, will be treated as a single financial contract. However, if the General Agreement relates to agreements that are not financial contracts the master agreement will be deemed to be one qualified financial contract (but only with respect to those underlying agreements that are qualified financial contracts).[159]

2. Right to Terminate.

The OLA provides that a person that is a party to a qualified financial contract will be entitled to enforce any right to cause the termination, liquidation or acceleration of such a contract which arises upon the date of the FDIC's appointment as receiver of a Covered Financial Company or at any time after such appointment, [160] except that any such right that arises solely as a result of or incidental to the appointment of the receiver (or the insolvency or financial condition of the Covered Financial Company for which the receiver has been appointed) may not be exercised until 5:00 p.m. (eastern time) on the business day after such appointment or after the Non-Defaulting Party has received notice that the General Agreement has been transferred pursuant to Section 210(c)(9)(A).[161] When termination rights are accessible, the OLA further provides that a person that is a party to a qualified financial contract will be entitled to enforce any right under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts.[162]

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157 12 U.S.C. § 5390(c)(8)(C). Under the safe harbor provisions of section 546(e), (g) and (j) of the Code applicable to forward contracts, swap agreements and master netting agreements for such qualified financial contracts, only the intent of the debtor/transferor is relevant. 11 U.S.C. § 546(e)-(g). See also 11 U.S.C. § 548(a)(1)(A).

158 12 U.S.C. § 5390(c)(8)(D)(i)-(iv). The term "swap agreement" also extends to any "similar agreement" that the FDIC determines by regulation, resolution or order to be a qualified financial contract.

159 12 U.S.C. § 5390(c)(8)(D)(viii).

160 12 U.S.C. § 5390(c)(8)(A), (10)(B).

161 12 U.S.C. § 5390(c)(10)(B)(i). 12 U.S.C. § 1821(e)(8)(A)(i) refers to the right to "accelerate", whereas the limitation in 12 U.S.C. § 5390(c)(10)(B)(i) refers to the right to "net." The FDIC must give notice to the counterparty to a qualified financial contract no later than 5:00 pm (eastern time) on the business day following the date of appointment of the FDIC as receiver. 12 U.S.C. § 5390(c)(10)(B)(ii).

162 12 U.S.C. § 5390(c)(8)(A)(ii). 12 U.S.C. § 5390(c)(8)(D)(x) defines a person to include "any governmental entity in addition to any entity included in the definition of such term in section 1 of Title I" of the United States

3. Netting.

A key provision of the OLA protects the rights of parties to forward contracts, swap agreements and other qualified financial contracts to "offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with [one] or more qualified financial contracts.[163]

Under the OLA, the liability of the FDIC in respect of a repudiated contract is generally limited to "actual direct compensatory damages" of the parties to the contract as of the date on which the FDIC was appointed as receiver.[164] With respect to qualified financial contracts, however, the compensatory damages arising in respect of the FDIC's repudiation of such a contract are deemed to include normal and reasonable costs of cover or other reasonable measure of damages utilized in the industries for such contract and agreement claims, calculated as of the date of the disaffirmance or repudiation of such contract or agreement".[165]

4. No Selective Transfer or Repudiation.

The OLA provides that, in any transfer of assets of the Covered Financial Company, the FDIC may not "cherry-pick" among qualified financial contracts between the Covered Financial Company and any particular counterparty. Instead, if any qualified financial contract with a given counterparty is transferred, all qualified financial contracts with that counterparty or its affiliates must be transferred to the same party (together with all claims, security and credit enhancements related thereto).[166] Likewise, the FDIC may not "cherry-pick" among qualified financial contracts between the insolvent Covered Financial Company and any particular counterparty or that counterparty's affiliates for purposes of repudiating or disaffirming any qualified financial contracts.[167]

Code.

163 12 U.S.C. § 5390(c)(8)(A)(iii).

164 Actual direct compensatory damages do not include punitive or exemplary damages, damages for lost profits or opportunity or damages for pain and suffering. 12 U.S.C. § 5390(c)(3)(B).

165 12 U.S.C. § 5390(c)(3)(A), (C).

166 12 U.S.C. § 5390(c)(9)(A). Qualified financial contracts, and related claims, security and credit enhancements of the counterparty's affiliates must also be included in such transfer. Id. Certain subordinated claims against the Covered Financial Company need not be transferred. 12 U.S.C. § 5390(c)(9)(A)(i)(II). In addition, a receiver has the express right to transfer qualified financial contracts of the debtor and its affiliates to certain foreign institutions provided that the qualified financial contracts will be treated under the laws applicable to the foreign institutions substantially the same as they would be treated under applicable U.S. insolvency law. 12 U.S.C. § 5390(c)(9)(B).

167 12 U.S.C. § 5390(c)(11). Qualified financial contracts of the counterparty's affiliates must be disaffirmed or repudiated together with the counterparty's qualified financial contracts although certain subordinated claims against the Covered Financial Company need not be transferred. 12 U.S.C. § 5390(c)(9)(A)(i)(II). The result of such transfer provisions may be quite different than that under the Code which is limited to assumption and

5. Pre-insolvency Payments.

The OLA expressly provides that the FDIC, whether acting in its corporate capacity or as receiver for a Covered Financial Company, may not avoid any transfer of money or other property in connection with any qualified financial contract with a Covered Financial Company, except where "the transferee had actual intent to hinder, delay, or defraud" such company, its creditors or the FDIC as receiver for such company.[168] Similarly to the corresponding provision of the FDIA, this provision applies "[n]otwithstanding…[Section 91 of the NBA, or] any other Federal or State law relating to the avoidance of preferential or fraudulent transfers.[169]

6. No Walkaway Clause.

Like the FDIA, the OLA denies enforcement against a Covered Financial Company in default of "walkaway" clauses in qualified financial contracts. A walkaway clause is defined in a substantively identical manner to the corresponding definition under the FDIA.[170] As under the FDIA, this restriction on enforcement of walkaway clauses applies notwithstanding section 403 and 404 of the FDICIA, discussed below.[171]

D. The NYBL[172]

1. NYBL Insolvency Proceedings

The FDIC or another qualified Federal receiver may be appointed or appoint itself as conservator or receiver for an insolvent New York State chartered banking institution under several different circumstances. First, the New York State Superintendent of Financial Services (the "**Superintendent**") is authorized to tender the receivership of an insolvent New York State chartered banking institution that accepts Federally-insured deposits to the FDIC or to another qualified Federal receiver.[173]

In addition, where the authority having supervision of any insured State depository institution tenders appointment of a conservator or receiver to the FDIC, the FDIC may accept

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assignment of financial contracts of the debtor and counterparty.

168 12 U.S.C. § 5390(c)(8)(C). Unlike the corresponding provision of the FDIA, the exception refers only to the transferee's actual intent, not to the FDIC's determination of such actual intent. See 12 U.S.C. § 1821(e)(8)(C).

169 12 U.S.C. § 5390(c)(8)(C).

170 12 U.S.C. § 5390(c)(8)(F).

171 12 U.S.C. § 5390(c)(8)(F)(i).

172 Throughout this Section II.D., we assume that the Superintendent has not tendered the receivership of an insolvent New York State chartered banking institution that accepts Federally-insured deposits to the FDIC.

173 N.Y. Banking Law § 634.

such appointment.[174] Such appointment may occur where the appropriate Federal banking agency (as defined in section 3(q) of the FDIA) has determined that (i) the institution is undercapitalized and has no reasonable prospect of becoming adequately capitalized or fails to satisfy certain conditions specified in the FDIA, or the institution is critically undercapitalized or otherwise has substantially insufficient capital, [175] and (ii) the appointment is necessary to carry out the purposes of the "prompt corrective action" provisions of section 38 of the FDIA. However, a Federal banking agency may not appoint a conservator on these grounds without 48 hours prior notice to the FDIC or without the FDIC's prior consent.[176] The "appropriate Federal banking agency" with respect to an insured state member bank is the Board.[177]

The FDIC may appoint itself as conservator or receiver for an insured New York state-chartered bank if it determines that (i) a conservator, receiver or other legal custodian has been appointed for such institution, such institution has been subject to the appointment of any such conservator, receiver or custodian for a period of at least 15 consecutive days, and one or more of the depositors in such institution is unable to withdraw any amount of any insured deposit, or that such institution has been closed by or under the laws of any state; and (ii) one or more of the grounds specified in section 11(c)(5)[178] of the FDIA existed with respect to such institution at the time the conservator, receiver, or other legal custodian was appointed or such institution was closed, or any such grounds exist at any time during the appointment of the conservator, receiver or other legal custodian or while such institution is closed.[179]

Moreover, the Board of Directors of the FDIC may appoint the FDIC as sole receiver or conservator for an insured state-chartered depository institution, after consultation with the appropriate Federal and state supervisory authorities, where the Board of Directors has made a determination (a) that grounds for such appointment exist[180] and (b) that the appointment is necessary to reduce (i) the risk of loss to the FDIC's deposit insurance fund with respect to the institution or (ii) any loss that the deposit insurance fund is expected to incur with respect to the institution.[181]

If the FDIC appoints itself as conservator or receiver for an insured state bank, or is appointed as conservator or receiver by the appropriate Federal bank regulatory agency, the conservatorship and receivership provisions of the FDIA apply to such appointment in the same manner as they would apply to a Federal depository institution, except that the FDIC is required

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174 12 U.S.C. § 1821(c)(3)(A).

175 12 U.S.C. § 1821(c)(5)(K) and (L).

176 12 U.S.C. § 1821(c)(11).

177 12 U.S.C. § 1813(q)(2)(A).

178 See, 12 U.S.C. § 1821(c)(5).

179 12 U.S.C. § 1821(c)(4).

180 See, 12 U.S.C. § 1821(c)(5).

181 12 U.S.C. § 1821(c)(10).

to give effect to state depositor preference statutes.[182] If the FDIC is appointed to such capacity by the applicable state banking supervisor, the FDIC may exercise both the powers given to conservators and receivers by the applicable state law and the powers conferred upon it by section 11 of the FDIA.[183]

In all other cases, an insolvency proceeding for an Uninsured N.Y. Institution which is not an insured state bank would be conducted solely under the NYBL.[184] As a general matter, the insolvency proceedings under the NYBL, which are administered by the Superintendent, are fairly similar to those applicable under the FDIA. A proceeding under the NYBL is commenced when the Superintendent takes possession of the business and property of such banking institution.[185] If the Superintendent does so, he may conduct proceedings to liquidate the institution or may appoint the FDIC as receiver or liquidator of such institution. The Superintendent has many of the powers of a bankruptcy trustee under the Code, including the right to repudiate burdensome contracts. The commencement of an insolvency proceeding is at the discretion of the Superintendent and may not be initiated by individual creditors.[186]

2. Right to Terminate

Section 619(d)(2)(i) of the NYBL provides that the Superintendent's taking possession of a New York banking organization does not operate as a stay or as an injunction against the termination of a "qualified financial contract" in accordance with its terms. That section also provides that a party to a qualified financial contract may exercise any of its rights under a security arrangement relating to any qualified financial contract free from any stay. The definition of qualified financial contracts under the NYBL enumerates certain categories of financial contracts.[187] Those categories include, among others, forward contracts (which unlike the Code and the FDIA are defined to include spot transactions). The NYBL does not describe in detail which financial contracts would be encompassed by this category. Nevertheless, we believe that generally the Superintendent should interpret each category to include the same range of financial

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182 12 U.S.C. § 1821(c)(13), (d)(11)(B).

183 12 U.S.C. § 1821(c)(3)(B).

184 The applicable laws are found in Article 13 of the NYBL.

185 There is no provision in the NYBL that permits a creditor of the bank or a person other than the Superintendent to commence such a proceeding.

186 N.Y. Banking Law § 606(1).

187 N.Y. Banking Law § 6l8-a2(e). Under section 618-a2(e)(i) of the NYBL, "qualified financial contract" means any securities contract, commodity contract, forward contract (including spot and forward foreign exchange), repurchase agreement, swap agreement, and any similar agreement, any option to enter into any such agreement, including any combination of the foregoing, and any master agreement for such agreements, as well as other agreements determined by the Superintendent to be qualified financial contracts, provided that such agreements satisfy certain documentary requirements. Since the definition of forward contract includes spot contracts, it would appear that forward contracts providing for the delivery of a commodity in two days or less will constitute forward contracts under the NYBL.

contracts that are covered by the corresponding definitions under the FDIA.[188] Moreover, the definition indicates that a master agreement for forward contracts, together with all supplements thereto, will be treated as one financial contract.

3. Netting

Section 619(d)(2) of the NYBL provides that the Superintendent's taking possession of a New York banking organization shall not act as an injunction against "any right to offset or net out any termination value, payment amount, or other transfer obligation arising under ... qualified financial contracts." Under section 618-a of the NYBL, once the Superintendent has taken possession of an institution, the Superintendent may "repudiate" any contract to which the institution is a party if the performance of that contract is burdensome and the repudiation of that contract would promote the orderly administration of the institution's affairs.

As under the FDIA, the liability of the Superintendent in respect of a repudiated contract is generally limited to "actual direct compensatory damages" of the parties to the contract as of the date on which the Superintendent took possession of the institution.[189] Section 618-a2(b) of the NYBL provides that the liability of the Superintendent upon the repudiation of any qualified financial contract, or in connection with the termination or liquidation of any qualified financial contract in accordance with the terms thereof, will be the "actual direct compensatory damages" arising in respect of the Superintendent's repudiation of such a contract and shall be "deemed to include normal and reasonable costs of cover or other reasonable measures of damages utilized among participants in the market for qualified financial contract claims, calculated as of the date of repudiation or termination of such qualified financial contract in accordance with its terms."[190] These damages are determined as of the date of the appointment of the conservator or receiver or the date of the disaffirmance or repudiation of the qualified financial contract.[191]

4. Selective Repudiation

Section 618-a2(e) of the NYBL provides that any master agreement for qualified financial contracts, together with all supplements thereto, "shall be treated as one qualified financial contract" provided that such contract is reflected in the books and records of the banking organization or documentary evidence of such agreement is provided.[192] Accordingly, if the

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188 See above under Section II; see also Staff Interpretive Letter from Rosanne Notaro, Assistant Counsel, N. Y. Banking Department, to Robert E. Hand, Esq., General Counsel, Bank of Tokyo-Mitsubishi, Ltd. (May 20, 2003) in which the staff of the State Banking Department referenced both the FDIA and the Code definitions and parallel purposes in determining a securities lending transaction to be within the section 618-a2(e) definition of qualified financial contract. While this precedent is not clearly on the point, we believe the Superintendent would look to the FDIA and Code as then in effect, rather than as those statutes were at the time of the enactment of the relevant NYBL provisions. See Id. (no reference to looking back to earlier versions of FDIA and Code).

189 12 U.S.C. § 1821(e)(3)(A); see also N.Y. Banking Law § 618-a2(a).

190 12 U.S.C. § 1821(e)(3)(C)(i); see also N.Y. Banking Law § 618-a2(a)-(b).

191 N.Y. Banking Law § 618-a2(b).

192 N.Y. Banking Law § 618-a2(e).

General Agreement had not been terminated, and the Superintendent determined to repudiate any Individual Contract, the Superintendent would be required to repudiate the General Agreement and all of the Individual Contracts and could not cherry pick among Individual Contracts.

5. No Forfeiture

Sections 618-a2(b) and (c) of the NYBL direct the Superintendent to disregard contractual provisions of qualified financial contracts that purport to "effect a forfeiture" of amounts due to the Superintendent upon termination or liquidation of the contract.

E. FDICIA

1. Application of FDICIA

In the event a court for some reason did not treat a General Agreement and the Individual Contracts as a single agreement or did not (or could not) apply the analysis concerning the Code, FDIA, NYBL and OLA set forth above, the close-out netting provisions in a General Agreement may still be enforced based on FDICIA so long as two "financial institutions" are the Parties to the General Agreement. Section 402(9) of FDICIA defines "financial institution" to mean a registered or licensed broker or dealer (and certain affiliates as determined by the Board), a depository institution (national and state banks, irrespective of their eligibility for deposit insurance, credit unions, thrift institutions, U.S. branches or agencies of foreign banks, foreign banks that established a branch or agency (with or without their U.S. branches or agencies (if any) as single entities), or Edge Act corporations), a registered or licensed futures commission merchant or any other institution determined by the Board.[193]

FDICIA recognizes the enforceability of the termination, liquidation, acceleration and netting of payment obligations and the covered contractual payment entitlements between two "financial institutions" under a "netting contract", "[n]otwithstanding any other provision of State or Federal law" (other than section 11(e) of the FDIA, section 210(c) of the Dodd-Frank Act and any order authorized under section 5(b)(2) of SIPA and certain other Federal statutes)[194] and notwithstanding any "stay, injunction, avoidance or similar proceeding or order, whether issued or granted by a court, administrative agency or otherwise" in accordance with, and subject to the conditions of, the terms of any applicable netting contract (except as provided in Section 561(b)(2) of the Code with respect to commodity brokers subject to a commodity broker liquidation pursuant to subchapter IV of chapter 7 of the Code). FDICIA further provides in Section 403(f) that "[t]he

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193 12 U.S.C. § 4402(9). Although we believe the reference to "foreign banks" is intended to address a foreign bank as a single institution encompassing all its branches and agencies (including its U.S. branches and agencies), this is not clear on the face of the statute. It is, therefore, possible that the statute may be construed so as to sever the effect of transactions with non-U.S. branches or agencies.

194 12 U.S.C. § 4403(a). Also carved out from this provision are section 207(c) of the Federal Credit Union Act (12 U.S.C. § 1787(c)) and Section 1367 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. §4617(d)).

provisions of any security agreement or arrangement or other credit enhancement related to one or more netting contracts between any 2 financial institutions are also enforceable in accordance with their terms (except as provided in Section 561(b)(2) of Title 11 [with respect to commodity brokers as aforesaid] and shall not be stayed, avoided or otherwise limited by any State or Federal law (other than section [11(e)] of the FDIA, [certain provisions of the Federal Credit Union Act not relevant to this Memorandum] and any order authorized under Section 5(b)(2) of SIPA" [with respect to stockbroker liquidations.]) [195]

Section 402(14) of FDICIA defines "netting contract" to mean, in pertinent part, "a contract or agreement between two (2) or more financial institutions that…provides for netting present or future payment obligations or payment entitlements (including liquidation or close out values relating to the obligations or entitlements) among the parties to the agreement . . ."[196]

The 2005 Act deleted the requirement that the netting contract be governed by the laws of the United States or a constituent jurisdiction. However, the contract must still be valid under, and not precluded by, Federal law to be a "netting contract" for purposes of FDICIA.[197] We believe that the General Agreement qualifies as a "netting contract" under FDICIA if both parties to the General Agreement are financial institutions.

The original terms of FDICIA delegated rule-making authority to the Board to expand the definition of financial institutions beyond the original enumerated entities.[198] Under Regulation EE adopted by the Board in 1994, the expanded definition of financial institution extended the protections of FDICIA to a significant number of new entities (both domestic and foreign) that met both prongs of a two-prong test (qualitative and quantitative) included in the new definition of "financial institution".[199]

(a) Qualitative Test

The qualitative test requires that a "person" "represents that it will engage in financial contracts as a counterparty on both sides in one or more financial markets".[200] We understand that

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195 12 U.S.C. § 4403(f). See generally 12 U.S.C. §§ 4401-4407. A plain reading of this broad language in FDICIA appears to preempt all contrary Federal and state laws and actions with respect to those laws. The Board of Governors of the Federal Reserve System has recognized that "[n]etting contracts between financial institutions in the United States generally are valid under the netting provisions of... FDICIA." 57 Fed. Reg. 31974 (July 20, 1992) (later codified at 7 C.F.R. pt 206). That the 2005 and 2006 Acts specifically carved out particular statutes from this provision argues strongly that courts should give this pre-emptive directive full effect as to all other statutes.

196 12 U.S.C. § 4402(14)(A)(i).

197 12 U.S.C. § 4402(14)(B).

198 12 U.S.C. § 4402(9). This authority remains in the amended statute.

199 Netting Eligibility for Financial Institutions Regulation EE, 12 C.F.R. § 231.3.

200 Netting Eligibility for Financial Institutions Regulation EE, 12 C.F.R. § 231.3(a).

in a letter addressed to the International Swaps Dealers Association ("ISDA") dated March 3, 1994, the Associate General Counsel of the Board explained that the word "represents" does not require written contractual representations; that the letter also states that there should be many ways to meet this requirement. For example, representations can be made in noncontractual writings or orally and that representations do not have to be made to a particular counterparty.

(b) Quantitative Test

An entity also must satisfy a quantitative test before it will be deemed a financial institution under the new definition. This quantitative test requires that the entity meet either of two minimum thresholds with respect to "financial contracts". (This test is not relevant to entities that qualify under the statute, such as state-chartered branches; it is only relevant to entities that seek to qualify under the rule.)

The definition of "financial contract" in the new rule adopts the definition of "qualified financial contract" that appears in section 11(e)(8)(D)(i) of the FDIA, as amended.[201]

The first minimum threshold test requires an entity to have outstanding financial contracts of at least $1 billion in notional principal amount with counterparties that are not affiliates. The alternative minimum threshold test requires that an entity have financial contracts with a total gross mark-to-market position of at least $100 million.[202] These quantitative requirements are substantially similar to those in the definition of "financial participant" under the Code. Satisfaction of either of these two quantitative thresholds will satisfy the quantitative prong of the two-prong test. Both of the alternative quantitative tests can be met by an entity that exceeds either of the thresholds on any single day during the prior 15-month period. If a person qualifies as a financial institution under the two-prong test, that person will be considered a financial institution for the purposes of any contract entered into during the period it qualifies even if the person subsequently fails to qualify.[203]

(c) Treatment of Transactions

Assuming that each of the parties to a General Agreement is a "financial institution", the netting provisions in FDICIA would apply to that contract.[204] After a review of the applicable

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201 The sole difference from the FDIA definition is that Regulation EE defines a "forward contract" to include a contract with a maturity date two days or less after the date the contract is entered into (i.e., a "spot" contract). 12 C.F.R., § 231.2(c). Under the FDIA, spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange, precious metals and commodity agreements are "swap agreements". 12 U.S.C. § 1821(e)(8)(D)(vi)(I).

