Insolvency close-out netting: A comparative study of English, French and US laws in a global perspective

Muscat, B.

5 Insolvency Close-out Netting under French Law

5.1 Overview of the Regulation of Insolvency Close-out Netting under French Law

Whilst in Chapter 4 the recognition of close-out netting provisions was considered from the perspective of English law which is based on the common law tradition, the same consideration will be made in this chapter in respect of French law which belongs to the civil law group. The assumption is that given the different legal traditions of these two bodies of law, an analysis of French law should or may bring out a different perspective of the treatment of insolvency close-out netting. Consistent with the approach taken in the English law chapter, the first part of this chapter will give an overview of the insolvency and bank resolution rules applying under French law and in relation to which a derogation applies in favour of close-out netting provisions. This is followed by a preliminary analysis of the law regulating insolvency close-out netting, including an assessment of the scope of these rules.

Insolvency Rules

French insolvency law proceedings are regulated by Book VI of the Commercial Code. This branch of French law is one characterised by continuous change, with major amendments being initiated in 1967 by Law no. 67-563 of 13 July 1967 which established a dual approach to insolvency, according to which a business could be either rescued or liquidated.[1] The term bankruptcy (*'faillite'*) was, until 1967, the generic name given to insolvency proceedings. The legal terminology nowadays is 'collective proceedings' (*'procédures collectives'*) or also 'law of businesses in difficulty' (*'droit des entreprises en difficulté'*) which terminology is reflected in the title given to Book VI and which is typically used to describe French insolvency proceedings where the debtor is in a payment cessation situation.[2]

---

1 Book VI applies to both corporate and individual insolvency proceedings. The Commercial Code was enacted in 2000 as part of the bicentenary celebrations of the codification project inaugurated by Napoleon. For a description of the main changes to French insolvency laws throughout modern times, see COUTURIER (2013) 14.

2 Hervé Synvet, 'The Exclusion of Certain Creditors from the Law of Collective Proceedings', in RINGE *et al.* (2009) 159. Under French law, a situation of cessation of payments (*'cessation des paiements'*) arises when a debtor is unable to meet current liabilities out of disposable assets as provided by article L.631-1 of the Commercial Code. The French insolvency test is therefore a cash-flow test.

There are three main types of collective insolvency proceedings under French law which may be considered relevant to the application of insolvency close-out netting provisions. These proceedings apply to self-employed individuals as well as to all types of legal entities. The main type of insolvency proceeding following the 1967 amendments is judicial restructuring ('*redressement judiciare*')[3] aimed at allowing a debtor company to recover from financial difficulty or to have the business sold as a going concern. Where there are prospects that the business can recover, the court will make an order for the start of restructuring proceedings subject to the supervision of a court-appointed administrator, a supervising judge and a creditors' representative. A moratorium on creditors' claims is imposed and the creditors must, as a general rule, accept any reorganisation plan that is approved by the court. Judicial restructuring culminates in a court decision that usually adopts the recommendation of the court-appointed administrator on whether a business should operate under a continuation plan, be sold under a sales plan, or be liquidated.

The second is the judicial liquidation ('*liquidation judiciare*') procedure which is resorted to if there is no possibility to restructure the business.[4] A liquidator is appointed to represent the dispossessed debtor and to liquidate all the assets of the debtor with a view to maximising proceeds. It is common for the court to nominate as liquidator the creditors' representative initially appointed in the context of restructuring proceedings. In liquidation proceedings, creditors expect to be paid from the proceeds realised from the sale of the debtor's assets. Claims are accelerated in the sense that they become immediately payable on the day of the opening of the proceedings. The liquidator appointed by the court receives lodged claims and is responsible for checking them, before proceeding to draw up a scheme of distribution.[5]

The third is the safeguard proceeding ('*procédure de sauvegarde*') introduced in 2005 by Law no. 2005-843 of 26 July 2005. This procedure has been tailored on Chapter 11 proceedings in the United States. Unlike the judicial restructuring or judicial liquidation proceedings, safeguard proceedings may be requested in favour of a debtor who is not yet insolvent and serves to suspend action by individual creditors. The debtor, however, needs to demonstrate financial difficulties that may lead to cessation of payments.[6] This is intended to create an early warning mechanism that would prevent failing businesses from becoming insolvent and provides for a six-month 'observation period', renewable for up to eighteen months, during which the debtor will negotiate with its creditors a rescheduling or waiver of debts

3 This procedure is also referred to as judicial reorganisation, judicial recovery or administration procedure.

4 See article L.640-1 of the Commercial Code.

5 The order of priority of payment is established under articles L.622-17 and L.641-13 of the Commercial Code. See in this respect SAINT-ALARY-HOUIN (2013) 420.

