HENGELER MUELLER

MEMORANDUM OF LAW
FOR THE
INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

The Enforceability of Close-out Netting
under the 1987 ISDA Master Agreements,
the 1992 ISDA Master Agreements
and the 2002 ISDA Master Agreement
in German Law

7 July 2014

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I.
INTRODUCTION

You have requested this Memorandum of Law in respect of the effects of Insolvency Proceedings under the laws of the Federal Republic of Germany ("**Germany**") on certain provisions relating to close-out netting of master agreements substantially in the form of:

- (i) the Interest Rate and Currency Exchange Agreement (the "**Interest Rate and Currency Exchange Agreement**") and (ii) the Interest Rate Swap Agreement (the "**Interest Rate Swap Agreement**"), both published by the International Swaps and Derivatives Association, Inc. ("**ISDA**") in 1987 (the Interest Rate and Currency Exchange Agreement and the Interest Rate Swap Agreement, collectively referred to as the "**1987 ISDA Master Agreements**", and each as a "**1987 ISDA Master Agreement**")

- (i) the Multicurrency-Cross Border Master Agreement (the "**Cross Border Agreement**") and (ii) the Local Currency-Single Jurisdiction Master Agreement (the "**Single Jurisdiction Agreement**"), both published by the ISDA in 1992 (the Cross Border Agreement and the Single Jurisdiction Agreement, collectively referred to as the "**1992 ISDA Master Agreements**", and each as an "**1992 ISDA Master Agreement**"); and

- the 2002 ISDA Master Agreement (the "**2002 ISDA Master Agreement**"), published by the ISDA in 2003 (the 1987 ISDA Master Agreements, the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement, collectively referred to as the "**Agreements**", and each as an "**Agreement**")

upon the insolvency of a party thereto that is established in Germany.

Capitalized terms used in this Memorandum which are defined in the Agreements shall have in this Memorandum the meanings attributed to them in the Agreements.

This Memorandum supersedes and replaces our Memorandum of Law dated August 25, 2010 related to the enforceability of close-out netting under the Agreements.

The opinions herein expressed relate solely to matters of German law as in force at the date hereof and do not consider the impact of any laws (including insolvency laws) other than German law, even in the case where, under German law, any foreign law falls to be applied. We have assumed that there is nothing in the laws of another jurisdiction that affects the opinions herein expressed.

This Memorandum is directed to you solely for the benefit of your members. The purpose of this Memorandum is to provide an aid to your members in understanding generally issues of close-out netting under German law when any of them want to enter into an Agreement. We wish to emphasize, though, with your explicit approval, that the purpose of this Memorandum is not to provide a basis on which any of your members or any other person can rely with respect to, or in connection with, any transaction or act which any of them may undertake or omit to undertake. Accordingly, we assume no liability to any person in the context of this Memorandum.

This Memorandum constitutes a legal opinion for banking regulatory purposes and may be made available to the appropriate bank regulatory authorities administering capital adequacy rules. This Memorandum may also be made available to professional advisors of your members.

II. THE AGREEMENTS

(A) The 1987 ISDA Master Agreements

The 1987 ISDA Master Agreements constitute form agreements designed to serve as master agreements for Swap Transactions between the same parties.

The Interest Rate Swap Agreement is designed for U.S. dollar interest rate swaps and the Interest Rate and Currency Exchange Agreement is designed for interest rate and currency swaps in any currency. The Interest Rate Swap Agreement is governed by New York law. The Interest Rate and Currency Exchange Agreement may be governed by either New York law or English law as the parties may elect. The Interest Rate Swap Agreement incorporates by reference the 1986 Edition of the Code of Standard Wording, Assumptions and Provisions for Swaps published by ISDA (the "ISDA Code"), whereas the Interest Rate and Currency Exchange Agreement restates the relevant provisions of the ISDA Code in the body of the Agreement. Apart from differences relating to the multicurrency aspects of the Interest Rate and Currency Exchange Agreement and certain minor differences to take account, as we are advised, of requirements of English law, the two 1987 ISDA Master Agreements are essentially identical in substance.

The 1987 ISDA Master Agreements state that the parties have entered or will enter into one or more Swap Transactions with each other and will exchange in respect of each Swap Transaction a document (each a Confirmation) confirming such Swap Transaction. Each 1987 ISDA Master Agreement includes a Schedule allowing the parties to make certain elections provided for in the relevant Agreement and to stipulate any additions or amendments to the relevant Agreement.

Section 5(a) provides for certain Events of Default. These include, inter alia, the failure to pay (Section 5(a)(i)), the breach of certain obligations under the Agreement (Section 5(a)(ii)), misrepresentations (Section 5(a)(iv)), defaults under other swap transactions between the parties not falling under the Agreement (Section 5(a)(v)) and, if so specified in the Schedule, defaults in respect of obligations for borrowed money (Section 5(a)(vi)). Moreover, Section 5(a)(vii) specifies several Events of Default related to insolvency, including, *inter alia*, the following: (i) a party "becomes insolvent or fails or is unable or admits in writing its inability generally to pay its debts as they become due" (Section 5(a)(vii)(2)); (ii) a party "institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights, or a petition is presented for the winding-up or liquidation of the party ... and ... such proceeding or petition (A) results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for the winding-up or liquidation of the party ... or (B) is not dismissed, discharged, stayed or restrained in each case within 30 days of the institution or presentation thereof (Section 5(a)(vii)(4)); (iii) "any event occurs with respect to the party ... which, under the applicable laws of any jurisdiction, has an analogous effect to any of the [foregoing] events ..." (Section 5(a)(vii)(7)); and (iv) "a party takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the foregoing acts" (Section 5(a)(vii)(8)).

If an Event of Default other than any of the insolvency related Events of Default specified in Section 5(a)(vii) has occurred in respect of a party and is continuing, the other party may, by giving not more than 20 day's notice, designate an Early Termination Date, whereupon all outstanding Swap Transactions will terminate. If any of the insolvency related Events of Default specified in Section 5(a)(vii) has occurred, all Swap Transactions outstanding under the Agreement will automatically terminate without any notice being required "immediately upon the occurrence of the" relevant event of default in relation to a party and, if the Event of Default is any event which is specified in Section 5(a)(vii)(4) (or an event analogous thereto under the laws of the relevant jurisdiction), "as of the time immediately preceding the institution of the relevant proceeding or the presentation of the relevant petition ..." (Section 6(a)).

Following the termination of the outstanding Swap Transactions as a result of an Event of Default pursuant to Section 5(a), the Agreement imposes on the Defaulting Party an obligation to pay to the Non-defaulting Party a lump-sum termination amount. Such lump-sum termination amount includes (i) all "Unpaid Amounts" (amounts which were or would have been due prior to termination) and (ii) an amount that reflects the netting of positive (i.e., each amount that would be payable by the Non-defaulting Party to replace Swap Transactions under the then current market conditions) and negative (i.e., each amount that would be received by the Non-defaulting Party to replace Swap Transactions under the then current market conditions) Market Quotations. If, in respect of any terminated Swap Transaction, a Market Quotation is not or cannot be determined, the Agreement provides for the determination of the closing value of such terminated Swap Transaction by an amount which is equal to the amount of a party's losses and costs (or gain, in which case expressed as a negative amount) arising as a result of the termination of the relevant Swap Transaction. If the lump-sum termination amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party, but if it is a negative number, no payment is due by the Non-defaulting Party to the Defaulting Party; the Non-defaulting Party is not required to make a termination payment to the Defaulting Party upon termination of the Swap Transactions following an Event of Default.

Under the 1987 ISDA Master Agreements, a party may enter into Swap Transactions on a multibranch basis by specifying in Part 4 of the Schedule that it is a "Multibranch Party".

Section 10 of each 1987 ISDA Master Agreement provides:

> "If a party is specified as a Multibranch Party in Part 4 of the Schedule, such Multibranch Party may make and receive payments under any Swap Transaction through any of its branches or offices listed in the Schedule (each an "Office"). The Office through which it so makes and receives payments for the purpose of any

Swap Transaction will be specified in the relevant Confirmation and any change of Office for such purpose requires the prior written consent of the other party. Each Multibranch Party represents to the other party that, notwithstanding the place of payment, the obligations of each Office are for all purposes under this Agreement the obligations of such Multibranch Party. This representation will be deemed to be repeated by such Multibranch Party on each date on which a Swap Transaction is entered into."

(B) The 1992 ISDA Master Agreements

The 1992 ISDA Master Agreements constitute form agreements designed to serve as master agreements for over-the-counter derivative transactions (each, a Transaction) between the same parties. These Transactions may include any or all the Transactions described in Appendix A hereto. Some of these Transactions may provide for payments by both parties, such as interest rate swaps, currency swaps, foreign exchange transactions, currency options and cash settled equity, bond and commodity options, while others, such as equity, bond and commodity options or swaps providing for physical delivery, may require one party to make a payment and the other party to deliver shares, bonds or commodities.

The Single Jurisdiction Agreement is designed for Transactions in a single currency between two parties organized or operating out of the same jurisdiction. The Cross Border Agreement is designed for Transactions in any currency between two parties irrespective of their jurisdiction of incorporation or operation. Both 1992 ISDA Master Agreements may be governed by either New York law or English law as the parties elect. Apart from differences relating to the multicurrency and cross border aspects of the Cross Border Agreement, both 1992 ISDA Master Agreements are essentially identical in substance.

The 1992 ISDA Master Agreements state that the parties have entered or will enter into one or more Transactions with each other from time to time and will in respect of each Transaction execute and exchange a document or other confirming evidence (each, a Confirmation) setting forth the particular terms of such Transaction. Each of the 1992 ISDA Master Agreements includes a Schedule allowing the parties to make certain elections provided for in the relevant Agreement and to stipulate any additions or amendments to the relevant Agreement.

Section 5(a)[1] provides for certain Events of Default. These include, *inter alia*, the failure to pay or deliver (Section 5(a)(i)), the breach of certain obligations under an 1992 ISDA Master Agreement (Section 5(a)(ii)), misrepresentations (Section 5(a)(iv)), defaults under other derivative transactions between the parties not falling under an 1992 ISDA Master Agreement (Section 5(a)(v)) and, if so specified in the Schedule, defaults in respect of obligations for borrowed money (Section 5(a)(vi)). Furthermore, Section 5(a)(vii) specifies several insolvency related Events of Default, including, *inter alia*, the following: (i) a party "becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due" (Section 5(a)(vii)(2)); (ii) a party

1 References herein to a "Section" are to the relevant section of the relevant Agreements.

"institutes[2] or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law affecting creditor's rights, or a petition is presented for its winding-up or liquidation, and, in the case of any such proceeding or petition instituted or presented against it, such proceeding or petition (A) results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for its winding-up or liquidation or (B) is not dismissed, discharged, stayed or restrained in each case within 30 days of the institution or presentation thereof" (Section 5(a)(vii)(4)); (iii) a party "causes or is subject to any event with respect to it which, under the applicable laws of any jurisdiction, has an analogous effect to any of the [foregoing] events [...]" (Section 5(a)(vii)(8)); and (iv) a party "takes any action in furtherance of, or indicating its consent to, approval of or acquiescence in, any of the foregoing acts" (Section 5(a)(vii)(9)).

If an Event of Default has occurred and is continuing with respect to a party, the other party may, by giving not more than 20 days notice, designate an Early Termination Date, whereupon all Transactions which are outstanding under an 1992 ISDA Master Agreement will terminate. The parties may also agree, at the time they enter into such an Agreement, on Automatic Early Termination in respect of certain insolvency related Events of Default, in which case again all Transactions which are outstanding under such Agreement will automatically terminate without any notice being required upon the occurrence of the relevant Event of Default in relation to a party and, if the Event of Default is any event which is specified in Section 5(a)(vii)(4) (or an event analogous thereto under the laws of the relevant jurisdiction), "as of the time immediately preceding the institution of the relevant proceedings or the presentation of the relevant petition ..." (Section 6(a)).

Following the termination of the outstanding Transactions as a result of an Event of Default pursuant to Section 5(a), each of the 1992 ISDA Master Agreements provide for close-out netting. A lump-sum amount reflecting the positive or negative values of all Transactions is to be calculated as of the Early Termination Date (Section 6). The 1992 ISDA Master Agreements contain certain alternatives for calculating this lump-sum amount upon early termination, which the parties may elect at the time they enter into such an Agreement, and which may briefly be described as follows:

- The 1992 ISDA Master Agreements allow the parties to elect a payment measure based upon Market Quotation (market values of the Transactions based upon the parties' future scheduled payment or delivery obligations) or Loss (a general indemnity). If the parties elect Market Quotation, the lump-sum amount includes (i)

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2 The term "to institute" or "institution" as used in this Memorandum with respect to German Insolvency Proceedings means the granting by the competent court of a petition for such proceedings. However, we understand that these terms are used differently in Section 5(a)(vii) of the 1992 ISDA Master Agreements: "institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy" in our understanding is analogous (within the meaning of Section 5(a)(vii)(8)) to the filing of a petition for the institution of Insolvency Proceedings under German law. The term "to open" or "opening" as used in this Memorandum with respect to matters governed by, and consistent with, the Regulation (as defined in VI.(A)) has with respect to Insolvency Proceedings under German law the same meaning as the term "to institute" or "institution" as used herein.

all "Unpaid Amounts" (amounts which were or would have been due prior to termination) and (ii) an amount that reflects the netting of positive (*i.e.*, each amount that would be payable by the Non-defaulting Party to replace Transactions under then current market conditions) and negative (*i.e.*, each amount that would be received by the Non-defaulting Party to replace Transactions under then current market conditions) Market Quotations. If the parties elect Loss, then any payment upon termination will be equal to the Non-defaulting Party's total net losses and costs (or gain, in which case expressed as a negative number) under a 1992 ISDA Master Agreement as a result of the termination of the Transactions.

- The 1992 ISDA Master Agreements also require the parties to elect between the "First Method" of calculating termination payments and the "Second Method" (also referred to as "full two-way payments"). Under the First Method, in the case of an Event of Default, if the lump-sum termination amount is positive, it is paid by the Defaulting Party to the Non-defaulting Party, but, if it is negative, no payment is due; the Non-defaulting Party is not required to make a termination payment to the Defaulting Party after an Event of Default. Under the Second Method, if the lump-sum termination amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if that amount is a negative number, the Non-defaulting Party will pay the absolute value of that number to the Defaulting Party.

Under the Cross Border Agreement, a party may enter into Transactions on a multi-branch basis by specifying in Part 4 of the Schedule that Section 10(a) applies to it.

Section 10(a) of the Cross Border Agreement provides that:

"If Section 10(a) is specified in the Schedule as applying, each party that enters into a Transaction through an Office other than its head or home office represents to the other party that, notwithstanding the place of booking office or jurisdiction of incorporation or organization of such party, the obligations of such party are the same as if it had entered into the Transaction through its head or home office. This representation will be deemed to be repeated by such party on each date on which a Transaction is entered into."

(C) The 2002 ISDA Master Agreement

The 2002 ISDA Master Agreement constitutes a form agreement designed to serve as a master agreement for over-the-counter derivative transactions (each, a Transaction) between the same parties. These Transactions may include any or all the Transactions described in Appendix A hereto. Some of these Transactions may provide for payments by both parties, such as interest rate swaps, currency swaps, foreign exchange transactions, currency options and cash settled equity, bond and commodity options, while others, such as equity, bond and commodity options or swaps providing for physical delivery, may require one party to make a payment and the other party to deliver shares, bonds or commodities.

The 2002 ISDA Master Agreement may be governed by either New York law or English law as the parties elect.

The 2002 ISDA Master Agreement states that the parties have entered or will enter into one or more Transactions with each other from time to time and will in respect of each Transaction execute and, as a rule, exchange a document or other confirming evidence (each a Confirmation) setting forth the particular terms of such Transaction. The 2002 ISDA Master Agreement includes a Schedule allowing the parties to make certain elections provided for in such Agreement and to stipulate any additions or amendments to the such Agreement.

Section 5(a)[3] provides for certain Events of Default. These include, *inter alia*, the failure to pay or deliver (Section 5(a)(i)), the breach of certain obligations under a 2002 ISDA Master Agreement or the repudiation, in whole or in part, of a 2002 ISDA Master Agreement or a Transaction thereunder (Section 5(a)(ii)), misrepresentations (Section 5(a)(iv)), defaults under other derivative transactions between the parties not falling under a 2002 ISDA Master Agreement (Section 5(a)(v)) and, if so specified in the Schedule, defaults in respect of obligations for borrowed money (Section 5(a)(vi)). Furthermore, Section 5(a)(vii) specifies several insolvency related Events of Default, including, *inter alia*, the following: (i) a party "becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due" (Section 5(a)(vii)(2)); (ii) a party "(A) institutes or has instituted against it, by a regulator, supervisor or any similar official with primary insolvency, rehabilitative or regulatory jurisdiction over it in the jurisdiction of its incorporation or organisation or the jurisdiction of its head or home office, a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law affecting creditor's rights, or a petition is presented for its winding-up or liquidation by it or such regulator, supervisor or similar official, or (B) has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights, or a petition is presented for its winding-up or liquidation, and such proceeding or petition is instituted or presented by a person or entity not described in clause (A) above and either (I) results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for its winding-up or liquidation or (II) is not dismissed, discharged, stayed or restrained in each case within 15 days of the institution or presentation thereof" (Section 5(a)(vii)(4)); (iii) a party "causes or is subject to any event with respect to it which, under the applicable laws of any jurisdiction, has an analogous effect to any of the [foregoing] events [...]" (Section 5(a)(vii)(8)); and (iv) a party "takes any action in furtherance of, or indicating its consent to, approval of or acquiescence in, any of the foregoing acts" (Section 5(a)(vii)(9)).

If an Event of Default has occurred and is continuing with respect to a party, the other party may, by giving not more than 20 days notice, designate an Early Termination Date, whereupon all Transactions which are outstanding under a 2002 ISDA Master Agreement will terminate. The parties may also agree, at the time they enter into such an Agreement, on Automatic Early Termination in respect of certain insolvency related Events of Default, in which case again all Transactions which are outstanding under such Agreement will automatically terminate without any notice being required upon the occurrence of the relevant Event of Default in relation to a party and, if the Event of

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3 With respect to the term "to institute" or "institution" as used in this Memorandum with respect to German Insolvency Proceedings and as used in Section 5(a)(vii) of the 2002 ISDA Master Agreements, *see* the discussion in the preceding footnote.

Default is any event which is specified in Section 5(a)(vii)(4) (or an event analogous thereto under the laws of the relevant jurisdiction), "as of the time immediately preceding the institution of the relevant proceedings or the presentation of the relevant petition ..." (Section 6(a)).

Following the termination of the outstanding Transactions as a result of an Event of Default pursuant to Section 5(a), the 2002 ISDA Master Agreement provides for close-out netting. A lump-sum amount reflecting the positive or negative values of all Transactions ("Early Termination Amount") is to be calculated as of the Early Termination Date (Section 6). The Early Termination Amount is to be calculated by deducting (i) the Termination Currency Equivalent of the Close-out Amount for each Terminated Transaction (or the Close-out Amounts for each group of Terminated Transaction) and (ii) the Termination Currency Equivalent of the "Unpaid Amounts" (amounts which were or would have been due prior to termination) owed to the Non-defaulting Party from the Termination Currency Equivalent of the Unpaid Amounts owed to the Defaulting Party (Section 6(e)(i)). If the resulting Early Termination Amount is a positive number, the Defaulting Party has to pay such amount to the Non-defaulting Party. If such amount is a negative number, the Non-defaulting Party has to pay such amount to the Defaulting Party. Subject to certain refinements, the "Close-out Amount" in respect of a Terminated Transaction will be determined by determining the amount of the losses or costs that the Determining Party has or would have incurred or gains that have or would have realised when replacing the Terminated Transactions. Any Close-out Amount shall be determined by the Determining Party by using commercially reasonable proceedures.

A party may enter into Transactions on a multibranch basis by specifying in Part 4(d) of the Schedule to a 2002 ISDA Master Agreement that Section 10(a) and (b) applies to it.

Section 10(a) of the 2002 ISDA Master Agreement provides that:

> "If Section 10(a) is specified in the Schedule as applying, each party that enters into a Transaction through an Office other than its head or home office represents to and agrees with the other party that, notwithstanding the place of booking or its jurisdiction of incorporation or organization, its obligations are the same in terms of recourse against it as if it had entered into the Transaction through its head or home office, except that a party will not have recourse to the head or home office of the other party in respect of any payment or delivery deferred pursuant to Section 5(d) for so long as the payment or delivery is so deferred. This representation and agreement will be deemed to be repeated by each party on each date on which the parties enter into a Transaction."

III.
ASSUMPTIONS[4]

You have instructed us to assume the following:

1. Two institutions either (i) a corporation, or (ii) a bank or other similar financial institution have entered into an Agreement and have selected either New York law or English law to govern. Neither institution has specified that the provisions of Section 10(a) of an Agreement apply to it. At least one of these institutions is incorporated or organized in Germany (herein often referred to as the "German party") and is within one of the following categories:

(a) credit institutions (*Kreditinstitute*) within the meaning of § 1(1) of the Banking Act of July 10, 1961, as amended (*Kreditwesengesetz* - "**Banking Act**")[5] and either incorporated or organized under private law (such as stock corporations (*Aktiengesellschaften* - "**AG**"), companies with limited liability (*Gesellschaften mit beschränkter Haftung* - "**GmbH**"), partnerships limited by shares (*Kommanditgesellschaften auf Aktien* - "**KGaA**"), registered cooperatives (*eingetragene Genossenschaften* - "**eG**"), general partnerships (*offene Handelsgesellschaften* - "**oHG**") or limited partnerships (*Kommanditgesellschaften* - "**KG**")) or under public law (such as the *Landesbanken*, the public law savings banks (*Sparkassen*) and other institutions under public law), including

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4 The additional facts which we have been instructed to assume in respect of multibranch parties are set forth under VII.(F)(1) below.

5 Credit institutions are undertakings that carry on banking transactions on a commercial basis, or to an extent that necessitates a commercially organized business operation (§ 1(1) of the Banking Act). Banking transactions are: (1) the taking of moneys from others as deposits or other repayable funds of the public, provided that the claim for repayment is not evidenced by a bearer or order bond, irrespective of whether or not interest is paid (deposit business); (2) the business specified in § 1(1), second sentence, of the Mortgage Bond Act [*Pfandbriefgesetz*] (mortgage bond business); (3) the granting of money loans and acceptance credits (credit business); (4) the purchase of bills of exchange and cheques (discount business); (5) the purchase and sale of financial instruments in its own name and for the account of others (financial commissions business); (6) the safe custody and administration of securities for others (safe custody business); (7) the incurring of obligations to acquire claims in respect of loans that have previously been sold prior to their maturity; (8) the granting of sureties, guarantees and other indemnities for others (guarantee business); (9) the processing of cashless cheque collection (cheque collection business) and bills of exchange collection (bills of exchange collection business) and the issuance of traveler cheques (traveler cheque business); (10) the acquisition of financial instruments for its own account for purposes of their placement or the issuance of equivalent guarantees (underwriting business); and (11) the activity as a central counterparty within the meaning of § 1(31) of the Banking Act. A credit institution is not limited in its activities to the above listed types of banking transactions. Under certain narrow circumstances, generally in respect of credit institutions of lesser significance from the viewpoint of prudential supervision, the Financial Services Supervisory Authority may determine that the special rules described under VII.(B)(1)(b) and VII.(B)(2)(a) regarding the institution of Insolvency Proceedings, including, *inter alia*, §§ 46 and 46b of the Banking Act, shall not apply.

(i) credit institutions incorporated under private law or organized under public law issuing mortgage bonds (*Hypothekenpfandbriefe*), public sector bonds (*Öffentliche Pfandbriefe*) or ship mortgage bonds (*Schiffspfandbriefe*)[6]; and

(ii) credit institutions having the right to issue secured bonds[7];

(b) financial services institutions (*Finanzdienstleistungsinstitute*) within the meaning of § 1(1a) of the Banking Act[8] incorporated or organized under private law (including AG, GmbH, KGaA, eG, oHG, KG);

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6 Pursuant to the Mortgage Bond Act (*Pfandbriefgesetz* – the "**Mortgage Bond Act**") which came into force on July 19, 2005, the rules applicable to the issuance of mortgage bonds (*Hypothekenpfandbriefe*), ship mortgage bonds (*Schiffspfandbriefe*) and public sector bonds (*Kommunalschuldverschreibungen* or *öffentliche Pfandbriefe*) have changed substantially. According to this Act, all credit institutions within the meaning of § 1(1) of the Banking Act (*cf.* the preceding footnote) may apply for a license to issue these types of bonds in compliance with the Mortgage Bond Act if they meet certain requirements. In other words, issuance of such bonds is no longer restricted to (i) specialized credit institutions (*i.e.*, mortgage banks (*Hypothekenbanken*) or ship mortgage banks (*Schiffspfandbriefbanken*), as the case may be) and (ii) public law credit institutions. – Credit institutions conducting the mortgage bond business under the Mortgage Bond Act must maintain cover (*Deckung*) for bonds issued thereunder. These cover assets must be registered in the relevant cover register (*Deckungsregister*) maintained by such institution. With the consent of, *inter alia*, the respective counterparty, such institutions may include certain derivative transactions in such cover (*cf.* §§ 5(1), 2nd sentence, 19(1) no. 4 of the Mortgage Bond Act). If so included, such derivative transactions do not qualify for being netted with derivative transactions that are not included in the cover (*cf.* §§ 29, 30 of the Mortgage Bond Act).