202 Id. The gross mark-to-market position is based on the sum of the absolute mark-to-market value of each financial contract (without regard to the in-the-money or out-of-the-money status of the entity), calculated in accordance with the methods normally used by the parties to value each contract. Netting Eligibility for Financial Institutions Regulation EE, 12 C.F.R. § 231.2(e).

203 Netting Eligibility for Financial Institutions, Regulation EE, 12 C.F.R. § 231.3(b).

204 In the case of a physically settled transaction, such contract may, but need not allow for conversion of the value of the physically settled transaction to a cash payment, because although section 402(14) of FDICIA limits the

statutory language and legislative history, we have not found anything to suggest that different types of Individual Contracts would fail to qualify under the applicable provisions of FDICIA. In fact, because Congress intended to reduce systemic risk in enacting sections 401-407 of FDICIA,[205] it appears that the correct view would support construing broadly the application of FDICIA so as to include Individual Contracts that may not fall within the definition of "forward contract" or "swap agreement". In the event that certain Individual Contracts are not treated as "forward contracts" or "swap agreements", a party to a General Agreement that is a financial institution may be able to rely on FDICIA to obtain close-out netting of a General Agreement upon the insolvency of a financial institution subject to FDICIA. The netting provisions of a General Agreement should be enforceable if both parties are "financial institutions", regardless of whether all of the Individual Contracts entered under the General Agreement are found to be "forward contracts", "swap agreements", "qualified financial contracts" or to fall within the definition of a "master agreement."

(d) Enforceability of termination provisions of a General Agreement under FDICIA

FDICIA protects the enforceability of "netting contracts" between "financial institutions", "notwithstanding any other provision of law" or any "stay, injunction, avoidance, moratorium or similar proceeding or order, whether issued or granted by a court, administrative agency, or otherwise", other than certain provisions of the FDIA, discussed below, the OLA, or any applicable order authorized under section 5(b)(2) of the SIPA.[206]

The 2006 Act amended Sections 403 and 404 of FDICIA to make clear that a solvent financial institution will be able to terminate, liquidate, accelerate and net as well as enforce the close-out netting provisions of a financial contract (such as a General Agreement).[207]

(e) Pre-insolvency payments

As noted above, FDICIA would apply to a General Agreement between two "financial institutions" where the General Agreement is a "netting contract". FDICIA does not provide for any insolvency proceeding nor does it empower any authority to void transfers. FDICIA as amended by the 2005 Act expressly provides that any provisions of any netting contract shall not be stayed, avoided or otherwise limited by any State or Federal law, other than certain provisions

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definition of "netting contract" to a contract that "…provides for netting present or future *payment obligations or payment entitlements…*" (emphasis added), "payment" is defined as "a payment of United States dollars, another currency, or a composite currency, and a noncash delivery, including a payment or delivery to liquidate an unmatured obligation." 12 U.S.C. § 4402(14) and (15).

205 See 12 U.S.C. § 4401 (setting forth Congressional findings and purpose).

206 12 U.S.C. §§ 4403(a), 4405.

207 12 U.S.C. §§ 4403(a), 4404. The 2006 Act made clear that the relevant terms of the General Agreement are to be enforced without delay subject to the limitations referenced in footnote 195 and the related text.

not directly relevant to avoidance of transfers.[208] Recovery of pre-insolvency payments under other statutes or a transfer made pursuant to a security arrangement would seem to constitute a limitation of a security arrangement that is expressly prohibited by FDICIA.[209]

Under the 2005 Act and the 2006 Act, however, FDICIA was amended to expressly permit certain provisions of the FDIA to override the netting provisions of a netting contract under FDICIA in two specific respects. First, the FDIA limits upon exercising termination and netting rights against a receiver or conservator, see Section II.B.2 above, also apply as limits upon FDICIA rights. This change in statute gives effect to the FDIC's longstanding view that FDICIA provisions should not overcome these specific limitations on termination found in the FDIA's qualified financial contract provisions.[210] Second, the unenforceability of walkaway clauses under the FDIA against insured depository institutions in default would apply to a netting contract under FDICIA.[211]

F. SIPA Liquidation and Stockbroker Liquidation under Subchapter III of Chapter 7 of the Code

A SIPA liquidation proceeding is commenced by the filing of an application and complaint by SIPC in an appropriate Federal district court.[212] The institution of the SIPA liquidation proceeding halts any case pending for the debtor under the Code.[213] Upon entry of a protective decree and appointment of a trustee, the SIPA liquidation proceeding is removed to the bankruptcy

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208 See footnote 194 and accompanying text referring to provisions of the FDIA, OLA, SIPA and the Code. FDIC staff has indicated that the cross reference to the FDIA in FDICIA was to protect the stay and transfer provisions of the FDIA and not Section 1821(e) in full and that the cross-reference to the OLA added by the Dodd-Frank Act should be interpreted similarly.

209 Despite this sweeping language in the 2005 Act, in certain instances (e.g., actual fraud) a court might nonetheless have the incentive and the means to facilitate recovery of a transfer. For example, under section 402(14)(B) of FDICIA, a "netting contract" does not include a contract that is "invalid under or precluded by Federal law." Under section 548(a)(l)(A) of the Code, a trustee may avoid certain obligations incurred with actual intent to defraud.

210 On the other hand, the express protection of FDIA limits on termination rights and SIPA orders appears to indicate that FDICIA generally does protect termination rights.

211 12 U.S.C. § 1821(e)(8)(G). These specific limitations were included in the 2005 Act as well, but the carve-out appears to have been expanded under the 2006 Act for consistency rather than for an increase in limitations. OLA § 5390(c) contains additional limitations on the exercise of termination rights not present in the FDIA relating to the ability of the FDIC as receiver of a Covered Financial Company, since the FDIC might be able to enforce contracts of a subsidiary or affiliate of a Covered Financial Company that are guaranteed or otherwise supported by or linked to the Covered Financial Company. See 12 U.S.C. § 5390(c)(16).

212 15 U.S.C. § 78eee(a)(3). Subsection (a)(3)(B) states that SIPC consent is required for the commencement of any insolvency, receivership or bankruptcy proceeding of a member, except as provided in the OLA.

213 15 U.S.C. § 78eee(b)(4).

court.[214] The SIPA proceeding goes forward separately from the chapter 7 case, because the SIPA proceeding is intended to protect certain public customers.[215]

A stockbroker liquidation under subchapter III of chapter 7 of the Code is independent of, but draws heavily on, the experience in liquidations under SIPA. SIPA itself specifically provides for the application of chapters 1, 3 and 5 and subchapters I and II of chapter 7 of the Code to the extent such provisions are not inconsistent with SIPA.[216] A primary reason for having subchapter III of the Code is the lack of uniformity of practices governing intrastate stockbrokers, who are not subject to the financial responsibility rules promulgated by the Securities and Exchange Commission (the "**SEC**") or rules and regulations of a self-regulatory organization or to SIPA. The Code seeks to treat cash and margin customers similarly as SIPA. The key differences between liquidation of a U.S. Stockbroker under the Code and one under SIPA is that under section 748 of the Code the trustee is charged with converting securities to cash as quickly as possible, and with the exception of delivering "customer name securities" (as defined in section 741(3) of the Code) to the owners thereof, distributing cash to "customers" (as defined in section 741(2) of the Code) of the debtor in satisfaction of their claims. The SIPA trustee, on the other hand, is required to distribute securities to "customers" (as defined in section 12(2) of SIPA) to the greatest extent practicable in satisfaction of their claims and may use cash to buy securities to satisfy customer claims from funds advanced by SIPC. The trustee in a proceeding under subchapter III of chapter 7 of the Code does not have that resource.

Under both subchapter III of chapter 7 and SIPA, "customers" as defined in section 741(2) of the Code and section 12(2) of SIPA, respectively, are treated as preferred creditors, receiving distributions from property defined as "customer property" under section 741(4) of the Code and section 12(4) of SIPA, respectively.[217] We have assumed for the purpose of this Memorandum

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214 15 U.S.C. § 78eee(b)(2)(B)(1), 11 U.S.C. § 742; see SIPC v. Blinder Robinson & Co. Inc., 962 F.2d 960, 962, 965-66 (10th Cir. 1992).

215 SIPA was enacted to provide special protection for certain "customers" of a failed broker-dealer in securities by allowing them to receive a preference over general creditors and allowing their claims to be satisfied, in whole or in part, through funds advanced by SIPC. See 15 U.S.C. § 78fff-3(a).

216 15 U.S.C. § 78fff(b). However, as noted above, in the event that a registered broker or dealer were to be determined to be a Covered Broker or Dealer certain provisions of the OLA, including the provisions concerning qualified financial contracts, would apply in a SIPA Liquidation of the Covered Broker or Dealer rather than the provisions in chapters 1, 3 and 5 and subchapters I and II of chapter 7 of the Code with respect to qualified financial contracts. 12 U.S.C. § 5385(b)(3) expressly provides that notwithstanding any provision of SIPA to the contrary, the rights and obligations of any party to a qualified financial contract (as defined in section 210(c)(8) of the OLA) to which a Covered Broker or Dealer for which the FDIC has been appointed receiver is a party shall be governed by section 210 of the OLA, including the limitations in section 210(c)(10)(B) (which limits the right to terminate, liquidate or net such contract solely by reason of the appointment of the FDIC as receiver until 5:00 pm (eastern time) on the business day following the appointment of the FDIC, as receiver). The provisions of the OLA concerning qualified financial contracts appear to be similar to those under the FDIA. See footnotes 124 and 125 and Section II.B generally.

217 See 11 U.S.C. § 741(4) and 15 U.S.C. § 78lll(4). It is to be noted that "customer property" means cash, security, or other property and proceeds thereof received, acquired, or held by or for the account of the debtor, from or for

that the Non-Defaulting Party is not a "customer". Therefore, the provisions relating to customer property are relevant only to the extent that customers are effectively given preferred creditor status with respect to the distribution of customer property over other unsecured creditors.

Notwithstanding that fact, section 5(b)(2)(C) of SIPA expressly recognizes that neither the filing of the application under section 5(a)(3) of SIPA, nor any order or decree obtained by SIPC from the court shall operate as a stay of any contractual rights of a creditor (i.e., Counterparty) to liquidate, terminate or accelerate a securities contract, commodity contract, forward contract, repurchase agreement, swap agreement or master netting agreement, as those terms are defined in sections 101, 741, and 761 of the Code, to offset or net termination values, payment amounts, or other transfer obligations arising under or in connection with one or more of such contracts or agreements, or to foreclose on any cash collateral pledged by the debtor, whether or not with respect to one or more of such contracts or agreements.[218] Moreover, section 362(o) of the Code prohibits a court or administrative agency (including SIPC) from imposing a stay in any proceeding under the Code, including subchapter III of chapter 7 of the Code, in the exercise of early termination and close-out netting permitted under section 362(b)(6) (forward contracts), 362(b)(7) (securities contracts), 362(b)(17) (swap agreements) or 362(b)(27) (master netting agreements) of the Code.[219] Thus, exercise of contractual rights of early termination of Individual Contracts that qualify as "forward contracts" or "swap agreements" cannot be stayed and such contractual rights of early termination and close-out netting may be exercised with respect to the General Agreement and Individual Contracts that so qualify both under SIPA and in a stockbroker liquidation under subchapter III of chapter 7 of the Code.

In addition, section 753 of the Code which applies to stockbroker liquidations under subchapter III further provides that

> "Notwithstanding any other provision of this title, the exercise of rights of a forward contract merchant, commodity broker, stockbroker, financial institution, financial participant, securities clearing agency, swap participant, repo participant, or master netting agreement participant under this title shall not affect the priority of any unsecured claim it may have after the exercise of such rights."[220]

This provision was added to the Code to protect the priority of an unsecured deficiency claim held by a forward contract merchant, swap participant, and master netting agreement

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the security account of a customer.

218 15 U.S.C. § 78eee(b)(2)(C)(i). Section 5(b)(2)(C) was added to SIPA by the 2005 Amendments to extend the "safe harbor provisions" to SIPA proceedings. However, under section 5(b)(2)(C)(ii) (15 U.S.C. §78eee(b)(2)(C)(ii)), "such application, order or decree may operate as a stay of the foreclosure on or disposition of, securities collateral pledged by the debtor, whether or not with respect to one or more of such [financial] contracts or agreements, securities sold by the debtor under a repurchase agreement, or securities lent under a securities lending agreement."

219 11 U.S.C. § 362(o).

220 11 U.S.C. § 753.

participant, among others, after exercise by such persons of their rights under the safe harbor provisions under the Code and to make clear that claims arising from exercise of rights to close-out net will not be subordinated to other unsecured claims. However, if the U.S. Stockbroker is a Covered Broker or Dealer, then under section 205(g) of the OLA the priority scheme under section 210(b) of the OLA will apply and certain claims will take priority over any unsecured damage claim.[221]

G. Commodity Broker Liquidation Under Subchapter IV of Chapter 7 of the Code

The Code limits the type of relief available to commodity brokers to that outlined in the special provisions of subchapter IV of chapter 7.[222] The provisions of subchapter IV of chapter 7 are supplemented and modified by the Commodity Exchange Act, as amended[223] (the "CEA") and the regulations (the "Part 190 Rules") promulgated by the Commodity Futures Trading Commission (the "**CFTC**") under the CEA. The CEA and Part 190 Rules supplement and supercede subchapter IV of chapter 7 in many instances.[224]

Under both subchapter IV of chapter 7 and the CEA, "customers" are treated as preferred creditors, receiving any "specifically identifiable" property to which a customer is entitled and then "customer property" as defined in section 761(10) of the Code in accordance with section 766 of the Code.[225] Under subsection 766(b), subject to subsection 766(h) the trustee is to distribute customer property ratably to customers on the basis and to the extent of such customer's allowed net equity claim, and in priority to all claims, except claims under section 507(a)(2) of the Code attributable to the administration of customer property.[226] The term "net equity" is defined in section 761(17) of the Code.[227] Under subsection (j) of section 766 the trustee shall distribute

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221 See 12 U.S.C. § 5385(g) and § 5390(b)(1), (6).

222 11 U.S.C. § 761(10); 11 U.S.C. § 766. Title VII of the Dodd-Frank Act contains regulations with respect to over-the-counter derivatives. Title VII defines the term "swap" for purposes of the Dodd-Frank Act and is intended to exclude from the definition forward contracts (and swap agreements) for the sale of a nonfinancial commodity for deferred shipment so long as the transaction is intended to be physically settled. Section 724 of the Dodd-Frank Act amends the definition of "commodities contract" under section 761(4) of the Code to include "with respect to a futures commission merchant or a clearing organization, any other contract, option, agreement or transaction that is cleared by a clearing organization", i.e., cleared swaps. As noted above, forward contract does not come within the definition of a commodity contract because only contracts for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade (U.S. or foreign) will qualify. Therefore, the amendment to the definition of "commodities contract" under the Code should not affect the discussion of subchapter IV of chapter 7 of the Code as it relates to the General Agreement.

223 7 U.S.C. §§ 1 et seq.

224 See e.g., 7 U.S.C. § 24 which permits the CFTC notwithstanding the Code to promulgate rules and regulations regarding what constitutes "customer property", how "net equity" is to be determined, etc.

225 11 U.S.C. § 766(b, (h) and 11 U.S.C. §507(a). See also 11 U.S.C. 766(i) (2015) which applies to the distribution of customer property where the debtor is a clearing organization.

226 11 U.S.C. § 726.

227 11 U.S.C. § 761(17).

customer property in excess of that distributed under (h) and (i) in accordance with section 726 of the Code which relates to the priority of distribution of property of the debtor's estate to unsecured creditors in a liquidation**.**

Notwithstanding that fact, section 362(o) of the Code makes clear that the provisions of the Code relating to the exercise of contractual rights of early termination and close-out netting applicable to forward contracts, swap agreements, and master netting agreements may not be stayed in any proceeding under chapter 7 of the Code (including subchapter IV).[228] Similarly, section 767 of the Code as applied to commodity broker liquidation, mirrors the language of section 753 of the Code as applied to stockbroker liquidation and clarifies that the exercise by a forward contract merchant, commodity broker, stockbroker, financial institution, financial participant, swap participant or master netting agreement participant (among others) of early termination and close out netting rights will not otherwise affect the priority of the creditor's claim after the exercise of netting, foreclosure and related rights.[229]

In the event that a U.S. Commodity Broker is a Covered Financial Company or a covered subsidiary, the FDIC will be appointed as receiver and the commodity broker's assets may be administered under the OLA rather than subchapter IV of chapter 7 of the Code subject to the limitations in section 210(m)(1)(B).[230] Accordingly, the provisions of the OLA, including section 210(c)(8)(F)[231] which suspends any payment or delivery obligations otherwise due from a party pursuant to a qualified financial contract until receipt of notice of transfer of such qualified financial contract or 5:00 pm (eastern time) on the business day following the date of the appointment of the FDIC and section 210(c)(10)(B)[232] which prohibits the exercise of the right to terminate, liquidate, or net a qualified financial contract solely by reason of or incidental to the appointment of the FDIC as receiver of the Covered Financial Company (or the insolvency or financial condition of the Covered Financial Company) until 5:00 pm (eastern time) on the business day following the date of appointment of the FDIC or receipt of notice of transfer, will apply.

The Code contains special limitations in subsections 561(b)(2) and (3) on netting with respect to commodity contracts in the case of a commodity broker liquidation under subchapter IV of chapter 7. These provisions (A) limit cross-product netting by a Counterparty with respect to an obligation of a commodity broker arising in connection with a commodity contract traded on, or subject to the rules of a contract market designated under the Commodity Exchange Act, or a derivatives transaction execution facility registered under the Commodity Exchange Act, against

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228 11 U.S.C. § 362(o). See reference therein to subsections 362(b)(6), (7), (17) and (27).

229 11 U.S.C. § 767. Compare to 11 U.S.C. § 753. As noted in Collier, the clear intent of the section is to protect deficiency claims only against subordination because of the exercise of rights under the safe harbors. COLLIER ON BANKRUPTCY, supra note 13, at P 767.01.

230 12 U.S.C. § 5390(m)(1)(B).

231 12 U.S.C. § 5390(c)(8)(F).

232 12 U.S.C. § 5390(c)(10)(B).

other financial contracts listed in section 561(a) (including forward contracts, swap agreements and master netting agreements) to the extent that the Counterparty has positive net equity (as defined in section 761(17) of the Code)[233] in the commodity accounts at the debtor (as calculated under subchapter IV) and (B) prohibit another commodity broker from netting or offsetting an obligation to the debtor arising under, or in connection with, a commodity contract entered into by, or held on behalf of, a customer of the debtor and traded on, or subject to, the rules of a contract market designated under the Commodity Exchange Act, or a derivatives transaction execution facility registered under the Commodity Exchange Act, against any claim arising under, or in connection with, other instruments, contracts or agreements listed in Section 561(a). However, section 561(b)(3) provides that these limitations will not prohibit offset of claims and obligations that arise under—(A) a cross-margining agreement or similar agreement approved by the CFTC or submitted to the CFTC pursuant to certain provisions of the Commodity Exchange Act that has not been adopted or rendered ineffective by the CFTC, or (B) any other netting agreement between a clearing organization or another entity that has been approved by the CFTC.

These special limitations to cross-product netting applicable to commodity broker liquidations should not have a bearing upon the exercise of a Non-Defaulting Party's right to close-out net under the General Agreement. That is because the cross-product netting permitted under the General Agreement relates to forward contracts and swap agreements and not commodity contracts. Moreover, for section 561(b)(2)(A) to come into play a Party to a General Agreement would have to be not only a customer of a U.S. Commodity Broker but also a party to a cross-product netting master agreement which allowed it to net Individual Contracts against commodity contracts of the type described in section 561(b)(2)(A). Since the General Agreement does not apply to commodity contracts and does not permit cross-product netting of commodity contracts, the limitations of section 561(b)(2)(A) would not come into play absent another cross-product netting master agreement. That circumstance is beyond the scope of this Memorandum. Similarly, section 561(b)(2)(B) would not come into play because it only prohibits a commodity broker from netting or offsetting an obligation to the debtor with respect to a commodity contract held by the commodity broker entered into or held on behalf of a "customer" of the debtor under the circumstances set forth in section 561(b)(2)(B). Since we have assumed that the Non-Defaulting Party to the General Agreement is not a "customer" of the U.S. Commodity Broker the restrictions of section 561(b)(2)(B) would not apply to another commodity broker acting on its behalf. Moreover, while subsection (b)(3) provides an exception to subsections (b)(2)(A) and (b)(2)(B) for cross-margining and other similar arrangements approved by, or submitted to and not rendered ineffective by, the CFTC, or certain other netting agreements between a clearing organization (as defined in Code section 761) and another entity that has been approved by the CFTC, they do not appear relevant to the General Agreement and are beyond the scope of this Memorandum.

[233] 11 U.S.C. § 761(17).

III. QUESTIONS PRESENTED BY EFET AND RESPONSES THERETO

A. Enforceability of Early Termination rights applicable as the result of an insolvency based Material Reason (§ 10.5(c)), whether by automatic or active termination on:

1. The General Agreement, and

2. All Individual Contracts in existence at the time under the General Agreement (the "Single Agreement" concept § 1.1). (Do we need the Single Agreement concept in order to preserve the enforceability under the Code, SIPA, FDIA, FDICIA, NYBL or OLA of Early Termination rights and the ability to close out net? Can you sever/terminate individual transactions or contracts from the General Agreement and still preserve the Single Agreement concept?)

The Code

The Early Termination rights of a Counterparty under its Transaction Documents, which qualify as "forward contracts" or "swap agreements" as those terms are defined under the Code that arise as a result of an insolvency based Material Reason under § 10.5(c)(iv) of the General Agreement would be enforceable under the Code, whether Early Termination occurs by notice pursuant to § 10.3 or by Automatic Termination under § 10.4 of the General Agreement, in each case subject to the limitations set forth below and the rights of rejection of the defaulting U.S. Party under the Code discussed above.