6 See article L.620-1 of the Commercial Code.

in the framework of a safeguard plan. The court will appoint a judicial administrator to supervise or assist the debtor and a creditors' representative to receive and verify declarations of claims. Further developments of the safeguard proceeding resulted in the establishment of an accelerated financial safeguard proceeding ('*sauvegarde financière accélerée*') and an accelerated safeguard proceeding ('*sauvegarde accélerée*') introduced by Law no. 2014-1 of 2 January 2014 which enable *inter alia* the implementation of pre-packaged plans, based on the 'pre-pack' procedure introduced in England under the Enterprise Act 2002.

Finally, French law provides for two amicable proceedings which may be considered as preventive measures, namely the conciliation procedure, whereby the creditors and the debtor may reach a contractual arrangement under the supervision of a conciliator appointed by the court to defer payments or agree on reductions on amounts due, and the appointment of an *ad hoc* representative ('*mandataire ad hoc*') to perform a mission as defined by the court. The latter can also play the role of conciliator but without being bound by the rules governing the conciliation procedure. These proceedings do not lead to a stay of payment or a stay of proceedings on creditors unless agreed to voluntarily.

A number of principles apply in relation to French insolvency collective proceedings, some of which directly affect the operation of insolvency close-out netting provisions. An important rule applied in relation to French collective insolvency proceedings is to 'freeze' the claims of creditors during the observation period in relation to both payment of money and the termination of contracts for payment default.[7] Under French law the aim of the observation period is to protect the debtor's assets and allows the court to determine the fate of the company. The commencement order stays claims arising prior to the commencement order.[8] For claims that arise after the commencement order, the principle is that where they are properly incurred for the conduct of the proceedings, they should be paid without delay, unless contractually provided otherwise.[9]

A form of 'cherry-picking' rule applies also under French law. This arises from article L.622-13 of the Commercial Code which allows the debtor company in the course of an observation period during safeguard or reorganisation proceedings to demand that the other party continue to

---

7 See article L.622-21 of the Commercial Code. Citing jurisprudence, Roussille confirms that these are public policy rules and cannot be derogated from by contract unless such derogation is foreseen in the law. ROUSSILLE (2006) 392. See also SAINT-ALARY-HOUIN (2013) 36.

8 There are exceptions to this rule such as in relation to payment by way of set-off of connected claims (see article L.622-7, I of the Commercial Code) or to the rights of creditors protected by a security *in rem* or where this is warranted for the continuance of business, for instance where the court authorises the debtor to pay to obtain a thing pledged. See Hervé Synvet, 'The Exclusion of Certain Creditors from the Law of Collective Proceedings', in RINGE *et al.* (2009) 160.

9 See article L.622-17, I of the Commercial Code.

perform the contract even if it has not been paid for past services. As this rule seems unfair, the contract can only be maintained if the appointed administrator has sufficient funds to pay for the requested services.

The *pari passu* rule also features under French insolvency law and applies to those classes of creditors who are not otherwise privileged in terms of articles L.622-17 and L.641-13 of the Commercial Code. Contrary to the situation under English law, the *pari passu* principle does not seem to be the subject of controversial debate amongst French legal writers in relation to the implications of any priority treatment given to contractual entitlements in an insolvency situation. It may be noted that this rule was strengthened by the 2014 amendments since creditors have been made subject to a new requirement to restore to the insolvent estate any sums received in breach of the *pari passu* rule or that result from a mistake as to the order of priority.[10]

On 26 July 2013, Law no. 2013-672 introduced, *inter alia*, a new banking resolution regime.[11] The adoption of this 2013 Law was the response of the French legislator to implement the Key Principles of the FSB into French law, in particular to implement the rule imposing a temporary stay pending a decision on resolution measures. This was replaced by Ordinance No. 2015-1024 of 20 August 2015[12] which implements the provisions of the BRRD, subsequently ratified and further amended by Law no. 2016-1691 of 9 December 2016. Today the updated provisions are codified in article L.613-34 *et sequens* of the Monetary and Financial Code (the Financial Code). The resolution regime is applicable to banks, financing companies, mixed holding companies and investment firms.[13] In terms of article L.613-49, II, the resolution college of the *Autorité de contrôle prudential et de résolution* (ACPR)[14] may initiate resolution proceedings if any of the institutions mentioned above is failing and such failure may not be otherwise avoided than by the implementation of a resolution measure.[15] The objective of resolution measures are said to be to ensure the continuity of critical functions, avoid financial instability, protect state resources and protect the funds and assets of clients, in particular insured deposits.[16] Under a resolution