7 The following credit institutions have the right to issue secured bonds (*gedeckte Schuldverschreibungen*): (i) DZ BANK AG Deutsche Zentral-Genossenschaftsbank (§ 9 of the Law on the Reorganisation of Deutsche Genossenschaftsbank (*Gesetz zur Umwandlung der Deutschen Genossenschaftsbank*) of August 13, 1998); (ii) Landwirtschaftliche Rentenbank, a credit institution established under public law (§§ 3(5), 13 of the Law on Landwirtschaftliche Rentenbank (*Gesetz über die Landwirtschaftliche Rentenbank*) of May 11, 1949, as amended), (iii) IKB Deutsche Industriebank AG (§ 1(1) of the Law on Industriekreditbank Aktiengesellschaft (*Gesetz betreffend die Industriekreditbank Aktiengesellschaft*) of July 15, 1951, as amended) and (iv) Deutsche Postbank AG (§§ 7 and § 14 (2) of the Law on the Reorganisation of Deutsche Siedlungs- und Landesrentenbank into a Stock Corporation) (*Gesetz über die Umwandlung der Deutschen Siedlungs- und Landesrentenbank in eine Aktiengesellschaft*) of December 16, 1999. In the case of DZ BANK AG Deutsche Zentral-Genossenschaftsbank, the considerations set out in footnote 3 with respect to credit institutions conducting the mortgage bond business under the Mortgage Bond Act apply *mutatis mutandis* to this credit institution. In the case of Landwirtschaftliche Rentenbank and Deutsche Postbank AG, it is uncertain whether or not these banks may generally include claims arising from derivative transactions in the security for covered bonds issued by either of them. In any event, if such claims were included, it would seem to follow from the applicable statutory provisions that they do not qualify for being netted with claims arising from derivative transactions that are not included in the security. In the case of IKB Deutsche Industriebank AG ("IKB"), creditors of secured bonds issued by IKB are granted priority in Insolvency Proceedings over the assets of IKB with regard to assets included in the security (*Deckung*) for such bonds; it would seem to follow from the applicable statutory provisions that claims arising from derivative transactions included in such security do not qualify for being netted with claims arising from derivative transactions that are not included in the security, provided that the netting would affect adversely the aforementioned priority right of the creditors of secured bonds issued by IKB.

(c) insurance companies (other than re-insurers) within the meaning of § 1(1) of the Insurance Supervisory Act of May 12, 1901, as amended (*Versicherungsaufsichtsgesetz* - **"Insurance Supervisory Act"**) (**"insurance com-**

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8 Financial services institutions are undertakings that are not credit institutions, but provide financial services for third parties on a commercial basis, or to an extent that necessitates a commercially organized business operation (§ 1(1a) of the Banking Act). Financial services comprise: (1) the broking of transactions for the purchase and sale of financial instruments or their referral (investment brokerage); (2) the provision of personal recommendations to a client or its representative in respect of one or more transactions relating to specific financial instruments to the extent that the recommendation is based on a verification of the investor's personal circumstances or is presented as being suitable for him and is not exclusively published through information distribution channels or for the public (investment advice); (3) the operation of a multilateral trading facility which brings together multiple third-party buying and selling interests in financial instruments - within the system and in accordance with non-discretionary rules - in a way that results in a contract for purchase of such financial instruments (operating a multilateral trading facility); (4) placing of financial instruments without a firm commitment (placing business); (5) the purchase and sale of financial instruments in the name and for the account of third parties (securities brokerage); (6) the management of individual assets invested in financial instruments for the account of third parties by manager with freedom of judgement (financial portfolio management); (7) (a) the continuous offer of the purchase or sale of financial instruments at an organized market or in a multilateral trading facility at prices quoted by itself, (b) the frequent organized and systematic conduct of trading for its own account outside of an organized market or a multilateral trading facility by way of supplying a system accessible to third persons in order to effect transactions with those persons, (c) the purchase and sale of financial instruments for its own account as a service for third persons or (d) the purchase and sale of financial instruments for its own account as a direct or indirect participant of a national-organized market or a multilateral trading facility by means of a high-frequency algorithmic trading technique characterized by the use of infrastructure which aims for a minimization of latency by the decision of the system regarding the introduction, the production, the forwarding or the implementation of the order without any human intervention for individual transactions or orders as well as by a high undergrounded arise of notification in the form of orders, quotes or cancellations, even without services for third parties (proprietary trading); (8) the arranging of deposit transactions with undertakings having their registered office outside of the European Economic Area (third country deposit brokerage); (9) the currency trading (currency exchange business); (10) the ongoing purchase of receivables based on master agreements with or without recourse (factoring); (11) the entry into finance leasing contracts as lessor and the management of property companies within the meaning of § 2(6), first sentence, no. 17 of the Banking Act outside the management of investment assets (*Investmentvermögen*) within the meaning of § 1(1) of the Capital Investment Code (finance leasing); (12) the purchase and sale of financial instruments outside the management of investment assets (*Investmentvermögen*) within the meaning of § 1(1) of the Capital Investment Code for a group of investors all of which are natural persons with freedom of judgement regarding the selection of relevant financial instruments to the extent this is a main feature of the offered product and is carried out with the intent that the investors participate in the performance of the purchased financial instruments (investment management); and (13) the deposit and the management of securities exclusively for alternative investment funds (AIF) within the meaning of § 1(3) of the Capital Investment Code (limited deposit-taking business). Financial services shall also include the purchase and sale of financial instruments for its own account which does not constitute a service for third parties (proprietary transaction); similarly to credit institutions, a financial services institution is not limited in its activities to the above listed types of financial services. Under certain narrow circumstances, generally in respect of financial services institutions of lesser significance from the viewpoint of prudential supervision, the Financial Services Supervisory Authority may determine that the special rules regarding the institution of Insolvency Proceedings described under VII.(B)(1)(b) and VII.(B)(2)(a) shall not apply.

panies") which may be incorporated either under private law (such as AG's and mutual insurance companies (*Versicherungsvereine auf Gegenseitigkeit*)) or under public law[9];

(d) capital management companies (*Kapitalverwaltungsgesellschaften*) within the meaning of § 17(1) of the Capital Investment Code of July 4, 2013 (*Kapitalanlagegesetzbuch* – "**Capital Investment Code**"), which term comprises, *inter alia*, (i) capital management companies (*Kapitalverwaltungsgesellschaften*) managing segregated pools of assets (*Sondervermögen*) within the meaning of § 1(10) of the Capital Investment Code and (ii) investment stock corporations with variable capital (*Investmentaktiengesellschaft mit veränderlichem Kapital*) within the meaning of § 108 *et seq.* of the Capital Investment Code having no external management company ("**capital management companies**")[10]; and

(e) undertakings incorporated or organized as AG, GmbH, KGaA, eG, oHG or KG which are neither credit institutions, financial services institutions nor insurance companies,

provided that this Memorandum does not consider the enforceability of close-out netting under Master Agreements entered into between a CCP within the meaning of Article 2 no. 1 of the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("**EMIR Regulation**") and a clearing member within the meaning of Article 2 no. 14 of the EMIR Regulation.[11]

2. In respect of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement: Sections 1(c), 2(a)(iii)(1) and (2), 5 and 6 and the related definitions have not been altered in any material respect (we believe that any selections contemplated by Sections 5 and 6 and made pursuant to a Schedule or in a Confirmation should not be considered material alterations).

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9 Insurance companies are obliged to maintain a pool of assets securing fulfilment of relevant policies (*Sicherungsvermögen*). Set-off or other form of netting in respect of assets included in the pool is essentially limited to claims arising from relevant policies. This Memorandum does not address the question which assets may form part of such pool.

10 Capital management companies (*Kapitalverwaltungsgesellschaften*) are undertakings engaged in the administration of domestic investment funds (*inländische Investmentvermögen*), EU investment funds (*EU-Investmentvermögen*) or non-German alternative investment funds (*ausländische AIF*). Domestic investment funds (*inländische Investmentvermögen*) may comprise segregated pools of assets (*Sondervermögen*). If a capital management company enters into derivative transactions for the account of one of the segregated pool of assets (*Sondervermögen*) it manages, it would seem to follow from the applicable statutory provisions that claims arising from such transactions do not qualify for being netted with claims arising from transactions into which the same capital management company enters into for the account of any other of such segregated pool of assets (*Sondervermögen*) (*cf.* § 93(6) of the Capital Investment Code).

11 With respect to such arrangements, special rules under Article 102b of the Introductory Act to the Insolvency Code (*Einführungsgesetz zur Insolvenzordnung*) apply aiming to provide for insolvency rules in respect of measures and procedures under Article 48 of the EMIR Regulation.

In respect of the 1987 ISDA Master Agreements: The fourth sentence of the introductory paragraph of the 1987 ISDA Master Agreements and Sections 2(a)(iii)(1), 5 and 6 and the related definitions have not been altered in any material respect (we believe that any selections contemplated by Sections 5 and 6 and made pursuant to a Schedule or in a Confirmation should not be considered material alterations), provided that (i) Section 6(a) of the 1987 ISDA Master Agreements is amended to the effect that an Early Termination Date will not be deemed to have occurred automatically upon the occurrence of an insolvency-related Event of Default under Section 5(a)(vii), and (ii) Section 6(e) of the 1987 ISDA Master Agreements is amended to provide for full two-way payments in respect of all Events of Default and Termination Events.

3. On the basis of the terms and conditions of the Agreements and other relevant factors, and acting in a manner consistent with the intentions stated in the Agreements, the parties over time enter into a number of Transactions (in the case of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement) or Swap Transactions (in the case of the 1987 ISDA Master Agreements) that are intended to be governed by such Agreement. The Transactions entered into include any or all the transactions described in Appendix A.

4. Some of the Transactions provide for an exchange of cash by both parties and others provide for the physical delivery of shares, bonds or commodities in exchange for cash.

5. After entering into these Transactions (in the case of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement) or Swap Transactions (in the case of the 1987 ISDA Master Agreements) and prior to the maturity thereof, one of the parties, which is incorporated or organized in Germany, becomes the subject of Insolvency Proceedings under the laws of Germany and, subsequent to the institution of such proceedings, either that party or the receiver seeks to assume the Confirmations representing profitable Transactions (in the case of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement) or Swap Transactions (in the case of the 1987 ISDA Master Agreements) for the insolvent party and reject the Confirmations representing unprofitable Transactions or Swap Transactions for the insolvent party.

6. With respect to the 1992 ISDA Master Agreements, the parties have selected the Second Method.

IV.
QUESTIONS PRESENTED[12]

You have instructed us to consider the following questions:

(A) In respect of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement:

1. Assuming the parties to an Agreement have not selected Automatic Early Termination upon certain insolvency related events to apply to the insolvent German party, are the provisions of an Agreement permitting the Non-defaulting Party to terminate all the Transactions upon the insolvency of the German party enforceable under German law?

2. Assuming the parties to an Agreement have selected Automatic Early Termination upon certain insolvency related events to apply to the insolvent German party, are the provisions of the Agreement automatically terminating all the Transactions upon the insolvency of the German party enforceable under German law?

3. Are the provisions of the Agreements providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of the German party enforceable under German law?

(B) In respect of the 1987 ISDA Master Agreements:

1. Assuming that the parties have amended Section 6(a) of the Agreements to the effect that an Early Termination Date will not be deemed to have occurred automatically upon the occurrence of an insolvency-related Event of Default under Section 5(a)(vii), are the provisions of an Agreement permitting the Non-defaulting Party to terminate all the Transactions upon the insolvency of the German party enforceable under German law?

2. Assuming that the parties have amended Section 6(e) of the Agreements to provide for full two-way payments in respect of all Events of Default and Termination Events, are the provisions of the Agreements providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of the German party enforceable under German law?

(C) In respect of the 1987 ISDA Master Agreements, the Cross Border Agreement and the 2002 ISDA Master Agreement:

1. Assuming the parties have entered into (i) either of the 1987 ISDA Master Agreements, (ii) a Cross Border Agreement or (iii) a 2002 ISDA Master Agreement, one of the parties is insolvent and, in the case of (x) a Interest Rate and Currency Exchange Agreement, (y) a Cross Border Agreement or (z) a 2002 ISDA

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12 The questions presented in respect of close-out netting for multibranch parties are set forth under VII.(F)(2) below.

Master Agreement only, the parties have selected a Termination Currency other than the currency of the jurisdiction in which the insolvent party is organized, is it possible to "prove" (that is, file) a claim in Insolvency Proceedings under the laws of Germany in a foreign currency (*i.e.*, a currency other than Euro)?

2. Is it possible to obtain or execute a judgement in a foreign currency under German law?

V.
KEY CONCLUSIONS[13]

Our conclusions on the questions set forth in IV.(A) and (B) above, which are subject to the analysis set forth below, are the following:

(A) In respect of applicable law:

1. Subject to the discussion and the reservations set out under VI.(C)(3)(b) and (4) below, where:-

   a. the German party is a Financial Institution[14]; or

   b. (i) the German party is not a Financial Institution and (ii) the counterparty to the German party is established in a State which is not an EC Member State (except for Denmark);

   German international insolvency law does not refer to any substantive insolvency law, but provides that close-out netting under the Agreements may take effect in accordance with the terms of the relevant Agreement. Accordingly, in these circumstances German substantive insolvency law does not apply.

2. Irrespective of the laws governing the Agreement, German substantive insolvency law applies with respect to the enforceability of close-out netting under the Agreements where (i) the German party is not a Financial Institution and (ii) the counterparty to the German party is established in an EC Member State (except for Denmark).

(B) In respect of substantive law (*Sachrecht*):

   (1) German law governs the enforceability of close-out netting:

   Insofar as German substantive insolvency law applies, our conclusions are the following:

13 The answers to all questions presented are set forth under IX. below.

14 As defined under VI.(B)(2)(a).

(a) In respect of the 1987 ISDA Master Agreements:

1. If (i) the relevant 1987 ISDA Master Agreement is a *Qualifying Master Agreement* (as defined under VII.(C)(2)(c)(iv) below) and (ii) the Early Termination Date falls *before* the institution of Insolvency Proceedings, the provisions of the 1987 ISDA Master Agreements permitting the other party to terminate all Swap Transactions upon the occurrence of an insolvency related Event of Default specified in Section 5(a)(vii) in respect of the German party are enforceable under German law. Further, Section 6(e) (as amended in accordance with the assumption made under III.2) providing for the netting of termination values in determining a single lump-sum termination amount and payment thereof by the Defaulting Party (if that amount is a positive number) or by the other party (if that amount is a negative number) is enforceable under German law.

2. If (i) the relevant 1987 ISDA Master Agreement is a *Qualifying Master Agreement* and (ii) the Early Termination Date falls *on or after* the date on which Insolvency Proceedings are instituted, the Swap Transactions and the Agreement will *ipso facto* terminate upon the institution of Insolvency Proceedings. Close-out and liquidation of the Swap Transactions will be governed by § 104(3) of the Insolvency Code; Section 6(e) will generally not apply.

3. If the relevant 1987 ISDA Master Agreement is a *Non-Qualifying Master Agreement* (as defined under VII.(C)(2)(c)(iv) below), the provisions of the 1987 ISDA Master Agreements permitting the other party to terminate all Swap Transactions upon the occurrence of an insolvency related Event of Default specified in Section 5(a)(vii) in respect of the German party are *not* enforceable under German law, irrespective of whether the Early Termination Date falls before, on or after the date on which Insolvency Proceedings are instituted. Any such 1987 ISDA Master Agreement (i) may not be terminated upon the occurrence of an insolvency related Event of Default and (ii), upon the institution of Insolvency Proceedings, will be subject to § 103 of the Insolvency Code under which the insolvency receiver may assume Swap Transactions which are profitable for the insolvent party and reject Swap Transactions which are not. With respect to rejected Swap Transactions, the solvent party may assert a claim for non-performance only as a creditor in insolvency proceedings.

(b) In respect of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement:

1. Assuming that the parties to a 1992 ISDA Master Agreement or a 2002 ISDA Master Agreement have *not* selected "Automatic Early Termination" upon the Events of Default specified in Section 6(a), second sentence, to apply to the German party, the legal position is as follows:

(i) If (a) the relevant 1992 ISDA Master Agreement or 2002 ISDA Master Agreement is a *Qualifying Master Agreement* and (b) the Early Termination

Date falls *before* the institution of Insolvency Proceedings, the provisions of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement permitting the other party to terminate all Transactions upon the occurrence of an insolvency related Event of Default specified in Section 5(a)(vii) in respect of the German party are enforceable under German law. Further, Section 6(e) providing for the netting of termination values in determining a single lump-sum termination amount and payment thereof by the Defaulting Party (if that amount is a positive number) or by the Non-defaulting Party (if that amount is a negative number) is enforceable under German law.

(ii) If (a) the relevant 1992 ISDA Master Agreement or 2002 ISDA Master Agreement is a *Qualifying Master Agreement* and (b) the Early Termination Date falls *on or after* the date on which Insolvency Proceedings are instituted, the Transactions and the Agreement will *ipso facto* terminate upon the institution of Insolvency Proceedings. Close-out and liquidation of the Transactions will be governed by § 104(3) of the Insolvency Code; Section 6(e) will generally not apply.

(iii) If the relevant 1992 ISDA Master Agreement or 2002 ISDA Master Agreement is a *Non-Qualifying Master Agreement*, the provisions of the 1992 ISDA Master Agreements or the 2002 ISDA Master Agreement permitting the other party to terminate all Transactions upon the occurrence of an insolvency related Event of Default specified in Section 5(a)(vii) in respect of the German party are *not* enforceable under German law, irrespective of whether the Early Termination Date falls before, on or after the date on which Insolvency Proceedings are instituted. Any such 1992 ISDA Master Agreement or 2002 ISDA Master Agreement (i) may not be terminated upon the occurrence of an insolvency related Event of Default and (ii), upon the institution of Insolvency Proceedings, will be subject to § 103 of the Insolvency Code under which the insolvency receiver may assume Transactions which are profitable for the insolvent party and reject Transactions which are not. With respect to rejected Transactions, the solvent party may assert a claim for non-performance only as a creditor in insolvency proceedings.

2. Assuming that the parties to a 1992 ISDA Master Agreement or a 2002 ISDA Master Agreement have selected "Automatic Early Termination" upon the Events of Default specified in Section 6(a), second sentence, to apply to the German party, the legal position is as follows:

(i) If (a) the relevant 1992 ISDA Master Agreement or 2002 ISDA Master Agreement is a *Qualifying Master Agreement* and (b) assuming that the Early Termination Date falls *before* the institution of the proceedings, then (i) the provision of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement automatically terminating all Transactions, and (ii) Section 6(e) providing for the netting of termination values in determining a single lump-sum termination amount and payment thereof by the Defaulting Party (if that amount is a positive number) or by the Non-defaulting Party (if that amount is a negative number), are enforceable under German law.

(ii) If the relevant 1992 ISDA Master Agreement or 2002 ISDA Master Agreement is a *Non-Qualifying Master Agreement*, (i) the provision of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement automatically terminating all Transactions, and (ii) Section 6(e) providing for the netting of termination values in determining a single lump-sum termination amount and payment thereof by the Defaulting Party (if that amount is a positive number) or by the Non-defaulting Party (if that amount is a negative number) are *not* enforceable under German law, irrespective of whether the Early Termination Date falls before, on or after the date on which Insolvency Proceedings are instituted. Any such 1992 ISDA Master Agreement or 2002 ISDA Master Agreement (i) will not automatically terminate upon the occurrence of an insolvency related Event of Default and (ii), upon the institution of Insolvency Proceedings, will be subject to § 103 of the Insolvency Code under which the insolvency receiver may assume Transactions which are profitable for the insolvent party and reject Transactions which are not. With respect to rejected Transactions, the solvent party may assert a claim for non-performance only as a creditor in insolvency proceedings.

(2) German law does *not* govern the enforceability of close-out netting:

Subject to the discussion and the reservations set out under VI.(C)(3)(b) below, where German substantive insolvency law does not apply, close-out netting under the Agreements in the insolvency of the German party will be enforceable in accordance with the terms of the relevant Agreement and German substantive insolvency law will be without relevance for the enforceability of close-out netting under the Agreements in such circumstances.

VI.
APPLICABLE LAW - CONFLICT OF LAWS

(A) German International Insolvency Laws

Since 2002, German international insolvency laws have undergone fundamental changes. These changes have evolved in several steps.

Prior to May 31, 2002, German international insolvency laws consisted of some fragmentary insolvency conflict rules which were only set out in the previous version of Article 102 of the Introductory Code to the Insolvency Code of October 5, 1994, as amended (*Einführungsgesetz zur Insolvenzordnung* - **"Introductory Code to the Insolvency Code"**).[15]

[15] *See* the discussion under VII.(A) and XI.(C) of our Memorandum of Law dated May 31, 2002 for ISDA on the enforceability of close-out netting under the Agreements, the 1987 Interest Rate and Currency Exchange Agreement and the 1987 Interest Rate Swap Agreement.

On May 31, 2002, the Council Regulation (EC) No 1346/2000 of May 29, 2000 on insolvency proceedings[16], as amended, (the "**Regulation**") came into force in all Member States of the European Community ("**EC**") except Denmark[17] (each such State, a "**Regulation State**").[18] The Regulation contains conflict rules for insolvencies having a cross-border effect in a Regulation State. The Regulation *ipso iure* forms part of the insolvency laws in all of the Regulation States, including Germany. Insofar as the Regulation applies, it has replaced the conflict rules set out in Article 102 of the Introductory Code to the Insolvency Code. Thus, as from May 31, 2002, German international insolvency laws was governed by two separate bodies of law, one contained in Article 102 of the Introductory Code to the Insolvency Code, the other in the Regulation.[19]

After May 31, 2002, Germany was presented with two tasks: It had to facilitate the rule of the Regulation, mainly by enacting provisions regarding the courts that were to have competence in matters governed by the Regulation, and it had to transform into German law two EC directives, namely (i) Directive 2001/24/EC of the European Parliament and of the Council of April 4, 2001 on the reorganization and winding up of credit institutions[20], as amended, ("**Directive on the Winding up of Credit Institutions**") and (ii) Directive 2001/17/EC of the European Parliament and of the Council of March 19, 2001 on the reorganisation and winding up of insurance undertakings[21], as amended, ("**Directive on the Winding up of Insurance Undertakings**"). In connection with the implementation of these directives, Germany resolved to enact more comprehensive conflict rules regarding insolvencies not covered by the Regulation which were until then governed by the rules of Article 102 of the Introductory Code to the Insolvency Code. The Act on the Regulation of International Insolvency Laws (*Gesetz zur Neuregelung des Internationalen Insolvenzrechts* - "**Act**") which came into force on March 20, 2003 accomplishes all of these tasks. The Act provides the conflict rules regarding insolvencies not covered by the Regulation in §§ 335 to 358 of the Insolvency Code.

As a result, the German international insolvency laws are currently contained in (i) the Regulation and (ii) §§ 335 to 358 of the Insolvency Code. Accordingly, there exist now two distinct legal regimes of German international insolvency law, each of them applying to specified entities and with respect to different cross-border scenarios and containing varying conflict rules.

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16 Official Journal no. L 160 of June 30, 2000, pp. 1 *et seq.*

17 *Cf.* recital 33 of the Regulation.

18 The Regulation applies to Insolvency Proceedings opened after its entry into force (Article 43 of the Regulation).

19 *See* the discussion under VII.(A) and XI.(C) of our Memorandum of Law dated May 31, 2002 for ISDA on the enforceability of close-out netting under the Agreements, the 1987 Interest Rate and Currency Exchange Agreement and the 1987 Interest Rate Swap Agreement.

20 Official Journal no. L 125 of May 5, 2001, pp. 15 *et seq.*

21 Official Journal no. L 110 of April 20, 2001, pp. 28 *et seq.*

The following discussion of the substantive law applicable to netting agreements under the existing system of German international insolvency laws describes the legal position solely in respect of Insolvency Proceedings for which the petition for the institution of such proceedings has been, or will be, filed on or after March 20, 2003.[22]

(B) The Regulation

(1) Summary

The Regulation applies where (i) the German party is not a Financial Institution (as defined under VI.(B)(2)(a) below) and (ii) the counterparty is established in a Regulation State. Where the Regulation applies, German substantive insolvency law is to be applied with respect to the enforceability of close-out netting under the Agreements.

(2) Application of the Regulation

The Regulation applies to Insolvency Proceedings (as defined under VII.(B)(1) below)[23] opened against a Regulation Debtor (as defined below) insofar as they have a cross-border effect in a Regulation State. Insofar as such proceedings have a cross-border effect in a State which is not a Regulation State, the provisions on international insolvency law set out in §§ 335 to 358 of the Insolvency Code apply (*see*, under VI.(C) below).

(a) Regulation Debtor

The Regulation applies to any debtor (hereinafter referred to as "**Regulation Debtor**"):-

(i) which has the center of its main interests situated within the territory of a Regulation State[24] which, in the case of a company or legal person, is presumed to be the place of its registered office (Article 3(1), second sentence, of the Regulation); and

(ii) which is neither

- a *credit institution*,

  which means, in accordance with Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential

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22 With regard to German international insolvency laws applicable to insolvency proceedings for which petitions for the institution of such proceedings have been filed before March 20, 2003, *see*, our Memorandum of Law dated May 31, 2002 for ISDA on the enforceability of close-out netting under the Agreements, the 1987 Interest Rate and Currency Exchange Agreement and the 1987 Interest Rate Swap Agreement.

23 Insolvency Proceedings under German law are listed in Annex A of the Regulation and, thus, qualify for application of the Regulation (Article 1(1), 2(a)).

