



**UNIDROIT Committee of governmental experts on  
the enforceability of close-out netting provisions  
Second session**

**Rome, 4 – 8 March 2013**

UNIDROIT 2012  
C.G.E./Netting/2/W.P. 03  
Original: English  
December 2012

**Draft Principles regarding the  
Enforceability of Close-out Netting Provisions**

**- Revision Notes -**

**Explanatory notes on amendments  
to the text of the Draft Principles and to the commentary**

Note: These Revision Notes set out the amendments to the text of the Draft Principles and give in the footnotes accompanying each Principle short explanations stating, by reference to the discussions of the Committee at its first meeting or otherwise, the objectives of each amendment.

After each Principle there is a short summary indicating the main amendments to the commentary to the Principle. The numbers refer to the paragraphs in the document CGE/Netting/2/WP 02.

This document is intended to explain the revision and amendment of the Draft Principles from the version in CGE/Netting/1/WP 02 and Addendum (first meeting of the Committee) to CGE/Netting/2/WP 02 (second meeting of the Committee). It does not itself form part of the Draft Principles.

**Principle 1: Scope of the Principles<sup>1</sup>**

**1. *These Principles deal with the effects and the enforceability<sup>2</sup> of close-out netting provisions that are entered into by eligible parties<sup>3</sup> in respect of eligible obligations.*<sup>4</sup>**

---

<sup>1</sup> See for the suggestion to split the former Principle 1 into a rule on scope and a definition proper the Doc. C.G.E./Netting/1/Report, paras. 16 and 18. Along the lines of the comments by the Government of Canada in the Doc. C.G.E./Netting/1/WP 05, p. 1, a division into two separate Principles is suggested.

<sup>2</sup> The phrase "*deal with the effects and the enforceability*" is intended to describe somewhat more precisely the ambit of the Principles as opposed to the phrase "*apply to*" as suggested in the Doc. C.G.E./Netting/1/Report, para. 18.

<sup>3</sup> The reference to "*eligible parties*" and "*eligible obligations*" in the provision on the scope of Principles follows the suggestion in the Doc. C.G.E./Netting/1/Report, para. 18.

<sup>4</sup> See the preceding footnote.

**Amendments to the commentary to Principle 1 (in Doc. C.G.E./Netting/2/WP 02):**

- The former Introduction (see Doc. C.G.E./Netting/1/WP 02, paras. 1-10) forms the basis of the commentary of this new Principle 1.
- Para. 2: Following a suggestion by the Government of the United States of America (see Doc. C.G.E./Netting/1/WP 03, p. 8), the distinction between set-off and close-out netting has been made clearer.
- Para. 4: The paragraph on the support of regulatory authorities for close-out netting has been clarified.
- Para. 11: There is now a reference to the general concept that the Principles contain a minimum field of harmonisation, where the enforceability of close-out netting provisions within the scope of the Principles should be ensured, whereas they acknowledge, without precluding further harmonisation, that beyond this minimum field, each implementing State may regard the enforceability of close-out netting provisions as an issue of its public policy.
- Para. 12: Following a suggestion in the first meeting of the Committee (see Doc. C.G.E./Netting/1/Report, para. 21), the commentary to Principle 1 refers to the factors that should be taken into consideration by each implementing State in the exercise of a discretion under the Principles for an expansion (or reduction) of the scope of application of the Principles.

It was suggested in the first meeting that there should also be a reference in the commentary to the principles of the UNCITRAL Model Law on Cross-Border Insolvency concerning the non-discrimination of foreign creditors (Art. 13 of the Model Law, see Doc. C.G.E./Netting/1/Report, para. 112).

**Principle 2: Definition of 'Close-out Netting Provision'**

2. A "close-out netting provision" means a contractual provision [...] <sup>5</sup> on the basis of which, upon the occurrence of an event predefined in the provision in relation to a party to the contract, <sup>6</sup> the due and undue obligations owed by the parties to each other <sup>7</sup> that are covered by the provision <sup>8</sup> are reduced to or replaced by <sup>9</sup> a single net obligation, whether by way of novation, termination or otherwise, <sup>10</sup> representing the value of the combined obligations, which is then payable by one party to the other. [...] <sup>11</sup>

---

<sup>5</sup> The phrase "relating to eligible obligations between eligible parties" has been deleted as this reference is now contained in Principle 1.

<sup>6</sup> The phrase "in relation to one of the parties" has been replaced by "in relation to a party to the contract" in order to accommodate concerns (see the comments of the Government of Sweden in the Doc. C.G.E./Netting/1/WP 03, p. 4) that the older wording would not cover also cases where the predefined event occurred in relation to both parties of the contract. The new wording avoids "one" and would therefore cover the plural as well.

<sup>7</sup> Since the phrase "relating to eligible obligations between eligible parties" was deleted (see *supra* fn. 5), it was necessary to introduce the phrase "owed by the parties to each other" replacing the former "respective" in order to limit the definition to the close-out netting of obligations owed between the parties to the close-out netting provision.

<sup>8</sup> Again, the deletion of the phrase "relating to eligible obligations between eligible parties" (see *supra* fn. 5) made it necessary to add a further element to the definition: The phrase "obligations of the parties that are covered by the provision" makes clear that in the close-out netting provision itself it must be determined which obligations the provision is intended to cover.

<sup>9</sup> It was decided in the first meeting of the Committee that the words "or replaced by" should be added (see Doc. C.G.E./Netting/1/Report, para. 11): The definition is intended to be as broad as possible and in some jurisdictions, the transformation of the original obligations into the single net obligation under the close-out netting provision is understood rather as a replacement than a reduction.