10 Article L.643-7-1, Commercial Code, inserted by Article 76 of Ordinance no. 2014-326 of 12 March 2014.

11 The provisions of the 2013 Law were codified as (former) article L.613-31-11 *et seq.* of the Financial Code. See KANNAN (2015) para 3.

12 For a general overview of the differences between the 2013 and 2015 Laws, see BONNEAU (2015) para 14 *et seq.*

13 See Article L.613-34 of the Financial Code for a full list of institutions, including applicable exceptions.

14 The ACPR is responsible for supervising the banking and insurance sectors in France. It is an independent administrative authority attached to the Banque de France, *i.e.* the central bank of France. See the website of the ACPR at < https://acpr.banque-france.fr/en/home.html>.

15 See article L.613-48 of the Financial Code.

16 See article L.613-50 of the Financial Code.

proceeding, the ACPR may adopt a number of resolution measures which may range from requesting information to appointing a special resolution administrator, transferring all or part of a business activity, activating the loss absorption clause of subordinated bonds, mandatory recapitalising of the failing entity, suspending obligations and payments, and the exercise of the bail-in tool in relation to capital and specified liabilities.

This brief overview of French insolvency rules indicates that collective proceedings have traditionally been controlled by the courts. Today French resolution laws give significant discretionary power to the resolution college of the ACPR and this power may be used also to intervene at the early stages of the failure situation in order to prevent further financial deterioration.

The Close-out Netting Provisions of the Financial Code

The main law regulating close-out netting provisions under French law is Section 4 of the Financial Code, with particular reference to article L.211-36-1.[17] This Section 4 implements the EU's Financial Collateral Directive. Contrary to the FCD, however, the French financial netting regime is not restricted to financial collateral arrangements but extends to both collateralised and non-collateralised agreements.[18] Article L.211-36-1 of the Financial Code sets the main rule allowing parties to set off debts and receivables arising under agreements relating to financial obligations referred to in article L.211-36 so that one net sum becomes payable. Article L.211-36 of the Financial Code lists four types of financial obligations:

(a) Those arising from operations in financial instruments as defined in article L.211-1, I of the Financial Code where at least one of the parties is a regulated or eligible person;
(b) Those arising from contracts relating to financial obligations giving rise to cash settlement or to the delivery of financial instruments where all the parties are eligible regulated persons, with the exception of entities referred to in paragraphs (c) to (n) of article L.531-2 of the Financial Code;[19]

17 Pursuant to Ordinance no. 2009-15 of 8 January 2009, article L.211-36-1 replaces the former article L.431-7 of the Financial Code. An examination of the evolution of close-out netting under French law will be carried out later in this chapter. For an account of the different types of netting, see ROUSSILLE (2006) 9; DELOZIÈRE-LE FUR (2003) 46.

18 See ISDA 2018 Jones Day, 9.

19 See article L.211-36-2 of the Financial Code. The terms used in this article namely '*aux obligations financières résultant de tout contrat donnant lieu à un règlement en espèces ou à une livraison d'instruments financiers*', are very wide and may be considered to cover a wide range of contracts. According to the ISDA French Law Opinion, the obligations under this provision need only qualify as 'financial obligations' within the meaning of the EU Financial Collateral Directive. See ISDA French Law Opinion at p 21.

(c) Those arising from a contract relating to financial obligations concluded in the framework of a system mentioned in article L.330-1 of the Financial Code;[20]
(d) Those arising from contracts relating to financial obligations concluded by one or more clearing houses and their participants or between these participants and their clients which directly or indirectly[21] offer set-off services between their clients and the clearing house, and which involve the setting off of claims.

For the purposes of this provision regulated or eligible persons comprise a credit institution, a financing company, an investment services provider, a public body (établissement public), a local government (*collectivité territoriale*), an entity listed in article L.531-2 of the Financial Code,[22] a clearing house, a non-resident establishment with a comparable status and an international financial organisation or body of which France or the EU is a member.