24 *Cf.* Article 3(1), first sentence, of the Regulation.

requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012[25], as amended, (**"EC Banking Regulation"**) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account;

- *an investment undertaking which provides services involving the holding of funds or securities for third parties,*

  where "*investment undertaking*" means, in accordance with Article 4 no. 1 of the Council Directive 2004/39/EC of April 21, 2004 on markets in financial instruments amending Council Directives 85/611/EEGC and 93//EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC[26], as amended, any legal person the regular occupation or business of which is the provision of investment services for third parties on a professional basis;

- a *collective investment undertaking,*[27]

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25 Official Journal no. L 176 of June 26, 2013, pp. 1 *et seq.*

26 Official Journal no. L 145 of April 30, 2004, pp. 1 *et seq.* .

27 It is the general view that, despite the term "collective investment undertaking" used in Article 1 (2) of the Regulation, the Regulation refers by such term to undertakings for collective investment in transferable securities (*i.e.* UCITS) within the meaning of Article 1(1) and (2) of the UCITS Directive (*see* the definition below), *cf.* Virgos/Schmit, Erläuternder Bericht zu dem EU-Übereinkommen über Insolvenzverfahren, in: Stoll (ed.), Vorschläge und Gutachten zur Umsetzung des EU-Übereinkommens über Insolvenzverfahren im deutschen Recht, 1997, pp. 32, 55 with respect to Article 1(2) of the 1995 draft European Convention on Insolvency Proceedings which is identical with the Article 1(2) of the Regulation; Moss/Fletcher/Isaacs (eds.), The EC Regulation on Insolvency Proceedings, 2002, note 8.08; Reinhart, in Münchener Kommentar zur Insolvenzordnung, 2nd ed. 2008, Article 1 EUInsVO, note 6; Duursma-Kepplinger et al. (ed.), Europäische Insolvenzverordnung, 2002, Article 1, note 45; Smid, Deutsches und Europäisches Internationales Insolvenzrecht, 2004, p. 27 note 33 *et seq.*; Wimmer, in Wimmer (ed.), Frankfurter Kommentar zur Insolvenzordnung, 6th ed. 2011, Annex I Art. 1 EUOInsVO note 5; Mincke, in Nerlich/Römermann, Insolvenzordnung, 25th supp. (July 2013), Article 1 EUInsVO, note 9 *et seq.* We note that in the UCITS Directive the term "collective investment undertaking" is used for such undertakings which are not UCITS and, accordingly, are not covered by the UCITS Directive (*see* Article 1(5)). However, the general view described above is supported by the following: As set out in the report by Virgos and Schmit (*see* above, note 54), the rationale behind the exceptions provided in Article 1(2) of the Regulation is to exclude such entities which are subject to (i) specific EC regulations and (ii) supervision by regulators in EC Member States. Collective investment undertakings which are not UCITS are neither subject to EC regulations nor in all cases subject to supervision in EC Member States (for example, collective investment undertakings of the closed-end type under German law). Further, as opposed to the other terms used in the exceptions provided in Article 1(2) of the Regulation, the term "collective investment undertaking" is not defined in any EC regulation. Therefore, the better arguments support the view that Article 1(2) of the Regulation refers to UCITS when using the term "collective investment undertaking". It must be noted, however, that due to the lack of any court precedents a certain degree of uncertainty remains. On the basis of the aforementioned interpretation the further question arises whether the exception in Article 1(2) of the Regulation in respect of UCITS also applies if, for example, a German management company manages investment funds, some of which qualify as UCITS and some of which do not. With respect to such cases the proper proposition appears to be that the exception in Article 1(2) of the

which means, in accordance with Article 1(2) of the Council Directive 2009/65/EC of July 13, 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities[28], as amended ("**UCITS Directive**"), undertakings (i) the sole object of which is the collective investment in transferable securities and/or other liquid financial assets referred to in Article 1(2) of the UCITS Directive[29] of capital raised from the public and which operate on the principle of risk-spreading, and (ii) the units of which are, at the request of holders, re-purchased or redeemed, directly or indirectly, out of those undertakings' assets ("**UCITS**");[30] nor

- an *insurance undertaking* (Article 1(2) of the Regulation),

  which means an undertaking which has received official authorization in relation to direct non-life assurance and direct life assurance in accordance with certain EC Directives addressing insurance businesses.[31]

Credit institutions, investment undertakings which provide services involving the holding of funds or securities for third parties, collective investment undertakings and insurance undertakings are herein referred to as "**Financial Institutions**".[32]

Regulation already applies if at least one UCITS is managed by such management company. Again, there is no authority available in this regard. On the basis of this proposition, it is conceivable that the insolvency conflict rules applicable to management companies may change in time depending on whether only non-UCITS or UCITS (solely or together with non-UCITS) are being managed.

28 Official Journal no. L 302 of November 17, 2009, pp. 32 *et seq*.

29 Such assets include, *inter alia*, certain money market instruments, certain financial derivative instruments, certain deposits with credit institutions and certain units of UCITS.

30 Pursuant to Article 3 of the UCITS Directive, the following UCITS are not considered as UCITS within the meaning of the Directive: (i) UCITS of the closed-ended type; (ii) UCITS which raise capital without promoting the sale of their units to the public within the EC or any part of it; (iii) UCITS the units of which, under the fund rules or the investment company's instruments of incorporation, may be sold only to the public in non-EC Member States; and (iv) categories of UCITS prescribed by the regulations of EC Member States in which such UCITS are situated, for which the rules regarding (x) the investment policies of UCITS set out in Chapter VII of the UCITS Directive and (y) borrowing set out in Article 83 of the UCITS Directive are inappropriate in view of their investment and borrowing policies.

31 Article 6 of First Council Directive 73/239/EEC of July 24, 1973 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life assurance (Official Journal no. L 228 of August 16, 1973, pp. 3 *et seq*.) and Article 6 of First Council Directive 79/267/EEC of March 5, 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance (Official Journal no. L 63 of March 13, 1979, pp. 1 *et seq*.).

32 Regarding the interpretation of the above terms *see* Virgos/Schmit, Erläuternder Bericht zu dem EU-Übereinkommen über Insolvenzverfahren, *op. cit.*, p. 54 *et. seq.* with respect to Article 1 of the 1995 draft European Convention on Insolvency Proceedings which is substantially identical with the Article 1 of the Regulation.

(b) Cross-border Effect in a Regulation State

The Regulation applies to Insolvency Proceedings opened against a Regulation Debtor insofar as such proceedings have a cross-border effect in a Regulation State.[33] This is the case if the Regulation Debtor has assets which are situated in the territory of at least one other Regulation State.[34]

Pursuant to Article 2(g), third indent, of the Regulation, claims are situated in the Regulation State within the territory of which the party required to meet them has the center of his main interests. In the case of a company or legal person, this is presumed to be the place of its registered office (Article 3(1), second sentence, of the Regulation).

Accordingly, with respect to a German party to an Agreement, Insolvency Proceedings have a cross-border effect in a Regulation State if the counterparty has the center of its main interests situated within the territory of a Regulation State other than Germany.

(3) Substantive Insolvency Law Applicable to Netting Agreements

Where Insolvency Proceedings fall under the Regulation in accordance with the discussion above, application of the Regulation is restricted to matters "closely connected" with such proceedings.[35] The enforceability of termination and close-out netting provisions providing for termination and close-out netting of agreements or transactions in the case of insolvency related events *prior* to the institution of Insolvency Proceedings should in our view constitute a matter closely connected with the insolvency proceedings.[36] Therefore,

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33 This is an implied requirement. However, it is reflected in various provisions of the Regulation on Insolvency Proceedings (*see*, for example, Articles 16(1) and 27(1)). *Cf.* Reinhart, in Münchener Kommentar zur Insolvenzordnung, *op. cit.*, Article 1 EUInsVO, notes 8 *et seq.*; Duursma-Kepplinger *et al.* (ed.), Europäische Insolvenzverordnung, *op. cit.*, Article 1, note 2 *et seq.*; Smid, Deutsches und Europäisches Internationales Insolvenzrecht, *op. cit.*, p. 20 note 6. Only Huber, ZZP 114 (2001), 133, 138 takes the view that any cross-border effect shall be sufficient for the application of the Regulation, irrespective of whether it takes place in a Regulation State.

34 It is not free from doubt whether a cross-border effect in a Regulation State may also be constituted through other links, *e.g.* contracts governed by foreign law to which the insolvent debtor is a party (*cf.* Reinhart, in Münchener Kommentar zur Insolvenzordnung, *op. cit.*, notes 12 *et seq.*). Given the fact that under the Regulation, as discussed under VI.(B)(3) below, German substantive insolvency law would fall to be applied even if this were true, this question does need to be decided in the context of this Memorandum.

35 *Cf.* recital 6 of the Regulation which reads: "In accordance with the principle of proportionality this Regulation should be confined to provisions governing jurisdiction for opening insolvency proceedings and judgments which are delivered directly on the basis of the insolvency proceedings and are closely connected with such proceedings. In addition, this Regulation should contain provisions regarding the recognition of those judgments and the applicable law which also satisfy that principle."

36 *See* the discussion in our Memorandum of Law dated May 31, 2002 for ISDA on the enforceability of close-out netting under the Agreements, the 1987 Interest Rate and Currency Exchange Agreement and the 1987 Interest Rate Swap Agreement.

we believe that, where Insolvency Proceedings fall under the Regulation, the Regulation will decide which substantive law applies on the enforceability of close-out netting under the Agreements.

Under the Regulation, the laws applicable to insolvency proceedings and their effects are those of the Regulation State within the territory of which such proceedings are opened (*lex fori concursus*) (Article 4(1) of the Regulation).

Article 6(1) of the Regulation contains an exception to this general rule with respect to set-off. It reads:

> "The opening of insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim."

Although close-out netting arrangements under master agreements for financial transactions involve set-off, we believe that Article 6(1) of the Regulation does not apply to arrangements which include other features than set-off. This is true for close-out netting arrangements because they include the valuation and conversion of transactions into commensurable claims.

This interpretation of Article 6(1) of the Regulation is supported by the fact that in relevant EC legislation special rules apply to netting agreements:

- Article 9 of the Regulation deals with netting agreements in the context of payment or settlement systems or financial markets;[37]

- The Directive on the Winding up of Credit Institutions contains, in addition to the general rule regarding set-off (Article 23(1)),[38] a specific rule in respect of "netting agreements" (Article 25) which reads: "Netting agreements shall be governed solely by the law of the contract which governs such agreements."

Therefore, the proper proposition would appear to be that Article 6(1) of the Regulation is not applicable to close-out netting arrangements under master agreements for financial transactions.[39] As a result, the general rule of Article 4(1) of the Regulation applies pursuant to which the law applicable to insolvency proceedings and their effects shall be that of the Regulation State in which such proceedings are opened. Hence, insofar

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37 *Cf.* recital 27 of the Regulation and Virgos/Schmit, Erläuternder Bericht zu dem EU-Übereinkommen über Insolvenzverfahren, *op. cit.*, p. 76 with respect to Article 9 of the 1995 draft European Convention on Insolvency Proceedings which is substantially identical with the Article 9 of the Regulation.

38 Such rule is substantially identical with the rule provided in Article 6(1) of the Regulation.

39 Some legal writers proposing that Article 6(1) does apply to netting agreements without discussing the divergent rules in relevant EC legislation disagree (*see*, von Wilmowski, WM 2002, 2264, 2277; Liersch, NZI 2003, 302, 305).

as Insolvency Proceedings over the assets of a German party fall under the Regulation in accordance with the discussion above, German substantive insolvency law is to be applied.

(C) §§ 335 to 358 of the Insolvency Code[40]

(1) Summary

The conflict rules of §§ 335 to 358 apply where (i) the German party is a Financial Institution or (ii) the German party is not a Financial Institution and the counterparty is established in a State which is not a Regulation State. Subject to the discussion and the reservations set out under VI.(C)(3)(b) below, where §§ 335 to 358 apply, close-out netting under the Agreements in the insolvency of the German party may take effect in accordance with the terms of the relevant Agreement and German substantive insolvency law will be without relevance for the enforceability of close-out netting under the Agreements in such circumstances.

(2) Application of §§ 335 to 358

The provisions on international insolvency law set out in §§ 335 to 358 apply to Insolvency Proceedings insofar as the Regulation does not apply.[41] Accordingly, these rules apply to Insolvency Proceedings:

(a) over the assets of a Financial Institution; or

(b) over the assets of a Regulation Debtor, provided that the proceedings do not have a cross-border effect in any Regulation State, but in a State which is not a Regulation State.

As discussed above (VI.(B)(2)(b)), Insolvency Proceedings have a cross-border effect in a Regulation State if the counterparty to the German party has the center of its main interests situated within the territory of a Regulation State other than Germany. Therefore, the conflict rules set out in §§ 335 to 358 apply if the counterparty to the German party has the center of its main interests situated in a State which is not a Regulation State.

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40 References in the following to a "§" or to "§§" are references to §§ of the Insolvency Code, unless otherwise indicated.

41 This is not expressly provided in §§ 335 to 358 of the Insolvency Code. However, pursuant to Article 249(2) of the Treaty Establishing the European Community, an EC regulation shall have general application and shall be binding in its entirety and directly applicable in all Member States. Any such regulation that conflicts with a provision of German law takes priority over such provision, even if such provision was enacted later than such regulation (Nettesheim in Grabitz/Hilf, Das Recht der Europäischen Union, Volume II, Article 249, notes 37 to 41; Bierwert, in Schwarze, EU-Kommentar, 2000, Article 249, note 7).

(3) Substantive Insolvency Law Applicable to Netting Agreements

On the basis of the same considerations as are set out above with respect to the Regulation,[42] we believe that, where applicable, §§ 335 to 358 determine the substantive law applicable to the enforceability of close-out netting even if the relevant provisions provide for termination and close-out netting of agreements or transactions in the case of insolvency related events *prior* to the institution of Insolvency Proceedings.

Where the conflict rules of §§ 335 to 358 apply, § 335 contains substantially the same general principle as Article 4(1) of the Regulation according to which the laws applicable to insolvency proceedings and their effects are those of the State within the territory of which such proceedings are instituted (*lex fori concursus*).

However, § 340(2) contains an exemption from this general principle relating, *inter alia*, to netting agreements.[43] The provision reads (in English translation) as follows:

> "The effects of insolvency proceedings on repurchase agreements within the meaning of § 340b of the Commercial Code and on netting agreements shall be governed by the law of the State which governs such agreements."

(a) Possible Interpretations of § 340(2)

It is questionable to which set of rules the wording "law of the State which governs such agreements" refers. No precedent of a German court and no developed rule of German law exists in respect of this question. Three different interpretations appear to be conceivable:

(1) § 340(2) points to the substantive insolvency laws of the State which law has been chosen by the parties to govern the relevant agreement.[44] In respect of the Agreements this would mean that either English or New York substantive **insolvency laws** are applicable, depending on whether English or New York law governs the relevant Agreement. German insolvency law would not be applicable;[45]

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42 *See*, VI.(B)(3) above.

43 The provisions of §§ 335 to 358 of the Insolvency Code contain also a provision regarding set-off (§ 338). For the reasons discussed above (VI.(B)(3)), we believe that § 340(2) of the Insolvency Code forms a *lex specialis* to § 338 of the Insolvency Code.

44 *See* Liersch in Braun (ed.), Insolvenzordnung, 5th ed., 2012, § 340 note 4 without detailed discussion of this issue. Although this is not free from doubt, this view seems to be shared by Stephan in Heidelberger Kommentar zur Insolvenzordnung, 7th ed., 2014, § 340 note 5 with no discussion at all.

45 Cf. Fried, in Zerey (ed.), Finanzderivate, 3rd ed., 2013, § 16 note 7; Jahn, in Münchener Kommentar zur Insolvenzordnung, *op. cit.*, § 340 note 7; Stephan, in Heidelberger Kommentar zur Insolvenzordnung, *op. cit.*, § 340 note 5; Kemper/Paulus, in Kübler/Prütting/Bork, Kommentar zur Insolvenzordnung, § 340 note 12; Wenner/Schuster, in Frankfurter Kommentar zur Insolvenzordnung, 6th ed., 2011, § 340 note 8 *et seq.*; Ehricke, WM 2006, 2109, 2111 *et seq.*

(2) § 340(2) refers solely to the contract law of the jurisdiction which law has been chosen by the parties to govern the relevant agreement. In respect of the Agreements this would mean that either English or New York **contract law** is applicable, depending on whether English or New York law governs the relevant Agreement. German insolvency law would not be applicable; or

(3) § 340(2) provides that in the event of the opening of insolvency proceedings close-out netting is governed solely by the **terms of the relevant agreement** without regard to any insolvency laws. In respect of the Agreements this would mean that close-out and liquidation would be governed by the terms of the relevant Agreement and will be enforceable in accordance with such terms. German substantive insolvency law would be without relevance for the enforceability of close-out netting under the Agreements in such circumstances.[46]

(b) Discussion

Neither the wording of the provision nor its legislative history provides conclusive guidance as to which of the above interpretations must be adopted.

The term "law" may be taken as reference to provisions of all areas of law which are applicable in a particular jurisdiction, including insolvency laws. The phrase "law of the State which governs an agreement" may be taken as reference solely to the contract law of the relevant jurisdiction. If the provision were to be read as though it would say "the law governing the effects of insolvency proceedings on netting agreements", the provision would have to be taken as a referral to the substantive insolvency laws of a particular jurisdiction.

The report of the Government submitting the Bill of the Act (*Begründung des Gesetzesentwurfs der Bundesregierung)* states with respect to § 340(2) that this provision aims to ensure predictability for the participants in the financial markets on the law that will apply upon the institution of insolvency proceedings against the counterparty to a close-out netting arrangement. This statement is not necessarily conclusive: Even if the general rule of § 335 were to apply according to which the laws applicable to insolvency proceedings are those of the State within the territory in which such proceedings are instituted (*lex fori concursus*), it could be predicted with certainty which law will apply upon the institution of insolvency proceedings against the counterparty to a close-out netting arrangement. Therefore, the introduction of a special rule deviating from the general principle as such does not enhance predictability in respect of the law applicable to a close-out netting arrangement upon the institution of insolvency proceedings.

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46 Cf. Schneider, Netting und Internationales Insolvenzrecht, in Kohler/Obermüller/Wittig (ed.), Kapitalmarkt - Recht und Praxis, 2006, p. 197 *et seq.*

§ 340(2) transforms into German law Articles 25 and 26 of the Directive on the Winding up of Credit Institutions on netting and repurchase agreements.[47] Article 25 of said Directive reads:

> "Netting agreements shall be governed solely by the law of the contract which governs such agreements."

The Directive on the Winding up of Credit Institutions does not provide any specific guidance in respect of the interpretation of this provision. However, such guidance can be found when taking account of relevant EC regulations and directives, in particular the Regulation, the Directive on the Winding up of Credit Institutions and the Directive 2002/47/EC of the European Parliament and of the Council of June 6, 2002 on financial collateral arrangements[48], as amended (the "**EC Collateral Directive**"). Although that is not explicitly expressed, the principal purpose of derogations from the general principle of the *lex fori concursus* in Article 4(1) of the Regulation and § 335 is to protect the expectation of parties that certain rights and contractual arrangements will be enforceable in accordance with a particular legal regime even if insolvency proceedings over the assets of the counterparty were opened. Thus, for instance, Article 6(1) of the Regulation (*see* VI.(B)(3) above) providing that the opening of insolvency proceedings shall not affect the rights of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim aims at protecting the expectation of a creditor to be able to effect set-off in accordance with the chosen law governing the relevant claim, irrespective of whether insolvency proceedings were opened.

With this purpose in mind, Article 25 of the Directive on the Winding up of Credit Institutions would not accomplish that purpose if it were read to provide that the contract law of the jurisdiction whose laws govern a close-out netting arrangement determines whether or not such arrangement may be enforced upon the opening of insolvency proceedings. If Article 25 would be read in that way, the expectation of parties that certain rights and contractual arrangements will be enforceable in accordance with a particular legal regime would not be protected where the relevant contract law should not address the enforceability of close-out netting arrangements in the context of insolvency proceedings.

More in line with the purpose of the derogations set out above, *i.e.* to protect the expectations of the parties, is Article 7(1) of the EC Collateral Directive which came in force later than the Directive on the Winding up of Credit Institutions. It provides that EC Member States shall ensure that a close-out netting provision can take effect in accordance with its terms notwithstanding the opening of insolvency proceedings over the assets of a party to the relevant contract.[49] This provision clearly means that the enforceability of con-

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47 However, whilst said directive does only apply to credit institutions, § 340(2) applies generally to all types of parties to netting agreements which are within the scope of application of the conflict of laws rules contained in §§ 335 to 358.

48 Official Journal no. L 168 of June 27, 2002, pp. 43 *et seq.*

49 Article 7(1) of the EC Collateral Directive reads as follows:

tractual close-out netting arrangements shall not be affected by insolvency proceedings over the assets of a party thereto. Instead, where such proceedings are being opened, such close-out netting arrangements shall be effective in accordance with the agreements between the parties without interference of any insolvency laws.

On the basis of this analysis, our conclusions are as follows:

(1) The interpretation of § 340(2) along the lines indicated under (1) above would lead to the result that the parties by subjecting their contract to a certain law may choose the applicable substantive insolvency laws. Such result would be highly irregular since, as a matter of principle, provisions of insolvency law form part of the public law of each jurisdiction and as such are excluded from a choice of law. Moreover, such result would not be in line with the purpose of this provision. As set out above, it follows from all relevant EC regulations and directives that derogations from the principle of *lex fori concursus* aim at protecting the expectations of parties regarding the enforceability of contractual arrangements in insolvency proceedings. From that perspective, a choice of an insolvency law other than the *lex fori concursus* may increase uncertainty regarding the applicability of a specific insolvency law regime, in particular where under the chosen insolvency law no insolvency proceedings over the assets of the relevant party may take place or the chosen law does not accept such choice of law.

(2) The interpretation of § 340(2) pursuant to (2) above seems to avoid the concerns which apply to the first way of interpretation. However, where the chosen contract law does not deal with the enforceability of close-out netting arrangements in the context of insolvency proceedings it would be uncertain which other rules should be applied. Thus, also the second way of interpretation of § 340(2) appears not be in line with the purpose of this provision, as derived from an interpretation of related EC regulations and directives.

(3) Under the interpretation of § 340(2) pursuant to (3) above close-out netting, in the event of insolvency proceedings, may take place in accordance with the very terms of the agreement between the parties. In such case no substantive insolvency laws would be applied and, consequently, would not interfere with the operation of the contractual close-out netting arrangement. Clearly, this interpretation is supported by the purpose of the provision, as in this case the expectations of the parties regarding the enforceability of close-out netting in the event of insolvency proceedings would be fully protected.

Although the matter is not free from doubt, the proper proposition appears to be that § 340(2) should be interpreted so as to provide that close-out netting is governed by

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"Member States shall ensure that a close-out netting provision can take effect in accordance with its terms:

(a) notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker; and/or

(b) notwithstanding any purported assignment, judicial or other attachment or other disposition of or in respect of such rights."

the relevant contractual arrangement and will be enforceable in accordance with the terms thereof, without interference by any substantive insolvency law. It must be noted, though, that any precedent of a German court or any developed rule of German law does not exist in this regard and that the legislative intent of the relevant EC regulations and directives cannot be determined with certainty.

Therefore, to the extent that not the Regulation, but the conflict rules of §§ 335 to 358 apply, we are proposing that § 340(2) should be interpreted to mean that close-out netting under the Agreements in the insolvency of the German party will take effect in accordance with the terms of the relevant Agreement.[50] German substantive insolvency law will be irrelevant for the enforceability of close-out netting under the Agreements in such circumstances.

(4) Requirement of an International Nexus

The conflict rules of §§ 335 to 358 make no express provision of whether or not these rules only apply where Insolvency Proceedings over the assets of the German party have an international (or cross-border) nexus and, if so, which factual elements would constitute such an international nexus. An international (or cross-border) nexus for the purposes of these rules does already exist where a contract to which the insolvent debtor is a party is governed by foreign law.[51] In other words, § 340(2) would also apply if two German parties enter into an Agreement governed by either English or New York law. This view is supported by the legislative intent of § 340(2) (see, VI.(C)(3)(b) above). Again, it must be noted that any precedent of a German court or any developed rule of German law does not exist in this regard.

VII. GERMAN INSOLVENCY LAW APPLICABLE

The following discussion under VII.(A) to (C) relates solely to circumstances where, according to the analysis set out under VI.(B)(3) and VI.(C)(3) above, German law is to be applied with respect to the enforceability of close-out netting under the Agreements.

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50 Although neither § 340(2) nor the underlying rule in Article 25 of the Directive on the Winding up of Credit Institutions provide guidance on the interpretation of the term "netting agreement", the Agreements in our view are covered by that term. Our view is supported by legislative history. The report of the Government (*Begründung des Gesetzesentwurfs der Bundesregierung*) submitting the Bill of the Act on the Regulation of International Insolvency Laws (*Gesetz zur Neuregelung des Internationalen Insolvenzrechts*), Bundestag-Drucksache 15/16, p. 20, refers in the context of § 340(2) to master agreements as are mentioned in § 104(2), third sentence. As a general rule, the Agreements constitute master agreements within the meaning of that provision (*see*, the discussion below under VII.(C)(2)(c)).

51 Stephan, in Heidelberger Kommentar zur Insolvenzordnung, *op. cit.*, note 5; Reinhart, in Münchener Kommentar zur Insolvenzordnung, *op. cit.*, introduction to Article 102 EGInsO, notes 1 and 3. *Cf.* also Jahr in Jaeger, Konkursordnung, 8th. ed., 1973, §§ 237, 238 notes 33 and 103.

(A) Recommendation to Agree on Automatic Early Termination

As follows from our conclusions under V.(B)(1) above, in order to preserve the full operation of the close-out netting rules of the Agreements in the event of Insolvency Proceedings being instituted in Germany over the assets of the German party (and to avoid application of § 104(2) and (3) of the Insolvency Code),[52] it is necessary to ensure that the Transactions under the Agreements terminate *before* the institution of Insolvency Proceedings where (i) the German party is not a Financial Institution and (ii) the counterparty is established in a Regulation State.[53] In such case, where the relevant Agreement is a Qualifying Master Agreement (as defined under VII.(C)(2)(c)(iv) below) close-out netting, in particular the determination of the positive and negative values, will be governed not by § 104(3) of the Insolvency Code, but by the provisions of the Agreements, and also an election of "Loss" in the case of a 1992 ISDA Master Agreement will be upheld.

We believe that termination of the Transactions before the institution of Insolvency Proceedings over the assets of the German party will be ensured if the parties to an Agreement agree, in respect of the German party, on Automatic Early Termination as of an insolvency related event which necessarily precedes the institution of the proceedings. We assume that under New York law or English law, being the laws which may govern an Agreement, Automatic Early Termination becomes effective on the date on which the earliest Event of Default referred to in Section 6(a), second sentence, occurs. In the practicalities of German insolvency law, Automatic Early Termination would, under Section 6(a), second sentence, then occur in the event of a petition for Insolvency Proceedings being filed. It is reasonable to expect that upon such petition by the relevant authority the insolvency court will forthwith institute the proceedings.