<sup>10</sup> Adding the phrase "whether by way of novation, termination or otherwise" follows another decision of the Committee at its first session (see Doc. C.G.E./Netting/1/Report, para. 11): This phrase is intended to express the functional approach of the Principles which cover close-out netting regardless of the exact legal technique employed to achieve its effects in the implementing States.

<sup>11</sup> The former second sentence of the definition which referred to the distinction between close-out netting taking place automatically and at the election of one of the parties has been deleted. Since the definition is intended to cover both alternatives, it was not necessary for the black letter rules to spell them out expressly, where a reference to these possibilities in the commentary would be sufficient.

**Amendments to the commentary to Principle 2 (in Doc. C.G.E./Netting/2/WP 02):**

- The commentary to former Principle 1 (see Doc. C.G.E./Netting/1/WP 02, paras. 11-33) forms the basis for the commentary of this new Principle 2, subject to the following amendments:
- Key considerations: Following a suggestion made at the first meeting of the Committee (see Doc. C.G.E./Netting/1/Report, paras. 9 and 42), the delimitation between *central clearing mechanisms* which are covered by the Principles) and *truly multilateral netting* (which is not) has been clarified through an amendment to the key considerations.
- Para. 14: While this is not a term that is used in the definition itself, the commentary to Principle 2 introduces the term "*operation*" of a close-out netting provision. This is to be understood as an all-encompassing functional term describing the taking of effect of a close-out netting provision that is validly created, enforceable, effective against third parties and admissible in evidence. The term "operation" is used in several Principles and is intended to replace the former enumeration of specific aspects such as creation or formal validity etc (see, e.g., Principle 5 (1)).
- Para. 17: The commentary in relation to close-out netting that takes effect partly on a contractual basis, partly on a statutory basis has been made more specific, see the discussion at the first meeting of the Committee (see Doc. C.G.E./Netting/1/Report, paras. 43 and 44).
- Para. 19: It has been clarified that master-master agreements can be covered by this definition (provided that the underlying transactions are eligible obligations, see the discussion in Doc. C.G.E./Netting/1/Report, para. 69).
- Para. 30: The commentary emphasises that the legal technique of *novation* is covered by the Principles whereas *settlement netting* (often called novation netting) is not (see Doc. C.G.E./Netting/1/Report, paras. 10 ss).
- Para. 30: The commentary refers to the term *transformation* as an additional alternative (see Doc. C.G.E./Netting/1/Report, para. 11).
- Para. 32: More emphasis is given to the fact that a monetary value is given to the original underlying obligations after their acceleration (see Doc. C.G.E./Netting/1/Report, para. 14).
- Paras. 32 and 33: More weight is given to the fact that the resulting net obligation must represent the value of the combined obligations and a reference to a commercially reasonable valuation process is included (cf. Doc. C.G.E./Netting/1/Report, para. 63).
- Paras. 35 and 37: The treatment of walk-away clauses and waiting periods has been clarified (cf. Doc. C.G.E./Netting/1/Report para. 70).

**Principle 3:<sup>12</sup> Definition of 'eligible party'****3. 'Eligible party' means**

- a) a person other than a natural person;**
- b) a partnership or unincorporated association (whether or not its membership includes natural persons); and**
- c) any other person or legal entity<sup>13</sup> designated as an eligible party under the law of the relevant State.**

---

<sup>12</sup> The former Principle 2 has become Principle 3 since the former Principle 1 has been split into two provisions.

<sup>13</sup> Sub-paragraph (c) has been extended in order to allow implementing States to extend the scope of application of the Principles to legal entities, *i.e.* such entities that do not qualify as legal persons (see CGE/Netting/1/Report para. 20).

**Principle 4:<sup>14</sup> Definition of ‘eligible obligation’**

4. *‘Eligible obligation’ means an obligation arising under one of the following contracts:*

- a) *derivative instruments, meaning<sup>15</sup> an option, forward, future, swap, contract for differences or other transaction in respect of a reference value that is [, or in the future becomes,]<sup>16</sup> the subject of recurrent contracts in the derivatives markets;*
- b) *repurchase agreements, lending agreements and margin loans for the sale or purchase of<sup>17</sup> securities, money market instruments and units in collective investment schemes;*
- c) *[...]<sup>18</sup> collateral arrangements securing another eligible obligation;<sup>19</sup>*
- d) *contracts for the sale, purchase or delivery of*
  - (i) securities;*
  - (ii) money market instruments;*
  - (iii) units in a collective investment scheme;*
  - (iv) currency of any country, territory or monetary union;*
  - (v) gold, silver, platinum, palladium, or any other precious metal; or*
  - (vi) any other fungible commodity, meaning<sup>20</sup> a commodity that is [,or in the future becomes,] the subject of recurrent contracts in the spot, forward or derivatives markets;*
- e) *any other type of contract designated to that effect under the relevant law; and*
- f) *agreements under which a party assumes a liability (whether by way of surety or as principal debtor) for the performance of obligations of<sup>21</sup> another person under any agreement referred to in sub-paragraphs (a) to (e).*

---

<sup>14</sup> The former Principle 3 has become Principle 4 since the former Principle 1 has been split into two provisions.

<sup>15</sup> For ease of reading, the phrasing of sub-paragraph (a) has been amended and the definition of the term “derivative instrument” has been integrated into the main provision.

<sup>16</sup> It might be possible to delete the words in brackets in order to shorten the provision.

<sup>17</sup> It was agreed at the first meeting of the Committee (see CGE/Netting/1/Report para. 23) that the formula “for the sale or purchase of” was preferable to “relating to”.

