

**Legal Expertise  
Prepared on behalf of  
European Commodity Clearing AG**

**For Submission to the Competent Supervisory Authorities**

**The Effectiveness of the Close-Out Netting Agreement  
Contained in Figure 3.9 of the Clearing Conditions  
of European Commodity Clearing AG**

**This translation is not legally binding. Please refer to the German version of  
this legal opinion.**

**8 October 2007**

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## A. Question to be answered

This expertise was prepared on behalf of European Commodity Clearing AG (“**ECC**”) for submission to the competent supervisory authorities by clearing members.

This expertise deals with the provisions contained in figure 3.9 of the Clearing Conditions of ECC in the version of 22 October 2007 as enclosed with this expertise as **Appendix A** (the “**Clearing Conditions**”) <sup>1</sup> in the way in which these form part of every NCM agreement (as defined herein below). These provisions are referred to as the “**Close-Out Netting Agreement**” herein below by way of summary.

The subject of this expertise is the legal effectiveness of the close-out netting agreement according to German law in case insolvency proceedings are instituted regarding the assets of a non-clearing member.

In as far as terms which are defined in the Clearing Conditions are used in this expertise, these terms shall have the meaning which is assigned to them in the clearing conditions in the framework of this expertise unless a deviating provision is made herein below.

### I. Scenario

In the framework of this expertise, we use the following assumptions:

1. The close-out netting agreement examined in this expertise is concluded in each case by means of the conclusion of an NCM agreement between a clearing member, a non-clearing member which has its registered offices within Germany (“**non-clearing member**”) <sup>2</sup> and European Commodity Clearing AG (the clearing member concerned and the non-clearing member are referred to jointly as the “**Parties**”), which has the content of the standard agreement enclosed herewith as **Appendix B** (“**NCM agreement**”).

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<sup>1</sup> Any reference to “figures“ in this expertise constitutes a reference to the respective figure of the Clearing Conditions unless another definition is made.

<sup>2</sup> In accordance with the task set, this expertise does not provide a view regarding the question of whether the Netting Agreement can be enforced legally in case there are set-off restrictions for the non-clearing members on account of the respective provisions which apply to them, e.g. in the case of banking institutions under public law on account of the respective foundation statute or statutes.

2. With regard to the Close-Out Netting Agreement and all of the Derivatives Market transactions included in the Close-Out Netting Agreement, every one of the parties complies with the legal restrictions applicable with regard to it.
3. A clearing member can have its registered seat within Germany or in another European country.
4. The Derivatives Market transactions included in the Close-Out Netting Agreement include the following transactions:
  - (a) Futures contracts regarding power which are executed by means of cash settlement as described in figure 4.2.2;
  - (b) Futures contracts regarding power which are executed by means of the delivery of power in return for the payment of the price agreed with regard to this as described in figure 4.2.3 (together with the transactions described under 1.4(a), "**Power Futures**");
  - (c) Options on futures contracts regarding power which are executed by means of cash settlement as described under figure 4.2.4 ("**Options on Power Futures**");
  - (d) Futures contracts regarding EU emission allowances which are executed by means of the delivery of EU emission allowances in return for the payment of the price agreed to that end as described in figure 4.2.5 ("**EU emission allowance futures**");
  - (e) Futures contracts regarding coal which are executed by means of cash settlement as described under figure 4.2.6 ("**Coal Futures**"); and
  - (f) Futures contracts regarding natural gas which are executed by means of the delivery of natural gas in return for the payment of the price agreed on to that end as defined under figure 4.2.7 ("**Natural Gas Futures**").

## II. Questions

On the basis of the assumptions referred to herein above, the expertise gives an opinion regarding the following questions:

1. Is the Close-Out Netting Agreement legally effective under German law outside insolvency proceedings regarding the assets of a non-clearing member?
2. Is the Close-Out Netting Agreement legally effective in domestic insolvency proceedings regarding the assets of a non-clearing member?

### B. Summary of the results

1. According to German law, the Close-Out Netting Agreement is legally effective outside insolvency proceedings regarding the assets of a non-clearing member. Its effectiveness is independent of the effectiveness of individual Derivatives Market transactions. (See C herein below with regard to this.)
2. The Close-Out Netting Agreement is effective in domestic insolvency proceedings regarding the assets of a non-clearing member. In particular, the Close-Out Netting Agreement cannot be contested solely on grounds of its conclusion; moreover, it does not violate articles 103, 104 InsO [German Insolvency Statute]. (See D herein below with regard to this.)

### C. Effectiveness of the Close-Out Netting Agreement outside Insolvency Proceedings regarding the Assets of a Non-Clearing Member

1. Every NCM agreement, whose element the Clearing Conditions are, is subject to German law according to the section entitled “Legal venue, place of performance”. This choice of law also applies with regard to the Clearing Conditions as is confirmed in Section 6.4 (1). In proceedings before a German court of law, the effectiveness of this choice of law is governed by German international private law. According to article 27, paragraph 1 EGBGB [Introductory Act to the German Civil Code], the choice of law is legally effective.<sup>3</sup>
2. All of the provisions contained in figure 3.9 can be agreed on effectively. In our view, neither the Close-Out Netting Agreement nor any other provision in figure 3.9 are ineffective outside German insolvency proceedings under German law under consideration of the assumptions made under A.I.2. In particular, Figure 3.9 does not contain any provisions which violate a legal ban (art. 134 BGB [German civil code]) or are contra bonos mores (art. 138 BGB). In as far as the Clearing Conditions have to be considered General Terms and Conditions of the respective clearing member concerned, Figure 3.9 does not contain any provisions which unreasonably affect a non-clearing member adversely in breach of good faith (art. 307 BGB) or which violate any other provisions contained in art. 305 ff. BGB in our view.

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<sup>3</sup> Heinrichs, in Palandt, Bürgerliches Gesetzbuch [German civil code], 66th edition, 2007, EGBGB [Introductory Act to the German Civil Code] 27 (IPR), margin no. 1, 8.

If any provisions in figure 3.9 or other provisions of the Clearing Conditions are evaluated as a violation of the provisions contained in art. 305 ff. BGB by the jurisdiction, this does not have any influence on the effectiveness of the remaining provisions contained in figure 3.9 according to art. 306, paragraph 1 BGB.

3. Any possible non-binding character or ineffectiveness of individual Derivatives Market transactions<sup>4</sup> would not lead to the ineffectiveness of the Clearing Conditions, in particular, such would not lead to the ineffectiveness of the Close-Out Netting Agreement. According to the clause of the NCM agreement entitled “Safeguarding clause”, the remaining provisions shall not be affected in case of the ineffectiveness or unenforceability of provisions. Even without such safeguarding clause, the ineffectiveness of individual Derivatives Market transactions according to art. 139 BGB [German civil code] would not have any impact on the effectiveness of the NCM agreement. It lies within the interest of each of the parties to be able to set off and assert all mutual claims<sup>5</sup> according to the provisions contained in the NCM agreement in the event of the ineffectiveness of Derivatives Market transactions and in particular in the event of the insolvency of the respective other party.