Any Individual Contract that provides for future delivery in two days or less (i.e., a spot transaction) could not be terminated by the Counterparty under Section 556 of the Code because it does not qualify as a "forward contract." However, as noted above, it may be possible to argue that under the amended definition of swap agreement any spot transaction could be terminated pursuant to the safe harbor for swap agreements found in Section 560 of the Code. Therefore, despite the fact that the Election Sheet for the General Agreement provides for Automatic Termination under § 10.4, such provision would likely only be ineffective as to any Individual Contract that does not qualify as a forward contract or swap agreement, since section 561(b)(1) of the Code makes clear that the contractual right to terminate a master netting agreement and the Individual Contracts only applies to financial contracts listed in Section 561(a). Moreover, a Party that gives notice of Early Termination under § 10.3 can avoid any issue as to any Individual Contract that does not qualify as a forward contract by virtue of a maturity date of two days or less by selecting an Early Termination Date that is after the maturity dates of any such Individual Contracts that have a maturity date of two days or less.[234]

[234] It is to be noted that an Included Code Entity may assume or reject an Individual Contract that does not qualify as a forward contract or swap agreement. However, it would appear that rejection of the General Agreement by the Included Code Entity should not make it possible for the Included Code Entity to net any Individual Contracts that could not be netted by the Non-Defaulting Party if the Non-Defaulting Party exercised its rights to terminate, accelerate or liquidate.

To the extent that pursuant to § 1.1 of the General Agreement, the General Agreement governs all transactions (i.e., Individual Contracts) that the Parties to the General Agreement enter into, the General Agreement is a master netting agreement for all Individual Contracts and the Early Termination rights under § 10.3 or § 10.4 and close-out netting under § 11 of the General Agreement would be enforceable as to the General Agreement and all the Individual Contracts that constitute forward contracts. The existence of a single master netting agreement should also preclude the Included Code Entity from cherry picking among Individual Contracts, i.e., rejecting some Individual Contracts (those unfavorable to the Included Code Entity) and assuming others (those favorable to the Included Code Entity) and thereby circumventing the very benefits that a master netting agreement is intended to afford. Moreover, the Included Code Entity should be subject to the contractually agreed netting provisions of § 11 of the General Agreement if the Included Code Entity exercises the right to reject the General Agreement and all Individual Contracts. There is nothing in the Code which would permit the Non-Defaulting Party to exercise its rights to terminate, accelerate or liquidate only some but not all of the Individual Contracts under the General Agreement. In order to terminate some Individual Contracts at a different time than others, a Counterparty should enter into a separate General Agreement with respect to those Individual Contracts it wants to be able to treat differently, with the understanding that the Included Code Entity would have the right to treat those Individual Contracts differently as well and that the termination and close-out netting rights of the Counterparty would only apply to the Individual Contracts entered into under the particular General Agreement.

Where a General Agreement is not terminated under § 10.3 or §10.4 by the Counterparty and the Counterparty is willing to enter into Individual Contracts after the bankruptcy filing date, a bankruptcy court may, at an Included Code Entity's request, enter an order that provides that if one or more Individual Contracts are entered into after the Filing Date pursuant to the General Agreement, the Counterparty's rights under Section 556 and/or Section 560 of the Code to liquidate, terminate and accelerate the General Agreement and the Individual Contracts will be deemed waived unless and until there occurs a subsequent default in payment or performance by the Included Code Entity under the Transaction Documents or any Credit Support Documents.[235] Although not expressly provided for under the Code, Calpine Corporation and its affiliated debtors obtained an order from the Bankruptcy Court for the Southern District of New York in their Chapter 11 cases that effectively modified Section 556 and Section 560 in that fashion.[236] However, under the Calpine Trading Contracts Order, so long as a counterparty did not enter into any new confirmations for forward contracts or swap agreements under a master agreement that existed on the Filing Date subsequent to the Filing Date and notice of the proposed order, the

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[235] However, in Bank of Am, N.A. v. Lehman Bros. Holdings, Inc. (In re Lehman Bros. Holdings Inc.), 439 B.R. 811, 833-37 (Bankr. S.D.N.Y. 2010) the court held that pursuant to Section 553 of the Code, funds received in a bank account after the filing date could not be offset against pre-petition obligations and that the safe harbor provisions in Section 560 and 561 of the Code did not override the mutuality requirement of Section 553.

[236] See "Final Order Authorizing the Debtors to (I) Continue to Honor Prepetition Trading Contracts; (II) Enter Into New Post Petition Trading Contracts; (III) Pledge Collateral Under Prepetition Trading Contracts and Post Petition Trading Contracts and (IV) Assume Certain Prepetition Contracts," entered Feb. 9, 2006 (the "**Calpine Trading Contracts Order**").

counterparty's right to terminate such contracts based on an insolvency default would continue to be effective under Section 556 or 560 of the Code and could be exercised at a later date.[237]

A decision of the bankruptcy court in the Lehman Brothers Holdings Inc. ("**LBHI**"), et al. chapter 11 cases involving Metavante Corporation ("**Metavante**"),[238] a counterparty to an ISDA Master Agreement, suggests that it may be necessary to exercise rights of early termination soon after the chapter 11 Filing Date but in any event within one year thereafter or risk forfeiting such rights. The bankruptcy court further held that the counterparty, Metavante, had forfeited its safe harbor rights to terminate, liquidate or accelerate the swap agreement because in order to preserve such rights, it had to act in respect thereof either immediately or "fairly contemporaneously with the bankruptcy filing." Metavante had entered into an ISDA Master Agreement with Lehman Brothers Special Financing, Inc. ("**LBSF**") prior to the filing of the LBSF and LBHI chapter 11 cases. Metavante exercised its right under its ISDA Master Agreement to withhold its periodic payments to LBSF as a result of the filing of a chapter 11 petition by both LBHI (the guarantor) and LBSF for approximately one year after the filing of the LBHI chapter 11 case. The debtor maintained that the withholding of such payments was a violation of the automatic stay. The bankruptcy court held that while the safe harbor provisions of the Code permitted termination, liquidation or acceleration, those provisions did not permit the exercise of any other rights of the non-defaulting party upon default and that Metavante's failure to make payments to LBSF constituted a violation of the automatic stay. [239] Although Metavante appealed the decision to the District Court for the Southern District of New York, the matter was subsequently settled.

SIPA Liquidation, Stockbroker Liquidation and Commodity Broker Liquidation

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237 The Included Code Entity retains the right to reject the forward contract at any time up to the confirmation of a plan of reorganization. See In re Enron Corp., 354 B.R. 652 (S.D.N.Y. 2006), in which the District Court for the Southern District of New York affirmed a decision of the bankruptcy court determined under the Code as in effect prior to the 2005 Amendment that allowed the debtor (a) to reject a financial contract well after the Filing Date and (b) to use the value on the day preceding the Filing Date for determining the termination amount. The court criticized the Counterparty for failing to exercise its right to move to compel the debtor to assume or reject the forward contract at a time when the termination values were different and the debtor might have assumed the contract. Id. at 659. Thus, failure to act is at the Counterparty's risk, i.e., to terminate the General Agreement or move for assumption or rejection by the debtor. However, it is to be further noted that courts may deny a motion by a Counterparty requesting that the bankruptcy court order the debtor to assume or reject the General Agreement and in such case leave the Counterparty at risk. A bankruptcy court may determine not to compel assumption of a forward contract or swap agreement because the assumption of a forward contract or swap agreement would mean that any amounts owed to a Counterparty upon a subsequent breach would be administrative expense claims entitled to priority over general unsecured claims.

238 In re Lehman Bros. Holdings Inc., et al., No. 08-13555 (Bankr. S.D.N.Y. 2008), appeal docketed, No. 09-09839 (S.D.N.Y. Nov. 30, 2009) (remanded to bankruptcy court for consideration of a proposed settlement). The proposed settlement was subsequently approved by the bankruptcy court.

239 A key factor in the Metavante decision may have been that Metavante had not terminated the ISDA Master Agreement in order to see whether its position would improve with the passage of time as a result of market changes such that Metavante would owe less to LBSF on a later termination date, while at the same time Metavante withheld payments from LBSF that came due under the ISDA Master Agreement during such period.

The foregoing discussion of the enforceability of the early termination rights of the Non-Defaulting Party under Sections 10.3 and 10.4 of the General Agreement applies to U.S. Stockbrokers in SIPA liquidation proceedings, or proceedings under subchapter III of chapter 7 (stockbroker liquidations), and to U.S. Commodity Brokers in proceedings under subchapter IV of chapter 7 (commodity broker liquidations). As noted above, section 5(b)(2) of SIPA was amended pursuant to the 2005 Act by adding a new subsection (C) which recognizes an exception from the automatic stay. Subsection (C) provides that "[n]otwithstanding section 362 of [the Code], neither the filing of an application under [section 5(a)(3)] nor any order or decree obtained by SIPC from the court will stay any contractual rights of a creditor to liquidate, terminate or accelerate a…forward contract… swap agreement, or master netting agreement…to offset or net termination values, payment amounts, or other transfer obligations arising under or in connection with one or more [financial contracts] or to foreclose on any cash collateral pledged by the debtor, whether or not with respect to one or more such contracts or agreements."[240] The only limitation in section 5(b)(2)(C) of SIPA is that such application, order or decree may operate as a stay of the foreclosure on, or disposition of securities collateral pledged by the debtor, securities sold by the debtor under a repurchase agreement, or securities lent under a securities lending agreement.[241] In a SIPA proceeding unsecured claims arising upon early termination of financial contracts are subject to the rights and priorities established for "customers" (as defined in section 78lll(2)) with respect to "customer name securities" (as defined in section 78lll(3)) and "customer property" (as defined in section 78lll(4)).

The safe harbor provisions of the Code permitting exercise of rights of early termination and close-out netting with respect to forward contracts and master netting agreements apply in stockbroker liquidations under subchapter III of chapter 7 of the Code. Section 753 of the Code further provides that "the exercise of rights by a forward contract merchant…swap participant…or master netting agreement participant under [the Code] will not affect the priority of any unsecured claim it may have after the exercise of such rights."[242] This provision acknowledges that a forward contract merchant or master netting agreement participant may exercise its early termination and netting rights in a stockbroker liquidation proceeding. The provision is intended to indicate that exercise of those rights does not subordinate any unsecured claims of the Non-Defaulting Party resulting from exercise of rights of early termination and close-out netting to those of other unsecured creditors. Those claims, however, are subject to the rights and priorities established for "customers" (as defined in section 741(2) of the Code) with respect to "customer name securities" (as defined in section 741(3) of the Code) and "customer property" (as defined in section 741(4) of the Code). Where a U.S. Stockbroker is a debtor in a case under subchapter III of chapter 7 and such U.S. Stockbroker also is a party to the General Agreement, any unsecured claim arising from a General Agreement will be subject to the priority scheme applicable to subchapter III of chapter 7.

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240 15 U.S.C. § 78eee(b)(2)(C)(i). Section 362(b) expressly states that "the filing…of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay—" with respect to the safe harbors in subsections 362(b)(6), (17) and (27).

241 15 U.S.C. § 78eee(b)(2)(C)(ii).

242 11 U.S.C. § 753.

If a U.S. Stockbroker becomes a Covered Broker or Dealer under the OLA, the provisions of the OLA governing the exercise of rights of early termination, liquidation and netting will apply and as discussed above in II.D. under Section 210(c)(10)(B), the right to terminate, liquidate or net a qualified financial contract solely by reason of the appointment of the FDIC as receiver or the financial condition of the U.S. Stockbroker may not be exercised until 5:00 pm (eastern time) on the business day following the date of the appointment of the FDIC as receiver or after the Counterparty has received notice of transfer of the General Agreement. Thus, Automatic Termination will not be given immediate effect under the OLA until 5:00 pm (eastern time) on the business day following the appointment of the FDIC as receiver or after notice that the General Agreement and the Individual Contracts have been transferred whichever is earlier. SIPC is to allocate customer property and deliver customer name securities in accordance with section 8(c) of SIPA, but all other claims will be paid in accordance with the priorities in section 210(b) of the OLA rather than the Code.[243]

The safe harbor provisions of the Code permitting exercise of early termination rights and close-out netting of forward contracts and master netting agreements apply in commodity broker liquidations under subchapter IV of chapter 7 of the Code, subject to the provisions of section 561(b)(2) and (3) of the Code. In the case of commodity broker liquidation, section 767 of the Code[244] provides that the exercise of rights by a forward contract merchant, swap participant or master netting agreement participant under the Code will not affect the priority of any unsecured claim such counterparty may have after the exercise of such rights. This provision acknowledges that a forward contract merchant or master netting agreement participant may exercise its early termination and close-out netting rights and indicates that the exercise of such rights will not cause any resulting unsecured claim of the Non-Defaulting Party to be subordinated to the claims of other unsecured creditors. However, if a Defaulting Party is a U.S. Commodity Broker in a proceeding under subchapter IV of chapter 7 of the Code, distributions on such unsecured claim will be subject to the provisions of subchapter IV of chapter 7 protecting the rights of customers (as defined a section 761(4) of the Code) in customer property (as defined in section 761(10) of the Code) and the priority scheme applicable to subchapter IV of chapter 7 of the Code as the same may be supplemented by the rules established by the CFTC.

Moreover, section 561(b)(2)(A) of the Code limits netting of any obligation arising under a commodity contract against a claim under a forward contract or master netting agreement (or other financial contract enumerated in section 561(a) of the Code)[245] to the extent that the nondebtor counterparty has positive net equity (as defined in section 761(17) of the Code)[246] in the commodity accounts at the debtor. Section 561(b)(2)(B) of the Code prohibits cross product netting by another commodity broker of an obligation to the debtor arising under, or in connection with a commodity contract entered into or held on behalf of a customer of the debtor and traded on or subject to the rules of a contract market designated under the Commodity Exchange Act or

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243 12 U.S.C. § 5385(g)(1), (2).

244 11 U.S.C. § 767.

245 11 U.S.C. § 561(a).

246 11 U.S.C. § 761(17).

a derivatives transaction execution facility registered under the Commodity Exchange Act. Since the General Agreement applies solely to forward contracts (or a swap agreement for the physical delivery of electricity that is a spot transaction) and does not provide for cross-product netting with commodity contracts, section 561(b)(2) would appear to be inapplicable to close-out netting under the General Agreement. Therefore, in the event that a U.S. Commodity Broker that is a debtor in a case under subchapter IV of chapter 7 is a party to a General Agreement, section 561(b)(2) should not come into play not only because the General Agreement relates to forward contracts but also because we have assumed that the Non-Defaulting Party is not a "customer" of the debtor or of another commodity broker, acting on its behalf.

In the event of the insolvency of a U.S. Commodity Broker that is a Covered Financial Company or a covered subsidiary, the FDIC may determine to act as receiver for the U.S. Commodity Broker and administer the U.S. Commodity Broker's assets pursuant to the OLA. [247] Section 210(c)(8)(F) of the OLA provides that upon the appointment of a receiver for the Covered Financial Company or a covered subsidiary, any payment or delivery obligations otherwise due pursuant to a qualified financial contract (including "commodity contracts") are suspended for one day[248] and the safe harbor provisions of the OLA with respect to financial contracts rather than subchapter IV of chapter 7 of the Code will apply. Moreover, pursuant to Section 210(c)(10)(B) the right to terminate, liquidate and net the General Agreement and Individual Contracts may not be exercised until 5:00 pm (eastern time) on the business day following the date of the appointment of the FDIC as receiver or after notice that the General Agreement and Individual Contracts have been transferred. Accordingly, Automatic Termination will not be given immediate effect under the OLA and it is unclear whether Automatic Termination will simply be deemed postponed until 5:00 pm (eastern time). As noted above, selective termination or "cherry-picking" of Individual Contracts is not permitted under the OLA.

The FDIA, the OLA and FDICIA

While the FDIA and OLA each permits termination, liquidation, and acceleration of qualified financial contracts, such as the General Agreement and Individual Contracts that qualify as forward contracts or swap agreements, as the result of an appointment of the FDIC as receiver or the insolvency or financial condition of an Insured Institution or Covered Financial Company, as applicable, a Counterparty may not exercise its rights until 5:00 p.m. (eastern time) on the business day following the appointment of the receiver or after receipt of notice that the General Agreement and Individual Contracts have been transferred whichever is earlier.[249] At such time, a Counterparty will be able to exercise rights under any security agreement or arrangement or other credit enhancement (including guaranties) and to offset or net any termination value, payment amount or other transfer obligation.[250] It does not appear that Automatic Termination will be

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[247] 12 U.S.C. §§ 5383 and 5390(a)(1)(E) powers with respect to a failing subsidiary.

[248] 12 U.S.C. § 5390(c)(8)(F).

[249] 12 U.S.C. § 1821(e)(8)(A), (10)(B)(i); 12 U.S.C. § 5390(c)(8)(A), (10)(B)(i).

[250] 12 U.S.C. § 1821(e)(8)(A), (10)(B)(i); 12 U.S.C. § 5390(c)(10)(B)(i).

enforceable upon the appointment of the FDIC as receiver and it is not clear whether Automatic Termination will simply be deemed postponed until 5:00 p.m. (eastern time) on the business day following such appointment or not effective at all. Moreover, in the case of a conservatorship under the FDIA, a Counterparty will not be able to exercise any contractual right to terminate, liquidate or net a qualified financial contract, based solely upon the appointment of the conservator or the insolvency underlying the existence of such power.[251] Thus, Automatic Termination will not be effective upon the appointment of a conservator. Moreover, another Material Reason (such as the failure to make payment) will have to exist on the date of such appointment or occur in the future for a Counterparty to be able to give notice of Early Termination Date pursuant to § 10.3 of the General Agreement.

Accordingly, when an Insured Institution or Covered Financial Company is a Party to the General Agreement, it would be preferable to select discretionary termination pursuant to § 10.3 of the General Agreement to avoid any uncertainty with respect to the right to terminate.

Any Individual Contract that provides for future delivery in two days or less would not qualify as a "forward contract" under section 11(e)(8)(D)(iv)[252] of the FDIA or section 210(c)(8)(D)(iv) of the OLA but may qualify as a "swap agreement" under section 11(e)(8)(D)(vi) of the FDIA or section 210(c)(8)(D)(vi) of the OLA,[253] given that the FDIA was amended by the 2006 Act to include "any agreement or transaction that is similar to any other agreement or transaction referred to in subsection I and that is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in swap or other derivatives markets… and that is a …spot transaction on one or more…commodities…." The OLA contains the same definition of swap agreement. So long as the Individual Contract qualifies as a swap agreement it may be terminated by the Counterparty notwithstanding that it would not qualify as a "forward contract".[254] Even if, in the case of a receivership, Automatic Termination were deemed effective after 5:00 p.m. (eastern time) on the business day following appointment of the receiver, Automatic Termination under § 10.4 would not be effective as to any Individual Contracts that do not qualify as qualified financial contracts, notwithstanding that a General Agreement is a master agreement, since under section 11(e)(8)(D)(vii) of the FDIA or section 210(c)(8)(D)(vii) of the OLA,[255] as applicable, a master agreement is deemed to be a qualified financial contract only with respect to those Individual Contracts that are themselves qualified financial contracts.

As under the Code, so long as the General Agreement provides for Early Termination under § 10.3 or § 10.4 as to all Individual Contracts and provides for netting as to all Individual Contracts,

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251 See footnote 117.

252 12 U.S.C. § 1821(e)(8)(D)(iv); 12 U.S.C. § 5390(c)(8)(D)(iv).

253 12 U.S.C. § 1821(e)(8)(D)(vi); 12 U.S.C. § 5390(c)(8)(D)(vi).

254 Notably, a forward contract for less than two days need not be considered as a swap agreement under FDICIA since under Regulation EE (which applies to financial institutions) a "forward contract" includes a contract with a maturity two days or less after the date the contract is entered into. See 12 C.F.R. § 231.2(c).

255 12 U.S.C. §§ 1821(e)(8)(D)(vii) and 5390(c)(8)(D)(vii).

the exercise of rights to terminate and to close-out net as to all Individual Contracts will be effective under the FDIA, the OLA and FDICIA whether or not the words "single agreement" are used. That is so because section 11(e)(8)(D)(vii) of the FDIA and section 210(c)(8)(D)(vii) of the OLA,[256] each expressly provides that a master agreement for any qualified financial contract (or any master agreement for such master agreement or agreements), together with all supplements to such master agreement, shall be treated as a single agreement and a single qualified financial contract. Thus, it appears that a Non-Defaulting Party to the General Agreement will not be able to treat some Individual Contracts differently than others by attempting to terminate and close-out net only some Individual Contracts. The only exception would be any Individual Contract that is not a qualified financial contract. This makes eminent sense since under both the FDIA and the OLA, the receiver or conservator, as applicable, is prohibited from cherry picking among all qualified financial contracts both with respect to repudiation and transfer, and any repudiation or transfer must be with respect to all qualified financial contracts between the Insured Institution and the Non-Defaulting Party and any affiliate of the Non-Defaulting Party.[257]

The provisions of Section 210(c) of the OLA largely mirror the provisions of Section 11(e) of the FDIA and treat all contracts under a master agreement (such as the General Agreement) as a single contract and, therefore, do not permit selective termination of Individual Contracts.

As set forth in Section II.E.1, FDICIA gives broad effect to close-out netting of qualified financial contracts between two financial institutions and accordingly, the single contract concept is not required for early termination and close-out netting of Individual Contracts.

NYBL

Section 618-a(2)(e) of the NYBL provides in relevant part that a "qualified financial contract" includes a forward contract … any option to enter into such contract … and any master agreement for such agreements" and that any master agreement for qualified financial contracts, together with all supplements thereto, "shall be treated as one 'qualified financial contract' provided that such contract is reflected in the books and records of the banking organization or documentary evidence of such agreement is provided." Thus, there is no question that the exercise of the early termination and close-out netting rights of the Counterparty with respect to the General Agreement and all Individual Contracts are enforceable, whether or not the words "single agreement" are used in the General Agreement. While Section 618-a(2)(e) is intended to prohibit selective repudiation by the Superintendent of qualified financial contracts (including the General Agreement and all of the Individual Contracts), the NYBL is silent as to the right of a Counterparty to selectively terminate Individual Contracts. Nonetheless, it would appear that the same concept should apply to the Counterparty's exercise of its rights to terminate early (pursuant to § 10.3 and § 10.4) and close-out net (pursuant to § 11) the General Agreement and all of the Individual Contracts. The Counterparty should not be able to terminate (and close-out net) some of the

[256] 12 U.S.C. § 1821(e)(8)(D)(vii) and §5390(c)(8)(D)(vii).