<sup>18</sup> By deleting the words “title transfer”, the scope of sub-paragraph (c) has been extended to cover security collateral arrangements as well. This was suggested in the discussion at the first meeting of the Committee (see CGE/Netting/1/Report para. 22) and seems also better to reflect the ideas expressed in the commentary in relation to non-title transfer collateral arrangements with a right of use (para. 63).

<sup>19</sup> It has been suggested in the discussion at the first meeting of the Committee (see CGE/Netting/1/Report para. 22) to limit the provision to such collateral arrangements which secure another eligible obligation.

<sup>20</sup> See supra fn. 15.

<sup>21</sup> It is suggested to extend the wording of this sub-paragraph to cover situations under such legal systems and types of security agreements where the performance by the surety is not regarded as performance of the obligation of the debtor (but as performance of an own obligation of the surety under the security agreement).

**Amendments to the commentary to Principle 4 (in Doc. C.G.E./Netting/2/WP 02):**

- Key considerations: The reference to the effects of stays on termination in insolvency proceedings under the key consideration "Rapid changes of value" has been deleted, since this would be an issue for Principle 7.
- Paras. 61 ss: Some changes were necessary as a consequence of the amendments to subparagraph (c).
- Para. 66: Following a suggestion in the discussion at the first meeting of the Committee (see Doc. C.G.E./Netting/1/Report, para. 87), there is now a reference to transactions concerning emission allowances.
- Para. 68: In this paragraph there is now, based upon a suggestion in the discussion at the first meeting of the Committee (see Doc. C.G.E./Netting/1/Report, para. 87), a reference to contracts for the clearing of obligations as an example of an obligation which could be included by the implementing States in the list of eligible obligations.

**Principle 5: Formal and Reporting Requirements**<sup>22</sup>

**5.(1) *The law should not make the [operation]<sup>23</sup> [creation, validity, enforceability, effectiveness against third parties or admissibility in evidence] of a close-out netting provision dependent on***

- a) *the performance of any formal act other than a requirement<sup>24</sup> that a close-out netting provision be evidenced in writing or any legally equivalent form; and*
- b) *the use of standardised terms of specific trade associations.*<sup>25</sup>

**(2) *The law should not make*<sup>26</sup> *the [operation]<sup>27</sup> [creation, validity, enforceability, effectiveness against third parties or admissibility in evidence] of a close-out netting provision and the obligations covered by the provision<sup>28</sup> dependent on the compliance with any requirement to report<sup>29</sup> data relating to those obligations<sup>30</sup> to a trade repository or similar organisation for regulatory purposes.***

***[ (3) This Principle does not affect the application of any laws or regulations of the implementing State that provide for administrative, regulatory or penal sanctions for the non-compliance with formal requirements. ]***<sup>31</sup>

<sup>22</sup> For ease of reading, the former Principles 4 – 6 on formal requirements have been merged into one Principle 5. The heading of the new Principle 5 has been amended in order to give more prominence to the fact that this rule covers the issue of reporting requirements as well (paragraph (2), formerly Principle 6).

<sup>23</sup> It is suggested to replace the phrase "*creation, validity, enforceability, effectiveness against third parties or admissibility in evidence*" by the term "*operation*" for ease of reading and with a view to avoiding the risk that a use of more specific terms could lead to inconsistencies in the text of the black letter rules (see the related discussion in Doc. C.G.E./Netting/1/Report, para. 97). The intended broad scope of the term "*operation*" is explained in the commentary to Principle 2, a cross-reference might be added to the commentary of Principle 5.

<sup>24</sup> The phrase "*but the law may require*" has been replaced by "*other than a requirement*" for linguistic reasons to better align this half-sentence with the main structure of the Principle.

<sup>25</sup> Principle 5 (1)(b) contains the former Principle 5 and no changes (apart from the suggested use of the term "*operation*" in the chapeau as referred to in fn. 23) have been made.

<sup>26</sup> Principle 5 (2) contains the rule that was formerly laid down in Principle 6. The wording of this rule has been adapted ("*The law should not make ... dependent on the compliance with ...*") for purely stylistic reasons: It was sought to achieve a structure of the sentence that is as close as possible to the related rule in Principle 5 (1).

<sup>27</sup> For the use of the term "*operation*" see fn. 23.

<sup>28</sup> The phrase "*contracts covered by a close-out netting provision*" has been replaced by the term "*obligations covered by this provision*". Principles 1 and 2 refer to (eligible) obligations covered by the close-out netting provision only. In the interest of consistency, the entire Draft Principles should therefore refer to obligations only. No difference in substance is intended.

<sup>29</sup> See fn. 26.

<sup>30</sup> For the use of "*obligations*" instead of "*contracts*" see fn. 28.

<sup>31</sup> This new paragraph covers issues formerly dealt with only in the commentary (paras. 70 and 77 of Doc. C.G.E./Netting/1/WP 02). In the first meeting of the Committee, the relevance especially of possible regulatory consequences was acknowledged (see Doc. C.G.E./Netting/1/Report, paras. 34 and 39). In order to give more prominence to such possible sanctions other than a restriction of the operation of the close-out netting provision (or the covered obligations, in the case of paragraph (2)), it is now expressly stated in the black letter rules that such administrative, regulatory and other sanctions are not affected by Principle 5. Alternatively, this notion could instead be reflected under the "key considerations" that precede the commentary.