#### **D. Effectiveness of the Close-Out Netting Agreement in domestic insolvency proceedings regarding the assets of a non-clearing member**

##### **I. Applicability of German insolvency law**

On principle, the consequences of domestic insolvency proceedings regarding the assets of a debtor, who has its commercial establishment in Germany like a non-clearing member shall be governed by German insolvency law. This shall apply in particular with regard to the proprietary consequences of the insolvency which are decisive in the framework of this expertise.<sup>6</sup> According to the rules of German international insolvency law (art. 335 ff. InsO [Insolvency Statute]; Directive (EC) no. 1346/ 2000 regarding Insolvency Proceedings (“**EUInsVO**”[EU Insolvency Directive])), this also applies in case such domestic insolvency proceedings have a border-crossing effect.<sup>7</sup>

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<sup>4</sup> The preconditions for the effectiveness of Derivatives Market transactions do not form part of the subject of this expertise.

<sup>5</sup> E.g. from gain without legal cause.

<sup>6</sup> BGHZ [Collection of the Decision by the German Federal Court of Justice in Civil Matters] 68, 16, 17; BGH ZIP [German Federal Court, civil procedures] 1983, 961, 962 with further proof; cf. also Lüer, in Uhlenbruck, Insolvenzordnung [Insolvency Statute], 12th edition, 2003, art. 102 EInsO [Introductory Act regarding the German Insolvency Statute], margin no. 74.

<sup>7</sup> In the framework of this expertise it does not matter whether the provisions of art. 335 ff. InsO or EUInsO are applied with regard to such insolvency proceedings. If the provisions contained in art. 335 ff. InsO are applied, art. 340 paragraph 2 InsO would be applied since the Close-Out Netting Agreement constitutes a set-off agreement within the meaning of this provision. In case this provision has to be understood to the extent that the effects of the insolvency proceedings on such set-off agreements depend on the substantive insolvency law of the legal system selected in the respective contract concerned, the German substantive insolvency law would be important as regards the Close-Out Netting Agreement with regard to the choice of law in the section of the NCM Agreement entitled “Legal venue, place of performance”. In case this provision has to be understood to the extent that the contractual provision in the respective set-off agreement should also be applicable in insolvency proceedings, the civil-law effectiveness of this contractual provision under

## **II. Preconditions for the effectiveness of the Close-Out Netting agreement**

### **1. General permissibility of set-off agreements under insolvency law**

Art. 94 InsO [Insolvency Statute] establishes that a right of set-off existing on account of an agreement, which an insolvency creditor holds at the time at which insolvency proceedings are opened, is not affected by the insolvency proceedings. It can be derived from the provision that set-off agreements shall be effective during insolvency proceedings on principle. However, art. 94 InsO does not exclude that a situation might arise in which special provisions under insolvency law might lead to the ineffectiveness of set-off agreements, such as the Close-Out Netting Agreement.<sup>8</sup>

### **2. Incontestability of the Close-Out Netting Agreement**

Art. 94 InsO establishes that the mere conclusion of the Close-Out Netting Agreement does not establish any right of rescission on the part of the receiver. For this reason, a contestation of the Close-Out Netting Agreement might be possible in case the special circumstances of the respective individual case fulfil the preconditions for a case of contestation according to art. 129 ff. InsO. For example, a right of contestation would exist according to art. 131 paragraph 1 InsO in case the Close-Out Netting Agreement is concluded during the last month before the application for insolvency proceedings to be instituted or subsequently after such application with regard to individual transactions which have already been concluded (right of contestation according to art. 131 paragraph 1 fig. 1) or during the second or third month before the application for insolvency proceedings to be instituted subsequently for Derivatives Market transactions which have already been carried out and in case the debtor was either insolvent at the time of the conclusion of the Close-Out Netting Agreement (right of contestation according to art. 131 paragraph 1 fig. 2) or in case the party entitled to compensation was aware that the Close-Out

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the applicable law of contracts, which has already been covered under C. herein above, would only be decisive instead of the substantive German insolvency law. If the EUInsVO were to be applied, it is not clear whether article 4 EUInsVO or the special provision contained in article 6 paragraph 1 EUInsVO with regard to the law applicable with regard to the set-off applies to the Close-Out Netting Agreement. However, this question does not need to be decided since, according to both provisions, German substantive insolvency law would apply with regard to the question of the effectiveness of the Close-Out Netting Agreement. However, this question does not need to be decided since German substantive insolvency law would apply in domestic insolvency proceedings with regard to the question of the effectiveness of the Close-Out Netting Agreement according to both provisions.

<sup>8</sup> Obermüller, *Insolvenzrecht in der Bankpraxis* [Insolvency law in banking practice], 6 edition, 2002, margin number 8.285. This perception is also supported by the former insolvency law situation according to which the effectiveness of a set-off agreement in bankruptcy is evaluated on the basis of general insolvency law principles. According to that, the provisions of a contract with the common debtor existing at the time of the opening of insolvency proceedings shall persist for the receiver in bankruptcy unless the contract cannot be contested according to art. 29 ff. KO [German statute of bankruptcy] or violates mandatory bankruptcy law. It can be derived from the legal materials regarding art. 94 InsO [Insolvency Statute] that this legal situation is intended to continue even after entry into force of the Insolvency Statute. The wording in art. 94 InsO [Insolvency Statute] “by virtue of law or on the basis of an agreement” was inserted into the provision upon a recommendation for a ruling by the judiciary committee of the German federal parliament. The substantiation by the judiciary committee explained that the insertion was only intended as a clarification compared with the current bankruptcy law (BT-Drucks. [printed document of the German federal parliament] 12/7302, p. 165)

Netting Agreement placed a disadvantage upon the insolvency creditors (right of contestation according to art. 131 paragraph 1 fig. 3).

### **3. No violation of mandatory insolvency law**

A breach of mandatory provisions under insolvency law by the Close-Out Netting Agreement might only be considered for the provisions listed herein below.

- (1) Art. 104 paragraph 2 InsO to the extent to which the transactions included in the Close-Out Netting Agreement are transactions regarding financial performances within the meaning of art. 104 paragraph 2 InsO; in case art. 104 paragraph 2 InsO should also be considered a ban on insolvency-related termination agreements for all legal transactions, which are not transactions regarding financial performances subject to art. 104 paragraph 2 InsO, beyond its wording, a violation of art. 104 paragraph 2 InsO might also be considered to the extent to which the transactions included in the Close-Out Netting Agreement are *not* part of the scope of application of art. 104 paragraph 2 InsO (see all of III with regard to this);
- (2) Art 104 paragraph 1 InsO to the extent to which the transactions included in the Close-Out Netting Agreement are not transactions regarding financial performances but firm transactions within the meaning of art. 104 paragraph 1 InsO (see IV with regard to this);
- (3) Art. 103 InsO to the extent to which the transactions included in the Close-Out Netting Agreement are neither transactions regarding financial performances nor firm transactions within the meaning of art. 104 paragraph 1 InsO (see V with regard to this);
- (4) The provisions regarding setting-off during insolvency (art. 94 ff. InsO) to the extent to which the admissibility of the calculation of the cash settlement claims is provided for in the Close-Out Netting Agreement (figure 3.9.3 (1) in connection with figure 3.8.3 fig. 1 and 2) and offsetting (figure 3.9.3) is not already established in the provisions referred to herein above (see VI with regard to this).