[257] See 12 U.S.C. § 1821(e)(9)(A) and (11) and §5390(c)(9)(A) and (11).

Individual Contracts and not others, since if it could, the Counterparty would obtain the benefits of selective termination and netting that the Superintendent is proscribed from getting.

There does not appear to be any impediment to the effectiveness (and enforceability) of Automatic Termination under the NYBL with respect to all Individual Contracts, including spot contracts, since the term forward contract under the NYBL includes spot contracts. Accordingly, the close-out netting provisions of the General Agreement will be enforceable with respect to any spot contracts as well.

B. Enforceability of discretionary termination rights, close-out netting and calculation and payment of a Termination Amount under §§ 10.3 and 11 (absent operation of Automatic Termination) arising as the result of an insolvency. In the event of an insolvency when close-out netting is being used, do you have to prove amounts owed in U.S. Dollars?

<u>The Code</u>

As a general matter, the exercise of discretionary termination rights by the Terminating Party under § 10.3 of the General Agreement resulting from an insolvency of an Included Code Entity is enforceable under sections 556, 560 (to the extent an Individual Contract is determined to be a swap agreement), and 561 of the Code, and the exercise of close-out netting under § 11 of the General Agreement is enforceable under sections 362(b)(6), 362(b)(17), 362(b)(27) and 561(a) of the Code.[258] Moreover, notwithstanding that the language of § 10.3 only gives the Non-Defaulting Party the right to terminate the General Agreement (and Individual Contracts) upon an insolvency of the other Party, the Included Code Entity will have the ability under section 365 of the Code to reject the General Agreement (and Individual Contracts) at any time on or after the Filing Date and before the Early Termination Date occurs. If the Terminating Party is the first to act, and the Early Termination Date is as much as 20 days after the notice of Early Termination Date, the Included Code Entity may give notice to the Terminating Party of rejection of the General Agreement and Individual Contracts effective on an earlier date than the Early Termination Date selected by the Terminating Party. Although we have not found any cases addressing this scenario, we note that if the Included Code Entity gives notice of an earlier rejection date and seeks approval by the bankruptcy court of rejection of the General Agreement and Individual Contracts as of such date, the bankruptcy court may enter an order that establishes a rejection date that is earlier than the Early Termination Date designated by the Terminating Party. The date so determined would be the date for calculation of damages under section 562 of the Code. That is so because section 562 of the Code provides that "the damages shall be measured as of the earlier of (i) the date of…rejection or (ii) the date or dates of liquidation, termination or acceleration."

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[258] As noted above, case law in both the <u>Enron</u> and <u>LBHI</u> chapter 11 cases suggests that the right to exercise discretionary termination may be limited in time. The <u>Metavante</u> decision, which was appealed to the district court and then settled, suggests that discretionary termination rights may be forfeited if not exercised fairly contemporaneously with the bankruptcy filing (or at least within one year of the default), particularly where the Counterparty has violated the automatic stay by withholding payments to the debtor after a default.

Under Section 562 of the Code, if the bankruptcy court were to give effect to such rejection as of a date earlier than the Early Termination Date, damages would be calculated based on values on the rejection date unless such value could not be determined as of such date. The Included Code Entity may seek to reject the General Agreement and the Individual Contracts effective as of an earlier date in order to effect the calculation of damages (since the value on such earlier date may be more beneficial to the Included Code Entity and its creditors). By selecting an Early Termination Date that is closer to the date of the Terminating Party's notice, the Terminating Party will lessen the possibility that the Included Code Entity will seek to reject the General Agreement and Individual Contracts effective as of an earlier date than the Early Termination Date.

As noted above, § 10.3 of the General Agreement provides that if a Material Reason with respect to a Party has occurred and is continuing, only the Terminating Party has the contractual right to terminate the General Agreement, which it may do by giving notice to the other Party. However, section 365 of the Code[259] nonetheless grants a defaulting debtor (i.e., the Included Code Entity) the right to reject any executory contract, including the General Agreement and the Individual Contracts. Moreover, although under the General Agreement only the Terminating Party has the right to calculate the Termination Amount, the Included Code Entity may determine the Termination Amount by rejecting the General Agreement and Individual Contracts before the Counterparty gives notice of termination. Furthermore, where there are no commercially reasonable determinants of value as of the date of termination or rejection, section 562 of the Code gives the Included Code Entity or Counterparty, as applicable, certain rights to challenge the timing of the measurement of damages that is determined by the Counterparty in the case of termination or by the Included Code Entity in the case of rejection.

If the Termination Amount is required to be paid by the Terminating Party to the Included Code Entity, such payment will be required to be made as required under the General Agreement. If the Termination Amount is required to be paid by the Included Code Entity to the Terminating Party, the Terminating Party will have recourse to any Collateral that effectively secures the obligations of the Included Code Entity under the Transaction Documents (to the extent constituting forward contracts or swap agreements), or to any guaranty from any person that provides Credit Support for the Included Code Entity's obligations, since offsetting, netting and recourse to Collateral and guaranties are permitted by the safe harbors that except forward contracts under section 362(b)(6), swap agreements under section 362(b)(17), and master netting agreements under section 362(b)(27) and section 561 of the Code from the application of the automatic stay. However, to the extent that the Termination Amount is an unsecured obligation of the Included Code Entity (either because there is no Collateral securing the Termination Amount or the value of the Collateral is insufficient to pay the Termination Amount in full), the Terminating Party will have an unsecured claim for which it will have to file a proof of claim in the bankruptcy case. The payment of such unsecured claim is subject to the automatic stay. Accordingly, unless the bankruptcy court orders otherwise, no payment may be made by the Included Code Entity on such unsecured claim until distributions are made (a) pursuant to the plan of reorganization to holders of general unsecured claims if the proceedings are for reorganization (or liquidation) under chapter 11 of the Code, or (b) pursuant to a liquidation of the Included Code

[259] 11 U.S.C. § 365.

Entity's assets if the proceedings are for liquidation under chapter 7 of the Code since the automatic stay under section 362 of the Code prohibits payment of the unsecured claim prior to such time.

Under the Code, SIPA, FDIA, NYBL and OLA the amount of claim will have to be proven in U.S. dollars notwithstanding anything in the General Agreement to the contrary.[260]

It is further to be noted that under the Code, claims may be disallowed or equitably subordinated under certain circumstances. A bankruptcy court may disallow payment of a claim under Section 502(d) of the Code[261] if the holder of the claim is the recipient of, or liable as the transferee of, an avoidable transfer and the debtor has not recovered the property transferred or the amount for which the transferee is liable in respect of the avoidable transfer even though the claim is unrelated to the avoidable transfer.[262] In addition, pursuant to Section 510(c) of the Code,[263] a claim may be equitably subordinated to all other claims in the same class if the person holding the claim has engaged in inequitable conduct that has conferred an unfair advantage upon such person or harmed other creditors, even though the inequitable conduct is unrelated to the avoidable transfer that gave rise to disallowance or the inequitable conduct that provided the basis for equitable subordination of the claim. Such subordination will be limited to the harm (damage) caused.[264] If equitable subordination applies to a claim, a lien securing a claim may be transferred to the estate for the benefit of the creditors. Moreover, the District Court for the Southern District of New York has held that a claim may under certain circumstances be disallowed or equitably subordinated in the hands of a post Filing Date good faith transferee of the claim if such claim could be disallowed or equitably subordinated, respectively, due to conduct of the transferor.[265]

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260 Under the Code, SIPA, FDIA, NYBL and OLA, any claim of a Counterparty or any judgment in favor of a Counterparty that is denominated in a currency other than U.S. dollars must be converted into U.S. dollars. See In re Good Hope Chemical Corp., 31 B.R. 887 (Bank. D. Mass. 1983) ("an American court cannot enter judgment in any currency other than U.S. dollars). See also Official Form 10 (Proof of Claim) indicating U.S. Dollars in front of the space where the creditor must insert the total amount of its claim at the Filing Date under the Code as well as 11 U.S.C. § 502(b) which requires the bankruptcy court to determine the amount of a claim "in lawful currency of the United States as of the date of the filing of the petition" if a party in interest objects to such claim. A party in interest is broadly construed and includes the debtor and any creditor. See 11 U.S.C. § 1109.

261 11 U.S.C. § 502(d).

262 In re Consol. Indus. Corp., No. 98-40533, 2006 Bankr. LEXIS 1679, at *6 (Bankr. N.D. Ind. June 19, 2006).

263 11 U.S.C. § 510(c).

264 Matter of Mobile Steel Co., 563 F. 2d 692, 700, (5th Cir. 1977). Commonly known as the "Mobile Steel test", the Fifth Circuit Court of Appeals set forth three conditions that must be satisfied before the exercise of equitable subordination is appropriate: (i) the claimant must have engaged in some type of inequitable conduct, (ii) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant, and (iii) equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Act. Id. According to the Mobile Steel court in determining whether the three conditions are satisfied, one of the guiding principles to consider is that "a claim or claims should be subordinated only to the extent necessary to offset the harm which the bankrupt and its creditors suffered on account of the inequitable conduct." Id.

265 Enron Corp. v. Springfield Assocs., LLC (In re Enron Corp.), 379 B.R. 425 (S.D.N.Y. 2007). The District Court

The FDIA, OLA and FDICIA

Under the FDIA, a receiver or conservator, has the right to repudiate or disaffirm a General Agreement and the Individual Contracts to which an Insured Institution is a party, if the conservator or receiver determines that the performance thereof would be burdensome and the repudiation or disaffirmation thereof will promote the orderly administration of the institution's affairs.[266] Similarly, under the OLA, the FDIC, as receiver, has the right to repudiate or disaffirm a General Agreement and the Individual Contracts to which a Covered Financial Company is a party if the receiver determines such repudiation or disaffirmance will promote the orderly administration of the affairs of the Covered Financial Company.[267] Such repudiation must take place within a reasonable period following such appointment.[268] As noted above, discretionary termination rights by the Terminating Party under § 10.3 of the General Agreement will be enforceable, in the case of a receivership, after 5:00 p.m. (eastern time) on the business day following the appointment of the receiver. Although we have not found any cases on point, it would appear that Automatic Termination could only be effective under the FDIA and the OLA, if at all, after 5:00 p.m. (eastern time) on the business day following the appointment of the receiver. In the case of a conservatorship, neither Automatic Termination nor discretionary termination can be effective as a result of the appointment of the conservator or the insolvency or financial condition of the underlying institution. Discretionary termination under § 10.3 of the General Agreement must be based upon another Material Reason, such as nonpayment, in the case that a conservator has been appointed.

As noted above, in the case that both parties to the General Agreement are financial institutions, FDICIA recognizes the enforceability of the early termination and close-out netting provisions of netting contracts, including the General Agreement.[269]

The calculation of the Termination Amount upon an effective termination may be effected by the Counterparty and in our view, it is likely that the provisions concerning the calculation of damages (i.e., the Termination Amount) in § 11 of the General Agreement will be given effect under the FDIA, OLA and FDICIA. That is because both under the FDIA and the OLA in the case of the repudiation of a qualified financial contract, the "actual direct compensatory damages"

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for the Southern District of New York in Enron concluded that equitable subordination and disallowance are personal disabilites that are not fixed as of the petition date and do not inhere in the claim. Nevertheless, the court held that a claim in the hands of a good faith transferee may be subject to equitable subordination and disallowance based solely on the conduct of the transferor if the claim was transferred to the transferee by way of an assignment (as opposed to a sale). Id. at 449. But see, In re KB Toys, Inc., 736 F.3d 247 (3d Cir. 2013) holding that a claim that could be disallowed in the hands of the original claimant could be disallowed in the hands of a subsequent transferee regardless of whether the transfer was an assignment or sale.

266 12 U.S.C. § 1821(e)(1).

267 12 U.S.C. § 5390(c)(1).

268 12 U.S.C. §§ 1821(e)(2), 5390(c)(2).

269 See discussion in Section II.E.1. above.

arising in respect of the repudiation of the contract "are deemed to include normal and reasonable costs of cover or other reasonable measures of damages utilized in the industries for such contract and agreement claims, calculated as of the date of the disaffirmance or repudiation of such contract or agreement."[270] Since the calculation provided in § 11 of the General Agreement is a measure of damages utilized in the electricity trading industry, the method of calculation should be enforceable. It would appear that if this method of calculation would be deemed appropriate in the case of a repudiation or disaffirmance by a receiver or conservator, then the same calculation should apply upon the exercise of the right of termination, although there is nothing in the FDIA or OLA that specifically addresses the calculation of damages upon termination. FDICIA recognizes the right to payment upon early termination of a qualified financial contract and does not have any particular requirements for the payment.

If the Termination Amount is required to be paid by the Terminating Party to the Insured Institution or Covered Financial Company, as applicable, such payment will be required to be paid to the U.S. Party by the Terminating Party in accordance with the General Agreement. If the Termination Amount is required to be paid to the Terminating Party by the Insured Institution or Covered Financial Company, as applicable, the Terminating Party will have recourse to any Collateral that effectively secures the obligations of the Insured Institution or Covered Financial Company under the Transaction Documents (that constitute forward contracts or swap agreements) or to any guaranty from any person that provides credit support for the obligations (provided however, that where the guarantor itself is a debtor, action taken must come within the safe harbor provisions or be limited to the filing of a proof of claim against the guarantor). It would appear that where the value of Collateral is less than the Termination Amount any balance would constitute a claim that would have to be filed against the Insured Institution or Covered Financial Company and would await distribution by the receiver or conservator, as applicable.

SIPA Liquidation, Stockbroker Liquidation and Commodity Broker Liquidation

As noted above, discretionary termination rights, close-out netting and calculation and payment of a Termination Amount will be given effect in a SIPA liquidation, a stockbroker liquidation under subchapter III of chapter 7 of the Code and a commodity broker liquidation under subchapter IV of chapter 7 of the Code.[271] Such calculation will be subject to the provisions of section 562 of the Code to a stockbroker liquidation under subchapter III of chapter 7 (as well as applicable limitations to netting in section 5(b)(2)(C) (ii) of SIPA in the case of a liquidation of a U.S. Stockbroker under SIPA)[272] and in the case of a liquidation of a U.S. Commodity Broker under subchapter IV of chapter 7, will be subject to the limitations of section 561(b)(2) and (3) of

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270 12 U.S.C. § 1821(e)(3)(C), (e)(3)(A)(ii); 12 U.S.C. § 5390(c)(3)(C), (c)(3)(A)(ii).

271 In the case of a U.S. Commodity Broker liquidation the limitations in section 561(b)(2) and (3) of the Code could apply but are not relevant to the facts related to the General Agreement as assumed in this Memorandum.

272 See footnote 242 and accompanying text. See also footnote 97 indicating that it is unclear under what circumstances section 562 of the Code will be applied in a SIPA Liquidation.

the Code. The SIPA trustee[273] or the chapter 7 trustee appointed in a stockbroker liquidation or commodity broker liquidation under subchapter III or subchapter IV of the chapter 7 of the Code, respectively, may reject financial contracts under section 365 of the Code. In the case of a SIPA Liquidation, stockbroker liquidation under subchapter III of chapter 7 or a commodity broker liquidation under subchapter IV of chapter 7, if close-out netting results in an unsecured claim after the application of any Collateral securing the Termination Amount, such unsecured claim will be subject to the priority rights of "customers" to share in customer property under the applicable statutory provisions of SIPA, as well as priority rights of "customers" in "customer name securities" and "customer property" in a stockbroker liquidation under chapter III of chapter 7 of the Code, and of "customers" in "customer property" in a commodity broker liquidation under subchapter IV of chapter 7 of the Code.[274]

However, in the event that a U.S. Stockbroker is a Covered Broker or Dealer the calculation of any claim arising under a qualified financial contract, such as the General Agreement, it would appear that such claim will be calculated in accordance with the provisions referenced above in section 210(c)(3)[275] of the OLA. Similarly, if a U.S. Commodity Broker is a Covered Financial Company or a covered subsidiary it would appear that any such claim arising under a qualified financial contract will be calculated in accordance with the provisions of Section 210(c)(3) of the OLA.[276]

C. Enforceability of close-out netting and the calculation and payment of a Termination Amount (§§ 10.4 and 11) under an Automatic Termination scenario.

1. Specific recommendation of efficacy, if any, of making Automatic Termination operative *vis a vis* a Party incorporated or organized in the fifty United States, the District of Columbia or Puerto Rico.

2. If recommendation is to make Automatic Termination operative, a second recommendation regarding specific wording to be employed in § 10.4 of the

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273 Under 15 U.S.C. § 78fff-1(b) to the extent consistent with SIPA, a SIPA Trustee is subject to the same duties as a trustee in a case under chapter 7 including, if the debtor is also a commodity broker to the duties specified in subchapter IV of chapter 7, except that the trustee has no duty to reduce securities constituting "customer property" to cash.

274 See also, 12 U.S.C. § 5390(m)(1) which requires (A) a Covered Financial Company that is a stockbroker, but is not a member of SIPC, to apply the provisions of subchapter III of chapter 7 of the Code in respect of the distribution to customers of customer name securities and customer property as if it were a debtor under that subchapter and (B) in the case of a Covered Financial Company that is a commodity broker, to apply the provisions of subchapter IV of chapter 7 of the Code, in respect of the distribution to customers of customer property as if it were a debtor under that subchapter.

275 12 U.S.C. § 5385(b)(4) concerning application of section 210 to a Covered Broker or Dealer and § 5390(c)(3)(C) and (A)(ii). It would appear that the same may apply if the U.S. Stockbroker were not a member of SIPC and became a Covered Financial Company since §5390(m)(1) only applies to customer claims.

276 12 U.S.C. § 5390(c)(3)(C), (A)(ii).

Election Sheet (identifying optional timing for such termination under local law).

<u>**The Code**</u>

Under the Code the enforceability of close-out netting and the calculation and payment of a Termination Amount (§§ 10.4 and 11) under an Automatic Termination scenario would be subject to the same conditions and limitations as the enforceability of close-out netting and the calculation and payment of a Termination Amount in a discretionary termination discussed above. Although, as a general matter, a provision of an executory contract providing for its automatic termination would not be enforceable under section 365(e)(1) of the Code,[277] given the exceptions to section 365(e)(1) in section 556[278] and section 560 of the Code[279] for forward contracts and swap agreements, respectively, and in section 561 of the Code[280] for master netting agreements, §10.4 of the General Agreement, which provides for Automatic Termination should be given effect as to the General Agreement and Individual Contracts that qualify as forward contracts or swap agreements. We have, however, found no cases specifically dealing with the enforceability of Automatic Termination.

It is not necessary for the Parties to agree to automatic, rather than discretionary, termination of the General Agreement since sections 556, 560 (to the extent applicable) and 561 of the Code permit early termination of the General Agreement and the Individual Contracts by the Counterparty after the Filing Date. We generally caution clients against choosing Automatic Termination because, depending on market factors, it may be in the client's best interest to be able to pick a date other than the Filing Date as the Early Termination Date. Thus, a Counterparty may benefit from the ability to select a later date for termination. While a General Agreement that provides for discretionary termination does not limit when such right may be exercised, developing case law may limit the period in which discretionary termination may be either exercised or deemed forfeited. The clear concern of the bankruptcy court in the <u>Metavante</u> decision in the <u>LBHI</u> cases was that a Counterparty should not be able to affect the debtor's recovery on a financial contract by refraining from exercising its right of termination and thereby "play the market" to the Counterparty's advantage. This view, however, would put the onus on the Counterparty to exercise its safe harbor right of termination or forfeit it even though the debtor could have simply rejected the financial contract and thereby precluded the Counterparty from reducing its obligation to the debtor's estate by choosing a later termination date.

Although as noted above, a Counterparty could seek an order of the bankruptcy court requiring the Included Code Entity to assume or reject the General Agreement and the Individual Contracts, the Counterparty would only do so if the Counterparty believed the Included Code

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277 11 U.S.C. § 365(e)(1).

278 11 U.S.C. § 556.

279 11 U.S.C. § 560.

280 11 U.S.C. § 561.

Entity would benefit from assuming the General Agreement and Individual Contracts or if rejection of the General Agreement would benefit the Counterparty.

<u>The FDIA, OLA, FDICIA and SIPA</u>

As noted above, it is questionable whether the FDIA and the OLA would give effect to Automatic Termination in the case of a receivership since the right to terminate, accelerate or liquidate does not exist until after 5:00 p.m. (eastern time) of the business day following the appointment of the receiver. Thus, Automatic Termination could only be effective in the case of a receivership if it were deemed to be effective after 5:00 p.m. (eastern time) of the business day following the appointment of a receiver. In the case of a conservatorship under the FDIA, the right to terminate, accelerate, liquidate or net may not be based upon the appointment of a conservator or the insolvency of the Insured Institution. These rights only apply to a conservatorship if there is a Material Reason enforceable under non-bankruptcy law, such as the right to terminate for nonpayment, which exists at such time or occurs thereafter. Thus, Automatic Termination based on the appointment of a conservator is not enforceable. Moreover, the right to terminate based upon the appointment of a receiver ceases upon receipt of notice of the transfer of the General Agreement and the Individual Contracts by the receiver.[281] Accordingly, we do not recommend election of Automatic Termination where the other Party to a General Agreement is an Insured Institution or a company that would qualify as a Covered Financial Company.

In the case that both Parties to a General Agreement are financial institutions there is no benefit in electing Automatic Termination since FDICIA expressly provides that the stay under various statutes does not impact rights of early termination and close-out netting under a netting contract such as the General Agreement.