**Amendments to the commentary to Principle 5 (in Doc. C.G.E./Netting/2/WP 02):**

The commentary to the former Principles 4 – 6 (see Doc. C.G.E./Netting/1/WP 02, paras. 70 - 77) has been clarified concerning the following issues:

- In the key considerations, there is now a reference to the idea expressed in Principle 5(3) that administrative, regulatory and penal sanctions of a failure to comply with reporting requirements are not affected (see the discussion at the first meeting of the Committee, Doc. C.G.E./Netting/1/Report, paras. 34 and 49) and to the relationship between Principle 5 and the form requirements of secured transactions law (see Doc. C.G.E./Netting/1/Report, paras. 32 and 47).
- Para. 82: The reasoning underlying the extension of Principle 5(2) to the protection of the operation of the obligations covered by the close-out netting provision has been clarified.
- Para. 83: A new paragraph has been added to the commentary explaining, *inter alia*, the issues dealt with in Principle 5(3).

**Principle 6: Operation of Close-out Netting Provisions in General**<sup>32</sup>

**6.(1) The law should ensure that a close-out netting provision is enforceable in accordance with its terms.<sup>33</sup> [...] In particular, the law<sup>35</sup>**

- a) *should not impose enforcement requirements beyond those specified in the close-out netting provision itself;<sup>36</sup> and*
- b) *should ensure that, where one or more of the obligations covered by the close-out netting provision are, and remain, invalid, unenforceable or ineligible, the operation of the close-out netting provision is not affected in relation to the other covered obligations<sup>37</sup> [*, which are valid, enforceable and eligible*].<sup>38</sup>*

**[(2) Nothing in these Principles affects the application of any laws and regulations restricting the operation of close-out netting provisions in whole or in part on the basis that the close-out netting provision conflicts with laws and regulations concerning fraud or the conditions for validity of contracts.]<sup>39</sup>**

<sup>32</sup> The former Principle 7 on the enforceability of close-out netting has been divided into two Principles so as to emphasize the fact that the draft Principles deal with the operation of close out netting provisions also outside insolvency proceedings. The rules on the enforceability of close-out netting provisions that are specific to insolvency proceedings (*i.e.* rules against provisions of national law that would restrict the operation of close-out netting provisions in an insolvency-specific context), are contained in Principle 7. Principle 6 covers general rules on the enforceability of close-out netting provisions that are relevant for the protection of the operation of these provisions in and outside insolvency proceedings.

<sup>33</sup> Sentence 1 of Principle 6 (1) contains the content of former Principle 7 (1) sent. 1. The last phrase of that sentence, "*before and after the commencement of an insolvency proceeding in relation to one of the parties*", however, has been deleted following a suggestion to this effect in the first meeting of the Committee (see Doc. C.G.E./Netting/1/Report, para. 62). The deleted phrase indicated a generality of the enforceability of the close-out netting provision, which would be misleading in the light of the various exceptions allowed under the Principles (formerly dealt with in the commentary only, para. 89 of Doc. C.G.E./Netting/1/WP 02, now see Principle 6 (2)).

<sup>34</sup> The opening phrase "*without limiting the generality of the foregoing*" in the former Principle 7 (1) sent. 2 has been deleted to reflect the view of the Committee that the deleted phrase would be misleading in the light of the various exceptions allowed under the Principles (see Doc. C.G.E./Netting/1/Report, para. 61).

<sup>35</sup> The new chapeau of Principle 6 (1) sent. 2 indicates that the enumeration of examples in subparagraphs (a) and (b) is non-exclusive. As under the former Principle 7 (1) sent. 2, the general rule in Principle 6 (1) sent. 1 would also exclude other restrictions of the operation of the close-out netting provision (subject to the exceptions in Principle 6 (2)).

<sup>36</sup> Principle 6 (1) sent. 2 sub-paragraph (a) corresponds to the former Principle 7 (1) sent. 2 sub-paragraph (a). The text of this provision has remained unaltered.

<sup>37</sup> The new wording is intended to address the concern, expressed at the first meeting of the Committee, that the former Principle 7 (1) sent. 2 sub-paragraph (b) was not sufficiently clear as to whether the close-out netting provision remained enforceable in its entirety, or only in relation to those obligations that are not unenforceable and/or ineligible (see Doc. C.G.E./Netting/1/Report, para. 64).

<sup>38</sup> The phrase in square brackets could be included in order to stress that the other obligations, in relation to which the operation of the close-out netting provision is upheld, must be "*valid, enforceable and eligible*." However, it could also be argued that the sentence is sufficiently clear even without this phrase, since the use of the term "*other*" indicates that these other obligations must be different from those obligations which are mentioned first in the sentence, and which are "*invalid, unenforceable or ineligible*."

<sup>39</sup> The new provision in draft Principle 6 (2) is intended to address the concern, expressed at the first meeting of the Committee (see Doc. C.G.E./Netting/1/Report, paras. 64 and 65), that Principle 6 (1) should not be understood as validating a close-out netting provision and underlying transactions that were invalid under general principles of contract law. However, this notion could instead be reflected under the "key considerations" that precede the commentary.

**Principle 7: Additional Rules on the Operation of Close-out Netting Provisions in Insolvency<sup>40</sup>**

**7.(1) The law should ensure<sup>41</sup> that upon the commencement of insolvency proceedings in relation to a party to the close-out netting provision<sup>42</sup>**

- a) *the operation of the close-out netting provision is not<sup>43</sup> stayed,<sup>44</sup>*
- b) *the [relevant]<sup>45</sup> insolvency administrator or [relevant]<sup>46</sup> court should not be allowed to demand from the other party performance of any<sup>47</sup> of the obligations covered by the close-out netting provision, even if these obligations are otherwise enforceable,<sup>48</sup> while rejecting<sup>49</sup> the performance of any obligation owed to the other party that is covered by the close-out netting provision and otherwise enforceable;<sup>50</sup>*
- c) *the mere entering into and operation of a close-out netting provision as such should not constitute grounds for the avoidance of a close-out netting provision on the basis that it is deemed inconsistent with the principle<sup>51</sup> of equal treatment of creditors; and*
- d) *the operation of a close-out netting provision<sup>52</sup> should not be restricted merely because the close-out netting provision or one or more of the obligations covered by this provision<sup>53</sup> were entered into during a prescribed period before, or on the day of but before, the commencement of the proceedings.*