The scale referred to herein above is established on the basis of the relationship between art. 103, 104 paragraph 1 and 104 paragraph 2 InsO which can be summarized as follows:

- According to art. 103 InsO, the insolvency administrator<sup>9</sup> is entitled to demand fulfilment of mutual contracts which have not been completely fulfilled by either of the parties upon opening of the insolvency proceedings.
- An exception to this provision is specified in art. 104 paragraph 1 InsO.<sup>10</sup> According to this, performance cannot be demanded with regard to certain firm transactions which fall due after the opening of the insolvency proceedings according to art. 103 InsO; in this case, the claim on grounds of non-performance to be calculated according to art. 104 paragraph 3 InsO can only be asserted.
- Art. 104 paragraph 2 InsO, which is based on art. 104 paragraph 1 InsO in terms of its provisions, forms a special provision both as regards art. 103 and as regards art. 104 paragraph 1 InsO. According to art. 104 paragraph 2 InsO, fulfilment cannot be demanded for transactions regarding financial performances under certain conditions under certain conditions; in these cases a claim on grounds of non-performance can only be asserted. This claim on grounds of non-performance also has to be calculated according to art. 104 paragraph 3 InsO. In addition to this, art. 104 paragraph 2 sentence 3 InsO permits several transactions regarding financial performances to be combined into one single mutual contract. In this context, transactions fulfilled unilaterally are also be covered under certain preconditions.
- In as far as neither art. 104 paragraph 2 InsO nor art. 103, 104 paragraph 1 InsO provide any clues regarding the effectiveness of the Close-Out Netting Agreement, we need to investigate whether art. 94 ff. InsO establishes any limits regarding the effectiveness of this agreement.

In the following sections III to VI we examine in detail whether the Close-Out Netting Agreement violates the provisions under insolvency law referred to herein above.

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<sup>9</sup> In the procedure of self-administration according to art. 270 ff InsO, the provisions of art. 103 ff InsO apply subject to the provision that the debtor, who is to exercise his rights under these provisions in accordance with the trustee (art. 279 sentences 1 and 2 InsO), takes the place of the insolvency administrator. In as far as no other provisions are made, the following explanations apply accordingly in the case of self-administration.

<sup>10</sup> Balthasar, in Nerlich/ Römermann (publisher), Insolvenzordnung [Insolvency Statute] (As of December 2006), art. 104, margin number 5; Marotzke, in: Heidelberger Kommentar zur Insolvenzordnung [Heidelberg Commentary on the Insolvency Statute], 4th ed., 2006, art. 104 margin no. 2, Lüer, in Uhlenbruck, Insolvenzordnung [Insolvency Statute], 12th ed., 2003, art. 104 margin no. 1.

### III No breach of art. 104 paragraph 2 InsO [Insolvency Statute]<sup>11</sup>

As has already been mentioned<sup>12</sup>, art. 104 paragraph 2 InsO does not directly provide for the permissibility of contractual set-off agreements such as those contained in figure 3.9. The provision rather provides for the transactions specified therein to be terminated upon opening of insolvency proceedings *by virtue of law* and the claims to performance each from one transaction to be replaced by an equalization claim which has to be established subject to art. 104 paragraph 3 InsO. Since the equalization claim arises by virtue of law, it is directed at a payment in domestic currency.<sup>13</sup> Art. 104 paragraph 2 InsO does not provide for offsetting of the equalization claims from several transactions regarding financial performances; it rather assumes that there is either a right of set-off under the respectively applicable contract law which can also be exercised during insolvency according to art. 94 ff. InsO or that one uniform claim on grounds of non-performance arises from the termination of one single mutual contract in the event of art. 104 paragraph 2 sentence 3 InsO.<sup>14</sup>

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<sup>11</sup> Art. 104 paragraphs 2 and 3 InsO have the following wording:

**“Art. 104 Firm transactions. Financial performances**

(1) ...

(2) *In case a certain time or a certain period of time was agreed on with regard to financial performances which have a market price or an exchange price, and in case such time or the expiry of such period of time only occurs after opening of the insolvency proceedings, fulfilment cannot be demanded; in this case a claim on grounds of non-performance can only be asserted. In particular the following shall be considered financial performances*

1. *the delivery of precious metals,*
2. *the delivery of stocks and shares or of comparable rights unless the acquisition of an interest in a company for the purpose of establishing a permanent connection with such company is envisaged,*
3. *payments of money which have to be furnished in foreign currencies or in an accounting unit,*
4. *payments of money the amount of which is directly or indirectly determined by the price of a foreign currency or of an accounting unit, by the interest rate on debts or the price of other goods or services,*
5. *options and other rights regarding deliveries or payments of money within the meaning of figures 1 to 4,*
6. *financial securities within the meaning of art. 1 paragraph 17 of the German Banking and Financial Dealings Act.*

*In case transactions regarding financial performances are summarized in a framework contract with regard to which it has been agreed that it can only be terminated uniformly in the event of a reason of insolvency for such, the entirety of these transactions shall be considered a mutual contract within the meaning of art. 103, 104.*

(3) *The claims on grounds of non-performance shall be aimed at the difference between the price agreed on and the market or exchange price which shall be decisive at a time agreed on between the parties; however, at the latest on the fifth business day after opening of the proceedings at the place of performance for a contract with the period of performance agreed on. In case the parties do not come to an agreement, the second business day after opening of the proceedings shall be decisive. The other party shall only be entitled to assert such claim as an insolvency creditor.*

<sup>12</sup> See herein above under D.II.1.

<sup>13</sup> Cf. recommendation for a ruling and report by the judiciary committee (6th committee), printed document by the German federal parliament 12/ 7302, p. 168 regarding art. 168.

<sup>14</sup> Cf. recommendation for a ruling and report by the judiciary committee (6th committee), printed document by the German federal parliament 12/ 7302, p. 168 regarding art. 168.

Even though art. 104 paragraph 2 InsO does not directly provide for the admissibility of contractual Closing-Out Netting Agreements, a breach of this provision might arise under two aspects:

- (a) On the one hand, a violation of art. 104 paragraph 2 InsO might be found in the fact that art. 104 paragraph 2 InsO cannot be applied during the insolvency of a non-clearing member as a result of the Close-Out Netting Agreement. According to figure 3.9.2 (1), all Derivatives Market transactions which have not been executed fully are terminated “in the event of the insolvency of a non-clearing member”. According to figure 3.9.1 (2), this condition is fulfilled in case insolvency proceedings regarding the assets of a non-clearing member are applied for and in case the non-clearing member concerned has either filed such application itself or in case such application is filed by the German Federal Financial Supervisory Authority according to art. 46b paragraph KWG [German Banking and Financial Dealings Act].
- (b) On the other hand, we could consider art. 104 paragraph 2 InsO to contain a provision beyond its actual wording according to which insolvency-related termination agreements are always ineffective outside the scope of application of this provision.

This results in the following questions with regard to a possible violation of art. 104 paragraph 2 InsO by the Close-Out Netting Agreement:

- (1) First of all, the question of in how far Derivatives Market transactions, which constitute the subject of the Close-Out Netting Agreement, lie within the scope of application of art. 104 paragraph 2 InsO arises (see 1 herein below with regard to this).
- (2) Then, we have to ask whether art. 104 paragraph 2 InsO is not mandatory or whether it is a mandatory right (see 2 herein below with regard to this).
- (3) In case art. 104 paragraph 2 InsO is mandatory, we have to establish whether Close-Out Netting Agreements regarding transactions which lie within the scope of application of the provisions are compatible with art. 104 paragraph 2 InsO (see 3 herein below with regard to this).
- (4) In as far as Derivatives Market transactions do not lie within the scope of application of art. 104 paragraph 2 InsO or in case uncertainties remain with regard to the classification of these transactions, we finally have to try to answer the question of whether art. 104 paragraph 2 InsO might not perhaps have to be interpreted in such a way that all termination agreements regarding transactions caused by cases of insolvency which do *not* lie within the scope of application of this provision are ineffective (see 4 herein below with regard to this).