Under the FDIA and the OLA, if the receiver (or conservator if appointed under the FDIA) repudiates the General Agreement (and Individual Contracts), the calculation of damages will be determined from the date of repudiation.[282] Since until a transfer of the General Agreement and Individual Contracts occurs, the Counterparty will have the right to terminate, liquidate and accelerate or net, subject to the limitations discussed above, there is no apparent disadvantage in the General Agreement providing for discretionary termination, since the Counterparty can determine the date for establishing the Termination Amount by exercising the right to terminate. These same considerations would apply where a U.S. Stockbroker is either a Covered Broker or Dealer or Covered Financial Company (to the extent applicable) under the OLA or a U.S. Commodity Broker is a Covered Financial Company or covered subsidiary under the OLA.

We are not aware of any cases or statutory provisions of SIPA dealing with the efficacy of Automatic Termination in the case of a SIPA Liquidation. It would appear that the same considerations would apply to a SIPA Liquidation, a stockbroker liquidation under subchapter III

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281 12 U.S.C. § 1821(e)(10)(B)(i) and §5390(c)(10)(B)(i).

282 12 U.S.C. §1821(e)(3)(A)(ii), (C) and §5390(c)(3)(A)(ii), (C).

of chapter 7 of the Code and a commodity broker liquidation under subchapter IV of chapter 7 of the Code as would apply to cases under chapter 11 or chapter 7 of the Code.

NYBL

Section 619(d)(2) of the NYBL provides that the Superintendent's taking possession of a New York banking organization does not act as an injunction to any right of automatic or discretionary termination under a qualified financial contract. Accordingly, there is no need to elect Automatic Termination, although, if elected, it will be given effect under the NYBL.

D. Is Early Termination, close-out netting or the calculation and payment of the Termination Amount voidable, challengeable or in any way deletable by the debtor in possession, a chapter 7 trustee, chapter 11 trustee or any third party if insolvency proceedings are commenced under the Code or a receiver (or conservator) is appointed under the FDIA or the OLA?

The Code

A party's right to terminate and to close-out net Individual Contracts (that are forward contracts or swap agreements) under the General Agreement is permitted under sections 556, 560, 561, 362(b)(6), 362(b)(17), 362(b)(27) and 561 of the Code, and, therefore, should not be voidable, challengeable or deletable (i.e., avoidable) by a trustee or the debtor in possession if proceedings under the Code are commenced against a U.S. Party. As amended by the 2006 Act, Section 546(e) excepts from avoidance any transfer that is a margin payment (as defined in section 101, 741 or 761 of the Code) or settlement payment (as defined in section 101 or 741 of the Code) made by or to (or for the benefit of), among others, a forward contract merchant, financial institution or financial participant that is made before the commencement of a case under the Code, except for any transfer made with actual intent to hinder, delay, or defraud creditors as provided in section 548(a)(1)(A) of the Code.[283] Section 546(g) excepts from avoidance transfers made by or to (or

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[283] 11 U.S.C. §§ 546(e) and 548(a)(1)(A). See In re Tribune Fraudulent Conveyance Litigation (the "**Tribune Litigation**"), 818 F.3d 98 (2d Cir. 2016), petition for writ of certiorari pending. In the Tribune Litigation, individual creditors of the Tribune Company (including the indenture trustees for certain noteholders and certain retirees of the Tribune Company) asserted causes of action that sought to avoid and recover "settlement payments" in respect of securities contracts received by former shareholders in connection with a leveraged buyout prior to the Tribune Company ("**Tribune**") filing for relief under chapter 11 of the Code. The Court of Appeals for the Second Circuit (the "**Second Circuit**") held that the state law constructive fraudulent conveyance causes of action brought by the plaintiffs were impliedly preempted by section 546(e) (applicable to securities contracts and forward contracts) of the Code. The Second Circuit further held that notwithstanding the language of section 546(e) which expressly prohibited the trustee (or debtor-in-possession) from bringing such avoidance actions, the Tribune individual creditors were barred from pursuing such claims. The Court also held that the safe harbor applied to all settlement payments made by or to a financial institution even though some of the financial institutions were mere conduits who transferred the settlement payments to beneficial owners of the securities contracts, some of whom may not have been qualified entities in their own right. The Court looked to the legislative history and context underlying section 546(e) and noted that the purpose of the safe harbors is to protect securities transactions from being unwound long after their completion and explained that "[u]nwinding settled securities transactions by claims such as [those of the Tribune individual creditors] would seriously

undermine--a substantial understatement—markets in which certainty, speed, finality, and stability are necessary to raise capital." The Second Circuit's rationale for not undoing securities transactions should apply to prohibit undoing settlement payments or margin payments made with respect to forward contracts as to which the safe harbor under section 546(e) also applies.

The Second Circuit, therefore, affirmed the dismissal of the Tribune Litigation by the District Court for the Southern District of New York below, but reversed the holding of the District Court below (499 B.R. 310 (S.D.N.Y. 2013)) that section 546(e) did not preempt state law constructive fraudulent conveyance claims because the language of the statute made clear that the prohibition applies only to the "trustee" and that the individual creditors therefore could have standing to bring such claims. However, District Judge Sullivan had dismissed the individual creditors' actions on the basis that the automatic stay in 11 U.S.C. § 362(a)(1) deprived the individual creditors of standing to avoid the same transactions that the trustee of a litigation trust established under a plan of reorganization was seeking to avoid in the trustee's action for intentional fraudulent conveyance (intent to hinder, delay or defraud creditors) under section 548(a)(1)(A) of the Code, unless and until the litigation trustee completely abandoned its intentional fraudulent conveyance claims. On January 6, 2017, the District Court in Kirschner v. Fitzsimons *et al.*, 2017 U.S. Dist. LEXIS 3039 (S.D.N.Y. Jan. 6, 2017) dismissed the intentional fraudulent conveyance action on the basis that the litigation trustee had failed to prove that the Tribune board of directors intended to hinder, delay or defraud creditors in approving the leveraged buyout and accordingly, there was no fraudulent intent that could be imputed to the Tribune.

The Second Circuit, in a separate summary order entered on the same day as its decision in the Tribune Litigation, affirmed for "substantially the same reason" as its holding in the Tribune Litigation, the dismissal in Whyte v. Barclays Bank PLC ("**Whyte**"), 644 Fed. Appx. 60 (2d Cir. 2016), aff'g, 494 B.R. 196 (S.D.N.Y 2013), cert. denied (2017 U.S. LEXIS 2953 (U.S. May 15. 2017), of an action brought by the trustee of a litigation trust established in another chapter 11 case. The plaintiff in Whyte sought to avoid settlement payments in respect of certain swap transactions under state law fraudulent conveyance statutes on the basis that the section 546(g) "safe harbor" for swap agreements impliedly preempts state-law fraudulent conveyance actions. The District Court in Whyte held that "[t]he facial breadth of the [safe harbor] provisions, and the corresponding legislative history, make plain that Congress intended to place swap transactions totally beyond the inherently destabilizing effects of a bankruptcy and its attendant litigation." The language of section 546(g) is substantially similar to the language in section 546(e) which, as noted, applies to forward contracts as well as securities contracts.

As noted above, while the petition for writ of certiorari was denied in Whyte, the petition for writ of certiorari filed by the plaintiffs in the Tribune Litigation remains pending. Notably, the petitioners in both the Whyte and Tribune Litigation cases raised the questions whether the Second Circuit erred in holding that (1) the safe harbor provisions of section 546(g) and section 546(e), respectively, of the Code impliedly preempt state law constructive fraudulent conveyance actions that seek to avoid and recover settlement payments made with respect to swap agreements and securities contracts, respectively, and (2) the language of section 546(g) and section 546(e) respectively, prohibits not only the trustee or debtor-in-possession from bringing state law constructive fraudulent conveyance actions but also individual creditors and litigation trustees. Therefore, the denial of certiorari in the Whyte case leaves standing the decision of the Second Circuit in both the Whyte and Tribune Litigation cases on these two points.

However, a third question was raised in the petition for writ of certiorari filed in the Tribune Litigation case that was not raised in the Whyte case, i.e., whether the safe harbor for settlement payments under section 546(e) applies if a settlement payment in respect of a securities contract is made to a financial institution which is a mere conduit and the beneficial owner of the securities contract is not a qualified entity under section 546(e). That question was raised in the petition for writ of certiorari filed in Merit Management Group, LP v. FTI Consulting, Inc. ("**Merit**") with respect to the decision of the Seventh Circuit Court of Appeals (830 F.3d 690 (7th Cir. 2016), cert. granted May 1, 2017). In Merit, the Seventh Circuit held that the safe harbor provisions of section 546(e) did not apply to settlement payments made to a financial institution in respect of securities contracts where the financial institution was merely a conduit and had no beneficial interest in the settlement payment. That decision is contrary to the decision of the Second Circuit in the Tribune Litigation case and the holdings of four other Circuit Courts of Appeal that addressed the same issue, all of which held that the safe harbor in section 546(e) was intended to protect transactions in which the transfer was made "by or to" a financial institution without regard to whether the financial institution was the beneficial owner of the settlement payment. If the Supreme Court were to affirm the decision of the Seventh Circuit in Merit, then such holding may result in reversal and remand of that portion of the decision of the Second Circuit in the Tribune Litigation that held that section 546(e) protects settlement payments made to financial institutions that are mere conduits. An amicus brief filed by various former Tribune and Lyondell stockholders in support of reversal of the Merit decision requests that if the Merit decision is affirmed the Supreme Court reserve decision with respect to the application of section 546(e) to transfers of public securities through the public company clearing and settlement systems. Nonetheless, the safe harbor would still apply in the case of a settlement payment in respect of a forward contract so long as the recipient of such payment is itself a qualified entity, e.g., a forward contract merchant, financial participant or financial institution (or a master netting agreement participant to which section 546(j) applies). But see, Conti v. Perdue Bio Energy, LLC (In re Clean Burn Fuels, LLC), 2016 Bankr. LEXIS 3656 (Bankr. M.D.N.C., Oct. 17, 2016), where the bankruptcy court held the safe harbor under section 546(e) was not available where the contracts for the grain in question were not forward contracts because they had a maturity of less than two days.

Prior to the entry of the Second Circuit's decision in the Tribune Litigation, the bankruptcy court in Weisfelner v. Fund 1, et al. (In re Lyondell Chemical Co.), (the "**Fund 1**"), 503 B.R. 348 (Bankr. S.D.N.Y. 2014), denied a motion to dismiss an adversary proceeding asserting state law causes of action for constructive fraudulent conveyance that sought to avoid and recover payments received by Lyondell's stockholders in connection with its leveraged buyout. The bankruptcy court followed the reasoning of the District Court in the Tribune Litigation and held that the safe harbor under section 546(e) of the Code did not preempt the state law causes of action. In Weisfelner v. Fund 1, *et al.* (In re Lyondell Chem. Co.), 541 B.R. 172 (Bankr. S.D.N.Y. 2015) the bankruptcy court dismissed the intentional fraudulent transfer claims asserted in the plaintiffs' Third Amended Complaint and refused to dismiss the state law constructive fraudulent conveyance claims. The shareholder defendants' motion for reconsideration of the court's decision with respect to the constructive fraudulent conveyance claims was denied.

However, after the decision of the Second Circuit in the Tribune Litigation, the defendants in Weisfelner v. Fund 1 (In re Lyondell Chem. Co.), 554 B.R. 655 (Bankr. S.D.N.Y. 2016) brought a motion to dismiss, or in the alternative, for a stay of, the adversary proceeding (pending either the ruling by the Supreme Court denying the petition for writ of certiorari in the Tribune Litigation, or if certiorari is granted, the Supreme Court's decision with respect to the Tribune Litigation, on the basis that under the decision of the Second Circuit in the Tribune Litigation, the Lyondell trustee's constructive fraudulent conveyance actions are barred by the safe harbor of section 546(e) of the Code. The bankruptcy court noted that the Second Circuit's decision in the Tribune Litigation addressed a similar set of facts and recommended that the District Court dismiss the Fund 1 case with prejudice because the bankruptcy court lacked jurisdiction to enter a final order.

The Lyondell litigation trustee appealed the bankruptcy court's dismissal of the intentional fraudulent conveyance claims. The District Court reversed the decision of the bankruptcy court and held that the knowledge and fraudulent intent of the corporation's CEO, acting within the scope of his authority, may be imputed to the debtor corporation, and remanded the case to the bankruptcy court for further proceedings. In re Lyondell Chemical Co., 554 B.R. 635 (S.D.N.Y 2016). The defendants moved for reconsideration of the District Court's decision and that motion was denied. Weisfelner v. Hofmann, *et al*. (In re Lyondell Chem. Co.), 2016 U.S. Dist. LEXIS 138449 (S.D.N.Y. Oct. 5, 2016).

The shareholder defendants in each of Weisfelner v. Hofmann and Weisfelner v. Fund 1 filed motions to dismiss the adversary proceedings with prejudice on the basis of collateral estoppel, because of the findings of the bankruptcy court in Weisfelner v. Blavatnik, et al. ("Blavatnik"), 567 B.R. 55, 63-67 (Bankr. S.D.N.Y. 2017), a suit which asserted both constructive and intentional fraudulent conveyance actions against the Blavatnik defendants based on the same facts. In Blavatnik, the bankruptcy court found (1) that the merger between Lyondell and Bassell AF S.C.A. did not leave Lyondell insolvent and thus the payments to shareholders for their for the benefit of) a swap participant or financial participant, under or in connection with any swap agreement that is made before the commencement of the case with the exception of any transfer made with actual intent to hinder, delay or defraud as provided in section 548(a)(1)(A) of the Code.[284] Section 546(j) excepts from avoidance transfers made by or to (or for the benefit of) a master netting agreement participant under or in connection with any master netting agreement or any individual contract covered thereby made before the commencement of the case, except under Section 548(a)(1)(A) of the Code and except to the extent the debtor or trustee could otherwise avoid such transfer made under an individual contract covered by such master netting agreement.[285] Thus, the taking of margin or Collateral should not be voidable and, therefore, the exercise of rights against margin or Collateral after the Filing Date should not be subject to challenge as avoidable, unless the original transfer of margin payment or the security interest in Collateral was obtained with actual intent to hinder, delay or defraud creditors and not obtained by the transferee in good faith.

Section 548(d)(2)(B)[286] of the Code also protects margin payments and settlement payments received by any forward contract merchant or financial participant prior to the Filing Date from avoidance as fraudulent transfers since it provides that such forward contract merchant or financial participant takes for value to the extent of such payment. Section 548(d)(2)(D)[287] provides the same avoidance "safe harbor" for transfers received by a swap participant or financial participant in connection with a swap agreement. Section 548(d)(2)(E)[288] of the Code protects transfers received by a master netting agreement participant made in connection with a master netting agreement or any individual contract covered thereby from avoidance as fraudulent transfers since it provides that the master netting participant takes the transfer for value to the extent of such transfer, except that, with respect to a transfer under any individual contract covered thereby, to the extent that such master netting agreement participant otherwise did not take (or is otherwise not deemed to have taken) such transfer for value. As long as the transfers referred to in section 548(d)(2)(B), 548(d)(2)(D) or 548(d)(2)(E) are also made "in good faith", as provided in section 548(c)[289] of the Code, they should be exempt from challenge as fraudulent transfers.

As noted, if an Individual Contract is neither a forward contract nor swap agreement, it may not be terminated or close-out netted without the bankruptcy court approving the Counterparty's motion to lift the automatic stay, but the existence of any such Individual Contract

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shares were not constructive fraudulent transfers and (2) Lyondell did not intend the merger to hinder, delay or defraud creditors and accordingly, the payments were not intentional fraudulent transfers. On September 5, 2017, both the Hofmann and Fund 1 adversary proceedings were dismissed by the bankruptcy court with prejudice with the consent of the plaintiff in those actions.

284 11 U.S.C. §§ 546(g) and 548(a)(1)(A). See discussion of Whyte in footnote 283.

285 11 U.S.C. § 546(j).

286 11 U.S.C. § 548(d)(2)(B). This section also applies to a commodity broker, stockbroker, financial institution or securities clearing agency.

287 11 U.S.C. § 548(d)(2)(D).

288 11 U.S.C. § 548(d)(2)(E).

289 11 U.S.C. § 548(c).

should not have any effect on the ability of a Counterparty to terminate the General Agreement with respect to, and to close-out net, Individual Contracts that qualify as forward contracts or swap agreements.

As noted above, the calculation and amount of the Termination Amount may be affected by the timing of the termination or rejection of the General Agreement (and Individual Contracts). As discussed above, notwithstanding the provisions of the General Agreement which only permit the Non-Defaulting Party to terminate the General Agreement and Individual Contracts, a trustee or debtor-in-possession may, at any time prior to termination of the General Agreement and Individual Contracts by the Non-Defaulting Party, reject the General Agreement and Individual Contracts, and such rejection will establish the rejection date as the date as of which damages are calculated and thus may affect the calculation and amount of the Termination Amount.

Under section 562(b)[290] of the Code, if there are not commercially reasonable determinants of value as of the date of termination, damages will be measured as of the earliest subsequent date or dates in which there are commercially reasonable determinants of value. In the case that the damages are measured as of a date other than the date of termination, the trustee or debtor-in-possession may object to such determination, and then the Counterparty will have the burden of proving that there were no commercially reasonable determinants on such date or dates.[291]

Payment of the Termination Amount by recourse (a) to Collateral that effectively secures the General Agreement and the Individual Contracts after termination or rejection of the Transaction Documents that are forward contracts or swap agreements, or (b) to a guaranty, should not be voidable by the defaulting U.S. Party or a trustee for such debtor, absent proof that any Collateral (including the grant and perfection of a security interest) or a guaranty was obtained with actual intent to hinder, delay or defend creditors or was not obtained in good faith.

As noted above, once the Termination Amount is determined, to the extent that such claim is unsecured, payment on the unsecured claim for such termination (assuming that the requisite proof of claim has been duly and timely filed and the claim allowed over any objection) will only be made by the Included Code Entity upon a distribution to unsecured creditors pursuant to a chapter 11 plan of reorganization (or liquidation) or by the chapter 7 trustee pursuant to a liquidation under chapter 7, as applicable, unless the bankruptcy court orders otherwise. As also noted above, if the Counterparty has an unsecured claim for any portion of the Termination Amount, such claim may be disallowed under section 502(d) of the Code[292] if the Counterparty is the recipient of an unrelated avoidable transfer and/or is liable therefor unless such Counterparty has turned over such property or paid the amount for which it is liable. Payment of a claim may

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290 11 U.S.C. § 562(b).

291 11 U.S.C. § 562(c). Similarly, if the rejection date is the earlier date, the Counterparty will have the right to challenge the debtor's calculation of the Termination Amount if damages are not measured on the rejection date. In such case, the debtor will have the burden of proving that there were no commercially reasonable determinants of value on such date.

292 11 U.S.C. § 502(d).

be equitably subordinated under section 510(c) of the Code[293] to payment of all other claims in the same class if the Counterparty is found to have engaged in inequitable conduct that conferred an unfair advantage upon the Counterparty or caused harm to the creditor body, but a claim (whether secured or unsecured) may be equitably subordinated only up to the amount of such harm. Disallowance and equitable subordination of a claim may apply even though a claim is unrelated to the avoidable transfer that gave rise to disallowance or the inequitable conduct that provided the basis for equitable subordination of the claim. If equitable subordination applies to a claim, a lien securing a claim may be transferred to the estate for the benefit of the creditors.[294]

<u>The FDIA, the OLA and FDICIA</u>

Section 11(e)(8)(C) of the FDIA provides that, notwithstanding § 91 of the NBA[295] or any other Federal or State law relating to avoidance of preferential transfers, the FDIC, whether acting as such or as conservator or receiver of an Insured Institution, may not avoid any transfer of money or other property in connection with any qualified financial contract with an Insured Institution absent a determination by the FDIC that the transferee had actual intent to hinder, delay or defraud the Insured Institution, the creditors of such institution, or any conservator or receiver appointed for such institution.[296] Accordingly, Early Termination, close-out netting or the calculation and payment of the Termination Amount will not be avoidable or challengeable under the FDIA absent determination of such actual fraudulent intent.

Section 210(c)(8)(C) of the OLA[297] provides that notwithstanding sections 210(a)(11) (fraudulent and preferential transfers and post receivership transfers), 210(a)(12) (setoff) and 210(c)(12) (security interests in any assets of a Covered Financial Company or interests in customer property, securities entitlements in respect of assets or property held by the covered financial company for any security entitlement holder)[298] and section 5242 of the Revised Statutes of the U.S. [§ 91 of the NBA], and any other provisions of Federal or State law relating to the avoidance of preferential or fraudulent transfers, the FDIC, whether acting in its individual capacity or as receiver, may not avoid any transfer of money or other property in connection with any qualified financial contract with a Covered Financial Company except if the transferee had actual intent to hinder, delay or defraud such company, the creditors of such company, or the FDIC as receiver of such company. Accordingly, Early Termination, close-out netting or the calculation and payment of the Termination Amount will not be voidable or challengeable under the OLA absent the transferee's actual fraudulent intent.

FDICIA protects the enforceability of netting contracts between two "financial institutions" notwithstanding any other provision of law or avoidance or similar proceeding subject

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293 11 U.S.C. § 510(c)(1). See footnote 294.

294 11 U.S.C. § 510(c)(2).

295 12 U.S.C. § 91.

296 12 U.S.C. § 1821(e)(8)(C).

297 12 U.S.C. § 5390(c)(8)(C).

298 12 U.S.C. § 5390(a)(11), (a)(12) and (c)(12).

to these limited exceptions discussed above. It is unclear whether the effect of the broad language is that a General Agreement between two financial institutions could supersede avoidability where there was a finding of actual intent to hinder, delay or defraud the insolvent institution, its creditors or the conservator or receiver, since there are limitations under FDICIA as to netting of any contract that is "invalid under or precluded by Federal law."