The financial instruments referred to in (a) and (b) above are primarily those listed in article L.211-1[23] of the Financial Code which include financial securities, namely equity securities issued by joint-stock companies, debt securities with the exception of bills of exchange and interest-bearing notes, and units or shares in undertakings for collective investment, as well as financial contracts as defined in article D.211-1 of the Financial Code. To this list, article L.211-36 of the Financial Code adds units listed in article L.229-7 of the Environmental Code, spot FX transactions or purchase, sell or delivery transactions in gold, silver, platinum, palladium or other precious metals, options, futures, swaps and all forward contracts provided that where instruments require physical settlement, they are registered by a recognised clearing house or they are the subject of regular requests for cover.

20 Article L.330-1 of the Financial Code implements the EU's Finality Settlement Directive and refers to systems for interbank settlements and settlement and delivery of financial instruments and provides the criteria for such a system. The consideration of netting provisions in relation to systems falls outside the scope of this research.

21 Whilst the reference to indirect set-off is being used in the context of clearing systems and may constitute a reference to the technical arrangements of such systems, it will be seen in part 5.2 of this chapter that both set-off and netting must involve bilateral mutual relationships to be effective. This distinction is also made by Bonneau *et al.* who consider that set-off and netting are based on the contract itself concluded between the parties, whether the relationship is bilateral or is regulated by a multilateral mechanism such as a clearing system. See BONNEAU *et al.* (2017) para 934.

22 The entities referred to by article L.531-2 of the Financial Code which fall within the scope of article L.211-36 *et seq.* of the Financial Code are primarily (i) public financial institutions such as the *Trésor Public,* the *Banque de France, La Poste,* the *Institut d'Emission des Départements d'Outre-Mer,* the *Institut d'Emission d'Outre-Mer* and (ii) insurance and reinsurance companies, collective investment schemes, *fonds comuns de créances* (French securitisation vehicles), *sociétés civiles de placement immobilier* (a type of building company) and management companies.

23 But excluding those listed in article L.211-1, III of the Financial Code. See article L.211-36, II of the Financial Code.

In its scope of application article L.211-36-1 of the Financial Code reflects a partial opt-out permitted by Article 1(3) of the FCD. The FCD permits Member States to limit the application of the FCD regime to financial collateral arrangements concluded between regulated or public entities. Article L.211-36-1 of the Financial Code recognises arrangements concluded between any parties but if one of the parties is not an eligible entity, then the arrangement must relate to one of the financial instruments listed in article L.211-1 of the Financial Code or others referred to in article L.211-36. If both are eligible parties, then the wider FCD regime becomes applicable and the field of application is not limited to transactions involving financial instruments but all contracts related to payment of cash or transfer of title.[24] Article L.211-36-1 of the Financial Code would not apply at all if none of the parties to a financial agreement is an eligible party.

Paragraph II of article L.211-36-1 of the Financial Code then provides that the contractual terms of cancellation, valuation and set-off applicable to transactions and obligations referred to above are effective as against third parties and may be included in agreements or master agreements. This covers the ability of the parties to incorporate in the close-out amount termination values of different types of transactions which, in terms of the ISDA French Law Opinion 'if performed in good faith, using pre-agreed determinable means and commercially reasonable procedures and rules to produce a commercially reasonable result, should be enforced by a French court'.[25] The net amount remaining to be paid after the netting is to be filed as a claim with the Creditors' Representative in order to be taken into account.[26]

Article L.211-40 of the Financial Code applies a derogation of these mechanisms from the provisions of Book VI of the Commercial Code, as well as from any provision regulating judicial or amicable proceedings instituted on the basis of foreign legal systems.[27] This rule has the effect of exempting this mechanism from the moratorium which accompanies

24 Praicheux, commenting on similar wording in relation to the former article L.431-7 of the Financial Code, states that when the law provides for the material scope of application in relation to parties, one of whom is not an eligible person, it refers to *financial obligations* resulting from operations of financial instruments generally and does not mention any contractual arrangements, whilst when it refers to obligations in relation to parties both of whom are eligible, it refers to *financial obligations resulting from any contract* giving rise to payment of money or transfer of title. Praicheux notes however that in reality the omission of referring to a contract in the first category is not a material one given that in the end the law provides that the modalities of termination, evaluation and set-off of the obligations may be those stipulated by contract or master agreement so that in both cases a contract may be in existence. PRAICHEUX (2005) para 22.