## 1 Scope of application of art. 104 paragraph 2 InsO

Art. 104 paragraph 2 InsO is applicable with regard to transactions regarding financial performances which have a market or stock exchange price and with regard to which a certain time or period of time is agreed on provided the time or the expiry of the period of time occurs after insolvency proceedings are opened.

### a. Transactions regarding financial performances

According to art. 104 paragraph 2 sentence 2 InsO [Insolvency Statute] in particular the following shall be considered financial performances:

1. *“the delivery of precious metals,*
2. *the delivery of stocks and shares or of comparable rights unless the acquisition of an interest in a company for the purpose of establishing a permanent connection with such company is envisaged,*
3. *payments of money which have to be furnished in foreign currencies or in an accounting unit,*
4. *payments of money the amount of which is directly or indirectly determined by the price of a foreign currency or of an accounting unit, by the interest rate on debts or the price of other goods or services,*
5. *options and other rights regarding deliveries or payments of money within the meaning of figures 1 to 4,*
6. *financial securities within the meaning of art. 1 paragraph 17 of the German Banking and Financial Dealings Act.”*

The majority of the Derivatives Market transactions included in the Close-Out Netting Agreement are transactions regarding financial performances within the meaning of art. 104 paragraph 2 sentence 2 InsO. This does not apply with regard to power futures in case delivery has been agreed on (see section (b) herein below) and with regard to natural gas futures (see section (f) herein below). The following Derivatives Market transactions are transactions regarding financial performances within the meaning of art. 104 paragraph 2 sentence 2 InsO:

- (a) In case **cash settlement has been agreed on, power futures** refer to financial performances within the meaning of art. 104 paragraph 2 sentence 2 **fig. 4**, if applicable (i.e. in as far as payments are due in foreign currencies or in accounting unit) in conjunction with **fig. 3** InsO.

- (b) In case **delivery has been agreed on, power futures** do not refer to the financial performances listed in art. 104 paragraph 2 sentence 2 InsO by way of example and, for this reason, they might perhaps not lie within the scope of application of art. 104 paragraph 2 InsO.
- (c) **Options on power futures** do not directly refer to any of the financial performances listed in art. 104 paragraph 2 sentence 2 fig. 1 to 4 InsO [Insolvency Statute] by way of example. The establishment of a position with regard to a power future as provided for in figure 4.2.4.3, in particular, does not constitute either a right comparable to a security or a payment of money. However, the power futures which are established in this way, in turn, deal with financial performances within the meaning of art. 104 paragraph 2 sentence 2 **fig. 4** (if applicable, in conjunction with **fig. 3** InsO). For this reason, options on power futures *indirectly* refer to the financial performances specified. As regards these options, there is the same need of excluding price speculations and “cherry picking” on the part of the insolvency administrator as in the case of options which are directly aimed at the corresponding payments of money. For this reason, art. 104 paragraph 2, sentence 2 fig. 5 InsO has to be interpreted in such a way with regard to the regulatory purpose of the provision<sup>15</sup> that options which are indirectly aimed at financial performances within the meaning of fig. 1 to 4 as in the case of options on power futures are also covered.
- (d) **Futures on EU emission allowances** refer to financial performances within the meaning of art. 104 paragraph 2 sentence 2 **fig. 2**. On account of their marketability, EU emission allowances have to be considered “comparable rights” within the meaning of art. 104 paragraph 2 sentence 2 fig. 2.
- (e) **Coal futures** also refer to financial performances within the meaning of art. 104 paragraph 2 sentence 2 **fig. 4**, if applicable (i.e. in as far as payments are owed in foreign currencies or in an accounting unit) in conjunction with **fig. 2** InsO.
- (f) **Natural gas futures** do not refer to the financial performances listed in art. 104 paragraph 2 sentence 2 InsO by way of example and for this reason, they might perhaps not lie within the scope of application of art. 104 paragraph 2 InsO.

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<sup>15</sup> Cf. recommendation for a ruling and report by the Judiciary Committee (6th committee), printed document by the German federal parliament 12/ 7302, p. 168 regarding art. 118

Hence, Derivatives Market transactions constitute transactions regarding financial performances within the meaning of art. 104 paragraph 2 InsO with the exception of power futures with agreed delivery and of natural gas futures.

#### **b. Market or exchange price**

Art. 104 paragraph 2 InsO only applies with regard to transactions regarding financial performances which have a market or an exchanger price. The report of the judiciary committee reads as follows with regard to this<sup>16</sup>:

*“In the case of some of the financial transactions covered by paragraph 2, an individual design by the parties to the contract is common on the market. This e.g. applies with regard to the exchange of payments of money on the basis of different interest rates. On the basis of this, it is established that the term of “market or exchange price” in paragraph 2 sentence 1 has to be understood broadly. In this context, it is decisive that there is the possibility of stocking up elsewhere, the fact that not all the information corresponds does not have a detrimental effect.”*

The term “Market or exchange price” in art. 104 paragraph 2 sentence 1 InsO has to be given a broad interpretation accordingly.<sup>17</sup> A transaction regarding financial performances shall, in particular, have a market price within the meaning of art. 104 paragraph 2 sentence 1 InsO if there is the possibility of closing out the transaction by means of one or two offsetting transactions. Fulfilment of this precondition always has to be assumed in the case of Derivatives Market transactions.

#### **c. Agreement regarding a certain time or period of time**

Art. 104 paragraph 2 InsO is furthermore based on the precondition that a “certain time or a certain period of time” was agreed on for the financial performance. In deviation to art. 104 paragraph 1 InsO, which is based on the precondition that the service has to be provided “precisely” at a “firmly” determined time or within a “firmly” determined period of time, art. 104 paragraph 2 InsO, hence, does not require the transaction to be a firm transaction. Usually, a certain period of time is agreed on with regard to Derivatives Market transactions.

#### **d. Due date of the financial performance after opening of insolvency proceedings**

Art. 104 paragraph 2 InsO does not apply with regard to a transaction regarding financial performances if all the financial performances owed under the transaction were already due at the time of opening of the insolvency proceedings. According to art. 104 paragraph 2 sentence 3 InsO, however, several transactions regarding

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<sup>16</sup> Cf. recommendation for a ruling and report by the Judiciary Committee (6th committee), printed document by the German federal parliament 12/ 7302, p. 168

<sup>17</sup> See also Bosch, WM 1995, 413, 417. Lüer, in Uhlenbruck, Insolvenzordnung [Insolvency Statute], 12th ed., 2003, art. 104 margin no. 14; Hess, Großkommentar [Comprehensive commentary], 2007, volume 1, art. 104 margin no. 49. Cf. also Ehrlicke, ZIP 2003, 273, 275.

financial performances are considered one single mutual agreement within the meaning of art. 103, 104 InsO if the transactions are summarized under a framework agreement with regard to which it has been agreed that it can only be terminated uniformly in case a reason for such termination on grounds of insolvency arises. Art. 104 paragraph 2 InsO is applicable with regard to all transactions summarized under such framework agreement if at least one financial performance from one of the transactions only falls due after opening of the insolvency proceedings.

In case insolvency proceedings are opened regarding the assets of a non-clearing member, the NCM agreement only provides for all of the Derivatives Market transactions to be terminated. With regard to Spot Market transactions, the NCM agreement does not contain any comparable provision. For this reason alone, the NCM agreement does not fulfil the precondition specified in art. 104 paragraph 2 sentence 2 InsO and, for this reason, it is not considered a mutual contract within the meaning of art. 103, 104 InsO. Hence, art. 104 paragraph 2 InsO is not applied with regard to such transactions regarding financial performances with regard to which all financial performances owed under the transactions were already due at the time at which the insolvency proceedings were opened.