Therefore, we recommend that the parties to an Agreement agree on Automatic Early Termination to be applicable to German parties where (i) such German party is not a Financial Institution and (ii) the counterparty is established in a Regulation State, with the

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52 As will be discussed below, the full operation of the close-out netting rules of the Agreements in the event of Insolvency Proceedings being instituted in Germany over the assets of the German party will only be preserved in circumstances where the relevant Agreement is a Qualifying Master Agreement. Where the relevant Agreement is a Non-Qualifying Master Agreement, the selection by parties to a 1992 ISDA Master Agreement or a 2002 ISDA Master Agreement of "Automatic Early Termination" upon the Events of Default specified in Section 6(a), second sentence, to apply to the German party would not improve the legal position of the solvent party upon the institution of Insolvency Proceedings over the assets of such German party. As it might be subject to uncertainty whether an Agreement qualifies as a Qualifying Master Agreement, we recommend that the parties agree, in respect of the German party, on Automatic Early Termination in respect of all Agreements in respect of which such recommendation applies.

53 For the avoidance of doubt, in circumstances where, under the German international insolvency laws, close-out netting under the Agreements in the insolvency of the German party will be enforceable in accordance with the terms of the relevant Agreement without interference of German substantive insolvency law (*see*, the discussion under VI.(C)(3)(b) above), the recommendation that the parties agree, in respect of the German party, on Automatic Early Termination does not apply.

result that German substantive insolvency law is to be applied to the enforceability of close-out netting under the Agreements.[54]

(B) Some Relevant Principles of German Insolvency Law

Effective as from January 1, 1999, insolvency law in Germany is governed by the Insolvency Code of October 5, 1994, as amended, (*Insolvenzordnung* - "**Insolvency Code**"). With effect from such date, the Insolvency Code has replaced the hitherto existing German insolvency statutes, *i.e.*, the Bankruptcy Code of 1877 (*Konkursordnung*), the Code Concerning Judicial Composition of 1935 (*Vergleichsordnung*) and the East German Insolvency Act of 1990 (*Gesamtvollstreckungsordnung*).[55] The Insolvency Code governs all Insolvency Proceedings with respect to which a petition for the institution of such proceedings is filed after December 31, 1998, and, in the context of such proceedings, also applies to all legal relations and rights that were created before January 1, 1999.[56]

The Insolvency Code includes provisions with respect to close-out netting and liquidation of derivative transactions of the kind described in Appendix A hereto.[57]

(1) Insolvency Proceedings under the Insolvency Code

The only insolvency, composition or rehabilitation proceedings (which, for the purposes of this Memorandum, shall include proceedings in respect of the assets which a non-German party may have in Germany) to which a party to any of the Agreements may become subject in Germany are Insolvency Proceedings (*Insolvenzverfahren*) ("**Insolvency Proceedings**") which may take the form of: (i) winding up proceedings, which result in the complete liquidation of the insolvent entity and the realization of its assets; (ii) composition proceedings (*Insolvenzplanverfahren*) which serve to reduce the insolvent's liabilities in order to allow the insolvent to remain in business and rehabilitate its economic potential; and (iii) proceedings of self-management (*Eigenverwaltung*) which are not administered by a receiver, but by the insolvent debtor under the supervision of a trustee acting on behalf of the creditors.[58]

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54 It is worth noting in this context that the German Master Agreement for Financial Derivatives Transactions (*Rahmenvertrag für Finanztermingeschäfte*) provides for automatic termination as of insolvency related events which necessarily precede the institution of Insolvency Proceedings (*see*, Section 7(2) of said Master Agreement).

55 Article 2, 110(1) of the Introductory Code to the Insolvency Code.

56 Article 104 of the Introductory Code to the Insolvency Code.

57 These provisions are substantially similar to the statutory provisions that applied during the period from October 19, 1994 to December 31, 1998 and that were contained in Article 105 of the Introductory Code to the Insolvency Code of October 5, 1994, as amended (*Einführungsgesetz zur Insolvenzordnung*). *See*, our Memoranda of Law dated November 12, 1994, December 20, 1994, July 28, 1995 and March 12, 1998.

58 What will be said below in respect of the receiver applies *mutatis mutandis* to the insolvent debtor in the case of proceedings of self-management.

(a) Main and Secondary Insolvency Proceedings[59]

Insolvency Proceedings may be instituted[60] in Germany as main proceedings or as secondary proceedings affecting only the assets of a debtor which are situated in Germany.

(i) Main Insolvency Proceedings

Insolvency Proceedings may be instituted in Germany as main proceedings affecting all assets of a German party subject to secondary insolvency proceedings in other jurisdictions:-

(a) in the case of a German party where the proceedings have a cross-border effect in another Regulation State, over the assets of an entity having the center of its main interests situated within Germany (§ 3(1) of the Regulation)[61]; or

(b) in the case of (i) a German Financial Institution or (ii) a German party where the proceedings do not have a cross-border effect in another Regulation State, over the assets of any entity which has its principal office (*i.e.*, the center of its business activity (*Hauptniederlassung*)) or, in the absence of a principal office, its registered office (*Sitz*) in Germany (§ 3(1) of the Insolvency Code in connection with §§ 12 *et seq.* of the Civil Procedure Act (*Zivilprozeßordnung* - "**Civil Procedure Act**")).

(ii) Secondary Insolvency Proceedings[62]

Subject as set out below, secondary insolvency proceedings may be instituted in Germany:-

(a) in the case of a non-German party where the proceedings have a cross-border effect in another Regulation State, over the assets situated in Germany of an entity having the center of its main interests situated in a Regulation State other than Germany, provided that such entity possesses an establishment (that is any place of operations where such entity carries out a non-transitory economic activity with human means and goods[63]) within Germany (Article 3(2) of the Regulation);[64] and

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59 The terms "main insolvency proceedings" and "secondary insolvency proceedings" used in this paragraph are the terms used in the Regulation (*cf.* Article 3(3), first sentence and Article 27, first sentence). However, these terms designate different types of proceedings having different prerequisites depending on whether the Regulation or the conflict rules contained in the Insolvency Code apply.

60 *See*, footnote 2, above.

61 Pursuant to Article 3(1), second sentence, of the Regulation, in the case of a company or legal person, the place of the registered office shall be presumed to be the center of its main interests in the absence of proof to the contrary.

62 For further refinements regarding secondary insolvency proceedings, *see*, the discussion under VII.(F)(3) below.

63 Article 2(h) of the Regulation.

(b) in the case of (i) a non-German Financial Institution or (ii) a non-German party where the proceedings do not have a cross-border effect in a Regulation State, over the assets of any entity which has neither its principal office (*i.e.*, the center of its business activity (*Hauptniederlassung*)) nor, in the absence of a principal office, its registered office (*Sitz*) in Germany and whose assets are situated in Germany (§§ 354(1), 356(1) of the Insolvency Code).[65]

An exception applies to certain types of credit institutions[66] and insurance companies[67] having their registered office within the territory of (i) an EC Member State or (ii) another contracting state of the Agreement on the European Economic Area in respect of which no secondary insolvency proceedings may be instituted in Germany.

(b) Relevant Principles of Insolvency Proceedings

In general, Insolvency Proceedings may be instituted on grounds of: (i) insolvency (*Überschuldung* - § 19(1) of the Insolvency Code), provided, as a rule, that the debtor is a legal person; (ii) inability to pay (*Zahlungsunfähigkeit* - § 17(1) of the Insolvency Code); or (iii) "imminent" inability to pay (*drohende Zahlungsunfähigkeit* - § 18(1) of the Insolvency Code); provided, that (ii) and (iii) apply both to legal and non-legal persons (including partnerships such as oHG and KG).

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64 For further refinements regarding this exception *see*, the discussion under VII.(F)(3) below.

65 For further refinements *see*, the discussion under VII.(F)(3) below.

66 Credit institutions exempted pursuant to § 46e(2) of the Banking Act are CRR credit institutions (*CRR-Kreditinstitute*) having their registered office within the territory of either an EC Member State or another contracting state of the Agreement on the European Economic Area other than Germany. CRR credit institutions (*CRR-Kreditinstitute*) are defined, pursuant to § 1(3d), first sentence, of the Banking Act, as credit institutions within the meaning of Article 4(1) of the EC Banking Regulation, *i.e.*, undertakings whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account.

67 Insurance companies are, pursuant to § 88(1b) of the Insurance Supervisory Act, exempted from secondary insolvency proceedings except for (i) branches of insurance companies which have their registered office in a Non-member State (as defined below) and which are required to have a licence to operate in accordance with Article 6 of the Directive 73/239/EEC or Article 4 of the Directive 2002/83/EC if they had their registered office within the European Economic Area, (ii) branches of insurance companies which have their registered office in a Non-member State and wish to conduct the primary or re-insurance business in Germany through intermediaries and (iii) insurance companies which have their registered office in another EC Member State or another contracting state of the Agreement on the European Economic Area which are not subject to the EC directives relating to insurance business and wish to conduct direct insurance business through a branch. For the purposes of (i) and (ii) above, a "Non-member State" means each State (i) which is neither an EC Member State nor another contracting state of the Agreement on the European Economic Area or (ii) which is a quasi-state administrative entity with independent regulatory powers where the EC law provisions concerning the freedom of movement, of establishment and to provide services do not apply (§ 105(1), second and third sentence, of the Insurance Supervisory Act).

"Insolvency" exists if the liabilities of the debtor exceed its assets (§ 19(2) of the Insolvency Code), "inability to pay" exists if the debtor is not in the position to fulfill its payment obligations when due (§ 17(2), first sentence, of the Insolvency Code) - and is presumed to exist, as a rule, upon cessation of payments (*Zahlungseinstellung* - § 17(2), second sentence, of the Insolvency Code), "imminent inability to pay" exists if it may be anticipated that the debtor will not be in the position to meet its payment obligations when they will become due (§ 18(2) of the Insolvency Code).

Insolvency Proceedings are commenced by the filing of a petition for the institution of such proceedings (*Insolvenzantrag*) with the insolvency court.

Such petition may be made by the debtor or by any of its creditors, except that a petition on grounds of an "imminent inability to pay" may only be filed by the debtor. Upon the filing of such petition the competent insolvency court will decide by court order on the institution of the proceeding (*Insolvenzeröffnung*). Upon such institution, the insolvency court will, as a rule, appoint a receiver (*Insolvenzverwalter*).

Special rules prevail in the case of credit institutions, financial services institutions (in each case including German branches of entities established outside of Germany which are engaged in banking transactions or financial services), insurance companies, capital management companies (*Kapitalverwaltungsgesellschaften*) and certain public law entities.

In the case of credit institutions, financial services institutions, capital management companies (*Kapitalverwaltungsgesellschaften*)[68] and German branches of entities established outside of Germany[69] which are engaged in banking transactions or financial services[70], the petition for Insolvency Proceedings may be filed only by the Federal Financial Services Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*

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68 *See*, § 43(1) of the Capital Investment Code pursuant to which § 46b(1) of the Banking Act shall apply *mutatis mutandis*.

69 As set out under VII.(B)(1)(a)(ii) above, no secondary insolvency proceedings may be instituted in Germany over the assets of certain types of credit institutions having their registered office within the territory of (i) an EC Member State or (ii) another contracting state of the Agreement on the European Economic Area. Accordingly, no petition may be filed by the Financial Services Supervisory Authority with respect to German branches of such institutions.

70 The legal position described at the end of footnotes 5 and 8 above with respect to credit institutions and financial services institutions, pursuant to which the special rules regarding the institution of Insolvency Proceedings may not apply to some types of such institutions, also apply to their branches, with the exception of branches of CRR credit institutions (*CRR-Kreditinstitute*) and investment firms (*Wertpapierhandelsunternehmen*) organized in another State of the European Economic Area. CRR credit institutions (*CRR-Kreditinstitute*) are defined, pursuant to § 1(3d), first sentence, of the Banking Act, as credit institutions within the meaning of Article 4(1) of the EC Banking Regulation, *i.e.*, undertakings whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account. Pursuant to § 1(3d), fourth sentence, of the Banking Act, investment firms are institutions that are not CRR credit institutions and that conduct banking transactions within the meaning of § 1(1), sentence 2, no. (4) or (10) of the Banking Act (*see*, footnote 5 above) or financial services within the meaning of § 1(1a), sentence 2, nos. (1) through (4) of the Banking Act (*see*, footnote 8 above), unless the banking transactions or financial services are restricted to foreign exchange or units of account.

- "**Financial Services Supervisory Authority**"). In these cases, insolvency (*Überschuldung*) or inability to pay (*Zahlungsunfähigkeit*) constitute grounds for the institution of Insolvency Proceedings.[71] In the case of imminent inability to pay (*drohende Zahlungsunfähigkeit*),[72] the Financial Services Supervisory Authority may only file a petition for the institution of Insolvency Proceedings over the assets of the entities or branches mentioned above if the relevant entity gives its consent (§ 46b(1), fifth sentence, of the Banking Act).[73]

In the case of insurance companies (including insurance companies established outside Germany, but operating through a branch in Germany which carries on insurance business) the petition for Insolvency Proceedings may only be made by the appropriate insurance supervisory authority (§ 88(1) of the Insurance Supervisory Act) and only on grounds of insolvency (*Überschuldung*) or inability to pay (*Zahlungsunfähigkeit*).[74] In these cases, "imminent inability to pay" (*drohende Zahlungsunfähigkeit*) does not constitute grounds for the institution of Insolvency Proceedings over the assets of insurance companies.

Legal entities incorporated under public law and subject to the supervision of a German State (*Land*) are exempt from Insolvency Proceedings in Germany if the law of such State so provides (§ 12(1) no. 2 of the Insolvency Code). Under this rule, certain German insurance companies incorporated under public law are, by virtue of express statutory provisions, exempt from Insolvency Proceedings in Germany. Where a public law insurance company is exempt from Insolvency Proceedings, German insolvency law will not in any way interfere with the provisions of a netting agreement such as the Agreements. Where a public law insurance company is not exempt from Insolvency Proceedings, it will be treated as any other party to any of the Agreements as described herein.

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71 The insolvency court, upon such petition, may institute Insolvency Proceedings if it finds that the grounds for the institution of such proceedings prevail. The court order by which Insolvency Proceedings are instituted is subject to appeal by the credit institution or the financial services institution under § 34(2).

72 "Imminent inability to pay" exists in respect of credit institutions or financial services institutions if it may be anticipated that such institution will not be in the position to meet its payment obligations when they will become due (§ 46b(1), first sentence, of the Banking Act).

73 Where in respect of the relevant entity a financial holding company (*Finanzholding-Gesellschaft*) or a mixed financial holding company (*gemischte Finanzholding-Gesellschaft*), each of which is deemed to be a superordinated enterprise (*übergeordnetes Unternehmen*) pursuant to § 10a of the Banking Act exists, the petition by the Financial Services Supervisory Authority in such circumstances may only be filed if such financial holding company or mixed financial holding company gives its consent, (§ 46b(1), fifth sentence, of the Banking Act.

74 As set out under VII.(B)(1)(a)(ii) above, no secondary insolvency proceedings may be instituted in Germany over the assets of certain types of insurance companies having their registered office within the territory of (i) an EC Member State or (ii) another contracting state of the Agreement on the European Economic Area. Accordingly, no petition may be filed by the appropriate insurance supervisory authority with respect to German branches of such institutions.

(2) Other Proceedings

(a) Moratorium Proceedings

Credit institutions, financial services institutions and German branches of entities established outside Germany which are engaged in banking transactions or financial services[75] may become subject in Germany to proceedings of the Financial Services Supervisory Authority under § 46 of the Banking Act. Essentially the same rules apply under § 42 of the Capital Investment Code with respect to capital management companies (*Kapitalverwaltungsgesellschaften*).

Under § 46 of the Banking Act[76], the Financial Services Supervisory Authority may take appropriate action if the fulfilment of the obligations of a credit institution or a

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75 Article 3(1) of the Directive on the Winding up of Credit Institutions and Article 4(1) of the Directive on the Winding up of Insurance Undertakings provide with respect to "reorganization measures" (which term includes "measures involving the possibility of a suspension of payments", Article 2, seventh indent, of the Directive on the Winding up of Credit Institutions and Article 2(c) of the Directive on the Winding up of Insurance Undertakings) that only the competent authorities of the home Member State of the relevant credit institution or insurance company, as applicable, shall be entitled to decide on such reorganization measures with respect to such institutions. Both directives provide for the same principle with respect to the opening of insolvency proceedings with respect to such institutions (*cf.* footnotes 68 and 73 above). Whilst the provisions of both directives concerning the opening of insolvency proceedings (Article 9(1) of the Directive on the Winding up of Credit Institutions and Article 8(1) of the Directive on the Winding up of Insurance Undertakings) have been implemented in Germany, the provisions of both directives concerning "reorganization measures", including a payment moratorium, have not been implemented in German law. Accordingly, the Financial Services Supervisory Authority may take measures described in this paragraph also with respect to German branches of those financial institutions which fall under both directives (*see*, footnotes 65 and 66 above).

76 § 46(1) of the Banking Act provides as follows in the relevant part (in English translation):

"(1) If the performance by an institution of its obligations to its creditors, in particular the security of the assets entrusted to it, is jeopardized, or if there is reason to believe that effective supervision of the institution is not possible (§ 33(3) items 1 to 3), the Supervisory Authority may take provisional measures for the purpose of averting such jeopardy. In particular, it may

1. make orders concerning the conduct of the management of the institution's operations;
2. prohibit the acceptance of deposits or moneys or securities from customers and the extension of credits (§ 19(1));
3. prohibit or limit the owners or managers in the exercise of their functions;
4. issue a temporarily order to the institution prohibiting disposals and payments;
5. order the closure of the institution for business with customers; and
6. prohibit the acceptance of payments not made in satisfaction of debts owed to the institution, unless the competent deposit protection scheme or scheme for the indemnification of investors undertakes to satisfy those entitled in full.

Resolutions regarding the distribution of profits shall be void to the extent that they contravene action taken pursuant to sentences 1 or 2. With respect to institutions not organized as sole propriefinancial services institution towards its creditors, in particular if the security of the assets entrusted to such institution, is jeopardized. In particular, the Authority may: (i) issue directives concerning the management of the institution's operations; (ii) prohibit or restrict the acceptance of deposits and the extension of credits; (iii) prohibit or restrict the managers' administration of the institution; (iv) issue a temporary order to the institution prohibiting disposals and payments and issue a payment moratorium (the "**Payment Moratorium**"); (v) order the closure of the institution for business with customers; and (vi) prohibit the acceptance of payments not made in satisfaction of debts owed to the institution, unless the competent deposit protection scheme or scheme for the indemnification of investors undertakes to satisfy those entitled in full.

If, prior to the commencement of Insolvency Proceedings, the appropriate insurance supervisory authority determines that an insurance company will be permanently unable to fulfil its obligations, it may, for purposes of avoiding Insolvency Proceedings, take any appropriate action under § 89(1) of the Insurance Supervisory Act, including the issuance of a Payment Moratorium.[77]

If the appropriate supervisory authority proceeds under § 46 of the Banking Act or § 89(1) of the Insurance Supervisory Act and issues a Payment Moratorium, such measure will lead to a temporary impediment to performance (*vorübergehendes Leistungshindernis*) with respect to any payment obligation that is or becomes due during the time of the Payment Moratorium.[78] However, pursuant to § 46d(3), third sentence, of the Banking Act § 340(2) of the Insolvency Act shall apply *mutatis mutandis* with respect to reorganization measures.[79] On the basis of the interpretation of this provision set out under VI.(C)(3)

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torships, managers who have been prohibited from exercising their functions shall be excluded from the management and representation of the institution for the duration of such prohibition. ... Rights which enable a manager in his capacity as shareholder or partner or in any other manner to take part in decisions regarding management of the institution may not be exercised for the duration of such prohibition."

77 § 89(1) of the Insurance Supervisory Act provides as follows in the relevant part (in English translation):

"(1) If it follows from an audit of the business and the financial position of any [insurance company] that such [insurance company] is permanently unable to fulfill its obligations, but it appears that the avoidance of an insolvency proceeding is required in the best interest of the insured, then the supervisory authority may determine by order whatever is necessary to that end, and may in particular require the representatives of the [insurance company] to change the basis of the business or otherwise to cure the deficiencies within a set period of time. All kinds of payments may temporarily be prohibited, including payments under insurance policies to the insured, the distribution of profits, in the case of life insurances also the repurchasing or crediting of insurance policies as well as advances with respect thereto."

The words "insurance company" in the above-quoted text have been put in square brackets because the German text speaks in those places of "enterprises" (*Unternehmen*); such term, however, refers in this context to nothing but insurance companies.

78 *See*, BGH WM 2013, 742.

79 § 46d(3), third sentence, of the Banking Act applies only to CRR credit institutions. CRR credit institutions (*CRR-Kreditinstitute*) are defined, pursuant to § 1(3d), first sentence, of the Banking Act, as credit institutions within the meaning of Article 4(1) of the EC Banking Regulation, *i.e.*,

above, that means that close-out netting under the Agreements upon taking of reorganization measures by the competent supervisory authority will take effect in accordance with the relevant Agreement and will not be affected by such measures.[80]

(b) Reorganization Proceedings

In addition to the proceedings discussed above, in circumstances where the stability of the financial system is endangered, credit institutions may become the subject of reorganization proceedings (*Reorganisationsverfahren*) under Act on the Reorganization of Credit Institutions (*Kreditinstitute-Reorganisationsgesetz* - the "**Reorganization Act**") which came into force on 1 January 2011.

Such reorganization proceedings may provide the basis to interfere with creditor's rights, in particular by reducing or postponing creditor's claims, as set out in a reorganization plan on which the relevant credit institution's creditors may decide by majority vote subject to court approval. § 13 of the Reorganization Act provides that (i) contractual arrangements with a credit institution which becomes the subject of such proceedings may not be terminated for a period beginning on the day on which the relevant credit institution institutes the proceedings by giving notice to the Financial Services Supervisory Authority in accordance with § 7 of the Reorganization Act until the end of the following business day and (ii) the occurrence of events of default or termination events are postponed until the end of this period. Where § 13 of the Reorganization Act applies to a German credit institution that is party to a 1992 ISDA Master Agreement or a 2002 ISDA Master Agreement, such application may prevent any automatic termination based on Section 5(a)(vii)(4) of the 1992 ISDA Master Agreements or on Section 5(a)(vii)(4) of the 2002 ISDA Master Agreement being effective until the end of the period described above. The same applies with respect to the designation of an Early Termination Date under an Agreement[81]It is, however, uncertain whether, and to what extent, § 13 of the Reorganization Act will affect contractual arrangements governed by a law other than German law. At present, there is no available legal authority on this issue. Given the

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undertakings whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account.

80 Assuming that German law would govern the Agreements and consequently apply to their construction and interpretation, it would be unlikely that a Payment Moratorium under § 46 of the Banking Act or § 89(1) of the Insurance Supervisory Act would constitute an insolvency-related event of default pursuant to Section 5(a)(vii); on the same assumption, however, failure to pay when due because of the imposition of the Payment Moratorium may constitute an event of default pursuant to Section 5(a)(i).

81 It is uncertain whether or not this provision will apply in all circumstances. § 23 of the Reorganization Act provides that the rules contained in the Insolvency Code aiming at protecting financial collateral arrangements shall apply *mutatis mutandis*. Pursuant to Article 7(1)(a) of the EC Collateral Directive Member States shall ensure that a close-out netting provision can take effect in accordance with its terms notwithstanding the commencement reorganisation measures in respect of the collateral provider and/or the collateral taker. If the rules contained in the Insolvency Code aiming at protecting financial collateral arrangements were interpreted in conformity with this provision of the EC Collateral Directive, § 13 of the Reorganization Act should not apply where a financial collateral arrangement exists with respect to the relevant Master Agreement. Any legal authority on this issue is not available.

legislative intent of § 13 of the Reorganization Act, we believe that this provision aims to interfere with all contractual arrangements of the relevant credit institution, irrespective of their governing law. However, it is for the law governing the relevant contractual arrangement (*i.e.*, in respect of a 1992 ISDA Master Agreement or a 2002 ISDA Master Agreement, English or New York law) to decide whether § 13 of the Reorganization Act will affect such contractual arrangement during reorganization proceedings (*Reorganisationsverfahren*) under the Reorganization Act.[82]

In addition, pursuant to §§ 48a of the Banking Act, which also came into force on 1 January 2011, assets of a credit institution which is in a crisis situation and poses a systemic risk may be transferred to another institution. In respect of such transfer proceedings § 48g(7) of the Banking Act provides (1) that contractual arrangements with a credit institution which is the subject of such proceedings may not be terminated, and cannot automatically terminate, solely because of the transfer and (2) that contractual provisions to the contrary are void. What has been said in respect of the effect of § 13 of the Reorganization Act on the automatic termination provisions of Section 5(a)(vii)(4) of the 1992 ISDA Master Agreements and Section 5(a)(vii)(4) of the 2002 ISDA Master Agreement, respectively, applies likewise to the effect of § 48g(7) of the Banking Act on these provisions. As with respect to § 13 of the Reorganization Act, it is uncertain whether and to which extent § 48g(7) of the Banking Act will affect contractual arrangements governed by a law other than German law. At present, there is also no available legal authority on this issue. What has been said above in respect of § 13 of the Reorganization Act applies *mutatis mutandis* in respect of the application of § 48g(7) of the Banking Act by the German courts.

Transfer proceedings under §§ 48a of the Banking Act may affect all or part only of the assets of a credit institution. With respect to partial transfer proceedings and contractual netting arrangements, § 48k(2), 3rd sentence, in connection with § 48j(5), 2nd sentence, of the Banking Act provides that a partial transfer relating to a master agreement (such as an Agreement) or one or more transactions thereunder may only be made in respect of the master agreement as a whole and to the effect that each of (i) the relevant master agreement, (ii) all transactions entered into thereunder and (iii) all claims resulting from such master agreement are being transferred.[83]

(C) The Effects of Insolvency Proceedings on the Agreements

(1) The Insolvency Related Events of Default of the Agreements

The Agreements, except for the 1987 ISDA Master Agreements, provide for Automatic Early Termination upon the occurrence of certain specified insolvency related

82 Although the matter is not free from doubt, this seems to follow from the reference in § 7(5), 2nd sentence, of the Reorganization Act to § 46d(3), 3rd sentence, of the Banking Act which in turn refers to § 340(2) of the Insolvency Code (with respect to this provision, see the discussion under VI.(C)(3) above).

83 The same applies *mutatis mutandis* in the event of a partial re-transfer of assets to the credit institution which has been subject to transfer proceedings under §§ 48a of the Banking Act, § 48j((5), 2nd sentence, of the Banking Act.