**[(2) These Principles do not affect a partial or total restriction of the operation of close-out netting provisions under the relevant insolvency law as a fraudulent transaction or as a preference that is detrimental to other creditors, where factors other than or additional to those covered by paragraph (1) of this Principle are present].<sup>54</sup>**

<sup>40</sup> As has been pointed out above in fn. 32, the former Principle 7 has been split up into two provisions, and the rules on the enforceability of close-out netting provisions that are specific to insolvency proceedings (*i.e.* rules against provisions of national law that would restrict the operation of close-out netting provisions in an insolvency-specific context), are contained in Principle 7. The title of the provision confirms that upon the commencement of insolvency proceedings, the rules in Principle 7 apply as “*additional rules*”, *i.e.* the rules in Principle 6 remain applicable as well. The provisions in Principle 7 (1)(a) to (d) cover the same issues as the former Principle 7 sent. 2 (c)(i) to (iv), even if the order of the first two sub-divisions has been reversed.

<sup>41</sup> The chapeau of Principle 7 (1) resembles the chapeau of the former Principle 7 sent. 2 (c). The phrase “*The law should ensure*” was introduced for purposes of consistency of the language applied in the various provisions of the Principles and no change to the substance of the rule was intended in this respect.

<sup>42</sup> In the chapeau of the former Principle 7 sent. 2 (c), the phrase “*in relation to one of the parties*” was used. Since this wording could invite doubts as concerns the question whether situations are covered, where insolvency proceedings in relation to both parties have been commenced (see for a similar issue *supra* fn. 6 and the comments of the Government of Sweden in the Doc. C.G.E./Netting/1/WP 03, p. 4), it is suggested to use the phrase “*in relation to a party to the close-out netting provision*” which would cover this case as well.

<sup>43</sup> Merely for linguistic reasons, the phrase “*should not*” in the former Principle 7 sent. 2 (c)(ii) has been replaced by “*is not*”. “*Should*” is already used in the chapeau of this provision.

<sup>44</sup> Apart from the minor change referred to in the preceding footnote, the text of the former Principle 7 sent. 2 (c)(ii) has not been altered in the new Principle 7 (1)(a).

<sup>45</sup> Principle 7 (1)(b) contains the rule formerly covered by Principle 7 sent. 2 (c)(i). A few amendments to the former wording are suggested: Since this is the first time that the Principles mention an insolvency administrator, and since Principle 7 (1) is now drafted wide enough to cover the case where insolvency proceedings have been commenced in relation to both parties (see *supra* fn. 42), it is suggested that the term “*relevant*” is added in order to express more clearly that it should be the insolvency administrator acting in the

insolvency proceedings in relation to the counterparty of the party from whom the performance of obligations is demanded under the first half-sentence of Principle 7 (1)(b).

<sup>46</sup> Similarly to the preceding footnote, this is the first time that the Principles mention an insolvency court and it is therefore suggested that the term "*relevant*" is added in order to highlight that the court referred to in this provision must be competent under the laws and regulations of the implementing state to act in the context of insolvency proceedings in relation to the counterparty of the party from whom the performance of obligations is demanded under the first half-sentence of Principle 7 (1)(b).

<sup>47</sup> The term "*only some*", which was used in the former version of Principle 7 sent. 2 (c)(i) has been replaced with the word "*any*" so as to make it clear that an insolvency representative that intends to reject any of the obligations owed to the counterparty of the insolvent party is not entitled to demand the performance of *any* (whether one, some or all) of the obligations covered by the close-out netting provision that are owed by the counterparty of the insolvent party.

<sup>48</sup> It is suggested that it is useful to introduce this reference to the enforceability of the obligations owed by the counterparty of the insolvent debtor since in all cases of an automatic termination under the close-out netting provision, the insolvency representative can no longer demand performance of the individual obligations that were formerly owed by the counterparty of the insolvent party, because these obligations have all been reduced to or replaced by the single net obligation under the close-out netting provision.

<sup>49</sup> The term "*repudiating*" has been replaced by "*rejecting*" since the latter term corresponds to the terminology of the UNCITRAL Legislative Guide on Insolvency (see recommendation 73 and Doc. C.G.E./Netting/1/Report, para. 65).

<sup>50</sup> The phrase "*any obligation owed to the other party that is covered by the close-out netting provision and otherwise enforceable*" (rather than simply "*the remaining obligations*") has been suggested in view of the comments by the World Bank (Doc. C.G.E./Netting/1/WP 06, p. 6) highlighting the principle that at least generally the unenforceability of obligations that are owed to the counterparty of the insolvent debtor and that are unenforceable for reasons unrelated to the close-out netting provision should not be affected by the draft Principles. The amendment suggested here also seeks to align this provision with the amendments in Principle 6 (1) sent. 2 (b) which expressly deal with the issue of the operation of a close-out netting provision where covered obligations are unenforceable (see Doc. C.G.E./Netting/1/Report, para. 64).

<sup>51</sup> The changes in this provision are intended to make it clear, as requested by the Committee of Governmental Experts (see Doc. C.G.E./Netting/1/Report, para. 68), that this principle is concerned only with the application of rules under which the entering into a close-out netting provision might be regarded as an *ipso facto* violation of the non-deprivation rule, but that instances of actual preferential treatment are not protected.