#### **e. Contract not fully fulfilled by both parties**

Art. 104 paragraph 2 InsO constitutes a special provision regarding art. 103 InsO. The latter provides for a right of option to demand or refuse performance on the part of the insolvency administrator in case of a mutual contract not fully fulfilled by both parties. For this reason, art. 104 paragraph 2 InsO only applies with regard to mutual contracts which have not been fully fulfilled by either of the parties at the time of opening of insolvency proceedings.<sup>18</sup> Since the recognition of the offsetting agreement under supervisory legislation is only important in each case if there are at least two claims under the Clearing Conditions, it can be assumed in all of the cases to be considered here that the NC agreement always constitutes a mutual contract which has not been fully fulfilled by both parties thereto at the time of opening of insolvency proceedings with regard to which art. 104 paragraph 2 InsO applies (subject to the Close-Out Netting Agreement).

#### **f. Intermediate result**

With the exception of power futures with an agreed delivery and natural gas futures, Derivatives Market transactions lie within the scope of application of art. 104 paragraph 2 InsO. With regard to power futures with agreed delivery and natural gas futures we refer to the explanations under D.III.4 and D.V. regarding the effectiveness of the Close-Out Netting Agreement for transactions which do not lie within the scope of application of art. 104 paragraph 2 InsO.

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<sup>18</sup> Balthasar, in Nerlich/ Römermann (ed.), *Insolvenzordnung [Insolvency Statute]* (as of December 2006), art. 104 margin no. 31; Bosch, WM 1995, 413, 415; the same, in *Kölner Schrift zur Insolvenzordnung [Cologne publication regarding the Insolvency Statute]*, 2nd edition, 2002, p. 1030 f.; Ehrlicke, ZIP 2003, 273, 276; Lüer, in Uhlenbruck, *Insolvenzordnung [Insolvency Statute]*, 12th edition, 2003, art. 104 margin no. 16; Marotzke, in *Heidelberger Kommentar zur Insolvenzordnung [Heidelberg Commentary regarding the Insolvency Statute]*, 4th edition, 2006, art. 104 margin no. 6; in detail also Reiner, *Derivative Finanzinstrumente im Recht [Derivative Financial Instruments in Law]*, 2002, p. 188 ff.

## 2. Art. 104 paragraph 2 InsO [Insolvency Statute] mandatory law

According to art. 119 InsO<sup>19</sup>, agreements by means of which the application of articles 103 to 118 InsO is excluded or restricted in advance are ineffective. For this reason, art. 104 paragraph 2 InsO is mandatory law.

## 3. Compatibility of the Close-Out Netting Agreement with art. 104 paragraphs 2 and 3 InsO regarding transactions within the scope of application of art. 104 paragraph 2 InsO

### a. Termination agreement (Figure 3.1 (2))

The Close-Out Netting Agreement does not contain any provision which eliminates art. 104 paragraph 2 InsO by contract within the meaning of art. 119 InsO. However, the provision contained in figure 3.92 (1) prevents the actual provisions for art. 104 paragraph 2 InsO from arising on account of the premature termination of the Derivatives Market transaction in case of the insolvency of a non-clearing member.

The government bill regarding art. 119 InsO contained an express provision for agreements providing for the termination of mutual contracts in the case of opening of insolvency proceedings. Art. 137 of the government bill which corresponded to art. 119 InsO had the following wording<sup>20</sup>:

#### **“Art. 137 Ineffectiveness of deviating provisions**

*(1) Agreements by means of which the application of articles 117 to 136 is excluded or restricted in advance shall be ineffective.*

*(2) Agreements which provide for the termination of a mutual contract in case of the opening of insolvency proceedings or which grant the other party the right to withdraw from the contract unilaterally shall be ineffective. In case it is agreed in a mutual contract that, in case of a worsening of the asset situation of one party, the respective other party to the contract is entitled to withdraw from the contract unilaterally, such right cannot be exercised any more once insolvency proceedings have been opened.*

*(3) The effectiveness of provisions which are connected to the default or to other breaches of contract shall not be affected by paragraphs 1 and 2.”*

Art. 137 paragraph 1 of the draft became the current art. 1190 InsO. Art. 137 paragraphs 2 and 3 were deleted without a replacement. With regard to this, the report by the Judiciary Committee explained the following<sup>21</sup>:

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<sup>19</sup> Art. 119 InsO reads:

**“Art. 119 Ineffectiveness of deviating provisions**

*Agreements by means of which the application of articles 103 to 118 is excluded or restricted in advance, shall be ineffective.”*

<sup>20</sup> Recommendation for a ruling and report by the Judiciary Committee (6th committee), printed document of the German federal parliament 12/7302, p. 49.

<sup>21</sup> Recommendation for a ruling and report by the Judiciary Committee (6th committee), printed document by the German federal parliament 12/7302, p. 170, regarding art. 137.

*“Paragraph 2 of the government bill was deleted by the committee. The contractual agreements recorded there regarding the termination of a mutual contract in case of the opening of insolvency proceedings or in case of a worsening of the asset situation of one party to the contract are not to be restricted by the Insolvency Statute as regards their effectiveness. The fact that such agreements indirectly restrict the right of option on the part of the insolvency administrator is not a sufficient reason for a serious intervention in the freedom of contract.*

*The change corresponds to the concern which was voiced expressly by business associations which pointed out the adverse effect of the provision in the government bill on reconstruction attempts in the hearing of the Judiciary Committee on 28 April 1993: The ineffectiveness of termination clauses in cases of insolvency increases the risk of insolvency for companies making attempts at a reconstruction during the critical stage; this is due to the fact that potential partners under contracts will not enter into the risk of committing themselves to the other party to the contract in the case of a threatening insolvency. Moreover, in international business transactions value is also placed on the fact that the termination of contracts remains possible in case of the insolvency of the other party to the contract.*

*Upon the deletion of paragraph 2, paragraph 3 also becomes dispensable. The effectiveness of provisions which are connected to the default or to other breaches of contracts emerges even without an express provision to that end.”*

From the history of legislation we can, hence, conclude with regard to the interpretation of art. 119 InsO that art. 104 paragraph 2 InsO does not preclude the effectiveness of provisions which provide for the termination of certain transactions between the parties in the event of opening of insolvency proceedings. This applies all the more with regard to provisions which provide for the termination of certain transactions between the parties in the event of an *application* for insolvency proceedings to be instituted as under figure 3.9.2 (1) in conjunction with figure 3.9.2 (2).

For this reason, the provision regarding terminations contained in figure 3.9.2 (1) does not violate art. 104 paragraph 2 InsO.

**b. Calculation of cash settlement claims (figure 3.9.3 (1) in conjunction with figure 3.8.3 fig. 1 and 2)**

According to art. 104 paragraph 3 sentence 1 InsO, the claim on grounds of non-performance within the meaning of paragraph 2 is directed at *“the difference between the price agreed on and the market or exchange price which is decisive at a point in time agreed on between the party, however, at the latest on the fifth business day after opening of the proceedings on the place of performance for a contract with an agreed time of performance”*. According to art. 104 paragraph 3 sentence 3 InsO the second business day after opening of the proceedings shall be decisive in case the parties do not make an agreement with regard to this.