Events of Default, provided that the parties have agreed in the Schedule to "Automatic Early Termination"; in the case of the 1987 ISDA Master Agreements or, in the case of any of the other Agreements, if the parties have not agreed on "Automatic Early Termination", the Agreements provide for termination upon the occurrence of certain insolvency related Events of Default by the giving of not more than 20 days notice from the Non-defaulting Party to the Defaulting Party.

Where Automatic Early Termination applies in respect of any of the Agreements, termination of the Transactions thereunder, and the Early Termination Date, is likely to occur prior to the institution of Insolvency Proceedings over the assets of the German Party.

Any automatic termination based on Section 5(a)(vii)(4) of the 1992 ISDA Master Agreements would occur before the institution of Insolvency Proceedings over the assets of the German party. As has been explained, the institution of Insolvency Proceedings by order of the insolvency court is necessarily preceded by the filing of a petition for the institution of such proceedings. If, in the case of a German party which is neither a credit institution, financial services institution nor an insurance company, the petition is filed by such party itself, termination of the Transactions, and the Early Termination Date, occur "as of the time immediately preceeding ... the presentation of the ... petition" (Section 6(a) of the 1992 ISDA Master Agreements). If the petition is filed, in the case of a German party which is neither a credit institution, financial services institution nor an insurance company, by a creditor of that party or, in the case of a German credit institution, financial services institution or insurance company, by the Financial Services Supervisory Authority or the appropriate insurance supervisory authority, in either case termination of the Transactions, and the Early Termination Date, occur "as of the time immediately preceeding ... the presentation of the relevant petition", subject to the condition that the petition results in a court order by which Insolvency Proceedings are instituted and subject to the condition subsequent that the petition is not dismissed, withdrawn[84], stayed or restrained within 30 days of the filing of the petition. Termination is expressed to become effective as of the time immediately preceding the filing of the petition (Section 6(a) of the 1992 ISDA Master Agreements). Accordingly, in Insolvency Proceedings over the assets of a German party it appears to be ensured that termination of the Transactions made under the Agreements by reason of the occurrence of an Event of Default pursuant to Section 5(a)(vii)(4) of the 1992 ISDA Master Agreements, and the Early Termination Date, fall *before* the institution of the proceedings.

Likewise, any automatic termination based on Section 5(a)(vii)(4) of the 2002 ISDA Master Agreement would occur before the institution of Insolvency Proceedings over the assets of the German party. As has been explained, the institution of Insolvency Proceedings by order of the insolvency court is necessarily preceded by the filing of a petition for the institution of such proceedings. If, in the case of a German party which is neither a credit institution, financial services institution nor an insurance company, the petition is filed by such party itself, termination of the Transactions, and the Early Ter-

84 The term "discharged" used in Section 5(a)(vii)(4)(B) of the 1992 ISDA Master Agreements is not meaningful in German insolvency law. However, we assume that the withdrawal of the petition is covered by Section 5(a)(vii)(4)(B), if necessary in connection with Section 5(a)(vii)(8).

mination Date, occur "as of the time immediately preceeding ... the presentation of the ... petition" (Section 6(a) of the 2002 ISDA Master Agreement). If the petition is filed, in the case of a German party which is neither a credit institution, financial services institution nor an insurance company, by a creditor of that party, termination of the Transactions, and the Early Termination Date, occur "as of the time immediately preceeding ... the presentation of the relevant petition", subject to the condition that the petition results in a court order by which Insolvency Proceedings are instituted and subject to the condition subsequent that the petition is not dismissed, withdrawn[85], stayed or restrained within 15 days of the filing of the petition (Section 5(a)(vii)(4)(B)(II) of the 2002 ISDA Master Agreement). If the petition is filed, in the case of a German credit institution, financial services institution or insurance company, by the Financial Services Supervisory Authority or the appropriate insurance supervisory authority, termination of the Transactions, and the Early Termination Date, will become effective as of the time immediately preceding the filing of the petition (Section 6(a) of the 2002 ISDA Master Agreement). Accordingly, in Insolvency Proceedings over the assets of a German party it appears to be ensured that termination of the Transactions made under the Agreement by reason of the occurrence of an Event of Default pursuant to Section 5(a)(vii)(4)(A) or (B) of the 2002 ISDA Master Agreement, and the Early Termination Date, fall *before* the institution of the proceedings.

In summary: Where Automatic Early Termination applies under an Agreement, termination of the Transactions, and the Early Termination Date, will by necessity fall *before* the institution of Insolvency Proceedings over the assets of the German party.

(2) Termination and Liquidation under Master Agreements Prior to the Institution of Insolvency Proceedings

Such termination of the Transactions *before* the institution of Insolvency Proceedings over the assets of the German party may be inconsistent with the statutory provisions of the Insolvency Code regarding the termination and liquidation of financial transactions under master agreements.

(a) The Statutory Termination and Liquidation Rules Regarding Master Agreements

The statutory rules applicable to the termination and liquidation of financial transactions under master agreements are set forth in § 104(2) and (3) of the Insolvency Code.

§ 104(2) provides (in English translation):

"(2) If it was stipulated that obligations under financial transactions which have a market or an exchange price are due to be performed at a certain time or within a certain period of time, and if such time or the expiration of such period occurs after the institution of the Proceedings, then in lieu of performance only a claim for non-performance may be asserted. The term "financial transactions" shall include in particular transactions relating to:

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85 The term "discharged" used in Section 5(a)(vii)(4)(B)(II) of the 2002 ISDA Master Agreement is not meaningful in German insolvency law. However, we assume that the withdrawal of the petition is covered by Section 5(a)(vii)(4)(B)(II), if necessary in connection with Section 5(a)(vii)(8).

1. the delivery of precious metals;

2. the delivery of securities or similar rights, unless it is intended to acquire an interest in another enterprise for purposes of creating a permanent connection to such enterprise;

3. payments in any foreign currency or any currency unit;

4. payments the amount of which is determined, directly or indirectly, by the price of any foreign currency or any currency unit or the rate of interest on money claims or the price of other goods or services;

5. options and other rights for delivery or payments pursuant to Nos. 1 to 4 above; and

6. financial collateral arrangements within the meaning of § 1(17) of the Banking Act.[86]

If individual contracts regarding financial transactions are combined in a master agreement for which it has been agreed that, where grounds for the institution of insolvency proceedings exist, it may be terminated only in its entirety, then all such

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86 § 1(17) of the Banking Act reads (in English translation):

"Financial collateral arrangements within the meaning of this Act shall comprise cash, securities, money market instruments as well as credit claims within the meaning of Article 2(1), lit. o, of the Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements, as amended by the Directive 2009/44/EC [*i.e.*, pecuniary claims arising out of an agreement whereby a credit institution grants credit in the form of a loan], in each case including all rights and claims relating to such assets which have been provided as collateral either in the form of a security financial collateral arrangement or in the form of a title transfer financial collateral arrangement, as agreed between a collateral provider and a collateral taker both of which belong to one of the categories set forth in Article 1(2) letter (a) to (e) of the Directive 2002/47/EC of the European Parliament and of the Council of June 6, 2002 on financial collateral arrangements (Official Journal no. L 168, p. 43). If the collateral provider is a person or company which is mentioned in Article 1(2) letter (e) of the Directive 2002/47/EC, a financial collateral arrangement shall only exist where the collateral secures obligations arising from contracts, or the brokerage of contracts, relating to

(a) the purchase and sale of financial instruments;

(b) repurchase, lending and similar transactions relating to financial instruments; or

(c) loans for financing the purchase of financial instruments.

If the collateral provider is a person or company which is mentioned in Article 1(2) letter (e) of the Directive 2002/47/EC and owns shares of the collateral provider or shares in affiliated companies within the meaning of § 290(2) of the Commercial Code (*Handelsgesetzbuch*), this shall not constitute financial collateral arrangements; the time as of which the security is created shall be decisive. Collateral providers incorporated or organized in a jurisdiction other than an EC Member State shall be treated as collateral providers mentioned in sentence 1 to the extent that they are substantially equivalent to the entities and financial institutions listed in Article 1(2) letter (a) to (e)."

individual contracts shall constitute a single contract providing for reciprocal obligations within the meaning of §§ 103, 104. "[87] [88]

§ 104(2), third sentence, relates to master agreements. The cryptic wording of the provision notwithstanding, its intents and purposes are beyond doubt. The provision is to permit termination and close-out netting of "financial transactions" within the meaning of § 104(2), first and second sentences, in the event of the institution of Insolvency Proceedings where such "financial transactions" are entered into under a master agreement.

For ease of reference, § 104(2), third sentence, will in the following often be referred to as the "master agreement clause of § 104(2)".

The "claim for non-performance" pursuant to § 104(2), first sentence, is to be determined in accordance with § 104(3). § 104(3) reads (in English translation):

> "(3) The claim for non-performance shall be determined by the difference between the agreed price and that market or exchange price which on a date agreed upon between the parties, however, at the latest on the fifth business day after the institution of the proceedings prevails at the place of performance for contracts entered into with the stipulated performance time. If the parties do not stipulate such date, the second business day after the institution of the proceedings shall be the decisive date. The other party may assert such claim only as creditor in insolvency proceedings."

In respect of a master agreement and the transactions made thereunder, the combined effect of the master agreement clause of § 104(2) and of § 104(3) is as follows.

Upon the institution of Insolvency Proceedings all financial transactions qualifying under the master agreement clause that have been made under the master agreement as well as the master agreement itself, in as much as it relates to such qualifying transactions, are terminated by operation of law. The master agreement and such qualifying transactions are replaced by a single claim of the receiver or the solvent party, as the case may be, derived by the netting of the aggregate of the claims for compensation of one side against

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87 § 103 reads (in English translation):

> "(1) If a contract providing for reciprocal obligations has not or not fully been performed by the debtor and the other party at the time of the institution of insolvency proceedings, the receiver may perform the contract in lieu of the debtor and require performance from the other party.
> (2) If the receiver refuses to perform, the other party may assert a claim for non-performance only as a creditor in insolvency proceedings. If the other party requests the receiver to exercise his right of election, the receiver must promptly declare whether or not he demands performance. If he fails so to inform the other party, he may no longer require performance."

88 § 104(1) reads (in English translation):

> "(1) If it was stipulated that the supply of goods that have a market or an exchange price is to be performed at a fixed time or within a fixed period of time, and if such time or the expiration of such period occur after the institution of insolvency proceedings, then in lieu of performance only a claim for non-performance may be asserted."

those of the other. The amount of such claims for compensation are to be determined for each such qualifying transaction in accordance with the provisions of § 104(3). Under the terms of § 104(3), such claims equal the amount of the difference between the originally agreed price and that market or exchange price prevailing at the place of performance for contracts entered into with the stipulated performance time on a date agreed upon between the parties which may be not later than the fifth business day after the institution of the Proceedings. To the extent that the parties have not agreed upon such date, the second business day after the institution of the proceedings shall be the decisive date. The amount of the difference between the originally agreed price and such market or exchange price is to be calculated in Euro and the resulting balance derived from the netting of the aggregate claims is expressed in Euro.[89] A procedure for finding the market price under § 104(3) is not prescribed. The rules of § 104(3) apply irrespective of whether or not the relevant party has suffered actual loss or has entered into a replacement transaction. Neither side is entitled to be compensated for actual loss or otherwise.

The single claim of the solvent party arising under § 104(2) and (3) constitutes an ordinary claim in insolvency, notwithstanding the fact that it arose by the very fact of the institution of the proceedings, and consequently shares in distribution, if any, to the ordinary creditors of the insolvency estate.

The single claim arising under § 104(2) and (3), being a claim created by German insolvency law, is governed by German law, even if the master agreement and the transactions made thereunder are validly governed by a foreign law.

(b) The Mandatory Nature of the Statutory Termination and Liquidation Rules

(i) § 119 of the Insolvency Code

The statutory provisions of § 104(2) and (3) regarding the termination and liquidation of financial transactions under master agreements are mandatory.[90]

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89 With regard to the question whether the single claim pursuant to § 104(3) is denominated in domestic currency, *see*, Bosch, Finanztermingeschäfte in der Insolvenz - Zum "Netting" im Insolvenzverfahren-, WM 1995, 365, 415; Bosch, Differenz- und Finanztermingeschäfte nach der Insolvenzordnung, Kölner Schrift zur Insolvenzordnung, 1997, 775, 783. The Report of the Judiciary Committee of the Bundestag states with respect to the provisions in the Goverment's Bill that became Article 15(2) of the Financial Markets Act (which corresponds nearly verbatim with § 104(2)): "The claim for the balance which is to be calculated under subsection (3) is per se denominated in DM." (Bericht des Rechtsausschusses, BT-Drucksache 12/7302, p.168).

90 We note that Article 7(1) of the EC Collateral Directive (*see* footnote 48 above) requires EC Member States to ensure that a close-out netting provision can take effect in accordance with its terms (a) notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker and/or (b) notwithstanding any purported assignment, judicial or other attachment or other disposition of or in respect of such rights. The mandatory nature of the statutory liquidation rules set forth in § 104(3) appears to be in contradiction to the above-mentioned requirement since these rules, upon the institution of Insolvency Proceedings, would prevail over any contractual liquidation rules contemplated in a close-out netting arrangement. It may be concluded, therefore, that Article 7(1) of the EC Collateral Directive has not been fully implemented into German law.

The parties may therefore not validly agree that the master agreement shall not be affected by the institution of Insolvency Proceedings (*e.g.* that the agreement shall continue in force beyond the institution of the proceedings, or that upon such institution it shall terminate only if the solvent party gives notice to that effect or otherwise) or that, upon termination as a result of the institution of Insolvency Proceedings, the claims for compensation shall be determined otherwise than in strict compliance with § 104(3).[91]

The mandatory nature of § 104(2) and (3) derives from § 119 of the Insolvency Code. § 119 reads in English translation:

> "Agreements which include or limit in advance the application of §§ 103 to 118 shall be void."

After the introduction of the Insolvency Code in 1999, the prevailing view in legal literature and amongst legal practitioners was that the mandatory character of § 104(2) and (3) is only of narrow application. According to this view, it did not constitute a violation, or illegal circumvention, of § 104(2) to provide that a master agreement and the financial transactions thereunder shall terminate before the institution of Insolvency Proceedings as a result of the occurrence of an insolvency-related event, with the ensuing result that § 104(2) and (3) do not apply.

Such view was based on legislative history. The Government's Bill for the Insolvency Code included a further provision to the provision that eventually became § 119 of the Insolvency Code pursuant to which, *inter alia*, contractual arrangements for the automatic termination of, or granting the solvent party a right to terminate, a mutually unperformed contract providing for reciprocal obligations upon the institution of Insolvency Proceedings were null and void.[92]

This further provision of the Government's Bill was stricken in the parliamentary proceedings upon the initiative of the Judiciary Committee of the Bundestag. The Report of the Judiciary Committee states in this context:

> "Subsection (2) of the Government's Bill has been stricken by the Committee. The validity of contractual arrangements pursuant to subsection (2) which provide for the termination of contracts providing for reciprocal obligations upon the institution

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91 Although this is, as we believe, free from doubt, it should be mentioned that some writers in legal literature disagree (Jahn in Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, Vol. III, 4th ed., 2011, § 114, note 122; Meyer in Smid, Insolvenzordnung, 3rd ed. 2010 § 104, note 36 *et. seq.*; Ebenroth/Benzler, ZvglRWiss 95 (1996), 335, 358 *et. seq.*).

92 Subsection (1) of § 137 of the Government's Bill became § 119 of the Insolvency Code. Subsection (2) of § 137 of the Government's Bill provided in the relevant part that:

> "Contractual arrangements which provide for the termination of, or grant the other party the right to terminate unilaterally, a contract providing for reciprocal obligations upon the institution of insolvency proceedings, shall be void ...".

of insolvency proceedings or upon the deterioration of the financial position of a party must not be restricted by the Insolvency Code. It is true that such contractual arrangements restrict indirectly the receiver's right to request or reject performance. However, that is not sufficient ground for such a grave encroachment upon the principle of freedom of contract...".[93]

This statement of the Report formed the basis of the view that the rule expressed in § 119 is of narrow application only. The Report expressly admits that an agreement automatically terminating a reciprocal contract upon the institution of insolvency may jeopardize the receiver's right to require performance. Nevertheless, the Report concludes that freedom of contract should prevail.

The legislative history, moreover, confirmed a long-established line of opinion applied by the courts under the German insolvency laws in force before January 1, 1999.[94]

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93 Report of the Judiciary Committee of the Bundestag (*Bericht des Rechtsausschusses*), BT-Drucksache, 12/7302, p.170.

94 While it has always been held that §§ 17 and 18 of the Bankruptcy Code (which have been replaced effective as from January 1, 1999 by the substantially identical provisions of §§ 103 and 104(1) of the Insolvency Code) are mandatory rules of law and that consequently any agreement directly derogating these provisions is null and void, nevertheless "indirect" derogations particularly of § 17 of the Bankruptcy Code have consistently been admitted by the courts. Thus, it has been the uncontested view among courts and commentators with regard to the former German insolvency laws that the parties to a contract otherwise falling under § 17 of the Bankruptcy Code may validly agree in their contract that events which necessarily precede the institution of Insolvency Proceedings entitle the solvent party to terminate the contract by giving notice prior to the institution of Insolvency Proceedings. In particular, it has been generally held that contractual arrangements are enforceable pursuant to which the occurrence of insolvency or the cessation of payments or the inability to pay debts when due or the making of a petition for the institution of Insolvency Proceedings, entitle the solvent party to terminate the contract by serving notice (Oberlandesgericht Düsseldorf ZIP 1981, 886; Heidland, Zeitschrift für Baurecht, 1975, 307; Jaeger-Henckel, Konkursordnung, 9th. ed., 1979, § 17 note 214; Henckel, JZ 1986, 297, 298). Moreover, the courts and legal commentators even have held with respect to the former German insolvency laws that a contract falling under § 17 of the Bankruptcy Code may validly provide that the solvent party may terminate the contract by giving notice upon the institution of bankruptcy proceedings. As early as in 1896, the German Supreme Court (*Reichsgericht*) stated "that it is permitted to provide that an agreement may be terminated upon the institution of bankruptcy proceedings over the assets of the other party" (JW 1896, 132), a principle which was universally accepted in the decades thereafter (BGH WM 1963, 964, 965; WM 1977, 849, 850; JZ 1986, 295, 296 Oberlandesgericht Düsseldorf ZIP 1981, 886; Jaeger-Lent, Konkursordnung, 8th ed. 1958, § 17 note 55b; Heidland, *loc. cit.*, 305; Ingenstau-Korbion, VOB, 13th ed., 1996 B § 8, Nr. 2, note 51). In the years preceding the introduction of the Insolvency Code, several leading commentators proposed that such contractual right of termination upon the institution of proceedings should not be upheld on the ground that it violates mandatory principles of bankruptcy law, in particular the receiver's right to require performance under § 17 of the Bankruptcy Code (Jaeger-Henckel, *loc. cit.*, note 214 to § 17; Kilger, Konkursordnung, 15th ed., 1987, § 17 note 8 id.; Rosenberger, Zeitschrift für Baurecht 1975, 233; Berger, ZIP 1994, 173 *et seq.* Berger, Lösungsklauseln im Insolvenzfall, in Kölner Schrift zur Insolvenzordnung, 1997, 375, 400, however, acknowledges the validity of contractual arrangements for the automatic termination of, or granting the solvent party a right to terminate, a contract, including master agreements, regarding financial transactions within the meaning of § 104(2) prior to the institution of Insolvency Proceedings, even if the event which gives rise to such termination is insolvency related). However, in 1985 the Federal Supreme Court (*Bundesgerichtshof*) rejected such proposition and sustained an early termination clause contained in a standard form construction contract entitling the customer to terminate the contract upon the institution of bankruptcy proceedings over the assets of the

(ii) Federal Supreme Court decision of November 15, 2012

In its decision dated November, 15 2012,[95] the Federal Supreme Court (*Bundesgerichtshof*) stated that an insolvency-related termination provision in a contract dealing with the supply of energy was to be found invalid. Such invalidity has been based on the argument that a contractual insolvency-related termination provision is incompatible with § 119 which, *inter alia*, protects § 103. Although dealing with a contract for the supply of energy, the Federal Supreme Court's judgment should be applicable to insolvency-related termination provisions of any other type of agreement as the Federal Supreme Court has stated the invalidity of such provisions in general.[96]

The Federal Supreme Court's reasons set out in the judgment may be summarized as follows: An insolvency-related termination provision is not valid if the application of § 103 stating the receiver's right of selection (*Wahlrecht des Insolvenzverwalters)* has been excluded in advance. According to the Federal Supreme Court, nothing different can be drawn from the legislative history of § 119: Although the Judiciary Committee of the Bundestag has declared itself in favor of the validity of insolvency-related termination provisions,[97] this endorsement can neither be found in the wording of § 119 nor of § 103. Additionally, the *ratio* of § 119 referring to § 103 is to be found in the protection and enhancement of the insolvency estate in the interest of an equal satisfaction of all creditors. According to the Federal Supreme Court, this content runs the risk of being circumvented when allowing the counterparty of the debtor to terminate a contract which is favorable for the insolvency estate. Additionally, the receiver's selection right in § 103 is pared back. In view of this, the Federal Supreme Court has held that insolvency-related termination provisions are in principle invalid.

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contractor and to claim compensation for non-performance from the contractor. The Court held that there was no provision of law which prohibited such a clause and concluded that contractual arrangements prejudicial to the estate should only be invalidated if and to the extent they fall under the provisions of voidability of legal transactions of the debtor pursuant to §§ 29 *et seq.* of the Bankruptcy Code. The Court explicitly recognized that subject to §§ 29 *et seq.* of the Bankruptcy Code "the receiver must accept the bankrupt's estate (including a contract which has not been fully performed by either party) in such state as it exists at the time of the institution of the bankruptcy proceedings" (BGHZ 96, 34, 37 *et seq.*). The Federal Supreme Court reconfirmed this position in a decision of November 1993 (BGH ZIP 1994, 40, 42; *see*, Berger, Lösungsklauseln im Insolvenzfall, in Kölner Schrift zur Insolvenzordnung, 1997, 375, 380, who takes the view, however, that the BGH dealt with the issue only as a "side remark").

95 BGH WM 2013, 274.

96 Römermann, NJW 2013, 1162; Raeschke-Kessler/Christopeit, WM 2013, 1592, 1596; with certain reservations also Obermüller, ZInsO 2013, 476, 480f.; Kliebisch/Linsenbarth, DZWiR 2013, 449, 455; Schwenk, jurisPR-BKR 5/2013 note 1; Stapper/Schädlich, NWB 2013, 1577, 1581; Feißel/von Hoff, EnWZ 2013, 184, 185; Braegelmann, KSI 2013, 259; Fischer, in WuB VI A. § 119 InsO 1.13. With a different tendency Jahn/Fried, in Münchener Kommentar zur Insolvenzordnung, *op. cit.*, § 104 note 169a. Huber, *ibid.*, § 119 note 40.

97 See Report of the Judiciary Committee of the Bundestag (*Bericht des Rechtsausschusses*), BT-Drucksache, 12/7302, p.170 and the discussion above.

The Federal Supreme Court has stated an exception which applies if the relevant contractual insolvency-related termination provision corresponds to a statutory termination right.[98] Whilst the Federal Supreme Court did not put in concrete terms what exactly a statutory termination right could be,[99] we believe that the provisions of § 104(1) and § 104(2) could be named as such exceptions.[100] § 104(1) provides for a statutory termination of transactions to be performed at a fixed time or within a fixed period of time upon the institution of Insolvency Proceedings and excludes the application of § 103.[101] Likewise, § 104(2) provides for a statutory termination of financial transactions upon the institution of Insolvency Proceedings and excludes the application of § 103. Within the scope of application of § 104(1) and § 104(2), there is no room for the receiver's selection right. However, § 104(1) is not relevant in the context of this Memorandum.[102]

Where a master agreement qualifying for application of § 104(2) provides for an insolvency-related termination, it provides for essentially the same legal result that would apply under the statutory termination provision of § 104(2). We believe that it would not matter that a contractual termination under the terms of such provision would apply prior to the institution of insolvency proceedings, whilst termination under the statutory termination rules would occur upon such institution.

98 BGH, WM 2013, 274, 275, no. 13.

99 In this context, the Federal Supreme Court refers to a previous decision of 2007 (BGH WM 2007, 409) which concerns a set-off arrangement in connection with a partnership agreement of a partnership organized under the Civil Code (*BGB-Gesellschaft*). It follows from § 736 of the Civil Code that a partnership agreement may provide that a partner shall be excluded from the partnership upon the institution of Insolvency Proceedings over its assets. The 2007 decision states that such termination provision does not contradict § 119. Cf. Huber in Münchener Kommentar zur Insolvenzordnung, 3rd ed., 2013, § 119 notes 30, 38; Huber, ZIP 2013, 493, 498.

100 With the same result Jahn/Fried, in Münchener Kommentar zur Insolvenzordnung, *op. cit.*, § 104 note 169a; Obermüller, ZInsO 2013, 476, 477; Knof, DB 2013, 1769, 1773: Stapper/Schädlich, NWB 2013, 1577, 1581; Feißel/von Hoff, EnWZ 2013, 184, 186; Raeschke-Kessler/Christopeit, WM 2013, 1592, 1596.

101 See footnote 87 above.

102 § 104(1) applies to transactions in respect of which the parties have agreed that the delivery obligations under such transactions may only be performed at a fixed time or within a fixed period of time. Generally, this requirement is not fulfilled where such obligations may also be performed during a certain grace period and the relevant contract may only be terminated after the expiry of such grace period. With respect to a failure to deliver, Section 5(a)(i) of the 1992 Master Agreements provides for a termination right if the relevant failure is not remedied on or before the third Local Business Day after notice of such failure is given to the relevant party. Section 5(a)(i) of the 2002 Master Agreement provides for a termination right if the relevant failure is not remedied on or before the first Local Delivery Day after _notice of such failure is given to the relevant party. Accordingly, the transactions falling under the categories described in Appendix A hereto do not qualify for application of § 104(1).

The above can be summarized as follows:

1. According to the Federal Supreme Court, contractual insolvency-related termination provisions are invalid, unless such provision corresponds to a statutory insolvency-related termination right.

2. § 104(2) in our view constitutes such statutory insolvency-related termination right. § 104(1) in our view also constitutes such statutory insolvency-related termination right, but this provision is not relevant in the context of this Memorandum.