25 ISDA French Law Opinion at p 11.

26 See ISDA French Law Opinion at p 12.

27 It is interesting to note that there is no imposition of the knowledge or constructive knowledge test of the impending insolvency existing under English law for the derogation to apply.

the opening of any type of collective procedures. It also derogates from the power of the judicial administrator to demand the continuity of contracts in terms of article L.622-13 of the Commercial Code with the cherry-picking risks that this entails. Also, the right to proceed to net reciprocal claims notwithstanding the opening of an insolvency collective procedure is an exception to the provisions of article L.622-7 of the Commercial Code prohibiting the payment of pre-existing claims. Although not related to insolvency proceedings, article L.211-40 of the Financial Code also protects close-out netting provisions from the rules of article 1343-2 of the Civil Code on the compounding of interest.

5.2 Constitutive Elements of Insolvency Close-out Netting

In contrast with English law which, as seen in the previous chapter, provides multiple definitions of close-out netting, French law does not provide any definition of this term in relation to article L.211-36-1 of the Financial Code and hence an indication of the constitutive elements of close-out netting under French law has to be sought from other sources. Another possibility is to consider the definition of set-off arrangement ('*accord de compensation*') provided under article L.613-34-1-19º of the Financial Code in relation to the bank resolution regime which could also shed light on the close-out netting concept.

The main elements of article L211-36-1 of the Financial Code may be listed as follows:

(a) The financial arrangement must fall within the scope of application of article L.211-36 of the Financial Code,
(b) The financial obligations under said arrangement may be terminated,
(c) The debts and credits related to said arrangement may be set off between all parties,
(d) The parties may establish a single amount, whether or not these financial obligations are governed by one or more agreements or master agreements,
(e) The modalities of termination of the financial obligations, of their evaluation and of their set off may be those foreseen in the relevant agreements or master agreements and are enforceable as against third parties.

The French legislator has implemented the FCD in three segments of the Financial Code. First, article L.211-36 sets the scope of application by defining the applicable parties and financial obligations, which are not necessarily collateralised obligations. Second, article L.211-36-1 regulates the enforceability of close-out netting provisions within the scope of article L.211-36 and, third, article L.211-38 sets the rules on the regulation and formalities of financial collateral regulations. Paragraphs I and IV of article L.211-38 create the link between the three segments by recognizing the possibility to set off collateralised financial obligations pursuant to

the provisions of article L.211-36-1, I, so that in the end close-out netting provisions are protected to the same extent in relation to both collateralised and uncollateralised arrangements. The three main phases of the concept of close-out netting described in Chapter 1, namely termination, valuation and determination of a net balance, also feature in this article. Some preliminary observations may be made in respect of these phases as they apply in terms of article L.211-36-1.

First, there is a marked absence of any reference to the occurrence of an event of default which typically triggers the termination phase. Article L.211-36-1, I refers to the possibility to terminate financial obligations under an agreement, including a master agreement, and it is further stated in paragraph II of the same article that the modality of termination may be that provided for in the agreement or master agreement concluded between the parties. It is therefore understood that the termination will be in accordance with the provisions of the agreement or master agreement which typically provide for an insolvency event to be a trigger for the early termination of outstanding transactions. It may therefore be assumed that the event of default triggering the termination of financial obligations under article L.211-36-1 may be related to insolvency. This interpretation is confirmed by article L.211-40 of the Financial Code when it protects the enforceability of a close-out netting provision from the rules on collective insolvency proceedings or amicable proceedings. However, the termination of transactions remains a contractual faculty, meaning that the agreement must clearly stipulate the manner in which termination operates and the events by which it is triggered. As a consequence, the French courts have held that if for instance a contract foresees the termination of transactions upon the opening of judicial restructuring procedures but does not specifically include safeguard procedures, then the courts will imply that the parties intended to limit the events of default triggering the termination of transactions to the cases where the debtor is unable to pay its debts and hence that the clause does not extend to the case of safeguard procedures.[28]

Second, linked to the issue of termination of obligations following an event of default is the fact that article L.211-36-1 does not refer to the acceleration of the maturity of obligations. For the same reasons explained above, a master agreement will typically provide for the acceleration of obligations in order to terminate and close-out and the maturity of obligations will necessarily be accelerated if it is to be made due and payable using the set-off process referred to in article L.211-36-1, II. This interpretation is confirmed by French doctrine where the termination of transactions is deemed to include the acceleration of their maturities if this is required to