Art. 104 paragraph 3 InsO does not contain any provision with regard to the question of how the claims from a contractual termination of transactions regarding financial performances (which is permissible according to art. 104 paragraph 2 InsO<sup>22</sup>) has to be calculated. The legal materials regarding art. 119 InsO indicate that art. 104 paragraph 2 InsO does not affect the contractual termination of contracts in particular with regard to the *priority of the freedom of contract*.<sup>23</sup> However, a provision regarding the termination of a contract in case of the insolvency of one of the parties without a provision regarding the legal consequences arising from such termination would be incomplete and not sensible for this reason. The priority of the freedom of contract with regard to agreements regarding terminations on grounds of insolvency on which art. 119 InsO is based can, hence, only be understood as a precedence of the freedom of contract for the overall provision to be made regarding termination and claims to compensation.

This does not mean, however, that any random resolution regarding the consequences of a termination in case of the insolvency of one of the parties to a contract has to be effective. In particular, a provision which targets an inadmissible disadvantage for the creditors can be contested according to art. 129 ff. InsO or such can be null and void as an immoral provision according to art. 138 paragraph 1 BGB [German civil code].<sup>24</sup> However, these limits are not established in art. 104 paragraph 3 InsO but in the respective general provisions.

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<sup>22</sup> See herein above under D.III.3.a.

<sup>23</sup> See the part quoted from the report by the Judiciary Committee herein above under D.III.3.a.

<sup>24</sup> Cf. C. and D.II.2 herein above with regard to this.

Art. 104 paragraph 3, hence, only provides for the consequences of a statutory termination of contract according to art. 104 paragraph 2 InsO according to its wording and does not restrict the parties' to provide for the legal consequences of such in addition to the termination of contract or the termination of certain transactions. Since the provision regarding closing-out which is contained in figure 3.8.3 fig. 1 and 2 does not deviate from the provisions in art. 104 paragraph 3 InsO as the basis for the determination of the uniform equalization claim with regard to this, this provision does not violate art. 104 paragraph 3 InsO.

**c. Intermediate result**

In the event that Derivatives Market transactions lie within the scope of application of art. 104 paragraph 2 InsO, the Close-Out Netting Agreement contained in figure 3.9.3 (1) in conjunction with figure 3.8.3 fig. 1 and 2 does not violate art. 104 paragraphs 2 and 3 InsO.

**4. Compatibility of the Close-Out Netting Agreement with art. 104 paragraph 2 InsO with regard to transactions outside the scope of application of art. 104 paragraph 2 InsO**

**a. Transactions not covered by art. 104 paragraph 2 InsO**

In as far as Derivatives Market transactions in the form of power futures with agreed delivery and of natural gas futures do not lie within the scope of application of art. 104 paragraph 2 InsO, we will examine herein below whether the Close-Out Netting Agreement violates art. 104 paragraph 2 InsO.

**b. Art. 104 paragraph 2 InsO as a ban on offsetting agreements for transactions not covered by art. 104 paragraph 2 InsO?**

As has been outlined herein above under D.III.2, art. 104 paragraph 2 InsO contains mandatory law. However, this provision does not preclude an offsetting agreement regarding transactions which lie in the scope of application of art. 104 paragraph 2 InsO (see herein above under D.III.3). We might consider that a provision might be derived from art. 104 paragraph 2 InsO by way of interpretation according to which agreements regarding terminations on grounds of insolvency (and, hence, also the Close-Out Netting Agreement) can *only* be effectively agreed with regard to those transactions which would otherwise be terminated by the operation of law according to art. 104 paragraph 2 InsO.

However, on account of the reasons enumerated herein below, we are convinced that such an interpretation is inapplicable and is in direct contradiction to the appropriate legal materials and the decisions by the German Federal Court of Justice.

- (a) The wording of the provision does not provide any indication for the interpretation referred to herein above. Moreover, a provision of the kind described herein above cannot be derived from the objective regulatory content of art. 104 paragraph 2 InsO. In particular, we cannot derive a legal provision according to which not only a statutory but also every contractual termination in case of insolvency is to be excluded in all other cases simply on account of the fact that art. 104 paragraph 2 InsO provides for a legal termination in case of insolvency for certain transactions only. Apart from the lack in conclusiveness of such an argumentation, it would also apply to art. 104 paragraph 1 InsO in the same way. In the continuous court decisions regarding art. 18 KO, which constitutes the preceding provision to art. 104 paragraphs 1 and 3 InsO, both the Imperial Court and the German Federal Court of Justice have recognized agreements regarding terminations on grounds of bankruptcy with regard to transactions which are not covered by art. 18 KO as being bankruptcy-remote.<sup>25</sup> There are no reasons which would militate against the assumption that the German Federal Court of Justice will continue this jurisdiction during the effectiveness of art. 104 paragraph 1 InsO.
- (b) Moreover, the legal system of art. 103 ff. InsO also militates against the interpretation referred to herein above. Art. 119 InsO shows that the Insolvency Statute reserves the ineffectiveness of provisions competing with art. 103 to 118 InsO for a special provision, i.e. art. 119 InsO. We can conclude from this that the ineffectiveness of termination agreements is exclusively provided for in art. 119 InsO and cannot be derived from articles 103 to 118 InsO. For this reason, a situation in which we want to derive the ineffectiveness of termination agreements directly from art. 104 paragraph 2 InsO, in particular with regard to transactions which do not lie within the regulatory area of art. 104 paragraph 2 InsO is in conflict with the system of this law.
- (c) Moreover, the history of legislation does not provide any indications for the interpretation outlined herein above. It rather emerges from the statutory materials cited herein above under D.III.3.a that such an interpretation of art. 104 paragraph 2 InsO is in direct conflict with the express regulatory intent of the legislature. The government bill regarding art. 119 InsO provided for agreements which provide for the termination of a mutual contract giving the respective other party to the contract the right to withdraw from the contract unilaterally in case insolvency proceedings are opened to be ineffective (art. 137 paragraph 2 sentence 1 E-InsO).<sup>26</sup> This provision was deleted without a replacement. The substantiation e.g. reads as follows:

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<sup>25</sup> See D.V and the source references cited there with regard to this.

<sup>26</sup> See D.III.3.a with regard to this in detail.

*“Paragraph 2 of the government bill was deleted by the committee. The contractual provisions regarding the termination of a mutual contract in the event of the opening of insolvency proceedings or in the event of a worsening of the asset situation of one party to the contract should not be restricted in the effectiveness by the Insolvency Statute. The fact that such agreements indirectly restrict the right of option on the part of the insolvency administrator does not constitute sufficient reason for a serious intervention in the freedom of contract.”<sup>27</sup>*

The reference to the right of option on the part of the insolvency administrator shows that termination agreements are to be permitted in particular also with regard to transactions which are not covered by the scope of application of art. 104 paragraph 2 InsO by means of the deletion of the original version of the bill.

- (d) As will be outlined in detail herein below under D.V., agreements which provide for a termination of contract in the event of insolvency or which permit such are effective in case of the bankruptcy of one party to the respective contract according to the continuous court decisions by the Imperial Court and by the German Federal Court of Justice. In the last decision which it rendered with regard to this during the year 1993 (BGHZ 124, 76) the IX Division of the German Federal Court of Justice, which has jurisdiction in bankruptcy cases, examined the question of whether the right of termination agreed on between the parties in the event of opening of bankruptcy proceedings and stated the following with regard to this: *“According to applicable law (other than art. 137 paragraph 2 sentence 1 E-InsO, printed document by the German federal parliament 12/ 2443, p. 30) this is [...] not the case”*. For this reason, the German Federal Court of Justice also holds that the effectiveness of an agreement regarding terminations on grounds of insolvency has to be assumed without a provision such as art. 137 paragraph 2 sentence 1 E-InsO. As has been outlined under (c) herein above, art. 137 paragraph 2 sentence 1 E-InsO was consciously not included in the Insolvency Statute in order to permit the termination agreements provided for therein also in the framework of the Insolvency Statute. A situation in which the German Federal Court of Justice might disregard the confirmation of its decision which was effected by means of the deletion of art. 137 paragraph 2 sentence 1 E-InsO and adopt the interpretation of art. 104 paragraph 2 InsO which was outlined at the beginning in the course of the interpretation of the new law after the entry into force of the Insolvency Statute appears to be virtually excluded.