SIPA Liquidation, Stockbroker Liquidation and Commodity Broker Liquidation

Under the facts we have assumed with respect to SIPA liquidation, stockbroker liquidation and commodity broker liquidation, the same safe harbor provisions under the Code should apply to the enforceability of the contractual right of early termination and close-out netting of a General Agreement under a SIPA Liquidation, a proceeding under subchapter III of chapter 7 (stockbroker liquidation) or under subchapter IV of chapter 7 (commodity broker liquidation). The payment of the Termination Amount prior to the Filing Date should not be voidable, challengeable or deletable by a SIPA trustee in a SIPA liquidation or by a chapter 7 trustee in a stockbroker liquidation or commodity broker liquidation, absent intentional fraud as provided in section 548(a)(1)(A) of the Code. Where the U.S. Stockbroker is a Covered Broker or Dealer or covered subsidiary or the U.S. Commodity Broker is a Covered Financial Company or covered subsidiary the safe harbor provisions of the OLA applicable to qualified financial contracts should apply.[299]

E. Will the mere institution of involuntary proceedings under the Code prior to the entry of an order for relief affect the enforceability of Early Termination, close-out netting and the calculation and payment of the Termination Amount? Please clarify the procedural issues under the Code regarding the operation of the bankruptcy courts. In particular, please clarify whether or not there is a distinction in time with respect to a creditor's rights between:

1. **the filing of a proceeding seeking an order for relief in an involuntary case;**
2. **the entry of an order for relief;**
3. **the date on which a bankruptcy court determines a party first becomes insolvent; and**
4. **any other stage of the proceeding where a creditor's rights may be affected.**

An involuntary case under chapter 11 or chapter 7 of the Code is commenced by the filing with the bankruptcy court of a petition under such chapter against an entity that may be a debtor

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[299] See footnotes 297 and 298 and the related text.

under such chapter.[300] The automatic stay under section 362 of the Code is imposed upon the filing of the petition.[301]

Although an involuntary case may ultimately be dismissed, the filing of an involuntary petition operates as a stay under section 362(a) of the Code until the case is dismissed.

After the filing of an involuntary case and before the entry of an order for relief, the business of the debtor continues to operate and the debtor may use, acquire or dispose of property. However, after notice to the debtor and a hearing, the bankruptcy court may order the appointment of an interim trustee to take possession of the property of the estate and operate the business. Notwithstanding that an involuntary case may later be dismissed, the safe harbor provisions of the Code relating to forward contracts, swap agreements and master netting agreements found in, inter alia, sections 556, 560, 561, 562 and 362(b)(6), 362(b)(17) and 362(b)(27) apply upon the filing of the involuntary petition and the Counterparty may terminate and close-out net the General Agreement and Individual Contracts without the order for relief being entered.

If an involuntary petition is objected to, the bankruptcy court will enter an order for relief if it concludes that (a) the debtor Included Code Entity, U.S. Stockbroker (subject to a proceeding under subchapter III of chapter 7) or U.S. Commodity Broker (subject to a proceeding under subchapter IV of chapter 7) is generally not paying its debts as they become due, unless such debts are the subject of a bona fide dispute as to liability or amount or (b) a custodian (i.e., trustee, receiver or agent) of its property (other than a trustee, receiver or agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property) was appointed or took possession within 120 days before the filing

[300] 11 U.S.C. § 303(a). However, as discussed above, a proceeding for liquidation of a stockbroker under SIPA may only be commenced by an application and complaint filed by SIPC in the district court. Upon entry of a protective decree and appointment of a trustee by the district court, the SIPA liquidation is removed to the bankruptcy court pursuant to section 5(b)(4) of SIPA. The Commodity Exchange Act requires a commodity broker to notify the Commissioner of the CFTC no later than one business day after filing or, in the case of an involuntary petition, receipt of the filing of a title 11 case. 7 U.S.C. §§ 1, et seq. 17 C.F.R. pt. 190. App.A.

[301] An involuntary case against a person that is eligible to be a debtor under the Code is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of the Code by either (1) three or more entities holding non-contingent, undisputed claims aggregating at least $14,425 (for cases commenced on April 1, 2010 and before April 1, 2013) or $15,325 (for cases filed April 1, 2013 and before April 1, 2016) and $15,775 (for cases filed April 1, 2016 and thereafter) more than the value of any lien on property of the debtor securing the claims held by such persons; or (2) if there are fewer than twelve such holders, excluding any employees or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of the Code, by one or more of such holders that hold in the aggregate at least $14,425 (for cases commenced on April 1, 2010 and before April 1, 2013) or $15,325 (for cases filed April 1, 2013 and before April 1, 2016) and $15,775 for cases filed April 1, 2016 and thereafter. 11 U.S.C. § 303(b)(1), (2). A U.S. Stockbroker or U.S. Commodity Broker may not be a debtor under chapter 11 of the Code. See 11 U.S.C. § 109(d).

If the person is a partnership, either the involuntary case may be commenced (A) by fewer than all of the general partners in such partnership; or (B) if relief has been ordered under the Code with respect to all of the general partners in such partnership, by a general partner in such partnership, the trustee of such a general partner, or a holder of a claim against such partnership. 11 U.S.C. § 303(b)(3).

of the involuntary case.[302] Even if the bankruptcy court in an involuntary case determines not to enter an order for relief, any actions taken in accordance with the Code before such determination will remain effective.

No determination that an Included Code Entity is "insolvent" (as that term is defined in Code[303]) is necessary to the entry of an order for relief in an involuntary case under the Code.[304] The determination of when an Included Code Entity became insolvent should have no effect on the contractual rights to terminate or close-out net under the General Agreement or Code sections 362(b)(6), 362(b)(17), 362(b)(27), 556, 560 and 561, which permit those rights to be given effect.

F. Will Individual Contracts for physically settled Options be treated in a manner consistent with Individual Contracts for forward sales and purchases or swap agreements?

Under the Code, physically settled Options should come within the definition of "forward contracts" in section 101(25)[305] so long as they have a maturity date more than two days after the date the contract is entered into. An Option that has a maturity of two days or less may qualify as a swap agreement since the definition of swap agreement includes "(ii) any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph and that (I) is of a type that has been, is presently, or in the future becomes the subject of recurrent dealings in the swap or other derivatives markets; and (II) is a forward, swap, future, option or spot transaction on one or more…commodities…and (iv) any option to enter into an agreement or transaction referred to in this subparagraph…."[306] Any physically settled Options that qualify as forward contracts or swap agreements should be treated in the same manner as Individual Contracts that qualify as forward contracts or swap agreements. The same applies to treatment of physically settled Options under section 11(e)(8)(D)(iv)[307] and section 11(e)(8)(D)(vi) of the FDIA

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302 11 U.S.C § 303(h). As noted above, a SIPA liquidation proceeding is commenced by the application of the FDIC to a district court for a protective order.

303 11 U.S.C. § 101(32) defines "insolvent" as follows:

"(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of-

(i) property transferred, concealed, or removed with intent to hinder, delay or defraud such entity's creditors; and

(ii) property that may be exempted from property of the estate under section 522 of this title."

304 See 11 U.S.C. § 303(h) discussed above.

305 11 U.S.C. § 101(25).

306 11 U.S.C. § 101(53B).

307 12 U.S.C. § 1821(e)(8)(D)(iv).

and section 210(c)(8)(D)(iv)[308] and section 210(c)(8)(D)(vi)[309] under the OLA, which have the same definition of "forward contract" and "swap agreement" as under the Code. Physically settled Options are also included in the definition of qualified financial contract under § 618-a2(e)(i) of the NYBL.[310]

G. Netting and Set-Off

1. A general description of limitations under the Code, the FDIA, and the OLA if any, applicable to set off of claims (both in an Early Termination scenario and otherwise).

(a) between Parties (of claims arising under the General Agreement);

(b) between Parties (of claims arising outside the General Agreement if contractually provided for in an amendment to the General Agreement);

(c) between Affiliates or Credit Support Providers of the Parties (if contractually provided for in an amendment to the General Agreement).

2. Whether the Code, the FDIA or the OLA considers the remedies of early termination, set-off and close-out netting as separate or related and interdependent rights.

The Code

1. (a) There is no limitation under the Code on the "set off" of unsecured claims arising under the General Agreement between Parties, in the Early Termination scenario or otherwise so long as the claims arising under the General Agreement relate to Individual Contracts that constitute forward contracts or swap agreements[311], as the result of the exceptions afforded under sections 362(b)(6), 362(b)(17), 362(b)(27), 553, and 561 of the Code for offset and netting of forward contracts, swap agreements and master netting agreements and so long as the amounts to be set off or netted are prepetition amounts.

(b) The Code also permits the "set off" of claims arising outside the General Agreement, if contractually provided for in an amendment to the General Agreement or a cross-product netting agreement that is entered into by the Parties prior to the filing of a case under the Code which provides for cross-product netting to the extent that such claims relate to financial

308 12 U.S.C. § 5390(c)(8)(D)(iv).

309 12 U.S.C. § 5390(c)(8)(D)(vi).

310 NYBL § 618-a2(e)(i).

311 We assume for this purpose, that the Non-Defaulting Party qualifies as either forward contract merchant, financial institution, financial participant, or swap participant, as applicable.

contracts enumerated in section 561(a) of the Code and to the extent that such amendment or cross-product netting agreement provides for netting and offset of such financial contracts between the counterparties to the General Agreement. While section 561(a) of the Code permits cross-product netting of the financial contracts listed in section 561(a) of the Code, section 561(b) makes clear that such cross-product netting does not extend to the offset of other claims that do not arise under a financial contract. To the extent claims arise under an amendment to the General Agreement that permits set off against claims arising under the General Agreement of other debts and claims that do not relate to a financial contract, the automatic stay will continue to apply to the set off of those claims, as will the provisions of section 553 of the Code[312] which permit set off of mutual prepetition debts and claims of the same parties but preclude any improvement of position by the creditor within the 90 days preceding the Filing Date (or after the commencement of the case if the claim was transferred by an entity other than the debtor.) Exercise of rights of setoff as to any claims that do not arise under the netting provisions of a financial contract requires an order of the bankruptcy court lifting the automatic stay. There have been a few rulings in the LBHI case which indicate that post-petition debts arising under non-qualified financial contracts may not be set off against pre-prepetition claims arising under financial contracts.[313]

(c) The Code does not permit setoff (or netting) of claims between Affiliates or Credit Support Providers of the Parties since section 553(a) of the Bankruptcy Code is designed to protect against triangular setoffs in which a creditor attempts to set off its debts to a debtor with the latter's debt to a third party. The mutuality requirement has been held to require that each party own its claim with the right to collect in its own name.[314] It should be noted that if an Affiliate or Credit

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312 11 U.S.C. §553.

313 In Lehman Bros. Holdings Inc. v. Swedbank, 433 B.R. 101 (Bankr. S.D.N.Y. 2010), aff'd, 445 B.R. 130 (S.D.N.Y. 2011), the bankruptcy court held that a party to a terminated swap agreement could not set off the prepetition termination amount owed by LBHI as guarantor against funds accumulated in a bank account after the Filing Date. See also, In re Lehman Bros. Holdings Inc., 404 B.R. 752 (Bankr. S.D.N.Y. 2009) concerning failure to meet mutuality requirement where prepetition claim was proposed to be set off against post-petition deposit. Bank of Am. N.A. v. Lehman Bros. Holdings Inc., (In re Lehman Bros. Holdings Inc.), 439 B.R. 811, 833 discussed at footnote 235 above.

314 It should be noted that bankruptcy courts have not enforced contractual rights of triangular setoff under the Code. In In re United Sci. of Am., Inc., 893 F.2d 720 (5th Cir. 1990), the United States Court of Appeals for the Fifth Circuit held that the mutuality requirement of section 553(a) of the Code is designed to protect against triangular setoff and requires that each party own its claim, with the right to collect in its own name); see also, In re SemCrude, L.P., 399 B.R. 388 (Bankr. D. Del. 2009), in which the bankruptcy court held that section 553 of the Code prohibited the triangular setoff of forward contracts and/or swap agreements entered into between a creditor and certain debtors, each a subsidiary of a common parent, as a matter of law, due to lack of mutuality even though the parties had entered into agreements that allowed for setoff against affiliate debt. The bankruptcy court held that there is no contractual exception to the mutuality requirement under section 553. The court, however, noted that there is a split of authority regarding the issue of whether an unpaid guaranty can confer mutuality for purposes of Section 553 of the Code. In a subsequent motion, the creditor sought reconsideration of the court's ruling in SemCrude on the grounds that the contracts were forward contracts or swap agreements entitled to the safe harbor provisions of the Code. The court denied the motion for reconsideration because there had been no change in the controlling law and no meaningful allegation of newly available evidence, which is the basis for reconsideration. The District Court affirmed the bankruptcy court's decisions and held that a "contractual exception" to the mutuality requirement does not exist based upon the plain language of Section

Support Provider is an affiliated debtor of an Included Code Entity, and if the bankruptcy court determines that, as a matter of equity, the assets and liabilities of an Affiliate (which may be a Credit Support Provider) should be substantively consolidated with the assets and liabilities of the Included Code Entity that is in a proceeding under chapter 11 or chapter 7, then the assets and liabilities of the Included Code Entity and such Affiliate may be substantively consolidated and treated as against a single entity. Although the assets and liabilities of affiliate debtors may be treated as one, at least one Federal district court, the District Court for the District of Delaware in In re Garden Ridge Corporation,[315] upheld a decision of the bankruptcy court that determined that where a creditor had claims against one debtor and debts owed to another debtor, and the assets and liabilities of the debtors were substantively consolidated, a set off could not take place for lack of mutuality notwithstanding substantive consolidation.

2. Under the Code, the remedies of early termination, setoff and close-out netting are related, in that, a Counterparty must exercise a contractual right of termination (including Automatic Termination) to close-out net. To the extent that close-out netting amounts to set off of mutual debts and claims, exercise of such rights under section 362(b)(6) (with respect to forward contracts), section 362(b)(17) (with respect to swap agreements) or section 362(b)(27) (with respect to master netting agreements) is expressly excepted from the limitations on setoff in section 553 of the Code and the application of the automatic stay.

The FDIA and the OLA

Section 11(e)(8)(A)(iii)[316] of the FDIA recognizes the right of a Counterparty to offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with one or more financial contracts subject to the limitations under sections 11(e)(9) and section 11(e)(10). Section 11(e)(8)(A)(i)[317] also permits the termination, liquidation or acceleration of any qualified financial contract at any time after 5:00 pm on the business day following the appointment of the FDIC as receiver so there is interrelation of those provisions.

553 of the Bankruptcy Code. (In re SemCrude, LLP, 428 B.R. 590 (D. Del. 2010). Chevron appealed the decision of the District Court to the United States Court of Appeals for the Third Circuit, but such appeal was dismissed by stipulation of the parties. See also, In re Lehman Bros. Inc., 458 B.R. 134 (Bankr. S.D.N.Y. 2011) which held in a SIPA proceeding that a triangular setoff does not satisfy the Code's mutuality requirement in connection with setoffs of financial contracts. The court held in that case that UBS AG was not entitled under Section 553 to retain collateral it held to satisfy debts the debtor owed the bank's affiliate UBS Securities LLC and that the bank violated the automatic stay imposed by section 362 when it retained the collateral. See also Sass v. Barclays Bank PLC (In re Am. Home Mortg. Holdings, Inc.), 501 B.R. 44 (Bankr. Del. 2013) following In re Lehman Bros., Inc., and stating that "nothing in section 561 of the Bankruptcy Code can preserve a right that that [sic] does not exist, inclusive of the mutuality requirement demanded in section 553."

315 In re Garden Ridge Corp., C.A. No. 06-213-GMS (December 29, 2008).

316 12 U.S.C. § 1821(e)(8)(A)(iii).

317 12 U.S.C. § 1821(e)(8)(A)(i).

Substantially similar provisions to sections 11(e)(8)(A)(iii) and 11(e)(8)(A)(i) of the FDIA are found in sections 210(c)(8)(A)(iii) and 210(c)(8)(A)(i)[318] of the OLA.

While cross-product netting is recognized under section 11(e)(8)(A)(iii) of the FDIA, there is no indication that cross affiliate offset or netting is permitted. The only requirements as to affiliated persons relate to transfer and repudiation of qualified financial contracts. Under section 11(e)(9)(A)[319] of the FDIA, a conservator or receiver must transfer (i) all qualified financial contracts between the depository institution and any person or any affiliate of such person and the Insured Institution in default; (ii) all claims of such person or any affiliate of such person against such depository institution under any such contract (other than any claim, which under the terms of any such contract, is subordinated to claims of general unsecured creditors of such institution); (iii) all claims of the depository institution against any such person or any affiliate of such person under any such contract; and (iv) all property securing or any credit enhancement for any contract referred to in clause (i) or any claim referred to in clause (ii) or (iii) of this paragraph. Under section 11(e)(11) of the FDIA,[320] repudiation or disaffirmance of qualified financial contracts is only permitted with respect to all qualified financial contracts between the depository institution and the Counterparty and any of the Counterparty's affiliates.

Similarly, cross-product netting is recognized under section 210(c)(8)(A)(iii) of the OLA, but there is no provision indicating that cross affiliate offset or netting is permitted. The only requirements as to affiliated persons relate to transfer and repudiation of qualified financial contracts. Section 210(c)(9)(A) of the OLA[321] is substantially identical to section 11(e)(9)(A) of the FDIA requiring the transfer of all qualified financial contracts between a Covered Financial Company and any person or any affiliate of such person and related claims, property securing or other credit enhancement of such qualified financial contracts or, the transfer of none of such qualified financial contracts, claims, property or credit enhancements. Similar to section 11(e)(11) of the FDIA, Section 210(c)(11)[322] of the OLA provides that in exercising rights of disaffirmance or repudiation with respect to any qualified financial contract to which a Covered Financial Company is a party, the FDIC must disaffirm or repudiate all qualified financial contracts between the Covered Financial Company and any person or any affiliate of such person or disaffirm or repudiate none of such contracts.

IV. PARENT COMPANY GUARANTEE [323]

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318 12 U.S.C. § 5390(c)(8)(A)(iii), (i).

319 12 U.S.C. § 1821(e)(9)(A).

320 12 U.S.C. § 1821(e)(11).

321 12 U.S.C. § 5390(c)(9)(A).

322 12 U.S.C. §5390(c)(11).

323 **IMPORTANT DISCLAIMER:** In this Section IV, we present both generalized examples, and in some cases recent and publicly available specific samples, of text purporting to address concepts discussed in this Section. All of those generalized examples and specific samples are presented for illustrative purposes only, **NOT** as this Firm's endorsement of that text as being sufficient for the purpose intended. U.S. legal counsel with appropriate competence should be consulted in connection with any actual or proposed transaction.

QUESTIONS PRESENTED BY EFET AND RESPONSES THERETO

1. Are there any specific statutory formalities that should be (or recommendable as good practice for the benefit of the Beneficiary) complied with in order to create a valid guarantee document?

2. Are there any specific statutory provisions that should be expressly set-aside, varied or referred to, or any specific statement/wording based on any such statutory provisions that should be expressly included, in the document of the guarantee in order to increase the chances of an effective enforcement of the guarantee as may be expected by the Beneficiary based on the assumptions?

Although the details may vary from one transaction to the next, at base a "guarantee" is a promise or other undertaking by one party (the guarantor), made to or for the benefit of another party (the beneficiary), to fulfill the payment or performance obligation (or both) of a third party (the underlying obligor) owed by that underlying obligor to that beneficiary. In some cases that guarantee may be oral, but usually it is made in a writing signed by the guarantor.[324]

There is no omnibus Federal law governing contractual guarantees. Under the dual federalism system of government in the United States, the guarantee by one entity of the contractual obligations of another entity largely is governed by the law of the particular State under which that guaranty is created, governed and interpreted. Nor is there one uniform model state law. Consequently, in some States (such as California) the law of guarantee is significantly statutory,[325] whereas in others (such as New York) it is based largely or entirely on case law.[326]

For purposes of this Memorandum, our discussion and analysis focus on the following situation:[327]

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[324] In New York, a guarantee generally must be in writing. See footnote 349 and related text. The beneficiary may or may not also be a party to a written guarantee (though, as named beneficiary, it would have rights to enforce it). Rarely is the underlying obligor also a party to a written guarantee.

[325] See, generally, Cal. Civ. Code, §§ 2787 et seq.

[326] In the United States, constitutional law and statutory law do not necessarily displace "common law" as a source of applicable law, especially in matters that, under the Federal Constitution, have been reserved to the States. Common law (which can include English case law predating the United States) continues to play a significant role in certain areas of law, including the law of guarantee.

[327] Section 16 of the General Agreement broadly contemplates that Credit Support Documents may be delivered on or at any time after the Effective Date. This Memorandum assumes the Parent Company Guarantee is delivered on the Effective Date, and that one or more Individual Contracts also are being entered into at that time. Although in this Section IV we discuss certain matters that may be relevant where the Parent Company Guarantee is delivered in other contexts, a comprehensive discussion of the additional variables that may arise in those other contexts (and their impact on, among other things, the single, integrated agreement stipulation in Section 1 of the General Agreement) is beyond the scope of this Memorandum.

i. two Parties are proposing to enter into the General Agreement and the initial Individual Contract(s);

ii. in accordance with Section 16 of the General Agreement, the Parties have specified in Section 16 of the Election Sheet that one Party (the "**Principal Obligor**"), a U.S. corporation, will provide to the other Party (the "**Beneficiary**") a Credit Support Document (in the form of a written parent company guarantee (the "**Parent Company Guarantee**")) from one stipulated Credit Support Provider ("**Parent Company Guarantor**");[328]

iii. the purpose of the Parent Company Guarantee is to induce the Beneficiary to enter into the General Agreement and the applicable Individual Contract(s) with the Principal Obligor;[329]

iv. the Parent Company Guarantor is a business corporation incorporated under the law of a U.S. State and is not, by virtue of the nature of its business or proposed business or the ownership of its assets, or by virtue of its subsidiaries or other affiliates, subject to any oversight or regulation by an U.S. State or Federal agency or other regulatory authority that would condition, impair or otherwise affect its authority or ability to enter into and perform its obligations under the Parent Company Guarantee or the enforceability of the Parent Company Guarantee against it;[330] nor is the Parent Company Guarantor itself the subject of a bankruptcy, insolvency or analogous proceeding (under the Code or otherwise); and

v. under the Parent Company Guarantee the Parent Company Guarantor promises or otherwise undertakes to pay, when due, amounts owed by the Principal Obligor pursuant to the terms of the General Agreement (as applied to the applicable Individual Contract(s))

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328 This Memorandum does not address the circumstance where one or more other affiliates of the Principal Obligor may be designated as Credit Support Providers providing contractual guarantees to the Beneficiary, in addition to (or instead of) the Parent Company Guarantor.