28 *CA Paris*, 21 June 2011, no. 10/20873, *SA Crédit du Nord c/ SCP Angel Hazane:* JurisData no. 2-11-020167; BRDA 18/11, no. 7. See also JURISCLASSEUR (2013) Fasc. 2050, para 83.

achieve termination under a close-out netting provision.[29] According to French doctrine, acceleration is also possible notwithstanding the provisions of article L.622-13 of the Commercial Code which permits the administrator to enforce outstanding contracts and to prevent the acceleration of their obligations.[30]

Third, article L.211-36-1, I refers to financial obligations under agreements or master agreements being '*compensables entre toutes les parties*' ('capable of being set off between all parties'), which might give the impression that this article envisages that close-out netting is possible in multilateral, and not solely bilateral, agreements.[31] However, it will be seen later in this chapter that the reference to the possibility to set off in this provision ('*compensables*') can only be to bilateral agreements, thus excluding multilateral ones, on account of the regulation of set-off under French law which imposes reciprocity as a mandatory requirement and thus presupposes the existence of bilateral and personal relations.[32] The wording used in the law may be an inadvertent reminiscence of the fact that originally netting was permitted on exchange traded financial instruments involving multilateral parties.

Fourth, this article foresees the possibility of establishing a single amount provided the applicable financial obligations are governed by '*une ou plusieurs conventions ou conventions cadre*' ('one or more agreements or master agreements'). French law thus explicitly allows for the possibility

29 JURISCLASSEUR (2013) Fasc. 3220, para 44. Referring to the joint application of articles L.211-36-1, II and L.211-40 of the Financial Code, it is stated in this paragraph 44 that; '[…] *la partie non défaillante est, en cas de "faillite" de sa contrepartie, autorisée à résilier l'opération et à prononcer ainsi son exigibilité anticipée; c'est ce que signifient les termes "close out" (accélération)* […]'. Thus, according to this text, the solvent party may, in the case of the insolvency of its counterparty, terminate the transaction and declare its accelerated payability, since close-out is taken to include acceleration. This is confirmed by Auckenthaler in relation to the interpretation of the former article 52 of Law no. 96-597 of 2 July 1996 which has been replaced by article L.211-36-1 of the Financial Code and in this respect contains the same wording. See AUCKENTHALER (1996) para 5.

30 JURISCLASSEUR (2013) Fasc. 3220, para 44.

31 Indeed, this interpretation was supported by writers in the past. For instance, Auckenthaler whilst interpreting the provisions of article 52 of Law no. 96-597 of 2 July 1996 refers to bilateral or multilateral master agreements, but then quotes types of agreements such as the ISDA master agreement which are intended to cover only bilateral arrangements. He also states that the words used in article 2 of the law of 1885 referred to agreements concluded between at least two parties ('*entre deux parties au moins*'). Similarly, Terret interprets the concept of netting to refer to set-off between multilateral parties. Terret explains that whilst only bilateral set-off is foreseen under the (former) article 1289 of the Civil Code, multilateral set-off is possible in the framework of netting between eligible institutions as foreseen under the (former) article L.431-7 of the Financial Code. See AUCKENTHALER (1996) paras 14 & 21; TERRET (2005) 49. Delozière-Le Fur, however, states that the resort to 'multilateral netting' in clearing systems is not netting at all but partakes of the nature of assignment of debts ('*cession de créances*') regulated by (former) article 1295 of the Civil Code so that netting *strictu sensu* should only comprise bilateral relationships. See DELOZIÈRE-LE FUR (2003) 82.

32 ROUSSILLE (2003) 81.

of cross-product netting or, what is more frequently referred to in French doctrine, global netting, which would imply that whilst reciprocity is still a requirement, there is either no connexity requirement between the financial obligations for netting of cross-product agreements to be enforceable or, alternatively, the connexity requirement is widely interpreted to cover instances where obligations are linked through multiple contracts relating to a bilateral relationship. This point is further analysed in the part of this chapter dealing with the comparison between set-off and netting.