3. An insolvency-related termination provision in a master agreement is thus valid if (i) it provides for essentially the same legal result that would apply under the statutory termination pursuant to § 104(2) and (ii) the relevant master agreement qualifies for the application of § 104(2).

Since the Federal Supreme Court remains silent on the concrete construction of an exception of the invalidity of contractual insolvency-related termination provisions, there is not yet any definitive legal authority regarding the above summary.

The Agreements provide in Section 5(a)(vii)(2) that in the event that a party becomes insolvent or unable to pay its debts all Transactions under the relevant Agreement shall be subject to termination, either automatically or by the giving of notice from the Non-defaulting Party to the Defaulting Party in the case of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement (see, Section 6(a) of such Agreements) or by the giving of notice to the Defaulting Party by the other party in the case of the 1987 ISDA Master Agreements (see, Section 6(a) of such Agreements). If such provision did not exist, termination of the Agreements would in such circumstances occur under the statutory termination rule of § 104(2) upon the institution of Insolvency Proceedings. As the overall result is the same, we believe that it does not matter that the termination under Agreements may or, where automatic early termination is selected, will occur prior to the institution of Insolvency Proceedings, *i.e.*, at an earlier point in time as under the statutory termination rule. Therefore, the insolvency-related termination provisions of the Agreements are valid if the relevant Agreement is within the scope of the statutory termination and liquidation rules of § 104(2) and (3).

(c) Master Agreements within the scope of the Statutory Termination and Liquidation Rules

In order to fall within the scope of the statutory termination and liquidation rules of § 104(2) and (3), a master agreement as such must qualify for the application of the statutory rules.

Pursuant to its express terms, the master agreement clause of § 104(2) applies to any master agreement only "for which it has been agreed that, where grounds for the institution of insolvency proceedings exist, it may be terminated *only in its entirety*" (italics supplied).

This requirement is also met if not the master agreement as such, but the transactions outstanding thereunder, may be terminated only in their entirety.[103]

The Agreements provide in Section 5(a)(vii)(2) that in the event that a party becomes insolvent or unable to pay its debts all Transactions under the relevant Agreement shall be subject to termination, either automatically or by the giving of notice from the Non-defaulting Party to the Defaulting Party in the case of the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreement (see, Section 6(a) of such Agreements) or by the giving of notice to the Defaulting Party by the other party in the case of the 1987 ISDA Master Agreements (see, Section 6(a) of such Agreements). We wish to observe that it is a matter of the respective laws governing the Agreements whether or not the grounds on which Insolvency Proceedings generally may be instituted, *i.e.* insolvency (*Überschuldung*) within the meaning of § 19(1), inability to pay (*Zahlungsunfähigkeit*) within the meaning of § 17(1) or "imminent" inability to pay (*drohende Zahlungsunfähigkeit*) within the meaning of § 18(1) (*cf.* VII.(B)(1)(b) above), are adequately covered by Section 5(a)(vii)(2), and we do not express any opinion as to such laws. We may note, though, that in our opinion, these grounds would in any event be covered by Section 5(a)(vii)(8). Accordingly, the Agreements in our view qualify as such for the application of the statutory termination and liquidation rules of § 104(2) and (3).

(i) Master Agreements with all transactions thereunder falling under § 104(2)

However, subject to the discussion under (ii) and (iii) below, the Agreements and the transactions thereunder would only fall within the scope of the statutory rules if the transactions under such agreement likewise qualify for the application of such rules. Under the master agreement clause of § 104(2) termination and liquidation of the transactions under a master agreement upon the institution of Insolvency Proceedings occur only in respect of those transactions which meet the - implied and expressed - requirements of § 104(2), first and second sentence.

These requirements are the following:

First: An implied requirement: The transaction must constitute a *contract providing for reciprocal obligations*. While it is necessary for financial transactions pursuant to § 104(2) which have not been made under a master agreement that such *contracts have not, or not fully, been performed by either party* at the time of the institution of Insolvency Proceedings, this latter requirement does not exist for financial transactions made under master agreements. Virtually all the transactions described in Appendix A hereto in our view constitute contracts providing for reciprocal obligations; they would fall under a master agreement that qualifies under § 104(2), even if they have been fully performed by

103 In fact, that is what was meant. The Report of the Judiciary Committee of the Bundestag states with respect to this requirement: "The criterion for the required close combination of the transactions is, in accordance with the usual master agreements, that in the event of a breach of contract it is possible to uniformly terminate *all transactions*" [Emphasis supplied] (Bericht des Rechtsausschusses, BT-Drucksache 12/7302, p. 168).

one side (*e.g.*, options or option-like transactions for which the premium has been paid by the option buyer to the option seller).[104]

Second: In order to fall under § 104(2), first and second sentence, a transaction must qualify as a "financial transaction" (*Finanzleistungen* – "**Financial Transactions**"). Examples of such "Financial Transactions" are mentioned in § 104(2), second sentence. The vast majority of the transactions falling under the categories described in Appendix A hereto do fall within one of these examples.

(a) **basis swap transactions, commodity forward transactions, commodity swap transactions, credit spread transactions involving a forward, cross currency rate swap transactions, equity swap transactions, forward rate transactions, freight transactions, fund swap transactions** and **interest rate swap transactions** constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

(b) **bond option transactions, equity option transactions** and **fund option transactions** constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with (i) No. 2 (if physical settlement is agreed) or (ii) No. 4 (if cash settlement is agreed) and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

(c) **bond forward transactions, equity forward transactions** and **fund forward transactions** with respect to which physical settlement is agreed qualify as Financial Transactions within the meaning of § 104(2), second sentence, No. 2. Bond forward transactions, equity forward transactions with respect to which cash settlement is agreed qualify as Financial Transactions within the meaning of § 104(2), second sentence, No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

(d) **bullion option transactions** constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with (i) No. 1 (if physical settlement is agreed) or (ii) No. 4 (if cash settlement is agreed) and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

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104 Palandt/Putzo, Bürgerliches Gesetzbuch, 73rd ed., 2014, note 17 before § 453; Obermüller, 7th ed., 2007, note 8.186; BGH WM 1984, 1598. Even where this German law-concept of two separate contracts is not recognized under the law applicable to a particular option, German courts would likely resort to this concept for purposes of classification of an option transaction under the Insolvency Code. See also Bosch, loc. cit. ("Netting"), 365, 416, 426 and loc. cit. ("Insolvenzordnung"), 775, 786 who proposes with reference to BGH WM 1984, 1598 that fully paid options providing for settlement by physical delivery, as distinct from cash settlement, are to be viewed as mutually unperformed contracts which are hence subject to § 104(2), but confirms that such different treatment of cash settled options on the one hand and options settled by physical delivery on the other is unsatisfactory.

(e) **bullion swap transactions** constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3. Bullion swaps in the form of cap, collar or floor transactions in respect of bullion qualify as Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

(f) **bullion trades** constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 1.

(g) **buy/sell-back transactions**, **repurchase transactions** and **securities lending transactions** constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 2 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

(h) **cap transactions, collar transactions, credit spread transactions involving an option, currency option transactions, equity index option transactions, floor transactions** and **interest rate option transactions** constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

(i) **commodity option transactions** in respect of which cash settlement is agreed constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3. If physical settlement is agreed, such transactions do not fall within one of the categories of Financial Transactions listed in § 104(2), second sentence;

(j) **currency swap transactions** and **foreign exchange transactions** constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 3;

(k) **economic statistic transactions** in respect of which the amounts payable are determined, directly or indirectly, by the price of other goods or services constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

(l) **emissions allowance transactions:**

(1) emissions allowance transactions which do not constitute a swap of emissions allowances or reductions or an option and in respect of which cash settlement is agreed constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3.

(2) if in respect of such transactions physical settlement is agreed, such transactions qualify as Financial Transactions within the meaning of § 104(2), second sentence, No. 2 to the extent that the relevant emissions allowances or reductions constitute "securities or similar rights" within the meaning of such provision.[105]

(3) emissions allowance transactions which constitute a swap of emissions allowances or reductions or an option and in respect of which cash settlement is agreed constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3.

(4) if in respect of such transactions physical settlement is agreed, such transactions qualify as Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with No. 2 to the extent that the relevant emissions allowances or reductions constitute "securities or similar rights" within the meaning of such provision;[106]

(m) **property index derivative transactions** structured in the form of a forward or a total return swap constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3. Property index derivative transactions structured in the form of an option constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3;

(n) **swap option transactions** in respect of which cash settlement is agreed constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 5 in connection with No. 4 and, to the extent that under such transactions payments in a foreign currency or a currency unit are owed, No. 3. Swap option transactions in respect of which (i) cash settlement is not agreed and (ii) the swap which is the subject of the option provide for Financial Transactions within the meaning of § 104(2), second sentence, No. 1 to 4, should constitute Financial Transactions within the meaning of § 104(2), second sentence, No. 5. With respect to this issue, no legal authority is available;

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105 Under the description of emissions allowance transactions in Appendix A hereto emissions allowances or reductions of any legal form are covered. Where emissions allowances or reductions are issued in the form of transferable securities, they would qualify as Financial Transactions within the meaning of § 104(2), second sentence, No. 2. Where emissions allowances or reductions are merely instruments under public law recorded in a register or have other legal form, there is no legal authority available whether such instruments constitute "similar rights" within the meaning of § 104(2), second sentence, No. 2. We believe that emissions allowances or reductions which are marketable instruments and are freely transferable should qualify as "similar rights" within such meaning.

106 See the discussion in the previous footnote.

(o) **total return swap transactions** in respect of which the financial instruments in relation to which the total return is calculated have a "price" within the meaning of § 104(2), second sentence, No. 4, qualify as Financial Transactions under this provision.

Exceptions apply to the following categories of transactions:

- **commodity option transactions** in respect of which physical settlement is agreed and **physical commodity transactions**. Such transactions are not mentioned in § 104(2), second sentence;

- **contingent credit default swaps, credit default swap options, credit default swaps, credit derivative transaction on asset-backed securities** and **swap deliverable contingent credit default swap transactions**. It is uncertain whether these transactions would fall in all circumstances within the scope of § 104(2), second sentence, as § 104(2) aims at preventing price speculations by the receiver (*Insolvenzverwalter*)[107] and not at preventing speculations in respect of the occurrence of a credit event;

- **economic statistic transactions** in respect of which the amounts payable are not determined, directly or indirectly, by the price of other goods or services. Such transactions are not mentioned in § 104(2), second sentence;

- **emissions allowance transactions** in respect of which physical settlement is agreed and where the relevant emissions allowances or reductions do not constitute "securities or similar rights" within the meaning of § 104(2), second sentence, No. 2.[108] Such transactions are not covered by this provision;

- **longevity/mortality transactions**. Such transactions are not mentioned in § 104(2), second sentence;

- **swap option transactions** in respect of which (i) physical settlement is agreed and (ii) the swap which is the subject of the option does not provide for Financial Transactions within the meaning of § 104(2), second sentence, No. 1 to 4. Such transactions are not covered by § 104(2), second sentence;

- **total return swap transactions** in respect of which the financial instruments in relation to which the total return is calculated do not have a "price" within the meaning of § 104(2), second sentence, No. 4; Such transactions are not covered by this provision; and

- **weather index transactions**. They are not mentioned in § 104(2), second sentence.

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107 Report of the Judiciary Committee of the Bundestag (Bericht des Rechtsausschusses), BT-Drucksache 12/7302, p.167.

108 See the discussion in footnote 100.

The Report of the Judiciary Committee of the Bundestag states that the examples of Financial Transactions which are mentioned in § 104(2), second sentence, are not meant to be an exhaustive list and other transactions may also constitute Financial Transactions for the purposes of § 104(2), depending on future developments in respect of such transactions.[109] However, neither the law nor legislative history provide any guidance according to which principles transactions not expressly mentioned in § 104(2), second sentence, may be considered to be Financial Transactions for the purposes of § 104(2). Moreover, there have been no court cases in this regard. It therefore cannot be determined with certainty whether or not the categories of transactions mentioned above as not covered by § 104(2), second sentence, constitute Financial Transactions for the purposes of § 104(2).

Third: A transaction must be dated in order to be subject to § 104(2), first and second sentence, because the provision requires that the transaction is "due to be performed at a certain time or within a certain period of time" (§ 104(2), first sentence). Undated transactions, *i.e.*, transactions for an undetermined period of time or transactions for which performance is due upon the giving of notice, are beyond the scope of application of § 104(2). Repurchase transactions entered into for an undetermined period of time or repurchase transactions for which performance is due upon the giving of notice, are not dated. Repurchase transactions which may be terminated on demand should in our opinion be viewed as dated transactions within the meaning of § 104(2) if provision has been made for a definitive date on which the securities have to be returned if a demand notice has not been given.

Fourth: A transaction must provide for a *settlement date* (or settlement dates) *falling after the institution* of Insolvency Proceedings if § 104(2) is to be applied to it (§ 104(2), first sentence): "... and if such time or the expiration of such period *occurs after* institution of the proceedings" - italics supplied).[110]

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109 The Report of the Judiciary Committee of the Bundestag (*Bericht des Rechtsausschusses*), BT-Drucksache 12/7302, p. 168.

110 Prior to the implementation of the EC Collateral Directive in German law which became effective on April 9, 2004, § 104(2) was headed "*Finanztermingeschäfte*" (in English translation: "financial forward transactions"). In view of this heading it was possible to argue that spot (or cash) transactions with settlement dates occurring one or two or more days after the trade date are not included. In our Memorandum of Law dated January 8, 2004 relating to the enforceability of close-out netting under the Agreements, we took the view, which was not confirmed by any precedent, that such an argument would be without merit in view of the wording of the provision itself, its legislative history and, most importantly, the legislative intent, and accordingly that spot (or cash) transactions with delivery dates occurring one or two or more days after the trade date should be included. Following the implementation of said Directive by the Act implementing the Directive 2002/47/EC of June 6, 2002 on financial collateral arrangements and amending the Mortgage Bank Act and other laws (BGBl. I 2004, p. 502 *et seq.*), the heading of § 104(2) has been changed to "*Finanzleistungen*" (in English translation: "financial transactions"). The report of the Government submitting the Bill of the Act (*Begründung des Gesetzesentwurfs der Bundesregierung*) implementing the Directive 2002/47/EC of June 6, 2002 on financial collateral arrangements and amending the Mortgage Bank Act and other laws (*Gesetz zur Umsetzung der Richtlinie 2002/47/EG vom 6. Juni 2002 über Finanzsicherheiten und zur Änderung des Hypothekenbankgesetzes und anderer Gesetze*, BT-Drucksache 15/1853, p. 14) states expressly that such change intends to clear up the argument described above according to which spot (or cash) transactions with settlement dates occurring one or two or

Fifth: In order to be subject to § 104(2), first and second sentence, a transaction must have "a market or an exchange price" (§ 104(2), first sentence). In accordance with the legislative intent, the term "market or exchange price" is to be construed broadly in order to give the widest possible effect to § 104(2). With respect to this requirement, the Report of the Judiciary Committee of the *Bundestag*[111] states with respect to the provisions in the Government's Bill that eventually became Article 15 of the Financial Markets Act (which is substantially the same as § 104(2)):

> "It is market practice in respect of some of the financial transactions included in subsection 2 for the parties to agree on individually negotiated structures... It follows from that that the term "market or exchange price" in the first sentence of subsection 2 *must be construed broadly*. What is decisive is that *the possibility* exists *to obtain cover elsewhere*; *it is in no way prejudicial that all offers do not match in respect of prices*." [Emphasis supplied]

Accordingly, a transaction would have a "market price" when it is possible to enter into a replacement transaction on equivalent terms in respect of the objects of the transaction as well as settlement dates, even if offers for the replacement transaction vary in prices.[112] The requirement of "a market or an exchange price" will in general be met, therefore, although it is conceivable that it may be wanting, for instance, for transactions involving non-convertible currencies; in such event they would be outside of the scope of application of § 104(2).

In summary it may be said that the vast majority of the transactions falling under the categories described in Appendix A hereto meet the requirements of § 104(2), first and second sentence, and therefore qualify for the application of the statutory termination and liquidation rules of § 104(2) and (3).

Exceptions apply to:

- (i) commodity option transactions in respect of which physical settlement is agreed, (ii) contingent credit default swaps, (iii) credit default swap options, (iv) credit default swaps, (v) credit derivative transaction on asset-backed securities, (vi) swap deliverable contingent credit default swap transactions, (vii) economic statistic transactions in respect of which the amounts payable are not determined, directly or indirectly, by the price of other goods or services, (viii) emissions allowance transactions in respect of which physical settlement is agreed and where the relevant emissions allowances or reductions do not constitute "securities or similar rights"

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more days after the trade date do not fall under § 104(2), first and second sentence. On this basis, the discussion set out in the earlier version of this Memorandum is no longer relevant.

111 Report of the Judiciary Committee of the Bundestag (Bericht des Rechtsausschusses), BT-Drucksache 12/7302, p. 168.

112 Köndgen, *op. cit.*, § 104 note 17; Wegener, in Wimmer (ed.), Frankfurter Kommentar zur Insolvenzordnung, *op. cit.*, § 104 note 14; Hess, *op. cit.*, § 104 note 65.

within the meaning of § 104(2), second sentence, No. 2,[113] (ix) longevity/mortality transactions, (x) physical commodity transactions; (xi) swap option transactions in respect of which (i) physical settlement is agreed and (ii) the swap which is the subject of the option does not provide for Financial Transactions within the meaning of § 104(2), second sentence, No. 1 to 4, (xii) total return swap transactions in respect of which the financial instruments in relation to which the total return is calculated do not have a "price" within the meaning of § 104(2), second sentence, No. 4 and (xiii) weather index transactions in respect of which it cannot be determined with certainty that they constitute Financial Transactions for the purposes of § 104(2); and

- repurchase transactions entered into for an undetermined period of time or repurchase transactions for which performance is due upon the giving of notice (other than repurchase transactions terminable on demand).

Such exempted transactions are referred to in this Memorandum as "**Non-Qualifying Transactions**".

(ii) Master Agreements with qualifying and non-qualifying transactions thereunder

Where the transactions entered into under a master agreement include both transactions which constitute Financial Transactions within the meaning of § 104(2), second sentence, and, thus, qualify for termination by operation of law under § 104(2) and Non-qualifying Transactions, the question arises in which way such master agreement will be treated with respect to the application of the statutory termination and liquidation rules.

This issue is not regulated by § 104(2). Hence, three different interpretations are conceivable. *First*, § 104(2) might divide the entire agreement, whereby the Financial Transactions would form a single agreement under § 104(2), sentence 3, which would be terminated under § 104(2) whilst the other transactions would be treated in accordance with §§ 103 and 104(1).[114] *Secondly*, § 104(2) might not be applicable to such master agreement as a whole. *Thirdly*, in light of the overall termination right contained in § 104(2), sentence 3, such master agreement might be subject as a whole to § 104(2), whereby §104(3) would apply *mutatis mutandis* to the transactions which do not constitute Financial Transactions for the purpose of the determination of the close-out net amount.

All three interpretations are defendable. This may only be different in exceptional circumstances where (i) under a master agreement only a single or very few transactions which qualify for termination by operation of law under § 104(2) exist and a large number of Non-qualifying Transactions or (ii) one or more transactions which qualify for termi-

113 See the discussion in footnote 100.

114 Wegener, in Wimmer (ed.), Frankfurter Kommentar zur Insolvenzordnung, op. cit., § 104 note 10; Ringstmeier, in K. Schmidt (ed.), InsO, 18th ed., 2013, § 104 note 26; von Hall, Insolvenzverrechnung in bilateralen Clearingsystemen, 2011, p. 152 *et seq.*, 201 *et seq.* With the same result also Lüer, in Uhlenbruck, InsO, 13th ed., 2010, § 104 note 36; Bornemann, in Graf-Schlicker (ed.), InsO, 3rd ed., 2012, § 104 note 30 and Knof, DB 2013, 1769, 1773 *et seq.*

nation by operation of law under § 104(2) are entered into evidently for the sole purpose that the relevant master agreement qualifies for the application of the statutory termination and liquidation rules.

The main argument against the first interpretation, *i.e.*, the splitting of the entire agreement, is that such division would lead to a contradiction. § 104(2), third sentence, would require an indivisible agreement, whilst simultaneously effecting the splitting of this agreement.

The second interpretation mentioned above does not take into account the legislative decision to exclude the receiver's right to assume or reject the performance of Financial Transactions.

Only the third interpretation mentioned above, *i.e.*, the overall termination of the agreement, seems to be closely in line with the purpose of § 104(2). The legislative intents of § 104(2) are to exclude "cherry picking" and price speculation by the receiver (*Insolvenzverwalter*) and to enable the solvent party to conclude hedging transactions in good time. In addition, an overall termination corresponds to the parties' intention as assumed in § 104(2), third sentence. § 104(2) is based on the legal assumption that any such intention is to be recognized in an insolvency situation. Overall termination of the contract thus conforms with the legislative purpose of § 104(2) when it recognises the assumed (typical) will of the parties in § 104(2), third sentence, thereof.

For the above reasons, we believe that, where the transactions entered into under a master agreement include both transactions which constitute Financial Transactions within the meaning of § 104(2), second sentence, and, thus, qualify for termination by operation of law under § 104(2) and transactions that do not so qualify, § 104(2) should be interpreted to the effect that any such master agreement as a whole will qualify for the application of the statutory termination and liquidation rules of § 104(2) and (3).[115]

We note, however, that no court rulings have yet been made in respect of this question of interpretation and the issue may be viewed differently in the exceptional circumstances discussed above.

(iii) Master Agreements with Qualifying Collateral Arrangements

In addition to (i) master agreements where all of the transactions under which fall within one of the categories of Financial Transactions listed in § 104(2), second sentence and (ii) master agreements under which qualifying and non-qualifying transactions are entered into, we believe that a third type of master agreements qualifies for the application of the statutory termination and liquidation rules of § 104(2) and (3).

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115 With the same resuult Jacoby, in Jaeger, InsO, 2014, § 104 note 55; Jahn/Fried, in Münchener Kommentar zur Insolvenzordnung, *op. cit.*, § 104 note 180; Jahn, in Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, *op. cit.*, § 114 note 141a; Fried, in Zerey, (ed.), Finanzderivate, *op. cit.*, § 19 note 29; Obermüller, ZInsO 2013, 476, 480; Kliebisch/Linsenbarth, DZWiR 2013, 449, 455.

Article 7(1) of the EC Collateral Directive requires EC Member States to ensure that a close-out netting provision can take effect in accordance with its terms, notwithstanding the commencement or continuation of winding-up proceedings in respect of the collateral provider and/or the collateral taker. A "close-out netting provision" is defined in Article 2(1)(n) of said Directive as

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

Article 7(1) of the EC Collateral Directive aims to protect collateral arrangements the terms of which provide that, upon termination of the agreement that is collateralised, the value of collateral provided may be combined with the secured claim into a single net claim.[116] Such arrangements are predominantly title transfer collateral arrangements where the collateral provider transfers full ownership of the relevant collateral to the collateral taker and, upon such transfer, acquires a conditional claim against the collateral taker for redelivery of equivalent assets. Such arrangements may also take the form of a security collateral arrangement, where the collateral taker only acquires a security interest in the collateral, if under the terms of such arrangement the collateral taker has the right to appropriate the collateral upon enforcement and the value of collateral so appropriated may be combined with the secured claim into a single net claim. Such types of collateral arrangements can only take effect upon the institution of insolvency proceedings against a party of the collateral arrangements if the relevant close-out netting provision is enforceable in such proceedings, as the value of collateral provided can solely be realized through such close-out netting mechanism.

This leads to the conclusion that close-out netting under an Agreement in respect of which a collateral arrangements qualifying under the EC Collateral Directive is entered

116 Cf. recital (14) of the EC Collateral Directive which reads: "The enforceability of bilateral close-out netting should be protected, not only as an enforcement mechanism for title transfer financial collateral arrangements including repurchase agreements but more widely, where close-out netting forms part of a financial collateral arrangement. Sound risk management practices commonly used in the financial market should be protected by enabling participants to manage and reduce their credit exposures arising from all kinds of financial transactions on a net basis, where the credit exposure is calculated by combining the estimated current exposures under all outstanding transactions with a counterparty, setting off reciprocal items to produce a single aggregated amount that is compared with the current value of the collateral."

into between the parties thereto is protected by Article 7(1) of the EC Collateral Directive. In order to qualify under the EC Collateral Directive, a collateral arrangement must meet the following requirements:

(a) each of the collateral taker and the collateral provider must belong to one of the categories set out in Article 1(2) of the EC Collateral Directive;[117]

(b) the financial collateral to be provided must consist of cash or financial instruments, see Article 1(4)(a) of the EC Collateral Directive; and

(c) the relevant arrangement must be evidenced in writing or in a legally equivalent manner, see Article 1(5) of the EC Collateral Directive (a collateral arrangement meeting such requirements, a "**Qualifying Collateral Arrangement**").

As a general rule, no requirements exist with respect to the type and nature of the transactions or agreements which are to be secured by such collateral arrangement.[118]

§ 104(2), second sentence, No. 6 lists financial collateral arrangements within the meaning of § 1(17) of the Banking Act (through which part of the EC Collateral Directive has been implanted in German law) as one of the categories of Financial Transactions. However, the statutory termination and liquidation rules of § 104(2) and (3) do not provide that close-out netting under a master agreement in relation to which a Qualifying Collateral Arrangement exists can take effect in accordance with its terms, as provided in Article 7(1) of the EC Collateral Directive. The general legal principle of interpretation of legal provisions in conformity with EC law (*Grundsatz der richtlinienkonformen Auslegung*) recognised in German law requires interpreting legal provisions in a manner that is consistent with provisions of EC Directives which EC Member States are required to implement. This means that the application of the statutory termination and liquidation rules of § 104(2) and (3) should include master agreements in relation to which a Qualifying Collateral Arrangement exists, irrespective of whether or not the transactions entered into under such master agreement constitute Financial Transactions within the meaning of § 104(2), second sentence.

We note, however, that no court rulings have yet been made in respect of the interpretation of § 104(2) in conformity with the requirements of the EC Collateral Directive.