<sup>52</sup> Principle 7 (1)(d) contains the content that was formerly covered in Principle 7 sent. 2 (c)(iv). The phrase "*a close-out netting provision and any of the obligations covered by it should not become unenforceable*" from the former Principle 7 sent. 2 (c)(iv) has been replaced by "*the operation of a close-out netting provision should not be restricted*" in this version of Principle 7 (1)(d). In the first meeting of the Committee, concerns were raised in relation to the issue that this provision seemed to be too far-reaching in its effects in relation to the covered obligations (see Doc. C.G.E./Netting/1/Report, para. 71 and the comments by the World Bank in Doc. C.G.E./Netting/1/WP 06, pp. 7 s). Therefore, this provision has been restricted so as to uphold the "*operation of a close-out netting provision*" only (which would include the consideration of the obligation concerned for purposes of the calculation of the single net obligation), but not also the enforceability of the obligation concerned as such.

<sup>53</sup> The changes referred to in the preceding footnote made it necessary to replace the simple term "*it*", which under the previous wording of former Principle 7 sent. 2 (c)(iv) clearly referred to the close-out netting provision and/or any obligation covered by this provision, by the more explicit phrase "*the close-out netting provision or one or more of the obligations covered by this provision*". This amendment was not intended to be a change of substance.

<sup>54</sup> The new paragraph is intended to clarify that the draft Principles do not constitute a safe harbour for instances of actual fraud (see Doc. C.G.E./Netting/1/Report, para. 64 and 68). Alternatively, this notion could instead be reflected under the "key considerations" that precede the commentary.

**Amendments to the commentary to Principles 6 and 7 (in Doc. C.G.E./Netting/2/WP 02):**

The commentary to the previous version of Principle 7 (Doc. C.G.E./Netting/1/WP 02, paras. 78 to 115) is used as the basis for the commentary to the new Principles 6 and 7. It should be noted that the order of some paragraphs has been changed. The following major amendments as to the substance have been made:

- Key considerations: More prominence is given in the key considerations to the core concept that the operation of close-out netting provisions should be governed by the terms agreed by the parties (see Principle 6(1) sent. 1).
- Paras. 84 – 88: These paragraphs have been added to set out the general systematic structure of Principles 6 and 7.
- Para. 92: There is a cross-reference to the delimitation of set-off and netting in the commentary to Principle 1.
- Paras. 103 ss: The commentary concerning the consequences of the invalidity etc. of one or some of the covered obligations has been clarified, see Doc. CGE/Netting/1/Report para. 64.
- Para. 107: The reference to Principle 8 has been adapted to correspond to the revised version of that Principle.
- Para. 111: This paragraph has been revised in order to reflect the changes to the wording of Principle 7(1)(b). It is also spelt out that the insolvency representative's right of rejection of *all* contracts covered by the close-out netting provision is not affected, see the request for clarification in Doc. CGE/Netting/1/Report para. 66.
- Para. 113: The amendments to this paragraph reflect the changes to the wording of Principle 7(1)(c).
- Para. 114: References to the *pari passu* principle and to the principle on the unenforceability of *ipso facto* clauses have been added.
- Paras. 118, 121 and 122: There have been small amendments to these paragraphs in order to reflect the changes to the wording of Principle 7(1)(d) concerning the effects of this Principle in relation to the obligations covered by the close-out netting provision.
- Paras. 125 ss: These paragraphs have been added to clarify the limitations of the principle on the enforceability of close-out netting provisions according to their terms and correspond to the new Principles 6(2) and 7(2), see also Doc. CGE/Netting/1/Report paras. 61 ss.

As was suggested at the first meeting of the Committee, it has been spelt out that these Principles refrain from defining the additional factors in the sense of Principle 7 (2), *i.e.* the additional elements whose presence justifies the application of the national laws and regulations restricting the operation of close-out netting provisions as a fraudulent transaction or as a preference that is detrimental to other creditors (see also Doc. CGE/Netting/1/Report para. 68).

The treatment of walk-away clauses and wait-and-see periods has been aligned with the commentary to Principle 2, the same applies to the application of standards of commercial reasonableness by some legal systems (see also Doc. CGE/Netting/1/Report paras. 63, 70).

- After para. 128: As of yet, there is only a footnote referring to the treatment of the consequences of a subordination of some of the obligations covered by the close-out netting provision. This issue was raised during the discussions at the first meeting of the Committee, but it was agreed that it needed further consideration, see Doc. CGE/Netting/1/Report para. 72).

### **Principle 8: Resolution of Financial Institutions**

**8. *These Principles*<sup>55</sup> *are without prejudice to a stay of the operation of a close-out netting provision*<sup>56</sup> *which the law of the implementing State, subject to appropriate safeguards,*<sup>57</sup> *may provide for in the course of resolution proceedings for financial institutions.*<sup>58</sup>**

---

<sup>55</sup> The opening phrase (and the heading of the draft Principle) has been redrafted in more general terms, rather than as a specific cross-reference to the former Principle 7 (c)(ii), so as to reflect the wish expressed in the first meeting of the Committee that Principle 8 should be drafted in more general terms, reflecting the fact that there are various types of resolution measures under national law beyond a temporary stay (see Doc. C.G.E./Netting/1/Report, para. 74).

<sup>56</sup> The former version of Principle 8 referred to the power to “temporarily” stay the “acceleration or termination rights” arising under a close-out netting provision. In the first meeting of the Committee, the point was raised that this was too narrow and Principle 8 should cover all stays, even where not only temporary (see Doc. C.G.E./Netting/1/Report, para. 74).