Fifth, article L.211-36-1, II provides, *inter alia*, that the modalities for the termination, valuation and set-off of financial obligations may be as provided for in the agreements or master agreements concluded between the parties. First of all, this article envisages that these modalities may be set by applicable agreements ('*Ces modalités* ***peuvent*** *être notamment prévues par des conventions ou conventions-cadres*'), but it does not appear to be necessarily so. This leaves open the possibility that if not set by agreement, these may possibly be set by statute or even by judicial declaration. In the case of global netting, however, it is mandatory that the mechanism to set off the various close-out amounts under the different agreements is stipulated by contract since global netting does not operate automatically but must have been devised in the contractual documentation of the parties.[33] Secondly, it has been argued above that termination by acceleration, although not stipulated in the law, is possible since this method is typically envisaged in master agreements. By the same argument, the modalities related to calculation typically resorted to in master agreements, although not specified in the law, may be assumed to be enforceable. Thus, it has been seen that the two most common types of calculation methods in master agreements are the estimation of the current value of outstanding obligations or, in the case of derivatives, their replacement cost. Though not spelt out in the law, it is presumed that these will be enforceable given the liberal terminology used in paragraph II.

Finally, article L.211-36-1 refers only to the set-off modality in order to achieve a single amount which is due. This may be only a linguistic issue since the term coined by French jurists for close-out netting is '*résiliation-compensation*'[34] so that the reference to '*compensation*' and '*compensables*' may signify nothing more other than that the word 'netting' as such has not been imported into French law, at least not at the time the law was written. This seems to be the case given that the same article does not restrict the modality of set-off to the provisions of French law but extends it to any modality envisaged in the agreements or master agreements concluded between the parties.

Moving on to the definition of a set-off arrangement under article L.613-34-1-19º of the Financial Code, it is to be noted that this is a functional definition meant to serve the specific purposes of French bank resolution

33 JURISCLASSEUR (2013) Fasc. 2050, 29.
34 ROUSSILLE (2001) 4.

law. Although it may appear to focus on the termination aspect of the arrangement, the term '*droit de résiliation*' is defined in paragraph 17⁰ of the same article to include not only termination and acceleration, but also any right to set off, to convert into a single amount and to extinguish or modify a contractual obligation. Aspects emerge from this definition which could support the interpretation given above to article L.211-36-1. Thus, this definition stipulates that termination may be exercised by acceleration of maturity ('*après déchéance de leur terme*') and also refers to two modalities for determining a single amount, namely by conversion ('*convertis*') and by set-off ('*compensés*'), rather than just set-off as stated in article L.211-36-1. Thus, the set-off mechanism may be considered as one, out of multiple, ways how to determine a net amount. One may think that the French legislator has taken the opportunity to modernise the notion of close-out netting by stipulating these additional details in this relatively new definition. However, the idea of clarifying the notion of close-out netting may not have been foremost in the legislator's mind since this definition ends by including within its scope any arrangement which gives to one of the parties the right to terminate ('*y compris tout accord conférant à l'une des parties un droit de résiliation*'). Thus, the legislator may have been more concerned to cover any possible situation where contractual arrangements may confer termination rights, rather than to finetune or modernise the concept of close-out netting.

Given the close affinity of set-off with netting, the question may be raised whether under French law the concept of netting is so intertwined with that of set-off that the rules governing the latter also need to be satisfied in relation to close-out netting. The terminology of article L.211-36-1, II may give this impression since the only modality mentioned to determine a single netting amount is that of set-off ('*compensation*'). In relation to the connection between set-off and netting, Roussille explains that with the development of the OTC market, the fight against systemic risk and competition with other financial centres rendered it necessary to protect close-out netting in order to eliminate risks of legal unenforceability of close-out netting arrangements for operators residing in France. Following this recognition, the French legislator had a choice to either create a *sui generis* mechanism which achieves the same result as close-out netting or to resort to existing mechanisms under French law and protect them from the collective procedure. Roussille concludes that the legislator took the latter option and combined two classical techniques, namely termination ('*résiliation*') and set-off ('*compensation*'), with the result that netting under French law consists simply in one of the parties being able to terminate outstanding operations on account of the risk of insolvency of the counterparty and to set off the value of the terminated obligations to determine a net amount. The former corresponds to the closing out and the latter to the netting. According to Roussille, the novelty of this new mechanism lies in its juridical implications since it applies notwithstanding the provisions of

any other law to the contrary.[35] In the light of this statement, it is proposed to give an overview of the concept of set-off under French law which will enable a comparison to be subsequently made between the two notions for the purpose of determining whether the close-out netting concept is to be considered as a contractual enhancement of set-off and whether it is influenced by the rules of set-off.