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<sup>27</sup> See D.III.3. with regard to this in detail.

#### IV. Inapplicability of art. 104 paragraph 1 InsO

Art. 104 paragraph 2 InsO constitutes *lex specialis* as regards art. 103 and 104 paragraph 1 InsO.<sup>28</sup> In as far as Derivatives Market transactions lie within the scope of application of art. 104 paragraph 2 InsO, art. 103 and 104 paragraph 1 InsO does not apply for this reason. This means, a breach of art. 103 and 104 paragraph 1 InsO by the Close-Out Netting Agreement is only possible at all in as far as Derivatives Market transactions do not lie within the scope of application of art. 104 paragraph 2 InsO (see D.III.4 herein above with regard to this).

As has been outlined, art. 104 paragraph 1 InsO<sup>29</sup> takes precedence over art. 103 InsO. Art. 104 paragraph 1 InsO is based on the precondition that the delivery of goods was “agreed precisely for a firmly determined time or within a firmly determined period of time”. This wording and the heading “Firm transactions”<sup>30</sup> which refers to paragraph 1 of art. 104 InsO show that this provision is only applicable with regard to such transactions.<sup>31</sup> A firm transaction is deemed to exist in case compliance with a time of performance specified precisely constitutes an essential content of the duty to perform under the contract.<sup>32</sup> The question of when this precondition is fulfilled can only be determined by means of contract interpretation.<sup>33</sup> In case it has been agreed that a transaction can only be terminated in compliance with an extension of time, a firm transaction is, usually, not deemed to exist.<sup>34</sup> In the case of a default, the Clearing Conditions do not establish provisions according to which Derivatives Market transactions can always only be terminated in compliance with an extension of time in the case of a delay in performance. However, with regard to the case of a technical default provided for in figure 3.8.2, the provisions provide for the possibility of making good the performance. This would militate against the interpretation that compliance with a firmly determined period of performance constitutes an essential element of the duty to perform under the contract as is required with regard to a firm transaction. For this reason, art. 104 paragraph 1 InsO

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<sup>28</sup> See herein above under D.II.3.

<sup>29</sup> Art. 104 paragraph 1 InsO has the following wording:

*“(1) In case the delivery of goods which have a market or exchange price was agreed precisely for a firmly determined time or within a firmly determined period of time and in case such time or the expiry of such period of time only arises after opening of the insolvency proceedings, performance cannot be demanded; rather, a claim on grounds of non-performance can only be asserted instead.”*

<sup>30</sup> Art. 104 InsO has the heading “Firm transactions. Financial performances”. The first part of the heading refers to art. 104 paragraph 1, the second part of the heading refers to art. 104 paragraph 2 InsO.

<sup>31</sup> Cf. also explanatory notes to the government bill regarding art. 118 which corresponds to art. 104 InsO, printed document by the German federal parliament 1/ 92, p. 145.

<sup>32</sup> BGHZ 110, 96; RGZ 108, 158; RGZ 51, 348; Kaiser, in Staudinger, Kommentar zum Bürgerlichen Gesetzbuch [Commentary regarding the German civil code], revised edition 2001; art. 361 margin no. 7; Heinrichs, in Palandt, Bürgerliches Gesetzbuch [German civil code], 66th ed., 2007, art. 323 margin no. 19 f; Koller, in Staub, Großkommentar zum HGB [Comprehensive commentary regarding the German commercial code], 4th ed., 1984, art. 376 margin no. 2 and 10; Baumbach/ Hopt, Handelsgesetzbuch [German commercial code], 31st ed., 2003, art. 376 margin no. 2. See also Lüer, in Uhlenbrock, Insolvenzordnung [Insolvency Statute], 12th ed., 2003 art. 104 margin no. 6; Marotzke, in Heidelberger Kommentar zur Insolvenzordnung [Heidelberg Commentary regarding the Insolvency Statute], 4th ed., 2006, art. 104 margin no. 3.

<sup>33</sup> Cf. Kaiser, in Staudinger, Kommentar zum Bürgerlichen Gesetzbuch [Commentary regarding the German civil code], revised edition 2001; art. 361 margin no.9.

<sup>34</sup> Koller, in Staub, Großkommentar zum HGB [Comprehensive Commentary regarding the German commercial code], 4th ed., 1984, art. 376 margin no. 12; Decker, WM 1990, 1001, 1008; Obermüller Insolvenzrecht in der Bankpraxis [Insolvency law in banking practice], 6th ed., 2002, margin no.8.281.

is not applicable with regard to these transactions and the Close-Out Netting Agreement. Hence, a breach of art. 104 paragraph 1 InsO by the Close-Out Netting Agreement is not applicable.

## V. No violation of art. 103 InsO<sup>35</sup>

Since art. 104 paragraph 1 InsO does not apply, the question arises as to whether the Close-Out Netting Agreement is compatible with art. 103 InsO in as far as Derivatives Market transactions are not covered by the scope of application of art. 104 paragraph 2 InsO.<sup>36</sup>

For the reasons listed herein below; we hold that the Close-Out Netting Agreement is compatible with art. 103 InsO and that this is in line with the relevant legal materials and the court decisions by the German Federal Court of Justice.

The legislative history of the Insolvency Statutes does not provide any indications with regard to the fact that the Close-Out Netting Agreement violates art. 103 InsO. We can rather conclude from the legal materials cited under D.III.3.a that agreements which provide for the termination of a mutual contract in case insolvency proceedings are opened or which permit a termination of a mutual contract in such case should be permissible according to the express regulatory intent of the legislature in case the Insolvency Statute is in force.

Even the maximum judicial justice supports the view that the Close-Out Netting Agreement is compatible with art. 103 InsO. Since the fundamental decision by the Imperial Court in the year 1896, contractual provisions which grant a right of termination to the respective other party in the event of opening of bankruptcy proceedings regarding the assets of one party have been recognized as effective in continuous court decisions with regard to this.<sup>37</sup> In the more recent literature with regard to this, a different view was held in part.<sup>38</sup> The German Federal Court of Justice has dealt with this view in detail in a decision from the year 1985 and has dismissed it as a result.<sup>39</sup> In its statement of reasons, the German Federal Court of

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<sup>35</sup> Art. 103 InsO has the following wording:

**“Art. 103 Right of Option on the Part of the Insolvency Administrator**

*(1) In case a mutual contract has not been fulfilled or in case such has not been fulfilled fully by the debtor or by the other party to the contract at the time of opening of the insolvency proceedings, the insolvency administrator can fulfil the contract in place of the debtor and demand fulfilment by the other party to the contract.*

*(2) In case the administrator refuses fulfilment, the other party to the contract can only assert a claim on grounds of non-performance as an insolvency creditor. In case the other party to the contract requests the administrator to exercise his right of option, the administrator shall state forthwith whether he intends to request performance. Failing that he cannot insist on such performance.”*

<sup>36</sup> See discussion under D.III.1.a with regard to the question of whether Repo-transactions constitute transactions regarding financial performances within the meaning of art. 104 paragraph 2 sentence 2 fig. InsO and lie within the scope of application of art. 104 paragraph 2 InsO.