(iv) Conclusions

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117 We refer to the discussion of these categories under B.1.(b) of our Memorandum of Law dated July 29, 2005 for the ISDA on the validity and enforcement of collateral arrangements under the ISDA Credit Support Documents in German Law, as updated by our letters to the ISDA dated January 12, 2007, September 28, 2007 and August 25, 2010 ("**Collateral Memorandum**").

118 Indirectly such requirement exists in circumstances where (i) the collateral taker belongs to one of the categories set out in Article 1(2)(a) to (d) of the EC Collateral Directive and (ii) the collateral provider (x) is not a natural person and (y) belongs not to one of the categories set out in Article 1(2)(a) to (d) of the EC Collateral Directive. See the discussion under B.1.(b)(ix) of the Collateral Memorandum.

In summary, the following types of master agreements are within the scope of the statutory termination and liquidation rules (in this Memorandum referred to as "**Qualifying Master Agreements**"):

(1) master agreements all or some of the transactions under which fall within one of the categories of Financial Transactions listed in § 104(2), second sentence (see the discussion under VII.(C)(2)(c)(i) with respect to master agreements all transactions under which are qualifying transactions for the purposes of § 104(2), second sentence and VII.(C)(2)(c)(ii) with respect to master agreements under which qualifying and non-qualifying transactions are entered into); and

(2) master agreements in respect of which a Qualifying Collateral Arrangement is entered into, including master agreements where none of the transactions under such master agreement falls within one of the categories of Financial Transactions listed in § 104(2), second sentence (see the see the discussion under VII.(C)(2)(c)(iii)).

It follows from the above that solely the following type of master agreement is outside the scope of the statutory termination and liquidation rules: Master agreements

(i) all of the transactions under which are Non-qualifying Transactions *and*

(ii) in respect of which *no* Qualifying Collateral Arrangement exists.

Such master agreements are referred to in this Memorandum as "**Non-Qualifying Master Agreements**".

It follows from the discussion in VII.(C)(2)(b)(ii) above that the insolvency-related termination provisions of the Agreements are valid if the relevant Agreement is a Qualifying Master Agreement. In such circumstances the rules set out in the Federal Supreme Court's decision of November, 15 2012 provide that the mandatory nature of § 104(2) may not be held to exclude the validity of contractual arrangements pursuant to which outstanding transactions under master agreements terminate prior to the institution of Insolvency Proceedings, even if the event which gives rise to such termination is insolvency related.

Likewise, in such circumstances the mandatory nature of § 104(3) regarding the determination of the amount of the compensation may not be construed so as to invalidate contractual arrangements. This follows from the fact that § 104(3), first sentence, itself permits such contractual arrangements in respect of the timing of the determination of the difference between the agreed price and that market or exchange price, subject to certain limitations, even if they have effect after the master agreement and the transactions thereunder have been terminated by operation of law under § 104(2) upon the institution of Insolvency Proceedings. Thus, contractual arrangements providing for other ways and methods of determining than § 104(3) in respect of the compensation in respect of transactions under master agreements which have terminated before the institution of Insolvency Proceedings are not invalid. The determination of the mutual compensation claims and the calculation of the single claim for the balance in compliance with § 104(3) is mandatory only where the master agreement and the transactions thereunder have terminated by operation of law under § 104(2) upon the institution of Insolvency Proceedings.[119]

In our opinion it is possible, therefore, to avoid the application of § 104(2) and (3) and thereby to preserve the provisions of a master agreement on termination and close-out netting if the parties agree on automatic termination as of an event which necessarily precedes the institution of Insolvency Proceedings, or if the master agreement is effectively terminated by notice of the solvent party before Insolvency Proceedings have been instituted. Agreement on automatic termination is necessary in order to ensure that termination occurs in all circumstances before the institution of the proceedings.

If financial transactions outstanding under a master agreement terminate (by virtue of notice having been given or automatically upon the occurrence of an insolvency-related event of default) before the institution of Insolvency Proceedings, the liquidation of the terminated transactions and the determination of the close-out balance owed by one party to the other are governed by the relevant provisions of the master agreement, provided that such provisions do not offend mandatory principles of German insolvency law. In our opinion, such principles will not be offended where closing gains or losses are determined for both parties on the basis of the same rules and such determination is not likely grossly to exceed the real gains or losses so that the net value under the transactions falling under the master agreement at the time of commencement of insolvency is essentially preserved to the estate and its creditors.

On the assumption that, with respect to an 1992 ISDA Master Agreement, the parties have selected the Second Method, Section 6(e) of the 1992 ISDA Master Agreements providing for the netting of the termination values in determining a single lump-sum termination amount and payment thereof by the Defaulting Party (if that amount is a positive number) or by the Non-defaulting Party (if that amount is a negative number) to the respective other party in our opinion does not offend mandatory principles of German insolvency law.

With respect to the 2002 ISDA Master Agreement, Section 6(e) of this Agreement provides for the netting of the termination values in determining a single lump-sum termination amount on the basis of commercially reasonable procedures, and payment of such amount by the Defaulting Party (if that amount is a positive number) or by the Non-defaulting Party (if that amount is a negative number) to the other party. Section 6(e) of the 2002 ISDA Master Agreement in our opinion does not offend mandatory principles of German insolvency law.

On the assumption that the parties have amended Section 6(e) of the 1987 Agreements to provide for full two way payments, the 1987 Agreements in our opinion do not offend mandatory principles of German insolvency law.

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119 Bosch, *op. cit.* ("Netting"), 365, 424; *loc. cit.* ("Insolvenzordnung"), 775, 798. Different view expressed by Köndgen in Kübler/Prütting (ed.), Insolvenzordnung, *op. cit.*, § 104, note 39.

(d) Master Agreements outside the scope of the Statutory Termination and Liquidation Rules

It follows from the discussion under VII.(C)(2)(b)(ii) above that the insolvency-related termination provisions of the Agreements are invalid if the relevant Agreement is a Non-Qualifying Master Agreement. In such circumstances, these provisions constitute an illegal circumvention of § 104(2) with leads to their invalidity pursuant to § 119.

As § 104(2) is inapplicable to a Non-Qualifying Master Agreement, the Transactions entered into thereunder will, upon the institution of Insolvency Proceedings, be subject to § 103 of the Insolvency Code under which the receiver may assume Transactions which are profitable for the insolvent party and reject Transactions which are not. With respect to rejected Transactions, the solvent party may assert a claim for non-performance only as a creditor in insolvency proceedings.

(3) Termination and Liquidation under Master Agreements Upon or After the Institution of Insolvency Proceedings

In order to determine the effects of the institution of Insolvency Proceedings on master agreements under which transactions do not terminate prior to the institution of the proceedings, it is necessary to distinguish between Qualifying Master Agreements and Non-Qualifying Master Agreements.

(a) Qualifying Master Agreements

In the case of a Qualifying Master Agreement, the transactions thereunder terminate by operation of law as of the time of the institution of Insolvency Proceedings. Liquidation of these transactions is determined by § 104(3), provided that the provisions of the relevant Agreement may be relevant for the timing of the determination of the difference between the agreed price and the market or exchange price, subject to the limitations of § 104(3), first sentence. Termination and liquidation pursuant to § 104(2) and (3) is statute based, not contract based. Subject as set out above, the provisions of the master agreement are inapplicable.

(b) Non-Qualifying Master Agreements

As § 104(2) is not applicable to a Non-Qualifying Master Agreement, the Transactions entered into thereunder will, upon the institution of Insolvency Proceedings, be subject to § 103 of the Insolvency Code under which the receiver may assume Transactions which are profitable for the insolvent party and reject Transactions which are not. With respect to rejected Transactions, the solvent party may assert a claim for non-performance only as a creditor in insolvency proceedings.

(D) Enforceability in Insolvency Proceedings of a Payment Claim in Foreign Currency

Payment claims in foreign currency against an insolvent party initially remain unaffected by the institution of Insolvency Proceedings. However, pursuant to § 45, second sentence, such claims, upon their recognition for purposes of participating in the distribution of any liquidation proceeds, are to be converted into Euro at the exchange rate which prevails at the place of payment at the time of the institution of Insolvency Proceedings. A claim of the solvent party under either the Cross Border Agreement or the 2002 ISDA Master Agreement for a net termination amount denominated in a currency other than Euro would, thus, only be enforceable in Insolvency Proceedings as so converted into Euro.

(E) Avoidance of Transactions

(1) Conflict of Laws

Where Insolvency Proceedings over the assets of the German party do not have any cross-border effect, German insolvency law applies to the avoidance of transactions.

Where such Insolvency Proceedings have a cross-border effect, the following conflict rules apply:

In the case of Insolvency Proceedings against a German party which is not a Financial Institution where the counterparty is established in a Regulation State (*i.e.*, where the Regulation applies), the general principle of Article 4(1) of the Regulation according to which the laws applicable to insolvency proceedings and their effects are those of the State within the territory of which such proceedings are instituted (*lex fori concursus*) applies also to the avoidance of transactions (Article 4(2)(m) of the Regulation).[120] However, Article 13 of the Regulation contains an exception to this general principle. Pursuant to that provision Article 4(2)(m) of the Regulation does not apply where the person who benefited from an act detrimental to all the creditors provides proof that (i) the said act is subject to the law of a Regulation State other than that of the State of the opening of proceedings and (ii) that law does not allow any means of challenging that act in the relevant case.

In the case of Insolvency Proceedings instituted over the assets of (i) a German party which is a Financial Institution where the counterparty is established outside of Germany or (ii) a German party which is not a Financial Institution where the counterparty is established in a State which is not a Regulation State (*i.e.*, where the conflict rules contained in §§ 335 to 358 of the Insolvency Code apply), §§ 335, 339 of the Insolvency Code apply which contain the same rules as the Regulation.

The following discussion relates solely to circumstances where German law is to be applied with respect to the avoidance of transactions because (i) the relevant Insolvency Proceedings do not have a cross-border effect or (ii) the person who benefited from an act detrimental to other creditors is unable to provide the proof described above.

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120 Pursuant to this provision the law of the State of the opening of Insolvency Proceedings determines also "the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors."

(2) German Insolvency Law Applicable

In the event of Insolvency Proceedings over the assets of the German party, the receiver may avoid any transaction (*Rechtshandlung*) made prior to the institution of the Insolvency Proceedings which adversely affects the position of the other creditors (§ 129(1)), if:

(i) such transaction is effected subsequent to the filing of the insolvency petition and results in, or puts the creditor in a position to obtain or seek, credit support (*Sicherung*) or satisfaction (*Befriedigung*), respectively, where the creditor has knowledge of the insolvency or the insolvency petition or of the relevant facts supporting a compelling conclusion with respect to such insolvency or insolvency petition (§ 130(1) no. 2);

(ii) such transaction is effected during a period of three months prior to the filing of the insolvency petition and results in, or puts the creditor in a position to obtain or seek, credit support or satisfaction, respectively, where the debtor is insolvent at the time of the transaction and the creditor has knowledge of such insolvency or of the relevant facts supporting a compelling conclusion with respect to such insolvency (§ 130(1) no. 1);

(iii) such transaction is effected during a period of one month prior to, or subsequent to, the filing of the insolvency petition and results in, or puts the creditor in a position to obtain or seek, credit support or satisfaction, respectively, which the creditor is not entitled to in such way or at such time or at all (§ 131(1) no. 1);

(iv) such transaction is effected during the second or third month prior to the filing of the insolvency petition and results in, or puts the creditor in a position to obtain or seek, credit support or satisfaction, respectively, which the creditor is not entitled to in such way or at such time or at all, where the debtor is insolvent at the time of such transaction (§ 131(1) no. 2) or the creditor has knowledge at the time of such transaction that it has adverse effects[121] on the ordinary creditors (*Insolvenzgläubiger*) of the debtor or has knowledge of the relevant facts supporting a compelling conclusion with respect to those adverse effects (§ 131(1) no. 3);

(v) such transaction is effected during a period of three months prior to the filing of the insolvency petition and results in immediate adverse effects on the position of the ordinary creditors of the debtor where at the time of such transaction the debtor is insolvent and the creditor has knowledge of, or of

121 Under similar provisions of the Bankruptcy Code, an "adverse effect" exists where the creditors cannot be satisfied out of the estate and the relevant transaction to be avoided, from an economic perspective, has prevented, made more difficult, endangered or delayed such satisfaction. *See, e.g.*, Bundesgerichtshof, ZIP 1996, 1516, 1518.

the relevant facts supporting a compelling conclusion with respect to, such insolvency (§ 132(1) no. 1);

(vi) such transaction is effected subsequent to the filing of the insolvency petition and results in immediate adverse effects on the ordinary creditors of the debtor where the creditor has knowledge of, or of the relevant facts supporting a compelling conclusion with respect to, the debtor's insolvency or the filing of the insolvency petition (§ 132(1) no. 2); or

(vii) such transaction is effected during a period of ten years prior to, or subsequent to, the filing of the insolvency petition where the debtor has the intention to adversely affect the position of its creditors and the creditor has actual knowledge of such intention (§ 133(1)) which knowledge is presumed to exist in the case that he has knowledge of the imminent insolvency of the debtor and the adverse effects caused thereby to the position of the debtor's creditors (§ 133(1), second sentence). Pursuant to § 132(2), transactions accompanied by immediate adverse effects on the position of the ordinary creditors include, without limitation, transactions that result in the forfeiture or unenforceability of a right of the debtor or in the preservation or enforceability of a liability of the debtor.[122]

Pursuant to the foregoing rules, a receiver's right to avoid transactions would, for instance, be given if the parties have, during a period of one month prior to the filing of an insolvency petition, entered into an Agreement in respect of Transactions made prior to the conclusion of the Agreement (§ 131(1) no. 1), or if the parties have, during the second or third month prior to the filing of an insolvency petition, entered into an Agreement in respect of Transactions made prior to the conclusion of the Agreement, provided that one of the parties is insolvent at the time of the conclusion of the Agreement (§ 131(1) no. 2) or the solvent party has knowledge at the time of the conclusion of the Agreement that it has adverse effects on the ordinary creditors of the other party or has knowledge of the relevant facts supporting a compelling conclusion with respect to those adverse effects (§ 131(1) no. 3).[123] It follows from all of the foregoing that the above-described provisions on avoidance of transactions will, as a rule, not be applicable if (i) the Non-defaulting Party has neither knowledge of an intention of the Defaulting Party to adversely affect the

122 In order to determine whether or not the debtor had the intention to adversely affect the position of his other creditors, the Federal Supreme Court in respect of the similar provision of § 31 no. 1 of the Bankruptcy Code has in several decisions distinguished whether or not the other party was entitled to receive satisfaction or security. If the other party was so entitled, the mere knowledge of the debtor that the fulfilment of his obligation will disadvantage the other creditors does not suffice. It must in addition be established that the debtor in granting satisfaction or security primarily intended to adversely affect the other creditors rather than to fulfil his obligation. It is likely in our view that this rule will also be applied by the courts under § 133 of the Insolvency Code (*cf.* Kreft, in Heidelberger Kommentar zur Insolvenzordnung, *op. cit.*, § 133 note 17 *et seq.*).

123 A commentator (Köndgen, in Kübler/Prütting, *op. cit.*, § 104 note 40) suggests that a set-off of contractual obligations on a date designated in a master agreement prior to the institution of insolvency proceedings will be generally subject to avoidance pursuant to § 131(1) no. 1 because it would put the solvent party in a position to obtain satisfaction which such party is not entitled to at such time.

position of the other creditors nor knowledge of an insolvency or an insolvency petition in respect of the Defaulting Party and (ii) if the Non-defaulting Party pursuant to the Agreement was entitled to receive the satisfaction made or the security given by the Defaulting Party.

(F) Multibranch Netting

(1) Assumptions

For the purposes of this paragraph, you have instructed us to assume the same facts as set out in III.1. to 6. above (as applicable) with the following modifications:

1. For the purpose of the first and third questions set forth below, we have been instructed to assume that a credit institution or financial services institution established in Germany (the "**German Institution**") has entered into an Agreement on a multibranch basis. In the 1987 Agreements, the German Institution was specified as a "Multibranch Party" and in the 1992 Agreements and the 2002 ISDA Master Agreement, the German Institution has specified that Section 10(a) applies to it. The German Institution then has entered into Transactions under such Agreement through its head office in Germany and also through one or more branches located in other jurisdictions that have been specified in the Schedule to the Agreement. After entering into these Transactions and prior to the maturity thereof, the German Institution becomes the subject of a voluntary or involuntary proceeding under the insolvency laws of Germany.

2. For the purpose of the second and third question set forth below, we have been instructed to assume that a bank ("**Bank F**") organized and with its headquarters in a jurisdiction ("**Country H**") other than Germany has entered into an Agreement on a multibranch basis. Bank F has entered into Transactions under such Agreement through its head office and also through one or more branches located in other jurisdictions that Bank F had specified in the Schedule to Bank F's Agreement, including a branch of Bank F located in and subject to the laws of Germany (the "**Local Branch**"). After entering into these Transactions and prior to the maturity thereof, Bank F becomes the subject of a voluntary or involuntary proceeding under the insolvency laws of Country H.

(2) Questions Presented

1. In relation to a multibranch party organized in Germany would there be any change in our conclusions concerning the enforceability of close-out netting under the Agreements based upon the fact that a German Institution has entered into an Agreement on a multibranch basis and then conducted business in that fashion prior to its insolvency?

2. In relation to a multibranch party with a branch located in Germany:

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

(b) If there would be a separate proceeding in Germany with respect to the assets and liabilities of the Local Branch, would the receiver in Germany, on the facts above, include Bank F's position under an Agreement, in whole or in part, among the assets of the Local Branch and, if so, would the receiver in Germany recognize the close-out netting provisions of the Agreement in accordance with their terms? The most significant concern would arise if the German receiver considering a single Agreement would require a counterparty of the Local Branch to pay the mark-to-market value of Transactions entered into with the Local Branch to the receiver of the Local Branch while at the same time forcing the counterparty to claim in the proceedings in Country H for its net value from other Transactions with Bank F under the same Agreement. In considering this issue, we assume that close-out netting under the Agreement would be enforced in accordance with its terms in the proceedings for Bank F in Country H.

3. Where German courts have jurisdiction over the assets of a German Institution or a Local Branch, would a multibranch master agreement such as an Agreement be treated as a single, unified agreement by a German receiver under German law regardless of the treatment of the Agreement or Transactions thereunder by an insolvency official in a jurisdiction where close-out netting may be unenforceable?

(3) Applicability of German Insolvency Law with respect to Multibranch Parties

(a) German Insolvency Proceedings Over the Assets of a German Party

As already explained above (VII.(B)(1)(a)), Insolvency Proceedings may be instituted in Germany as main proceedings:-

(a) in the case of a German party where the proceedings have a cross-border effect in another Regulation State, over the assets of an entity having the center of its main interests situated within Germany (§ 3(1) of the Regulation) which, in the case of a company or legal person, is presumed to be the place of its registered office (Article 3(1), second sentence, of Regulation); or

(b) in the case of (i) a German Financial Institution or (ii) a German party where the proceedings do not have a cross-border effect in another Regulation State, over the assets of any party having its principal office (*i.e.*, the center of its business activity) or, in the absence of a principal office, its registered office in Germany.[124]

Main Insolvency Proceedings, under the principle of "universality of insolvency" prevailing in German law, extend to all domestic and foreign assets of such party, includ-

124 § 3(1) in connection with §§ 12 *et seq.* of the Civil Procedure Act.

ing the assets created, acquired or held through any foreign branch,[125] subject to secondary insolvency proceedings in other jurisdictions:

- in the case of a non-German party where the Insolvency Proceedings have a cross-border effect in another Regulation State (*i.e.*, where the Regulation applies), secondary insolvency proceedings will be recognized in Germany pursuant to Article 16(1) of the Regulation;[126]

- in the case of (i) a non-German Financial Institution or (ii) a non-German party where the proceedings do not have a cross-border effect in another Regulation State (*i.e.*, where the conflict rules contained in §§ 335 to 358 of the Insolvency Code apply), secondary insolvency proceedings will be recognized in Germany pursuant to § 343(1) of the Insolvency Code.[127]

Payment claims of an insolvent German party (such as payment claims under a master agreement) would be situated in Country H in accordance with the following rules:

- in the case of a Regulation Debtor where the Insolvency Proceedings have a cross-border effect in a Regulation State (*i.e.*, where the Regulation applies), payment

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125 With respect to the Insolvency Code Kemper, in Kübler/Prütting, *op. cit.*, Article 102 EGInsO, note 168, and with respect to the Bankruptcy Code Bundesgerichtshof IPRax 1993, 87; BGHZ 88, 137; 68, 16.

126 Recognition is subject to Article 26 of the Regulation according to which an EC Member State may refuse to recognize insolvency proceedings opened in another EC Member State or to enforce a judgment handed down in the context of such proceedings where the effects of such recognition or enforcement would be manifestly contrary to that State's public policy, in particular its fundamental principles or the constitutional rights and liberties of the individual (*ordre public*).

127 This provision reads, in English translation, as follows:

"(1) The institution of foreign insolvency proceedings shall be recognized. This shall not apply,

1. if, pursuant to German law, the courts where the proceeding was instituted do not have jurisdiction;

2. to the extent that recognition of the foreign proceedings would lead to a result that is obviously incompatible with fundamental principles of German law, including, but not limited to, incompatibility with basic rights."

With respect to Article 102(1) of the Introductory Code to the Insolveny Code, which has been superseded by § 343(1) of the Insolvency Code, it was questioned whether foreign secondary insolvency proceedings would have qualified for recognition in Germany (*see*, the discussion under XI.(C) of our Memorandum of Law dated May 31, 2002 for the ISDA on the enforceability of close-out netting under the Agreements, the 1987 Interest Rate and Currency Exchange Agreement and the 1987 Interest Rate Swap Agreement). However, with respect to § 343(1) of the Insolvency Code, it seems to follow from § 356(1), first sentence, of the Insolvency Code that recognition of foreign insolvency proceedings is not limited to main proceedings.

claims are situated in the Regulation State within the territory of which the third party required to meet such claims has the center of its main interests.[128]

- in the case of (i) a Financial Institution or (ii) a Regulation Debtor where the proceedings do not have a cross-border effect in a Regulation State (*i.e.*, where the conflict rules contained in §§ 335 to 358 of the Insolvency Code apply), payment claims are situated at the place where the counterparty (*i.e.*, the debtor of such claims) had its registered office (in the case of a corporation) or its place of residence (in the case of a natural person).[129]

Accordingly, in Insolvency Proceedings with respect to a German party, separate insolvency proceedings in Country H would have no effect on the enforceability of the netting provisions of a master agreement between the German party and a counterparty organized or resident in any jurisdiction other than Country H. In particular, it would not be relevant in such insolvency proceedings if under the insolvency laws of Country H the netting provisions of a master agreement were not enforceable (whether in respect of transactions entered into through a branch of the German party in Country H or in respect of all transactions under that agreement).

If, however, payment claims of an insolvent German party are viewed as being situated in Country H, either due to the counterparty being organized or resident in such jurisdiction or, by way of exception from the aforementioned rule regarding the location of payment claims[130], and assuming further that under the insolvency laws of Country H the netting provisions of a master agreement were not enforceable, then the effect of separate insolvency proceedings in Country H on insolvency proceedings with respect to a German party would be as follows: (i) the German receiver would be prohibited from enforcing the relevant payment claims, and (ii) a net payment claim of the insolvent German party pursuant to the netting provisions of a master agreement would decrease accordingly, and the net payment claim of the solvent party would increase accordingly.

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128 Article 2(g), third indent, of the Regulation. Pursuant to Article 3(1), second sentence, of the Regulation the center of a debtor's main interests is, in the case of a company or legal person, presumed to be the place of its registered office.

129 *See*, with respect to the Insolvency Code Kemper, in Kübler/Prütting, *op. cit.*, note 252 and with respect to the Bankruptcy Code Jaeger/Jahr, Konkursordnung, *op. cit.*, §§ 237, 238 note 63. By way of exception, payment claims of an insolvent party may be viewed as being situated in the jurisdiction of the branch of the debtor (*i.e.*, the solvent party) if the underlying transaction was entered into through that branch and (i) the courts of the jurisdiction of the branch have exclusive jurisdiction in respect of that transaction (Bundesgerichtshof, BGHZ 2, 218, 223) or (ii) the branch is subject to the supervision of a local authority and is required to maintain a reserve fund within the jurisdiction of the branch as coverage for the relevant claim (Bundesgerichtshof, BGHZ 9, 34, 39 et seq. regarding obligations of an insurance company under a life insurance policy entered into through the insurance company's German branch) or (iii) the debtor's liability is agreed to be limited to the assets attributable to that branch (Kreuzer, in Münchener Kommentar zum Bürgerlichen Gesetzbuch, 3rd ed., 1998, Nach Article 38 Anh.III, note 59). For the avoidance of doubt, the aforementioned three exceptions regarding the situation of payment claims do not apply to payment claims of entities subject to the Regulation.

130 *See*, the preceding footnote.

(b) Foreign Insolvency Proceedings Over the Assets of a Foreign Party

Insolvency proceedings instituted in a jurisdiction outside Germany in respect of a party, having its principal office or, in the absence of a principal office, its registered office in that jurisdiction are recognized in Germany with respect to all assets of such party, subject to German public policy and jurisdiction of the foreign insolvency court.[131]

(c) German Insolvency Proceedings Over the Assets of a Foreign Party which are Situated in Germany

The rules applying to secondary insolvency proceedings in Germany over the assets of a foreign party which are situated in Germany depend on the applicable conflict of laws rules.[132]

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131 Within the scope of application of the conflict rules contained in §§ 335 to 358 of the Insolvency Code, this follows from § 343(1) of the Insolvency Code (*see*, footnote 111 above). Within the scope of application of the Regulation, this rule follows, *inter alia*, from Articles 3(1), 16(1), 17(1) and 26. These provisions read as follows:

Article 3(1):

"The courts of the Member State within the territory of which the center of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary."

Article 16(1):

"Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognised in all the other Member States from the time that it becomes effective in the State of the opening of proceedings. This rule shall also apply where, on account of his capacity, insolvency proceedings cannot be brought against the debtor in other Member States."

Article 17(1):

"The judgment opening the proceedings referred to in Article 3(1) shall, with no further formalities, produce the same effects in any other Member State as under this law of the State of the opening of proceedings, unless this Regulation provides otherwise and as long as no proceedings referred to in Article 3(2) are opened in that other Member State."