329 This arrangement seeks to mitigate the risk to the Beneficiary that, at some future point, it may be the Non-Defaulting Party upon some default by the Principal Obligor (the Defaulting Party). Contractual guarantees typically recite the contractual consideration for the guarantor delivering such guarantee; and such reference is even more important where the guarantee is a so-called "continuing" guarantee; all as discussed in greater detail below.

330 For example, as discussed above Title VII of the Dodd-Frank Act regulates certain types of swaps (including certain derivatives transactions relating to commodities) and prohibits entry into a swap that is governed by Title VII absent compliance with applicable requirements of Title VII. 7 U.S.C. §2(e). The CFTC has interpreted this provision as applying to a guarantee of such a swap, at least where the counterparty to a swap would have recourse to the guarantor in connection with the position. 77 Fed. Reg. 48208, 48226 (August 13, 2012). Other Federal laws, including the Investment Company Act of 1940, 15 U.S.C. §80a-1 et seq., also regulate the incurrence of indebtedness of certain obligors. A full discussion of Title VII and these other laws is beyond the scope of this Memorandum.

in the event the Principal Obligor fails to do so after any applicable grace period ("**Principal Obligor Default**").[331]

In general, guarantees in the United States fall into two basic categories – guarantees of payment and guarantees of collection. Both categories typically contain the guarantor's undertaking to pay the amount owed, but guarantees of collection typically require that the beneficiary make specific (and often extensive) enforcement efforts against the underlying obligor before the beneficiary may enforce the guarantee against the guarantor.[332] In this Memorandum our analysis assumes the Parent Company Guarantee is a guarantee of payment (and not of collection)[333] that expressly entitles the Beneficiary to demand payment from the Parent Company Guarantor immediately upon the occurrence of a Principal Obligor Default without having first taken any action against the Principal Obligor (such as (i) making any demand upon or giving any notice to the Principal Obligor (beyond any demand or notice required under the General Agreement), (ii) commencing or continuing any legal proceedings against the Principal Obligor, or (iii) filing any claim in any bankruptcy or insolvency proceeding of the Principal Obligor).[334] We further assume that the Beneficiary would, upon the Principal Obligor Default, make demand on the Parent Company Guarantor and provide the Parent Company Guarantor with appropriate evidence of the amount claimed (such as a copy of any applicable unpaid invoices and any breakdown of any additional outstanding amounts then due (such as termination payments, or late payment interest)); and that in any event, the Beneficiary's demand made on the Parent Company Guarantor would not exceed the limit of the Principal Obligor's obligation under the terms of the General Agreement (or any lower cap on the amount of the Parent Company Guarantor's liability as may have been provided for in the Parent Company Guarantee).[335]

The form, contents and enforceability of a guarantee very much depend on the jurisdiction that will govern the creation, interpretation and enforceability of that guarantee. In some respects, guarantees are regarded as ordinary contracts and thus are subject to ordinary contract law principles.[336] A threshold matter is whether the choice of governing law expressed in the Parent

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331 We assume, for purposes of this Memorandum, that the demand on the Parent Company Guarantee is being made on account of the Underlying Obligor's bankruptcy (General Agreement Section 10.5(c)(iv)). See also the assumptions we have made in Section I.B.(k) which apply to this Section IV.

332 N.Y. Gen. Oblig. Law § 15701, provides that "[u]nless otherwise agreed between the parties in writing, the failure or refusal by a creditor, after a demand by a person bound as surety, to bring an action against a principal debtor upon a contract ... for the payment of money or the performance of any act shall not discharge such surety."

333 Guarantees of payment often contain some variation of the confirmatory statement that they are "a guarantee of payment and not of collection only."

334 One or more of these (or other) conditions precedent also may implicate suretyship defenses that also must be appropriately addressed. See discussion of suretyship defenses, below.

335 Contractual guarantees may contain a cap on the guarantor's own liability, as a negotiated business point and/or to mitigate fraudulent conveyance risks. As to this latter aspect, see more detailed discussion below.

336 See Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A., v. Herrera Navarro, 25 N.Y.3d 485 (2015) ("A guaranty is a promise to fulfill the obligations of another party, and is subject to ordinary principles of contract

Company Guarantee ultimately will be respected. New York law broadly provides for the enforceable selection of New York law to govern contractual relationships whether or not the transaction bears any reasonable relation to the State of New York.[337] We assume the Parent Company Guarantee includes an express choice of New York law.[338] By a companion statute, New York law also broadly provides for the enforceability of an express consent by the parties to a contract to the jurisdiction of the courts of the State of New York when the parties have chosen New York law to govern that same contract.[339] We assume the Parent Company Guarantee includes such a consent to New York court jurisdiction, and provides an appropriate address (either within or without the State of New York) for service of process on the Parent Company Guarantor.[340] We caution, however, that were the Parent Company Guarantee to be litigated in the courts of some jurisdiction other than New York, the courts of that other jurisdiction might not honor the parties' choice of New York law, particularly where the contract lacks a reasonable relationship to the State of New York.[341] And, in any case, contractual choice of law provisions typically must yield to any overriding public policy considerations that may apply.

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construction. Under those principles, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms.") (internal quotation marks and citations omitted) (hereinafter, "RaboBank").

337 See N.Y. Gen. Oblig. Law §51401. The limitations on the applicability of that section should not apply to the Parent Company Guarantee so long as the underlying transaction between the Parties involves not less than $250,000.

338 New York attorneys had a longstanding practice of using lengthy and cumbersome text in making the choice of New York law to govern the creation, interpretation and enforceability of contracts; but New York's highest state appellate court has indicated that simple and straightforward language also may suffice. IRB-Brasil Resseguros, S.A. v. Inepar Invs., S.A., 20 N.Y.3d 310 (2012) (hereinafter "IRB-Brasil") (guarantee provided that it would be governed by, and construed in accordance with, the laws of the State of New York); N.J.R. Assocs. & c. v. Tausend, 19 N.Y.3d 597 (2012); Matter of Diamond Waterproofing Sys., Inc., v. 55 Liberty Owners Corp., 4 N.Y.3d 247 (2005).

339 See N.Y. Gen. Oblig. Law §51402. The limitations on the applicability of that section should not apply to the Parent Company Guarantee so long as the underlying transaction between the Parties involves not less than $1,000,000. There is no parallel provision applicable to the consent to the jurisdiction of Federal courts sitting in the State of New York; consent to personal jurisdiction in Federal court is subject to other rules.

340 Often, the provision consenting to the courts of a particular jurisdiction also will include a waiver of any right to assert that proceedings brought in such jurisdiction would be brought in an inconvenient forum. In addition, New York law provides an accelerated process for civil suits seeking to enforce instruments for the payment of money only. N.Y. C.P.L.R. §3213. That section applies to the enforcement of unconditional guarantees. RaboBank, supra note 336, at 492. A contractual guarantee may expressly reference the beneficiary's right to rely on §3213. See, e.g., ICBC (London) PLC v. The Blacksands Pac. Grp., Inc., 2015 U.S. Dist. LEXIS 131211 (S.D.N.Y. Sept. 29, 2015).

341 As New York's highest state appellate court explained in IRB-Brasil, N.Y. Gen. Oblig. Law §51401 displaced the traditional conflicts-of-law analysis that would have applied otherwise. Under that analysis, "courts would conduct a conflicts analysis and apply the law of the jurisdiction with the most significant relationship to the transaction and the parties." IRB-Brasil, at 314. That traditional analysis nevertheless may apply were the Parent Company Guarantee to be litigated in a court outside of New York.

Many ordinary contract law principles apply to guarantees. At least five would have special significance in the case of the Parent Company Guarantee:

1. Acceptance of the Offer: Under ordinary principles of contract law, a binding contract requires both an offer and an acceptance. Those components rarely are problematic in a typical bilateral contract. Many guarantees are not also signed by the beneficiary and, even if one is, typically beneficiaries don't formally reaffirm reliance on the guarantee each time a new obligation arises under the underlying contract. To address this issue, guarantors typically waive acceptance and notice of acceptance of the guarantee.[342]

2. Contractual Consideration: Under ordinary contract law principles, a binding contract also requires contractual consideration.[343] Contractual consideration typically is addressed expressly in contractual guarantees and, for purposes of New York law, the consideration supporting the underlying obligation also typically suffices to support the guarantee as well (even without any direct consideration flowing to the guarantor), at least where the beneficiary's receipt of the guarantee is part of the bargained-for consideration relating to the creation of the guaranteed

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342 This has particular importance in the case of a so-called "continuing" guarantee, which (as discussed below) is intended to guarantee (in addition to underlying obligations established contemporaneously with the delivery of the guarantee) one or more specified or unspecified future underlying transactions that may be entered into between the principal obligor and the beneficiary. In that case, the guarantee should reference the nature of the future underlying obligations (sometimes done by a broad reference to any and all future indebtedness and other obligations, contingent or otherwise, of the underlying obligor to the beneficiary), should waive the beneficiary's acceptance of the guarantee, notice from the beneficiary of such acceptance and of its reliance on such guarantee, and notice of (and waiver of any consent rights with respect to) the establishment of any such future underlying obligations. Guarantees also typically contain waivers of other common commercial law defenses, such as "diligence", "presentment", "protest", "notice of protest" and "notice of dishonor".

343 Contractual guarantees implicate two distinct types of consideration: (x) contractual consideration, which often can be satisfied with nominal consideration (the proverbial "peppercorn" consideration); and (y) reasonably equivalent value (i.e., consideration that is tangible enough and valuable enough, each as determined under applicable law, to overcome the possible concern that the issuance of that guarantee was made by a guarantor already insolvent or thereby rendered insolvent). The analysis of reasonably equivalent value and related concepts (such as fraudulent conveyance) implicate issues under both New York State law and Federal law, and are beyond the scope of this Memorandum. Contractual guarantees sometimes include a fixed or floating cap on guarantor liability in an effort (which may or may not be effective) to reduce the risk that the guarantee causes the Guarantor's insolvency.

underlying obligation.[344] Greater care may be needed where the guarantee post-dates the creation of the applicable underlying obligation being guaranteed.[345]

3. Legal Capacity to Contract: Like in all ordinary contracts, the parties to a guarantee must have the legal capacity to contract. This is no less true in the case of the Parent Company Guarantee. The legal capacity of a juridical entity to guarantee depends on the law of its jurisdiction of formation and on the terms of its constituent documents. For example, New York's Business Corporation Law generally grants business corporations organized under that law the power to give guarantees;[346] however, if that guarantee would not be in furtherance of the corporation's corporate purposes, entry into that guarantee must be authorized by its board of directors and by the two-thirds vote of all outstanding shares authorized to vote on such question.[347] In addition, a particular guarantor, by virtue of the nature of its business or the ownership of its assets, may be subject to specific statutory or regulatory restrictions on its ability to give a guarantee.[348]

4. Guarantee Must Be in Writing: In general, under New York law the promise to answer for the debts of another must be in writing.[349] This requirement should be

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344 Sun Oil Co. v. Heller, 248 N.Y. 28 (1928) ("where one party agrees with another party that, if such party for a consideration performs a certain act for a third person, he will guarantee payment of the consideration by such person, the act specified is impliedly requested by the guarantor to be performed and, when performed, constitutes consideration for the guaranty."); Dunkin' Donuts of Am., Inc. v. Liberatore, 138 A.D.2d 559 (2d Dept. 1988); Michelin Mgmt. Co., Inc. v. Mayaud, 307 A.D.2d 280 (2d Dept. 2003). It is advisable for the contractual guarantee to recite, at a minimum, nominal consideration received by the guarantor for its issuance ("In consideration of $1.00 in hand paid and other good and valuable consideration, the existence, receipt and sufficiency of which hereby are acknowledged..."). Often, this will be accompanied by reference to the specific transaction at hand ("...and to induce the beneficiary to enter into the referenced underlying transaction..."). Critically, if the guarantee is a so-called "continuing" guarantee (see discussion below), the guarantee also should clearly recite that it also is being delivered "to induce the beneficiary to enter into any and all future transactions" in accordance with the underlying documentation.

345 This would constitute "past consideration". New York law recognizes "past consideration" as valid, at least where the later-issued guarantee is part of one overall transaction. See Michelin Mgmt., supra (no need for new or additional consideration to make guaranty valid and enforceable given that the guaranty and the earlier-executed real estate lease now being guaranteed both provided explicitly that the guaranty was issued to induce the landlord to enter into the lease); N.Y. Gen. Oblig. Law § 51105 ("A promise in writing and signed by the promisor or his agent shall not be denied effect as a valid contractual obligation on the ground that consideration for the promise is past or executed, if the consideration is expressed in the writing and is proved to have been given or performed and would be a valid consideration but for the time when it was given or performed.").

346 N.Y. Bus. Corp. Law § 202(a)(7).

347 Id. at § 908.

348 See footnote 330 and related text. Contractual guarantees typically will contain one or more representations and warranties from the guarantor addressing, among other things, the absence or existence of legal limitations on its ability to render such guarantees.

349 See, generally, N.Y. Gen. Oblig. Law, § 5701(a)(2).

satisfied where the Parent Company Guarantee is in writing and has been signed and delivered by a duly authorized officer of the Parent Company Guarantor.[350]

5. Fraudulent Inducement: Guarantors frequently raise fraudulent inducement as a defense to enforcement of their guarantees. For example, a guarantor may assert that the beneficiary had given assurance at the outset that the guarantee would not be enforced against the guarantor except in certain circumstances none of which had occurred. Standard contractual "merger" clauses may be ineffective against this risk.[351] In the case of a guarantee, New York law enforces express provisions in the guarantee whereby the guarantor stipulates to the enforceability of that guaranty in the face of a fraudulent inducement assertion. For example, New York courts typically would enforce a guarantee against a claim of fraudulent inducement where the guarantee is sufficiently specific in (x) stipulating there were no representations or warranties made by the beneficiary other than any contained within the contract and (y) providing it was absolute and unconditional irrespective of any lack of validity or enforceability or other circumstance that otherwise might constitute a defense to a guarantor in respect of a guarantee.[352] Often, the more specifically tailored the text may be to the defense sought to be raised by the guarantor, the more likely it is for that text to be enforced.[353]

In addition to ordinary contract law principles, certain other concepts also must be addressed because they are unique to the guarantee context or otherwise typically arise there. These concepts include the following:

1. Absolute, Unconditional and Irrevocable: A contractual guarantee that contains a New York choice of law election also commonly recites that the guarantee is

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350 New York law also generally makes enforceable a clause in a written agreement providing that it may not be amended or terminated orally. N.Y. Gen. Oblig. Law, § 15301. Sample text might read that "[t]his agreement may not be amended or otherwise modified, or terminated, except by a writing signed by the parties to this agreement." Comparable text might address oral waivers under the agreement. Enforceability of "no oral modification or termination clauses" is not absolute, however. See, e.g., Israel v. Chabra, 12 N.Y.3d 158 (2009).

351 A contractual "merger" clause is a provision in a written contract stipulating, in substance, that the written agreement "contains the entire agreement and understanding of the parties as to the subject matter of the contract". In effect, everything has been "merged" into that contract. Sabo v. Delman, 3 N.Y.2d 155 (1957). Under New York law, however, a standard "merger" clause does not preclude a guarantor's claim that the guarantee is unenforceable by virtue of having been induced by fraud. Citibank, N.A. v. Plapinger, 66 N.Y.2d 90 (1985).

352 Plapinger, supra note 351; Manufacturers Hanover Trust Co. v. Yanakas, 7 F.3d 310 (2d Cir. 1993).

353 Negotiated guarantees may have a stronger chance of having their waivers enforced. See Plapinger, supra note 351 ("...here we do not have the generalized boilerplate exclusion referred to by the commentators. Rather, following extended negotiations between sophisticated business people, what has been hammered out is a multimillion dollar personal guarantee proclaimed by defendants to be 'absolute and unconditional.'") (internal quotation marks omitted).

"absolute and unconditional" and almost as frequently also provides that the guarantee is "irrevocable".

Courts have tended to blur the precise meaning of "absolute" and "unconditional". In general, an "absolute" contractual guarantee is one that has been made absolutely enforceable against the guarantor (i.e., nothing further is needed to make it effective as against the guarantor);[354] whereas an "unconditional" contractual guarantee is one that is unconditionally enforceable against the guarantor (i.e., enforcement against the guarantor is not conditioned upon already having enforced the underlying obligation against the underlying obligor).[355] Joined together as one phrase, however, "absolute and unconditional" when so referenced in a guarantee suggests a heightened degree of enforceability of that guarantee.[356]

Misunderstandings often arise as to the revocability of a contractual guarantee. Some guarantees (known as "**restricted guarantees**") guarantee the underlying obligor's obligations under one or more specifically identified transactions, such as a term loan being made to the underlying obligor concurrently with the entry into the guarantee. Other guarantees (known as "**continuing guarantees**") guarantee the underlying obligor's obligations to the beneficiary under unspecified underlying transactions that may be effected concurrently with the entry of the guarantee, or thereafter.[357] Continuing guarantees may be revoked by the guarantor, but that revocation typically applies only as to future transactions between the underlying obligor and the beneficiary (i.e., the guarantee remains fully effective as to all obligations, including contingent obligations, of the underlying obligor under transactions predating the guarantor's notice of revocation).[358]

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354 See, RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 8 cmt. a (AM. LAW INST. 1996).

355 As discussed above, a guarantee of collection is a quintessential "conditional" guarantee.

356 See RaboBank, supra note 336 ("...guarantees that are 'absolute and unconditional[]' have been consistently upheld by New York courts. Absolute and unconditional guaranties have in fact been found to preclude guarantors from asserting a broad range of defenses.") (internal quotation marks and citations omitted).

357 The Parent Company Guarantee well may be a continuing guarantee. If so, it is important that it clearly identify the nature of the future underlying obligations thereby guaranteed (see footnote nos. 343 and 345, above, and accompanying text). A continuing guarantee may make the solvency analysis (see footnote 344 above, and accompanying text) more complicated, especially where there is no contractual cap on the aggregate principal amount of underlying obligations to be covered by such guarantee.

358 See, RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 16. For example, a continuing guarantee may provide, in substance that it "shall remain in full force and effect until any and all underlying obligations have been indefeasibly paid in full in cash and may not be revoked prior thereto by the guarantor (except that the guarantor may, upon written notice to the beneficiary effective 30 days after the beneficiary's receipt of that notice, revoke this guaranty as to any underlying obligations that may be entered into subsequent to the effectiveness of that revocation notice; and, for the avoidance of doubt, such revocation shall not be effective to terminate the guarantor's guarantee as to any and all underlying obligations incurred prior to the effective date of that revocation notice)."

Restricted guarantees by their nature should not be revocable, but beneficiaries often require that restricted guarantees nevertheless expressly confirm such nonrevocability.

2. Rule of Explicitness: In 1999, New York's highest appellate state court was asked to consider whether the so-called "Rule of Explicitness", which had been a judicially-created equitable doctrine under Federal law, also applied as a matter of New York state law. The doctrine, addressing the Code's limitations on the allowance and recovery of post-petition interest from a debtor in bankruptcy, generally provided that in an intercreditor subordination agreement a senior creditor could not recover an equivalent amount of post-petition interest out of the junior creditor's recovery unless the subordination agreement explicitly so provided. The New York court held that the doctrine did also apply, under New York law.[359] Practitioners customarily apply that doctrine, by analogy, to contractual guarantees, to increase the chance of recovering post-petition interest and fees from the guarantor even where the sum would not be allowed as a claim in the bankruptcy of the underlying obligor.[360]

3. Reinstatement: Where a beneficiary recovers from an underlying obligor, the guarantor's corresponding guarantee obligation under the guarantee would be discharged. In certain situations, including the Code's provisions regarding the bankrupt debtor's ability to recover disallowed or avoided transfers, the beneficiary may be forced to return such payment made by the underlying obligor. To assure, contractually, the beneficiary's right to resume resort to the guarantee in that instance (to the extent such right does not otherwise arise under applicable law), it is customary for contractual guarantees to provide for their reinstatement expressly.[361]

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359 In the Matter of Southeast Banking Corp., Debtor (Chemical Bank v. First Trust of New York, Nat'l Ass'n), 93 N.Y.2d 178, 186 (1999) ("In accordance with the Rule of Explicitness, New York law would require specific language in a subordination agreement to alert a junior creditor to its assumption of the risk and burden of allowing the payment of a senior creditor's post-petition interest demand.").

360 Collection of post-petition interest from a nonbankrupt guarantor should be allowable. See Nat'l Energy & Gas Transmission Inc. (f/k/a PG&E Nat'l Energy Grp. Inc.) et al. v. Liberty Elec. Power LLC (In re Nat'l Energy & Gas Transmission Inc.), 492 F.3d 297, 303 (footnote 5) (4th Cir. 2007). This concept typically is implemented by including, in the guarantee's description of the underlying obligations being guaranteed, text to the effect that such guaranteed obligations "include, among other things, any and all interest, fees and other amounts that otherwise would accrue in connection with the underlying obligations, whether or not allowed or allowable as a claim in any bankruptcy or other proceeding of the underlying obligor".