The Financial Stability Board’s Key Attributes for Effective Resolution Regimes for Financial Institutions (October 2011, available under [http://www.financialstabilityboard.org/publications/r\\_111104cc.pdf](http://www.financialstabilityboard.org/publications/r_111104cc.pdf)) refer not only to temporary stays (see Key Attributes, para. 4.3), but also to the power of the resolution authorities permanently to stay the exercise of certain rights under the close-out netting provision where the contracts concerned have been transferred to a bridge institution and where the termination rights concerned are based solely upon an event that had occurred only in relation to the original debtor institution (Key Attributes, Annex IV, 2.1 (vi)).

<sup>57</sup> The former paragraph (2) of Principle 8 restricted the possibility to order a temporary stay of the operation of a close-out netting provision to a very limited set of circumstances, reflecting the policy choices expressed by the Financial Stability Board under para. 4.3 of its Key Attributes for Effective Resolution Regimes for Financial Institutions. However, in the first meeting of the Committee it was argued that the Principles should allow for more flexibility and that it would not be necessary to express all the criteria for the exercise of such powers in the context of the resolution of financial institutions in the black letter rules (see Doc. C.G.E./Netting/1/Report, paras. 75 s).

<sup>58</sup> The former version of Principle 8 referred to the competent authorities’ “power, in the exercise of their resolution powers in respect of financial institutions”. This phrase has been replaced in the present version of Principle 8 by the words “in the course of resolution proceedings for financial institutions”. The new formula is intended to be broader in order to cover both the exercise of a power by a competent authority and also situations where there is a stay by operation of law.

**Amendments to the commentary to Principle 8 (in Doc. C.G.E./Netting/2/WP 02):**

- Key considerations: In the key considerations, it is highlighted that the use of the term 'appropriate safeguards' is to be understood as a reference to the international standards on special resolution regimes, which currently are set by the Financial Stability Board's Key Attributes. For the discussion at the first meeting of the Committee concerning the concept of adequate safeguards see Doc. C.G.E./Netting/1/Report, paras. 75 s.
- Key considerations: The key considerations also refer to the fact that under the Financial Stability Board's Key Attributes there are also other types of resolution measures that are different from a (temporary) stay. It is clarified that the Principles are without prejudice to such other powers that do not affect the operation of close-out netting provisions.
- Para. 129: This paragraph reiterates the reference to the standards set by the Financial Stability Board's Key Attributes. In order to express clearly that the Principles do not intend to deviate from the international standards on special resolution regimes as set by the Financial Stability Board's Key Attributes, those standards are quoted literally.

### **Principle 9: Governing Law of Close-Out Netting Provisions**

**9. (1) *The private international law rules of the implementing State should determine the law<sup>59</sup> that governs the operation<sup>60</sup> of the close-out netting provision, taking into account, to the extent permitted by the laws of the implementing State, any choice of the governing law by the parties.***<sup>61</sup>

**(2) *The governing law in accordance with paragraph (1)***<sup>62</sup> *further determines which parties and obligations are eligible for being covered by the close-out netting provision.*

**(3) *The law should ensure that***<sup>63</sup> *[...]*<sup>64</sup> *a choice of law made in a close-out netting provision prevails [in relation to this provision]*<sup>65</sup> *over any other*<sup>66</sup> *choice of law made in or in relation to the obligations*<sup>67</sup> *covered by the close-out netting provision except as otherwise provided by the parties.*<sup>68</sup>

**[(4) *The law should ensure that the commencement of insolvency proceedings does not affect the determination of the governing law or laws for the operation of the close-out netting provision and the obligations covered by this provision.*]**<sup>69</sup>

**(5) *Notwithstanding the above, if insolvency proceedings have been commenced in respect of a party to the close-out netting provision [or a branch of that party] and under a law other than the law determined in accordance with paragraph (1), the implementing State may provide that the law governing the insolvency proceedings governs also***<sup>70</sup>

**a) *the determination of the scope of parties and obligations that are eligible for close-out netting for the purposes of the enforcement of the close-out netting provision in the context of insolvency proceedings before the courts of the relevant implementing State;***<sup>71</sup> *and*

**b) *the avoidance of a close-out netting provision as a fraudulent transaction or as a preference that is detrimental***<sup>72</sup> *to other creditors of the insolvent party.*<sup>73</sup> *[...]*<sup>74</sup>

---

<sup>59</sup> While the former version of Principle 9 (1) referred substantive issues relating to certain specified aspects of the close-out netting provisions to “*the law governing the close-out netting provision*”, the amended version suggested states that “*The private international law rules of the implementing State should determine the law*” governing the close-out netting provision. The wording suggested here was partly inspired by a drafting proposal of the Government of the United States of America (Doc. C.G.E./Netting/1/WP 03, p. 8 s) and it expresses more clearly the general concept of this Principle.

<sup>60</sup> In the former version of Principle 9 (1), there was an enumeration of the various issues to be determined by the law governing the close-out netting provision (“*The conditions for the validity and effectiveness of the close-out netting provision, including formal steps to be taken to render the provision valid and effective*”). This enumeration of individual issues has been replaced by the use of the all-encompassing term “*operation*” (see fn. 23).

<sup>61</sup> References in the Principles to a choice of law by the parties must be made subject to the qualification that such a choice of law is given effect to under the applicable regime of private international law (see former paragraph (3)). By inserting such a qualified reference to choice-of-law clauses in paragraph (1) of Principle 9, more prominence is given to the role of party autonomy concerning choice of law. This reflects the importance in practice of agreements on the applicable law in relation to close-out netting provisions. See also the discussion in Doc. C.G.E./Netting/1/Report, para. 101.

<sup>62</sup> The cross-reference to paragraph (1) avoids repetition of the phrase “*the law that governs the operation of the close-out netting provision*”.