Article 26:

"Any Member State may refuse to recognise insolvency proceedings opened in another Member State or to enforce a judgment handed down in the context of such proceedings where the effects of such recognition or enforcement would be manifestly contrary to that State's public policy, in particular its fundamental principles or the constitutional rights and liberties of the individual."

132 Pursuant to draft legislation aiming at implementing the Directive on the Winding up of Credit Institutions and the Directive on the Winding up of Insurance Undertakings in German law, no secondary insolvency proceedings may be instituted in Germany over the assets of certain types of credit institutions and insurance companies having their registered office within the territory of an EC Member State or another contracting state of the Agreement on the European Economic Area (*see*, the discussion under VII.(B)(1)(a) above).

(i) Where §§ 335 to 358 of the Insolvency Code Apply

Where §§ 335 to 358 of the Insolvency Code apply, secondary insolvency proceedings in Germany may take the form of:

- secondary insolvency proceedings (*Sekundärinsolvenzverfahren*) which may be instituted in addition to main insolvency proceedings in a foreign jurisdiction over the debtor's assets situated in Germany; or

- territorial insolvency proceedings (*Partikularverfahren*) pursuant to § 354(1) of the Insolvency Code which may be instituted irrespective of whether main insolvency proceedings in a foreign jurisdiction have been instituted, provided that, if such entity has no branch in Germany, the institution of such secondary insolvency proceedings upon the petition of a creditor is only permitted where such creditor has a specific interest in the institution of such proceedings; this may be the case in particular if his position in a non-domestic insolvency proceeding would be substantially worse than in domestic proceedings (§ 354(2), first sentence, of the Insolvency Code).

Except for secondary Insolvency Proceedings in relation to which no grounds for institution of the proceedings needs to be determined (§ 356(3) of the Insolvency Code), the institution of secondary Insolvency Proceedings in respect of a foreign corporation is subject to the same prerequisites as Insolvency Proceedings in respect of a German corporation. In particular, the relevant foreign corporation[133] must either be generally unable to pay its debts (*Zahlungsunfähigkeit*) or insolvency must exist (*Überschuldung*).[134] If the foreign party is (i) Bank F with a branch in Germany engaged in banking business or financial services[135] or (ii) an insurance company with a branch in Germany engaged in insurance business, the proceedings may only be instituted upon a petition of the Financial Services Supervisory Authority or the appropriate insurance supervisory authority, as the case may be.[136]

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133 One could take the view that Insolvency Proceedings may also be instituted if only the German branch is generally unable to pay the debt attributable to it.

134 Insolvency Proceedings over the German assets of a foreign debtor may also be commenced in the case of imminent inability to pay (*drohende Zahlungsunfähigkeit*) if the debtor itself files the petition for the institution of Insolvency Proceedings with respect to its German assets (Kemper, in Kübler/Prütting, *op. cit.*, note 265). However, it is unlikely that any foreign debtor will file such a petition in Germany with respect to its assets situated there.

135 The regulations described at the end of footnotes 5 and 11 above with respect to credit institutions and financial services institutions, pursuant to which the special rules regarding the institution of Insolvency Proceedings may not apply to some types of such institutions, also apply to their branches (with the exception of branches of deposit credit institutions and investment firms organized in another state of the European Economic Area).

136 As set out under VII.(B)(1)(a)(ii) above, no secondary insolvency proceedings may be instituted in Germany over the assets of certain types of credit institutions, financial services institutions and insurance companies having their registered office within the territory of (i) an EC Member State or (ii) another contracting state of the Agreement on the European Economic Area. Accordingly, no

Any such Insolvency Proceedings are limited to those assets of the foreign party that are situated in Germany.[137] For this purpose, a payment claim (such as a payment claim under a master agreement) is deemed to be an asset situated (in the case of a corporation) at the registered office or (in the case of a natural person) at the place of residence of the debtor.[138] The involvement of the Local Branch in creating, acquiring or holding an asset has no impact on its situation.

(ii) Where the Regulation Applies

Where the Regulation applies, secondary insolvency proceedings may take the form of:

- secondary insolvency proceedings which may be instituted in addition to main insolvency proceedings in a foreign jurisdiction (*cf.* Article 3(3) of the Regulation) to the extent that the debtor possesses an establishment[139] within Germany. The effects of such proceedings are restricted to the assets of the debtor situated within Germany[140]; or
- territorial insolvency proceedings pursuant to Article 3(2) and (4) of the Regulation which may be instituted irrespective of whether main insolvency proceedings in a foreign jurisdiction have been instituted.[141]

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petition for secondary or territorial insolvency proceedings may be filed by the Financial Services Supervisory Authority or the appropriate insurance supervisory authority, as the case may be, with respect to German branches of such institutions.

137 §§ 354(1), 356(1) of the Insolvency Code.

138 With regard to the Insolvency Code Kemper, in Kübler/Prütting, *loc. cit.*, note 252 and with respect to the Bankruptcy Code Jaeger/Jahr, *op. cit.*, §§ 237, 238 note 63. In respect of exceptions from the aforementioned rule regarding the situation of payment claims *see*, footnote 113).

139 Pursuant to Article 2(h) of the Regulation, "establishment" means any place of operations where the debtor carries out a non-transitory economic activity with human means and goods.

140 With respect to the situation of assets for the purposes of the Regulation, *see* Article 2(g). According to this provision, assets of an entity having its center of main interests in an EC Member State other than Germany are situated in Germany if (i) in the case of tangible property, such property is situated within the territory of Germany, (ii) in the case of property and rights ownership of or entitlement to which must be entered in a public register, the register is kept under German authority, and (iii) in the case of claims, the third party required to meet them has the center of his main interests within Germany.

141 Pursuant to Article 3(4) of the Regulation, territorial insolvency proceedings may only be opened prior to the opening of main proceedings (i) where main insolvency proceedings cannot be opened because of the conditions laid down by the law of the Regulation State within the territory of which the center of the debtor's main interests is situated or (ii) where the opening of territorial insolvency proceedings is requested by a creditor who has his domicile, habitual residence or registered office in the Regulation State within the territory of which the establishment is situated, or whose claim arises from the operation of that establishment.

Generally, where the Regulation applies, the institution of Insolvency Proceedings in respect of a foreign corporation is subject to the same prerequisites as Insolvency Proceedings in respect of a German corporation described above. However, where main proceedings within the meaning of Article 27 of the Regulation have been instituted in a Regulation State, German secondary insolvency proceedings pursuant to Article 27 of the Regulation may be instituted in Germany without the foreign corporation's insolvency being examined. Any such German secondary insolvency proceedings are limited to those assets of the foreign party that are situated in Germany. Although such German secondary insolvency proceedings under the Regulation may only be instituted if the foreign corporation has an establishment within the meaning of Article 2(h) of the Regulation in Germany, the involvement of such German establishment in creating, acquiring or holding an asset has no impact on the situation of payment claims relating to a foreign corporation.

(d) Relationship between German and Foreign Insolvency Proceedings

If any Insolvency Proceedings referred to under (1) through (3) above are instituted, such proceedings take precedence over the foreign insolvency proceedings over the assets of the foreign party which are situated in Germany.

(4) Conclusions

Our conclusions on the questions set forth in (A) above, based on the analysis under (C) above, are as follows:

1. The rules applying in the insolvency of a German Institution do not vary depending on whether or not a German Institution has entered into an Agreement on a multibranch basis and entered into Transactions under such Agreement through one or more foreign branches. Therefore, our conclusions concerning the enforceability of close-out netting under the Agreements would not change.

2. The commencement of a foreign insolvency proceeding does not automatically give rise to Insolvency Proceedings in Germany. However, Insolvency Proceedings can be instituted with respect to the assets of Bank F that are situated in Germany, subject to the rules set out under VII.(F)(3)(a) above. Such proceedings would take precedence over the foreign insolvency proceedings in relation to the assets of Bank F situated in Germany.

3. As discussed under VII.(F)(3)(c) above, there would be no separate Insolvency Proceeding regarding the Local Branch of Bank F, rather, the Insolvency Proceeding would cover the assets of Bank F situated in Germany. The receiver would include in such assets Bank F's positions under an Agreement in whole, to the extent that the debtors have a registered office in Germany, or, in the three exceptional cases mentioned at footnote 113, to the extent the assets would be deemed to be situated at the debtor's branch in Germany. Accordingly, the position of Bank F under an Agreement with a German debtor would be subject to such Insolvency Proceedings, while the position of Bank F under an Agreement with a non-German debtor would not be subject to such an Insolvency Proceeding.

4. Our answers to the above would remain the same, notwithstanding possible actions that could be taken by an insolvency official in Country H. Separate insolvency proceedings in Country H would have no effect on the enforceability of the close-out netting provisions of the Agreements. If, however, the claims of the insolvent German Institution are to be viewed as being situated in a jurisdiction where close-out netting may be unenforceable, either due to the counterparty being organized in such jurisdiction or due to the fact that the claims of the insolvent institution would have to be viewed as being situated at a branch of the counterparty located in such jurisdiction in accordance with the discussion at footnote 113, the effect of separate insolvency proceedings in a jurisdiction where close-out netting may be unenforceable would be (i) that the German receiver would be prohibited from enforcing the relevant claims and (ii) that a net payment claim of the insolvent German Institution would decrease accordingly and the net payment claim of the solvent party would increase accordingly.

(G) Impact of the 2001 ISDA Cross-Agreement Bridge

The inclusion of the 2001 ISDA Cross-Agreement Bridge would not materially affect the conclusions reached in this Memorandum.

(H) Impact of the 2002 ISDA Energy Agreement Bridge

The inclusion of the 2002 ISDA Energy Agreement Bridge would not materially affect the conclusions reached in this Memorandum.

VIII.
OBTAINING AND EXECUTING A JUDGEMENT IN A FOREIGN CURRENCY

Subject to certain limitations, it is possible to obtain and execute a judgement in a foreign currency under German law.

IX.
ANSWERS TO QUESTIONS PRESENTED

Based on all of the foregoing, the answers to the questions presented under IV. above are as follows:

1. Assuming the parties to an Agreement have not selected Automatic Early Termination upon certain insolvency related events to apply to the insolvent German party, are the provisions of an Agreement permitting the Non-defaulting Party to terminate all the Transactions upon the insolvency of the German party enforceable under German law?

Insofar as German substantive insolvency law applies (*see* the discussion under VI.(B)(3) and VI.(C)(3) above), our conclusions are the following:

(i) If (a) the relevant Agreement is a *Qualifying Master Agreement* (as defined under VII.(C)(2)(c)(iv) below) and (b) the Early Termination Date falls *before* the institution of Insolvency Proceedings, the provisions of the Agreements permitting the other party to terminate all Transactions upon the occurrence of an insolvency related Event of Default specified in Section 5(a)(vii) in respect of the German party are enforceable under German law.

(ii) If (a) the relevant Agreement is a *Qualifying Master Agreement* and (b) the Early Termination Date falls *on or after* the date on which Insolvency Proceedings are instituted, the Transactions and the Agreement will *ipso facto* terminate upon the institution of Insolvency Proceedings. Close-out and liquidation of the Transactions will be governed by § 104(3) of the Insolvency Code; Section 6(e) will generally not apply.

(iii) If the relevant Agreement is a *Non-Qualifying Master Agreement*, such Agreement may not be terminated upon the occurrence of an insolvency related Event of Default, irrespective of whether the Early Termination Date falls before, on or after the date on which Insolvency Proceedings are instituted. Upon the institution of Insolvency Proceedings, such Agreement and the Transactions entered into under it will be subject to § 103 of the Insolvency Code under which the insolvency receiver may assume Transactions which are profitable for the insolvent party and reject Transactions which are not. With respect to rejected Transactions, the solvent party may assert a claim for non-performance only as a creditor in insolvency proceedings.

Reference is made to the discussion under VII.(C) above.

Subject to the discussion and the reservations set out under VI.(C)(3)(b) above, where German substantive insolvency law does not apply, the termination provisions of the Agreements in the insolvency of the German party are enforceable in accordance with the terms of the relevant Agreement. Reference is made to the discussion under VI.(C)(3) above.

Neither the Force Majeure Termination Event set out in Section 5(b)(ii) of the 2002 ISDA Master Agreement nor the set-off provision of Section 6(f) of the 2002 ISDA Master Agreement affects the answer set out above.

2. Assuming the parties to an Agreement have selected Automatic Early Termination upon certain insolvency related events to apply to the insolvent German party, are the provisions of the Agreement automatically terminating all the Transactions upon the insolvency of the German party enforceable under German law?

Insofar as German substantive insolvency law applies (*see* the discussion under VI.(B)(3) and VI.(C)(3) above), our conclusions are the following:

(i) If (a) the relevant Agreement is a *Qualifying Master Agreement* and (b) assuming that the Early Termination Date falls *before* the institution of the proceedings, then the provision of the Agreements automatically terminating all Transactions are enforceable under German law.

(ii) If the Agreement is a *Non-Qualifying Master Agreement*, the provision of the Agreements automatically terminating all Transactions are not enforceable under

German law, irrespective of whether the Early Termination Date falls before, on or after the date on which Insolvency Proceedings are instituted.

Reference is made to the discussion under VII.(C) above.

Subject to the discussion and the reservations set out under VI.(C)(3)(b) above, where German substantive insolvency law does not apply, the automatic early termination provisions of the Agreements in the insolvency of the German party are enforceable in accordance with the terms of the relevant Agreement. Reference is made to the discussion under VI.(C)(3) above.

Neither the Force Majeure Termination Event set out in Section 5(b)(ii) of the 2002 ISDA Master Agreement nor the set-off provision of Section 6(f) of the 2002 ISDA Master Agreement affects the answer set out above.

3. Are the provisions of the Agreements providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of the German party enforceable under German law?

Insofar as German substantive insolvency law applies (*see* the discussion under VI.(B)(3) and VI.(C)(3) above), our conclusions are the following:

(i) If (a) the relevant Agreement is a *Qualifying Master Agreement* and (b) the Early Termination Date falls *before* the institution of Insolvency Proceedings, Section 6(e) providing for the netting of termination values in determining a single lump-sum termination amount and payment thereof by the Defaulting Party (if that amount is a positive number) or by the Non-defaulting Party (if that amount is a negative number), is enforceable under German law.

(ii) If (a) the relevant Agreement is a *Qualifying Master Agreement* and (b) the Early Termination Date falls *on or after* the date on which Insolvency Proceedings are instituted, close-out and liquidation of the Transactions will be governed by § 104(3) of the Insolvency Code and not by Section 6(e)), provided that the provisions of the relevant Agreement may be relevant for the timing of the determination of the differrence between the agreed price and the market or exchange price, subject to the limitations of § 104(3), first sentence.

(iii) If the relevant Agreement is a *Non-Qualifying Master Agreement*, Section 6(e) is not enforceable under German law.

Reference is made to the discussion under VII.(C) above.

Subject to the discussion and the reservations set out under VI.(C)(3)(b) above, where German substantive insolvency law does not apply, the close-out netting under the Agreements in the insolvency of the German party are enforceable in accordance with the terms of the relevant Agreement. Reference is made to the discussion under VI.(C)(3) above.

Neither the Force Majeure Termination Event set out in Section 5(b)(ii) of the 2002 ISDA Master Agreement nor the set-off provision of Section 6(f) of the 2002 ISDA Master Agreement affects the answer set out above.

4. *Assuming the parties have entered into either a Cross Border Agreement or a 2002 ISDA Master Agreement, one of the parties is insolvent and the parties have selected a Termination Currency other than the currency of the jurisdiction in which the insolvent party is organized, is it possible to "prove" (that is, file) a claim in Insolvency Proceedings under the laws of Germany in a foreign currency (i.e., a currency other than Euro)?*

If the Termination Currency is denominated in a currency other than Euro, any claim of the solvent party against the insolvent German party for payment of the lump-sum termination amount in that Termination Currency is enforceable under German law only as converted into Euro. Reference is made to the discussion under VII.(D) above.

5. *Is it possible to obtain or execute a judgement in a foreign currency under German law?*

Subject to certain limitations, it is possible to obtain and execute a judgement in a foreign currency under German law.

HENGELER MUELLER
Partnerschaft von Rechtsanwälten

(Haag) (Peters)

APPENDIX A

CERTAIN TRANSACTIONS UNDER THE ISDA MASTER AGREEMENTS

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

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

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

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

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

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

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

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

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

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

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

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

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

Contingent Credit Default Swap. A Credit Default Swap Transaction under which the calculation amounts applicable to one or both parties may vary over time by reference to the mark-to-market value of a hypothetical swap transaction.

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

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

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

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

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

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

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

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

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

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

Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

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

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

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

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

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

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

Fund Option Transaction: A transaction in which one party grants to the other party (for an agreed payment or other consideration) the right, but not the obligation, to receive a payment based on the redemption value of a specified amount of an interest issued to or held by an investor in a fund, pooled investment vehicle or any other interest identified as such in the relevant Confirmation (a "Fund Interest"), whether i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests in relation to a specified strike price. The Fund Option Transactions will generally be cash settled (where settlement occurs based on the excess of such redemption value over such specified strike price (in the case of a call) or the excess of such specified strike price over such redemption value (in the case of a put) as measured on the valuation date or dates relating to the exercise date).

Fund Forward Transaction: A transaction in which one party agrees to pay an agreed price for the redemption value of a specified amount of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests at a future date and the other party agrees to pay a price for the redemption value of the same amount of the same Fund Interests to be set on a specified date in the future. The payment calculation is based on the amount of the redemption value relating to such Fund Interest and generally cash-settled (where settlement occurs based on the difference between the agreed forward price and the redemption value measured as of the applicable valuation date or dates).

Fund Swap Transaction: A transaction a transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency based on the redemption value of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests.

Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

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

Longevity/Mortality Transaction. (a) A transaction employing a derivative instrument, such as a forward, a swap or an option, that is valued according to expected variation in a reference index of observed demographic trends, as exhibited by a specified population, relating to aging, morbidity, and mortality/longevity, or (b) A transaction that references the payment profile underlying a specific portfolio of longevity- or mortality- contingent obligations, e.g. a pool of pension liabilities or life insurance policies (either the actual claims payments or a synthetic basket referencing the profile of claims payments).

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

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

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

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

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

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

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

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

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

APPENDIX B

CERTAIN COUNTERPARTY TYPES[142]

Description	Covered by Memorandum	Legal form(s)
Bank/Credit Institution. A legal entity, which may be organized as a corporation, partnership or in some other form, that conducts commercial banking activities, that is, whose core business typically involves (a) taking deposits from private individuals and/or corporate entities and (b) making loans to private individual and/or corporate borrowers. This type of entity is sometimes referred to as a "commercial bank" or, if its business also includes investment banking and trading activities, a "universal bank". (If the entity only conducts investment banking and trading activities, then it falls within the "Investment Firm/Broker Dealer" category below.) This type of entity is referred to as a "credit institution" in European Community (**EC**) legislation. This category may include specialised types of bank, such as a mortgage savings bank (provided that the relevant entity accepts deposits and makes loans), or such an entity may be considered in the local jurisdiction to constitute a separate category of legal entity (as in the case of a building society in the United Kingdom (**UK**)).	Covered by our Memorandum, see III.1.(a).	Banks/Credit institutions in the legal form of a AG, GmbH, KGaA, eG, oHG, KG or public law institutions
Central Bank. A legal entity that performs the function of a central bank for a Sovereign or for an area of monetary union (as in the case of the European Central Bank in respect of the euro zone).	Not covered by our Memorandum. Further legal analysis would be required.	

142 In these definitions, the term "legal entity" means an entity with legal personality other than a private individual.

Corporation. A legal entity that is organized as a corporation or company rather than a partnership, is engaged in industrial and/or commercial activities and does not fall within one of the other categories in this Appendix B.	Covered by our Memorandum if incorporated as AG, GmbH, KGaA or eG, see III.1.(e).	AG, GmbH, KGaA, eG
Hedge Fund/Proprietary Trader. A legal entity, which may be organized as a corporation, partnership or in some other legal form, the principal business of which is to deal in and/or manage securities and/or other financial instruments and/or otherwise to carry on an investment business predominantly or exclusively as principal for its own account.	Hedge Fund: Covered by our Memorandum to the extent organized as a capital management company (*Kapitalverwaltungsgesellschaft*) in the form of an investment stock corporation with variable capital (*Investmentaktiengesell-schaft mit veränderlichem Kapital*), see III.1.(d); Otherwise not covered by our Memorandum. Proprietary Trader: Covered by our Memorandum to the extent being a financial services institution within the meaning of the Banking Act, see III.1.(b); Otherwise not covered by our Memorandum.	 InvAG Financial services institutions in the legal form of a AG, GmbH, KGaA, eG, oHG or KG
Insurance Company. A legal entity, which may be organized as a corporation, partnership or in some other legal form (for example, a friendly society or industrial & provident society in the UK), that is licensed to carry on insurance business, and is typically subject to a special regulatory regime and a special insolvency regime in order to protect the interests of policyholders.	Covered by our Memorandum to the extent being an insurance company within the meaning of the Insurance Supervisory Act, see III.1.(c).	Insurance companies in the legal form of a AG, VVaG or public law institutions
International Organization. An organization of Sovereigns established by treaty entered into between the Sovereigns, including the International Bank for Reconstruction and Development (the World Bank), regional development banks and similar organizations established by treaty.	Not covered by our Memorandum. Further legal analysis would be required.	
Investment Firm/Broker Dealer. A	Investment firms which are	Investment firms in

legal entity, which may be organized as a corporation, partnership or in some other form, that does not conduct commercial banking activities but deals in and/or manages securities and/or other financial instruments as an agent for third parties. It may also conduct such activities as principal (but if it does so exclusively as principal, then it most likely falls within the "Hedge Fund/Proprietary Trader" category above.) Its business normally includes holding securities and/or other financial instruments for third parties and operating related cash accounts. This type of entity is referred to as a "broker-dealer" in US legislation and as an "investment firm" in EC legislation.	financial services institutions (*Finanzdienstleistungsinstitute*) within the meaning of § 1(1a) of the Banking Act are covered by our Memorandum, see III.1.(b); otherwise investment firms and broker dealers are not covered.	the legal form of a AG, GmbH, KGaA, eG, oHG or KG
<u>Investment Fund</u>. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide investors with a share in profits or income arising from property acquired, held, managed or disposed of by the manager(s) of the legal entity or arrangement or a right to payment determined by reference to such profits or income. This type of entity or arrangement is referred to as a "collective investment scheme" in EC legislation. It may be regulated or unregulated. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by general law and/or, typically in the case of regulated Investment Funds, financial services legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Investment Fund (for example, a trustee of a unit trust) contract on behalf of the Investment Fund, are owed the rights and owe the obligations provided for in the contract and are entitled to be	Covered by our Memorandum to the extent organized as a capital management company (*Kapital-verwaltungsgesellschaft*), which may be organized in different forms, see III.1.(d); Otherwise not covered by our Memorandum.	

indemnified out of the assets comprised in the arrangement.		
Local Authority. A legal entity established to administer the functions of local government in a particular region within a Sovereign or State of a Federal Sovereign, for example, a city, county, borough or similar area.	Not covered by our Memorandum. Further legal analysis would be required.	
Partnership. A legal entity or form of arrangement without legal personality that is (a) organized as a general, limited or some other form of partnership and (b) does not fall within one of the other categories in this Appendix B. If it does not have legal personality, it may nonetheless be treated as though it were a legal person for certain purposes (for example, for insolvency purposes) and not for other purposes (for example, tax or personal liability).	Covered by our Memorandum if organized as oHG or KG, see III.1.(e); not covered if organized as GbR or in other forms.	oHG, KG
Pension Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide pension benefits to a specific class of beneficiaries, normally sponsored by an employer or group of employers. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by pensions legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Pension Fund (for example, a trustee of a pension scheme in the form of a common law trust) contract on behalf of the Pension Fund and are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	Covered by our Memorandum if organized as a mutual insurance company (see III.1.(c)) or as a non-profit making limited liability company (*gemeinnützige Gesellschaft mit beschränkter Haftung* - gGmbH) (see III.1.(e)); otherwise not covered.	
Sovereign. A sovereign nation state recognized internationally as such, typically acting through a direct	Not covered by our Memorandum. Not relevant, as the Federal Republic of Germany may	

agency or instrumentality of the central government without separate legal personality, for example, the ministry of finance, treasury or national debt office. This category does not include a State of a Federal Sovereign or other political sub-division of a sovereign nation state if the sub-division has separate legal personality (for example, a Local Authority) and it does not include any legal entity owned by a sovereign nation state (see "Sovereign-owned Entity").	not become the subject of German insolvency proceedings.	
Sovereign Wealth Fund. A legal entity, often created by a special statute and normally wholly owned by a Sovereign, established to manage assets of or on behalf of the Sovereign, which may or may not hold those assets in its own name. Such an entity is often referred to as an "investment authority". For certain Sovereigns, this function is performed by the Central Bank, however for purposes of this Appendix B the term "Sovereign Wealth Fund" excludes a Central Bank.	Not covered by our Memorandum. Further legal analysis would be required.	
Sovereign-Owned Entity. A legal entity wholly or majority-owned by a Sovereign, other than a Central Bank, or by a State of a Federal Sovereign, which may or may not benefit from any immunity enjoyed by the Sovereign or State of a Federal Sovereign from legal proceedings or execution against its assets. This category may include entities active entirely in the private sector without any specific public duties or public sector mission as well as statutory bodies with public duties (for example, a statutory body charged with regulatory responsibility over a sector of the domestic economy). This category does not include local governmental authorities (see "Local Authority").	Covered by our Memorandum to the extent being (i) a public law credit institution (see III.1.(a)), (ii) a public law insurance company (see III.1.(c)) or (iii) sovereign-owned corporation incorporated or organized as AG, SE, GmbH or KGaA (see III.1.(e)); otherwise not covered.	
State of a Federal Sovereign. The principal political sub-division of a	Not covered by our Memorandum. Not relevant, as the States	

federal Sovereign, such as Australia (for example, Queensland), Canada (for example, Ontario), Germany (for example, Nordrhein-Westfalen) or the United States of America (for example, Pennsylvania). This category does not include a Local Authority.	(*Bundesländer*) within the Federal Republic of Germany may not become the subject of German insolvency proceedings.	