



**UNIDROIT Study Group on principles and  
rules on the netting of financial  
instruments**

***First Meeting***  
**Rome, 18 – 21 April 2011**

UNIDROIT 2011  
Study LXXVIII C – Doc. 3  
Original: English  
April 2011

**A first tentative structure for  
Principles regarding the enforceability of netting agreements**

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**Definitions**

1. “Close-out netting agreement”<sup>1</sup> means an agreement between two or more parties under which, on the occurrence of an enforcement event in relation to one of the parties, either or both of the following should occur, or may at the election of the other party occur:
  - the respective 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;
  - an account is taken of what is due from each party to the other in relation to 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.
2. “Umbrella-netting agreement” means or of a set of connected close-out netting agreements.
3. “Enforcement event”<sup>2</sup> means, in relation to a close-out netting agreement, an event of default of one of the parties or other event in relation to one of the parties on the occurrence of which, under the terms of that close-out netting agreement,
  - the other party is entitled elect the operation of a the close-out netting agreement, or
  - the operation of the close-out netting occurs;
4. “Insolvency proceeding”<sup>3</sup> means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the debtor are subject to control or supervision by a court or other competent authority for the purpose of reorganisation or liquidation.

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<sup>1</sup> Adapted from the Geneva Securities Convention, Article 31(j); EU Financial Collateral Directive, Article 2(1)(n). Cf. Doc. 2 [83-85], [109]-[110], [278]-[282].

<sup>2</sup> Adapted from the Geneva Securities Convention, Article 31(h); EU Financial Collateral Directive, Article 2(1)(l).

<sup>3</sup> Adapted from the Geneva Securities Convention, Article 1(h).

**Formal requirements for close-out netting agreements<sup>4</sup>**

5. The creation, validity, perfection, enforceability or admissibility in evidence of a close-out netting agreement should not be dependent on the performance of any formal act.<sup>5</sup>

6. Principle 5 is without prejudice to the requirement that a close-out netting agreement can be evidenced in writing or any legally equivalent form.<sup>6</sup>

7. Principle 5 is without prejudice to any requirement regarding the registration of the financial contracts covered by the close-out netting agreement with a trade repository or similar organisation for purposes of prudential supervision. Failure to comply with that requirement should not affect the creation, validity, perfection, enforceability or admissibility in evidence of a close-out netting agreement.

8. The creation, validity, perfection, enforceability or admissibility in evidence of a close-out netting agreement should not depend on the use of standardised terms, as for example the terms of specific trade associations.

**Enforceability of close-out netting agreements<sup>7</sup>**

9. A close-out netting agreement should take effect in accordance with its terms.<sup>8</sup>

10. A close-out netting agreement should be enforceable notwithstanding the commencement or continuation of insolvency proceedings in relation to one of the parties to the agreement. This principle is subject to any contrary provision of the netting agreement.<sup>9</sup>

11. After the commencement of an insolvency proceeding:

- the net sum is payable to the insolvent party by the other party if it is owed by the latter;
- if the insolvent party owes the net sum to the other party, the latter becomes creditor in the insolvency proceeding to the amount of the net sum.

12. A close-out netting agreement should be enforceable without any requirement that:<sup>10</sup>

- prior notice of the intention to operate the close-out netting agreement should have been given;
- the terms of the realisation or the operation of the close-out netting agreement be approved by any court, public officer or other person; or
- the realisation be conducted by public auction or in any other prescribed manner or the close-out netting agreement be operated in any prescribed manner;

subject to any contrary provision of the netting agreement.

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<sup>4</sup> Cf. Doc. 2 [93-94]; [283]-[289].

<sup>5</sup> Adapted from the EU Financial Collateral Directive, Article 3(1).

<sup>6</sup> Adapted from the EU Financial Collateral Directive, Article 3(2).

<sup>7</sup> Cf. Doc. 2 [44]-[54]; [292]-[296].

<sup>8</sup> Adapted from the Geneva Securities Convention, Article 32, and Article 7(1) EU Financial Collateral Directive.

<sup>9</sup> Adapted from the Geneva Securities Convention, Article 33(3)(b); Article 4(5) EU Financial Collateral Directive.

<sup>10</sup> Adapted from the Geneva Securities Convention, Article 33(3)(a); Article 4(4) EU Financial Collateral Directive.

13. Principle 12 does not affect the application of any rule of law pursuant to which the valuation of the respective obligations of the parties as part of the operation of a close-out netting agreement must be conducted in a commercially reasonable manner.<sup>11</sup>

14. A close-out netting agreement or an obligation covered by it should not be treated as invalid, reversed or declared void solely on the basis that the agreement is entered into or the obligation is incurred during a prescribed period before, or on the day of but before, the commencement of an insolvency proceeding in relation of one of the parties.<sup>12</sup>

15. A close-out netting agreement should remain enforceable even if one or more of the covered financial contracts are ineffective, void or voidable.

### **Enforceability of umbrella-netting-agreements<sup>13</sup>**

16. An umbrella-netting agreement should take effect in accordance with its terms. Principles 9 - 15 apply accordingly.

### **Conflict of laws<sup>14</sup>**

17. Any question in respect of the matters stated below should be governed by the law of the country which has been chosen by the parties as governing the close-out netting agreement:

- the validity and effectiveness of the close-out netting agreement, including formal steps to be taken to render the agreement valid and effective;
- the question of which types of financial contracts can be covered by the close-out netting agreement.

18. The reference to the law of a country is a reference to its substantive domestic law, excluding its rules of private international law. The choice of law made in a close-out netting agreement should prevail over any previous differing choice-of-law clause contained in a contract covered by the close-out netting agreement to the extent that the matters specified in third sentence of Principle 17 are concerned if the parties have not made express provision to that effect.

19. Any question in respect of the matters stated below should be governed by the law governing the insolvency proceeding which may have been commenced in respect of one of the parties to a close-out netting agreement:

- the avoidance of a close-out netting agreement as a preference or a contract in fraud of other creditors of the insolvent;
- the termination or temporary stay of a close-out netting agreement as a consequence of the commencement of the insolvency proceeding.

### **Eligible parties**

To be determined, *cf.* Doc. 2 [98]-[100] and [305]-[307].

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<sup>11</sup> Adapted from the Geneva Securities Convention, Article 35; EU Financial Collateral Directive, Article 4(6).

<sup>12</sup> Adapted from the Geneva Securities Convention, Article 37; EU Financial Collateral Directive, Article 8(1).

<sup>13</sup> *Cf.* Doc. 2 [290]-[291].

<sup>14</sup> *Cf.* Doc. 2 [102]-[106].

**Eligible financial contracts**

To be determined, *cf.* Doc. 2 [95]-[97] and [297]-[304].

**Any additional principles regarding commercial/insolvency law issues arising in the context of cross-border bank resolution**

Such issues might relate to civil/insolvency law issues in respect of bank resolution procedures as such or to adjacent issues as for example the treatment of collateral arrangements in respect of regulatory transfers, *cf.* Doc. 2 [165]-[269], including footnote 151.