<sup>63</sup> For purposes of consistency, the formula “*The law should ensure that*” has been introduced, cf. the similar wording of Principles 6 (1) and 7 (1).



<sup>64</sup> The qualification formerly contained in paragraph (3) (*"to the extent that choice-of-law clauses are admitted by the relevant rules of private international law"*) has been deleted since this issue is now dealt with more prominently in paragraph (1). See above fn. 61.

<sup>65</sup> It is suggested to add this qualification so as to avoid the impression, which seems unintended, that a choice-of-law clause in the close-out netting provision would always prevail over any different agreement as to the applicable law even in relation to the determination of the governing law of the individual obligations covered by the close-out netting agreement.

<sup>66</sup> The reference to *"any other choice of law"* replaces the phrase *"any previous, different choice of law"* from the former version of Principle 9 (3), which was felt to be too narrow by limiting the effects of the draft Principle only to other agreements on the applicable law that were concluded *before* the choice of law-clause in the close-out netting provision (see Doc. C.G.E./Netting/1/Report, para. 101).

<sup>67</sup> The phrase *"choice-of-law clause contained in a contract"* in the former Principle 9 (3) has been replaced by *"choice of law made in or in relation to the obligations"* for purposes of consistency with the terminology used elsewhere.

<sup>68</sup> The phrase *"except as otherwise provided by the parties"* has been moved from the beginning of former Principle 9 (3) to the end of this provision without there being any change in substance.

<sup>69</sup> Paragraph (4) of Principle 9 as suggested here is intended to reflect the discussions at the first meeting of the Committee, where there was wide support for the recommendation that Principle 9 should give more prominence to the general principle that insolvency proceedings should recognise existing rights and obligations of the insolvent debtor under their own law regardless of the forum of the insolvency proceedings (see Doc. C.G.E./Netting/1/Report, para. 93). It was stressed that it should be ensured that also the interpretation of close-out netting provisions should continue to be governed by their own proper law, rather than by the law of the forum State of the insolvency proceedings (see Doc. C.G.E./Netting/1/Report, para. 112).

<sup>70</sup> In the first meeting of the Committee (see Doc. C.G.E./Netting/1/Report, para. 104), member States of the European Union stated that they are bound under the Insolvency Regulation to apply foreign insolvency avoidance provisions (Art. 13 of Regulation 1346/2000) and therefore a mandatory application of the law of the forum as envisaged under the former version of Principle 9 (4)(a) would be in conflict with European secondary legislation. The present version of Principle 9 (5) allows for more flexibility and merely provides that *"the implementing State may provide that the law governing the insolvency proceedings governs also"* the issues covered by sub-paragraphs (a) and (b). This means that there is under these Principles a preference for the application of the own proper law of the close-out netting provision, while the implementing States may opt out of this approach and provide for the application of the forum law instead.

<sup>71</sup> In the first meeting of the Committee, it was argued that at least the issue whether a close-out netting provision was enforceable in insolvency in relation to certain covered parties and obligations should be left for the forum state to decide under its own law (see Doc. C.G.E./Netting/1/Report, paras. 99 s and 108 ss). Other members of the Committee, however, argued in favour of the application of the own proper law of the close-out netting provision also in relation to this issue (see Doc. C.G.E./Netting/1/Report, paras. 98 and 109; this was also the position under the previous version of Principle 9 (2)). The present wording of Principle 9 (5)(a) is a compromise between these positions by way of an opt-out solution.

<sup>72</sup> The reference to the avoidance of a close-out netting provision *"as a preference or a contract in fraud of other creditors"* in the former version of Principle 9 (4)(a) has been replaced by the phrase *"as a fraudulent transaction or as a preference that is detrimental to other creditors"* to adapt it to the new wording of Principle 7 (2) (see also the discussion in Doc. C.G.E./Netting/1/Report, para. 106).

<sup>73</sup> Apart from the amendment referred to in the preceding footnote, the text of the former Principle 9 (4)(a) has remained unaltered in the new Principle 9 (5)(b). For the change of the structure of new Principle 9 (5)(a) and (b), see above fn. 70.

<sup>74</sup> The former Principle 9 (4)(b) has been deleted since under the new structure of paragraph (5) a separate reference in the black letter rules to the law governing the temporary stay was no longer thought to be necessary.

**Amendments to the commentary to Principle 9 (in Doc. C.G.E./Netting/2/WP 02):**

- Key considerations: The key considerations to the Principle have been redrafted in order to reflect more clearly the policies of this Principle especially as expressed in its revised paragraphs (1), (4) and (5), respectively.
- Para. 133: References in the former version of the commentary to Principle 9 to possible policy choices regarding the private international law rules of the national legal systems have been deleted.
- Para. 134: While the references to overriding mandatory rules of the forum in general have been kept, the reference has been deleted that there could be a possibility that such rules could “contribute to determining the law governing the close-out netting provision, thus preventing the parties from circumventing the State’s policy choices concerning, for instance, the parties and obligations eligible for close-out netting”. For the discussion at the first meeting of the Committee concerning these issues see Doc. C.G.E./Netting/1/Report, para. 92).
- Paras. 135 - 137: These paragraphs have been redrafted and have been limited to the role as a commentary to paragraph (2), which allowed the deletion of such paragraphs which referred to mandatory rules of the forum or to the choice of law by the parties.
- Para. 141: This paragraph has been introduced in order to set out clearly the qualification that is now contained at the end of Principle 9(1), i.e. that a choice of law by the parties is relevant only if permitted by the laws of the implementing State.
- Paras. 144 - 146: These new paragraphs have been introduced in order to set out the policy choices of the revised version of Principle 9, especially 9(4) and 9(5).

\* \* \*