361 Typical text would provide, in substance, that "if at any time any payment received by the beneficiary from the underlying obligor is rescinded or otherwise must be returned or restored by the beneficiary upon the bankruptcy or insolvency of the underlying obligor, the guarantor's obligations under this guarantee with respect to such payment shall be reinstated, as though such payment had never been made." The existence of safe harbor provisions of the Code relating to pre-petition transfers of settlement payments or margin payments under section

4. Subrogation and Related Rights: Certain rights (of reimbursement, restitution, and subrogation) in favor of a guarantor, to enable the guarantor to seek recovery from the underlying obligor,[362] arise by operation of law once the guarantor has performed under the guarantee. One or more of these rights may arise before the beneficiary has been made whole, and even may arise upon partial performance by the guarantor. To avoid the guarantor competing against the beneficiary in enforcing rights against the underlying obligor, beneficiaries often require that contractual guarantees contain provisions postponing (or waiving entirely)[363] the guarantor's exercise of those rights.[364]

5. Suretyship Defenses: A guarantor typically is entitled to raise as a defense to the enforcement of the guarantee most defenses that the underlying obligor could raise to the enforcement of the underlying obligation.[365]

   In addition, an entirely distinct category of defenses, known as suretyship defenses, must be addressed expressly in the guarantee and, as explained below, can provide a challenge when drafting a contractual guarantee. These defenses arose under common law to counterbalance the traditional notion that a guarantor was ill-equipped to assure that his own interests would be protected adequately. The importance of the suretyship defenses to the beneficiary is that unless such defenses

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546(e) of the Code may reduce the likelihood that reinstatement may occur.

362 As discussed below, the concept underlying suretyship status is that, as between the surety and the underlying obligor, it is the latter who ought to perform or ultimately bear the cost of performance or nonperformance.

363 Waiver, in particular, of those rights may complicate existing (or introduce additional) business and legal issues that might need to be addressed. For example, a solvency analysis of the guarantor that had taken into account the guarantor's right of subrogation against the underlying obligor may need to be revisited where that subrogation right is to be waived entirely rather than postponed. This question of deferral vs. waiver also may implicate issues under the so-called "Deprizio" doctrine. This doctrine, which arises out of the preferential transfer provisions of the Code (section 547 applicable to insiders), typically will apply within the context of a parent company guarantee. It was first recognized in a 1989 Federal appellate court decision, Levit v. Ingersoll Rand Fin. Corp. (In re Deprizio), 874 F.2d 1186 (7th Cir. 1989), and in 1994 became the subject of a "fix" to section 550(c) of the Code relating to the liability of the transferee of an avoided transfer. Notwithstanding that fix, Deprizio issues continue to exist in connection with guarantees by insiders as defined in section 101(31) of the Code. See, e.g., In re Adamson Apparel, Inc., 785 F.3d 1285, 1292 (9th Cir. 2015).

364 Sometimes a guarantor will require that the underlying obligor enter into a reimbursement agreement to set forth contractually and in detail the parameters of the underlying obligor's reimbursement obligation to the guarantor. In that case, the contractual guarantee would need to address the postponement or waiver of the guarantor's contractual reimbursement rights, too.

365 These defenses available to the surety can be waived contractually, and typically are included within the broad waivers many guarantees contain respecting suretyship and other matters, as further discussed below. A few defenses are personal to the underlying obligor and cannot also be raised by the guarantor, such as the underlying obligor's discharge in bankruptcy. 11 U.S.C. § 524(e) ("discharge of a debt of the debtor does not affect the liability of any other entity on ... such debt").

are properly waived by the guarantor, the beneficiary will not be able to enforce the guaranty if any such defenses exist.

To understand suretyship defenses (and address them), it is necessary, as New York's highest state appellate court has said, to "dust off the venerable law of suretyship ... [and] guaranty ... and to reexamine these principles within the context of a multifaceted, contemporary business transaction which involves several parties, sophisticated financing arrangements and a variety of legal obligations."[366] The court explained that a suretyship arrangement arises within the confluence of three distinct, yet interrelated, relationships. Within the context of the General Agreement, those three relationships consist of: (i) the relationship between the Principal Obligor and the Beneficiary, which is defined contractually (under the General Agreement); (ii) the relationship between the Parent Company Guarantor and the Beneficiary, which also is defined contractually (under the Parent Company Guarantee); and (iii) the relationship between the Parent Company Guarantor and the Principal Obligor. This third relationship rarely is defined contractually, and the void long has been filled via common law where, as applied to the transaction addressed in this Memorandum, the Parent Company Guarantor is answerable to the Beneficiary in some way with respect to a payment obligation under the General Agreement the cost of which, as between the Principal Obligor and the Parent Company Guarantor, ought to be borne by the Principal Obligor.[367]

The common law recognized that, in entering into the arrangement, the guarantor would have assessed the risk of nonperformance by the underlying obligor and also the risk that the guarantor, if called upon to perform under its guarantee, would be successful in ultimately causing the underlying obligor to bear the cost of that performance. Suretyship defenses relate to situations that may impair or undermine that risk assessment analysis by increasing the guarantor's cost of performance or by decreasing the guarantor's potential ability to cause the underlying obligor to bear the cost of that performance. These situations may be viewed as fitting broadly into six basic categories: (i) complete or partial releases of the underlying obligation; (ii) extensions of the time for performance of the underlying obligation; (iii) other amendments to or modifications of the underlying obligation;[368] (iv) impairment of collateral securing performance of the underlying obligation; (v)

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366 Chem. Bank v. Meltzer, 93 N.Y.2d 296 (1999). See, generally, RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY.

367 Id. Although, for purposes of this Memorandum, we assume the Parent Company Guarantor's suretyship status arises by virtue of its guarantee of payment pursuant to the Parent Company Guarantee, suretyship status also could arise by virtue of a secondary obligor providing (with or without recourse to the secondary obligor) collateral as security for the payment or performance obligations of an underlying obligor. See, e.g., N.Y.U.C.C. § 9-102 cmt. 2. That aspect is beyond the scope of this Memorandum.

368 In the case of a so-called "continuing" guarantee, the increase in the aggregate amount of underlying obligations resulting from subsequent underlying transactions also should be addressed.

delays in enforcement of the underlying obligation; [369] and (vi) other situations that may impair or undermine rights the secondary obligor may possess by virtue of having suretyship status.[370]

Under New York law, although it may not be possible to disclaim suretyship **status**,[371] it nevertheless is permissible to vary or waive the **effect** of that suretyship status.[372] In other words, within the context of the overall arrangement under the General Agreement, careful drafting of the Parent Company Guarantee can successfully mitigate the risks to the Beneficiary arising by virtue of the suretyship status of the Parent Company Guarantor. Regrettably, New York law lacks any definitive, all-encompassing talismanic language to achieve that result.[373] As a result, the drafting of enforceable suretyship defense waivers entails some balance

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369 The existence of collateral securing the underlying obligation would bring into play issues, including those arising under the Uniform Commercial Code, that are beyond the scope of this Memorandum.

370 See, RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY §§ 37-49.

371 Suretyship status is determined by the substance of the overall transaction, rather than by its form or the use of any specific technical words. Meltzer, 93 N.Y.2d at 303.

372 See, RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 48.

373 Compare California law, which statutorily prescribes exact language to be used to waive various incidents of suretyship defenses. Cal. Civ. Code, §2856.

For an example of a recent, publicly available form of guaranty (electing New York law) that seeks to implement the California statutory provisions, see the guaranty filed with the SEC on December 24, 2015 by The Cheesecake Factory Incorporated on Form 8-K (Exhibit 99.1), which provided (among other things):

> WITHOUT LIMITING THE GENERALITY OF ANY OTHER WAIVER OR OTHER PROVISION SET FORTH IN THIS GUARANTY, GUARANTOR HEREBY WAIVES, TO THE MAXIMUM PERMITTED BY LAW, ANY AND ALL BENEFITS OR DEFENSES THAT MAY BE DERIVED FROM OR AFFORDED BY LAW WHICH LIMITS THE LIABILITY OF OR EXONERATES GUARANTIES OR SURETIES OR REQUIRES BENEFICIARIES TO EXHAUST REMEDIES AGAINST THE BORROWER PRIOR TO COMMENCING ANY ACTION OR FORECLOSURE AGAINST SUCH GUARANTOR OR ITS PROPERTIES INCLUDING, WITHOUT LIMITATION, THE BENEFITS OF CALIFORNIA CIVIL CODE §§2787 THROUGH AND INCLUDING §2855, CALIFORNIA CIVIL CODE §§2899 AND 3433, CALIFORNIA CODE OF CIVIL PROCEDURE §§580A, 580B, 580C, 580D, AND 726, AND CHAPTER 2 OF TITLE 14 OF THE CALIFORNIA CIVIL CODE, AND ANY SUCCESSOR PROVISIONS OF SUCH SECTIONS, OR ANY SIMILAR LAWS OF THE STATE OF CALIFORNIA OR OF ANY OTHER APPLICABLE JURISDICTION.
>
> WITHOUT LIMITING THE GENERALITY OF ANY OTHER WAIVER OR OTHER PROVISION SET FORTH IN THIS GUARANTY, GUARANTOR WAIVES ALL RIGHTS AND DEFENSES ARISING OUT OF AN ELECTION OF REMEDIES BY ANY BENEFICIARY, EVEN THOUGH SUCH ELECTION OF REMEDIES, SUCH AS A NONJUDICIAL FORECLOSURE WITH RESPECT TO SECURITY FOR THE GUARANTIED OBLIGATIONS, HAS DESTROYED GUARANTOR'S RIGHTS OF SUBROGATION AND REIMBURSEMENT AGAINST BORROWER BY THE OPERATION OF APPLICABLE LAW INCLUDING §580D OF THE CALIFORNIA CODE OF CIVIL PROCEDURE OR ANY SIMILAR LAWS OF THE STATE OF CALIFORNIA OR OF ANY OTHER APPLICABLE JURISDICTION.

between, on the one hand, text that is succinct and, on the other hand, text that is expansive enough to anticipate, and yet detailed enough to have waived with sufficient specificity, the particular defense(s) that the guarantor actually ultimately may seek to raise when faced with the enforcement of the guarantee. This balancing implicates both legal and business considerations,[374] and can result in text ranging from a simple sentence to text that may span multiple pages.[375]

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374 For example, commercial banks sometimes intentionally sacrifice specificity in favor of brevity in presenting suretyship defense waivers in their so-called "printed forms" of commercial loan guarantees. In doing so, those lenders are able to use short and simple forms in a multitude of transactions, accepting the risk that the waivers may prove inadequate in individualized situations.

375 Some New York practitioners rely on a minimalistic approach, using some variation of "The guarantor hereby waives all defenses based on principles of suretyship." Other New York practitioners also will include some variation of that sentence in their drafted guarantee, but only as a final catch-all concept after having also made reference to innumerable specific eventualities.

For an example of a recent, publicly available form of guaranty (electing New York law) that includes this generalized waiver as part of a broader panoply of suretyship waivers, see the guaranty filed with the SEC on January 7, 2016 by Mack-Cali Realty Corporation on Form 8-K (Exhibit 10.1), which provided (among other things):

> 9. Freedom of Lender to Deal with Borrower and Other Parties. The Administrative Agent and each Lender shall be at liberty, without giving notice to or obtaining the assent of the Guarantor and without relieving the Guarantor of any liability hereunder, to deal with the Borrower and with each other party who now is or after the date hereof becomes liable in any manner for any of the Obligations, in such manner as the Administrative Agent or such Lender in its sole discretion deems fit, and to this end the Guarantor gives to the Administrative Agent and each Lender full authority in its sole discretion to do any or all of the following things: (a) extend credit, make loans and afford other financial accommodations to the Borrower at such times, in such amounts and on such terms as the Administrative Agent or such Lender may approve, (b) vary the terms and grant extensions of any present or future indebtedness or obligation of the Borrower or of any other party to the Administrative Agent or such Lender, (c) grant time, waivers and other indulgences in respect thereto, (d) vary, exchange, release or discharge, wholly or partially, or delay in or abstain from perfecting and enforcing any security or guaranty or other means of obtaining payment of any of the Obligations which the Administrative Agent or any Lender now has or may acquire after the date hereof, (e) accept partial payments from the Borrower or any such other party, (f) release or discharge, wholly or partially, any endorser or guarantor, and (g) compromise or make any settlement or other arrangement with the Borrower or any such other party.
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> * * *
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> 11. Waivers by Guarantor. The Guarantor waives notice of acceptance hereof, notice of any action taken or omitted by the Administrative Agent or any Lender in reliance hereon, and any requirement that the Administrative Agent or any Lender be diligent or prompt in making demands hereunder, giving notice of any default by the Borrower or asserting any other rights of the Administrative Agent or any Lender hereunder. The Guarantor also irrevocably waives, to the fullest extent permitted by law, all defenses in the nature of suretyship that at any time may be available in respect of the Guarantor's obligations hereunder by virtue of any statute of limitations, valuation, stay, moratorium law or other similar law now or hereafter in effect.

For an example of a recent, publicly available form of guaranty that includes this generalized waiver as part of an even broader panoply of suretyship waivers, see the guaranty filed with the SEC on June 23, 2015 by Spectrum

Brands Holdings, Inc. on Form 8-K (Exhibit 10.3), which provided (among other things):

Section 2.03. No Discharge or Diminishment of Loan Guaranty.

(a) Except as otherwise provided for herein (including under Section 3.15), the obligations of each Loan Guarantor hereunder are unconditional, irrevocable and absolute and not subject to any reduction, limitation, impairment or termination for any reason, including: (i) any claim of waiver, release, extension, renewal, settlement, surrender, alteration, or compromise of any of the Guaranteed Obligations, by operation of law or otherwise; (ii) any change in the corporate existence, structure or ownership of any Obligated Party; (iii) any insolvency, bankruptcy, reorganization or other similar proceeding affecting any other Obligated Party, or their assets or any resulting release or discharge of any obligation of any Obligated Party; (iv) the existence of any claim, setoff or other rights which any Loan Guarantor may have at any time against any Obligated Party, the Administrative Agent, any Lender or any other Person, whether in connection herewith or in any unrelated transactions; (v) any direction as to application of payments by the Borrowers or by any other party; (vi) any other continuing or other guaranty, undertaking or maximum liability of a guarantor or of any other party as to the Guaranteed Obligations; (vii) any payment on or in reduction of any such other guaranty or undertaking; (viii) any dissolution, termination or increase, decrease or change in personnel by the Borrowers; (ix) any payment made to any Secured Party on the Guaranteed Obligations which any such Secured Party repays to the Borrowers pursuant to court order in any bankruptcy, reorganization, arrangement, moratorium or other debtor relief proceeding, and each Loan Guarantor waives any right to the deferral or modification of its obligations hereunder by reason of any such proceeding or (x) the failure of any Loan Guarantor to receive any benefit from or as a result of its execution, delivery and performance of this Loan Guaranty.

(b) Except for termination of a Loan Guarantor's obligations hereunder or as expressly permitted by Section 3.15, the obligations of each Loan Guarantor hereunder are not subject to any defense or setoff, counterclaim, recoupment, or termination whatsoever by reason of the invalidity, illegality, or unenforceability of any of the Guaranteed Obligations or otherwise, or any Requirements of Law purporting to prohibit payment by any Obligated Party, of the Guaranteed Obligations or any part thereof.

(c) Further, the obligations of any Loan Guarantor hereunder are not discharged or impaired or otherwise affected by: (i) the failure of the Administrative Agent to assert any claim or demand or to enforce any remedy with respect to all or any part of the Guaranteed Obligations; (ii) any waiver or modification of or supplement to any provision of any agreement relating to the Guaranteed Obligations; (iii) any release, non-perfection, or invalidity of any indirect or direct security for the obligations of the Borrowers for all or any part of the Guaranteed Obligations or any obligations of any other guarantor of or other Person liable for any of the Guaranteed Obligations; (iv) any action or failure to act by the Administrative Agent with respect to any Collateral securing any part of the Guaranteed Obligations; or (v) any default, failure or delay, willful or otherwise, in the payment or performance of any of the Guaranteed Obligations, or any other circumstance, act, omission or delay that might in any manner or to any extent vary the risk of such Loan Guarantor or that would otherwise operate as a discharge of any Loan Guarantor as a matter of law or equity (other than as set forth in Section 3.15).

Section 2.04. Defenses Waived. To the fullest extent permitted by applicable Requirements of Law, and except for termination of a Loan Guarantor's obligations hereunder or as otherwise provided for herein (including under Section 3.15), each Loan Guarantor hereby waives any defense based on or arising out of any defense of the Borrowers or any other Loan Guarantor or arising out of the disability of the Borrowers or any other Loan Guarantor or any other party or the unenforceability of all or any part of the Guaranteed Obligations or any part thereof from any cause, or the cessation from any cause of the liability of the Borrowers or any other Loan Guarantor. Without limiting the generality of the foregoing, each Loan Guarantor irrevocably waives acceptance hereof, presentment, demand, protest and, to the fullest extent permitted by law, any notice not provided for herein or in any other Loan Document, including notices of nonperformance, notices of protest, notices of dishonor, notices of acceptance of this Loan Guaranty, and notices of the existence, creation or incurring of new or additional Guaranteed Obligations, as well as any requirement that at any time any action be taken by any Person against any Obligated Party, or any other Person, including any right (except as may be required by applicable Requirements of Law and to the extent the relevant requirement cannot be waived) to require the Administrative Agent to (i) proceed against the Borrowers, any other Loan Guarantor, any other guarantor or any other party, (ii) proceed against or exhaust any security held from the Borrowers, any other Loan Guarantor, any other guarantor or any other party or (iii) pursue any other remedy in the Administrative Agent's power whatsoever. The Administrative Agent may, at its election and in accordance with the terms of the applicable Loan Documents, foreclose on any Collateral held by it by one or more judicial or nonjudicial sales, whether or not every aspect of any such sale is commercially reasonable (to the extent permitted by applicable Requirements of Law), accept an assignment of any such Collateral in lieu of foreclosure or otherwise act or fail to act with respect to any Collateral securing all or a part of the Guaranteed Obligations, and the Administrative Agent may, at its election, compromise or adjust any part of the Guaranteed Obligations, make any other accommodation with any Obligated Party or exercise any other right or remedy available to it against any Obligated Party, or any security, without affecting or impairing in any way the liability of such Loan Guarantor under this Loan Guaranty, except as otherwise provided in Section 3.15. To the fullest extent permitted by applicable Requirements of Law, each Loan Guarantor waives any defense arising out of any such election even though such election may operate, pursuant to applicable Requirements of Law, to impair or extinguish any right of reimbursement or subrogation or other right or remedy of any Loan Guarantor against any Obligated Party or any security.

Section 2.05. Authorization. Each Loan Guarantor authorizes the Administrative Agent without notice or demand (except as may be required by applicable Requirements of Law and to the extent the relevant requirement cannot be waived), and without affecting or impairing its liability hereunder (except as set forth in Section 3.15), from time to time, subject to the terms of the referenced Loan Documents, to:

(a) change the manner, place or terms of payment of, and/or change or extend the time of payment of, renew, increase, accelerate or alter, any of the Guaranteed Obligations (including any increase or decrease in the principal amount thereof or the rate of interest or fees thereon), any security therefor, or any liability incurred directly or indirectly in respect thereof, and this Loan Guaranty shall apply to the Guaranteed Obligations as so changed, extended, renewed or altered;

(b) take and hold security for the payment of the Guaranteed Obligations and sell, exchange, release, impair, surrender, realize upon or otherwise deal with in any manner and in any order any property by whomsoever at any time pledged or mortgaged to secure, or howsoever securing, the Guaranteed Obligations or any liabilities (including any of those hereunder) incurred directly or indirectly in respect thereof or hereof, and/or any offset there against;

(c) exercise or refrain from exercising any rights against the Borrowers, any other Loan Party or others or otherwise act or refrain from acting;

(d) release or substitute any endorser, any guarantor, the Borrowers, any other Loan Party and/or any other obligor;

(e) settle or compromise any of the Guaranteed Obligations, any security therefor or any liability (including any of those hereunder) incurred directly or indirectly in respect thereof or hereof, and/or subordinate the payment of all or any part thereof to the payment of any liability (whether due or not) of the Borrowers to their creditors other than the Secured Parties;

(f) apply any sums by whomsoever paid or howsoever realized to any liability or liabilities of the Borrowers to the Secured Parties regardless of what liability or liabilities of the Borrowers remain unpaid;

In light of the limitless breadth of potential suretyship defenses and the lack of authoritative omnibus waiver language, it is not practicable for us to recommend any particular text or even any particular approach.[376] Instead, we recommend that the Beneficiary and its legal counsel consider the context of the particular transaction and the approach that, within that context, will best achieve the legal and business results desired.

Very truly yours,

FISHERBROYLES LLP

(g) consent to or waive any breach of, or any act, omission or default under, this Loan Guaranty, the Credit Agreement, any other Loan Document, any Hedge Agreement with respect to any Secured Hedging Obligation or any of the instruments or agreements referred to herein or therein, or otherwise amend, modify or supplement this Loan Guaranty, the Credit Agreement, any other Loan Document, any Hedge Agreement with respect to any Secured Hedging Obligation or any of such other instruments or agreements; and/or

(h) take any other action which would, under otherwise applicable principles of common law, give rise to a legal or equitable discharge of the Loan Guarantors from their respective liabilities under this Loan Guaranty.

The RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY, in Comment *d* to section 48, states that "a statement to the effect that the duty of the secondary obligor [i.e., guarantor] is absolute and unconditional is ordinarily not sufficient to indicate that the secondary obligor is agreeing to forego discharges based on suretyship status…. [but] [g]eneral language indicating that the secondary obligor waives defenses based on suretyship is sufficient." A guaranty that provided that it was "absolute and unconditional irrespective of lack of validity or enforceability of the guaranty or any other circumstance that might otherwise constitute a defense available to a guarantor in respect of the guaranty" was held sufficient to bar a defense of fraud in the inducement, see e.g., Citibank, N.A. v. Plapinger, 66 N.Y. 90, 495 N.Y.S.2d 309, 455, N.E. 2d 974 (1985); and it might be argued that the same logic adopted by the court in that case (i.e., to accept the guarantor's fraudulent inducement defense, notwithstanding the guarantor's disclaimer in his guaranty, would in effect condone his own fraud in his expressed disclaimer) also should apply to an omnibus suretyship defense waiver.

376 See footnote 327 above. We note, however, the prudence of considering inclusion of a severability clause in the contractual guarantee, especially where an expansive approach to drafting suretyship and other waivers is being undertaken. A severability clause indicates the parties' intention that the balance of the subject contract is intended to be enforced notwithstanding that one or more discrete aspects of it may be held unenforceable.