<sup>37</sup> RG JW 1982, 132.

<sup>38</sup> Henckel, in Jaeger, Konkursordnung, Großkommentar [Bankruptcy Act, Comprehensive Commentary], 9th ed., 1979, art. 17 margin no. 214; Hess, Kommentar zur Konkursordnung [Commentary on the Bankruptcy Act], 6th ed., 1998, art. 17 margin no. 1; Huber, in Gottwald, Insolvenzrechts-Handbuch [Handbook on Insolvency Law], 1990, art. 36 margin no. 13; Marotzke, Gegenseitige Verträge in Konkurs und Vergleich [Mutual contracts in bankruptcy and amicable settlement], 1985, p. 37 ff.

<sup>39</sup> BGHZ 96, 34.

Justice referred to the principle recognized in continuous court decisions<sup>40</sup> that the receiver has to accept the stock of insolvent assets (i.e. also a contract which has not been fulfilled fully by both parties) in the state in which such are at the time at which bankruptcy proceedings are opened.<sup>41</sup>

In one part of the literature, the significance of this ruling which was given regarding a case under construction law was restricted to construction contracts as well as to other particularities of the case with regard to which the ruling was given.<sup>42</sup> However, this interpretation of the court decisions cannot be maintained any more at the latest since the latest decision by the German Federal Court of Justice<sup>43</sup> regarding a right of termination on grounds of bankruptcy from the year 1993. The respective case did not concern a construction contract but a contract concluded between a town and a cable operating company regarding the use of space dedicated as public thoroughfares for the construction and operation of a sound and TV cable system. The contract which had been concluded for a period of 15 years provided for a right of termination on the part of the town and the transfer of the system constructed until such time to the town without compensation in the event of the bankruptcy of the operator company. Without dealing with the critical voices in the relevant literature once again and without repeating the reasons outlined in the previous decisions for the view held by the German Federal Court of Justice, the IX Civil Division, which has jurisdiction in bankruptcy cases, held that the right of termination is legally effective in accordance with valid law in line with the court decisions by the German Federal Court of Justice so far.

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<sup>40</sup> RGZ 115, 271, 273, 274; BGHZ 24, 15, 18; 44, 1, 4; 56, 228, 230, 232.

<sup>41</sup> BGHZ 96, 34, 36.

<sup>42</sup> Henckel, JZ 1986, 297, 299; ; Berger, ZIP 1994, 173, 175; Ebenroth/ Messer ZvgIRWiss 87 (1988), 1, 24.

<sup>43</sup> BGHZ 124, 76, 78f.

The German Federal Court of Justice underlines the fundamental scope of this renewed confirmation of its former jurisdiction, which transcends the underlying contract, by means of the comparison of the current legal situation and the provision deviating from this in art. 137 paragraph 2 sentence 1 of the government bill for an Insolvency Statute which was current at the time. With regard to the question of whether the right of termination agreed on between the parties in case of the opening of bankruptcy proceedings is effective, the German Federal Court of Justice states the following: “According to current law (other than art. 137 paragraph 2 sentence 1 E-InsO, printed document by the German federal parliament 12/2443, p. 30) this is [...] not the case.” For this reason, the German Federal Court of Justice also holds that the effectiveness of agreements regarding terminations on grounds of insolvency has to be assumed without a provision like art. 137 paragraph 2 sentence 1 E-InsO according to which a right of termination on grounds of insolvency is to be excluded generally as outlined herein above<sup>44</sup>.

Even though the ruling by the German Federal Court of Justice regarding the effectiveness of the right of termination was decisive for the decision<sup>45</sup> and was as clear as could be hoped for, two critical contributions by *Berger*<sup>46</sup> and *Lehnhoff*<sup>47</sup>, which remained individual cases, however, attested a “lack of significance” and a “restricted precedence content” only to the decision. In their substantiation of this, the authors refer to the “minimal effort at substantiation”, the mere “apodictic statement” of the “alleged” effectiveness of the termination clause which only constitutes “a type of orbiter dictum” as well as to a general lack of a plausible reason.<sup>48</sup> However, it appears to be impossible that the German Federal Court of Justice might disregard the express regulatory intent of the legislator and the confirmation thereof which was provided by means of the deletion of art. 137 paragraph 2 sentence 1 E-InsO and that it might hold agreements which provide a termination of contracts in case of insolvency or which permit such to be ineffective in deviation to its decisions so far after the entry into force of the Insolvency Statute.

Hence, we can conclude as a result that the Close-Out Netting Agreement does not violate art. 103 InsO.

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<sup>44</sup> See D.III.3 herein above.

<sup>45</sup> Cf. Bosch, WM 1995, 413, 423 with regard to this.

<sup>46</sup> Berger, ZIP 1994, 173.

<sup>47</sup> Lehnhoff, WM-Festgabe Hellner, 1994, 41.

<sup>48</sup> Berger, ZIP 1994, 173, 178 ff.

## VI. No violation of offsetting provisions under insolvency law

In as far as Derivatives Market transactions lie within the scope of application of art. 104 paragraph 2 InsO<sup>49</sup>, offsetting according to figure 3.9.3 (1) as outlined herein above corresponds to offsetting in the framework of a uniform claim on grounds of non-performance. The permissibility of Close-Out Netting Agreements in the scope of application of art. 104 paragraph 2 InsO, which is derived from art. 104 paragraph 2 InsO in conjunction with art. 119 InsO, constitutes a preferential special provision in comparison with the general provisions regarding offsetting and settlement of mutual claims in case of insolvency under insolvency law.

However, outside the scope of application of art. 104 paragraph 2 InsO the question arises whether figure 3.9.3 (1) violates general insolvency law provisions regarding offsetting and settlement of mutual claims in case of insolvency.

Offsetting of mutual claims in case of insolvency is provided for in art. 94 ff. InsO. Art. 94 InsO<sup>50</sup> establishes that a right of offsetting which is based on a contractual agreement and exists at the time of opening of the insolvency proceedings is not affected by opening of the insolvency proceedings. We can conclude from this that agreements regarding offsetting or settlement of mutual claims are effective in case of insolvency. This has to apply all the more with regard to agreements which effect offsetting of mutual claims even before opening of the insolvency proceedings, like figure 3.9.3 (1).

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<sup>49</sup> See D.III.1.a herein above.

<sup>50</sup> Art. 94 InsO reads:

**“Art. 94 Maintenance of an Offset Position**

*In case an insolvency creditor is entitled to offsetting at the time of opening of the insolvency proceedings by virtue of law or on account of an agreement regarding offsetting, such right shall not be affected by the proceedings.”*

This expertise is solely intended for submission to the competent supervisory authorities in the framework of the recognition of the Close-Out Netting Agreement covered in the expertise under regulatory law and does not establish any liability towards parties to the transactions covered in the expertise and other third parties. It may only be used for other purpose in case we have expressly approved such use in writing in a specific case.

Frankfurt am Main, 8 October 2007

HENGELER MUELLER

Stefan Krauss

## **Appendix A**

Figure 3.9 of the Clearing Conditions of European Commodity Clearing AG

## **Appendix B**

NCM Agreement between a Clearing Member, a Non-Clearing Member and  
European Commodity Clearing AG