5.2.1 Insolvency Set-off under French Law

The provisions on set-off under French law are currently contained in articles 1347 and 1348 of the Civil Code under the heading 'Extinguishment of obligations' ('*L'extinction de l'obligation*') since set-off under French law is considered as a means of payment.[36] These articles were introduced by Ordinance no. 2016-131 of 10 February 2016 and since 1 October 2016 replace the former articles 1289 to 1299 of the Civil Code which were in existence since Napoleonic times and were enacted in 1804 by Law 1804-02-07.

Set-off under French law is a bilateral operation which requires mutuality and which may be invoked when the parties are reciprocally debtor and creditor towards each other. Thus, the buyer of a specified asset may seek set-off of the purchase price payable by it to the seller against damages payable to it by the seller in respect of defects affecting the asset sold. For this reason, the triangular relationship between members of the same group does not permit setting off their obligations with a creditor of one of its members.[37] It is also for this reason that article 1347-6 of the Civil Code allows the surety to oppose payment of the debtor's debt by referring to another debt owed by the creditor to the debtor. However, the debtor may not set up the debt owed by the creditor to the surety in order to oppose payment.

---

35 ROUSSILLE (2001) 311. For a similar view see AUCKENTHALER (1996) para 5; BONNEAU (2017) para 933.

36 See DELOZIÈRE-LE FUR (2003) 59. According to Delozière-Le Fur, set-off extinguishes obligations owed between parties and creates the same juridical situation as if they had paid their dues. This author adds that sometimes set-off may also be considered as a security of payment and is considered as such especially in the settlement of payments in a payment system. *Ibid.* 39 & 59. Hubert states that whilst set-off was originally considered as a simplified means of payment, it may also be considered as a simplified means of enforcement of collateral for instance in relation to financial transactions regulated by article L.211-36 of the Financial Code. See Olivier Hubert, 'Chapter 14: France', in JOHNSTON *et al.* (2018), para 14.33.

37 DELOZIÈRE-LE FUR (2003) 70. Hontebeyrie states that the words used in the article 1347, namely that set-off is ('*est*') the simultaneous extinction of reciprocal obligations between two persons, indicates that reciprocity is consubstantial to set-off and therefore multilateral set-off does not exist or, to be more precise, does not emanate from the Civil Code. This is confirmed by the new article 1348-2 on conventional set-off which explicitly re-confirms the reciprocity requirement. See HONTEBEYRIE (2016) 154. It is also the case that what is referred to as multilateral set-off in French doctrine may be actually broken down into the settlement of bilateral transactions through, for instance, a central clearing house. See MATTOUT (2006) 165.

Contrary to the situation under English law, French law does not distinguish between insolvency set-off and other types of set-off. The former article 1289 of the Civil Code formally recognised only legal set-off which under article 1290 of the Civil Code applied as a matter of law even without the knowledge of the debtors,[38] whereas the new law recognises three types of set-off commonly referred to as legal, judicial and contractual set-off. In addition, under the new law, legal set-off needs to be invoked by the creditor in order to be effective and no longer operates automatically as a matter of law. It appears therefore that French law has moved away from the classical notion of the Roman *Corpus Juris* of '*ipso iure compensatur*' originally embraced by the Napoleonic Code. In terms of the classification established by Dalhuisen, the requirement of invocation results in a shift from set-off being a procedural tool under the old law to a mechanism becoming dependent on the will of the parties and thus subject to party autonomy.[39]

A similar view is expressed by Andreu who confirms that under the current law legal set-off has become a voluntary mechanism which requires a unilateral manifestation of the will of one of the parties to be effective.[40] It was explained in the Report to the President of the Republic on the Ordinance of 10 February 2016 that the amendment was introduced to put an end to an anomaly in the application of the law pointed out by a number of French jurists, in terms of which the courts required that set-off is invoked in order to be applicable even if its effects were automatic under the former article 1290 of the Civil Code.[41] Andreu criticises this view stating that it is surprising that the legislator refers to jurisprudence to justify this new requirement. He states that there is no judgment which indicates that set-off needs to be 'invoked', but it is rather the case that the judge could not raise the plea of set-off *ex officio* since it is not, under French law, a rule of

38 It is to be noted that although the former article 1289 of the Civil Code specifically provided for one type of set-off, namely the automatic set-off of debts which are certain, liquid and due, the court or the parties could intervene to modify these requirements, as will be seen later. The only requirement in respect of which no 'intervention' was allowed related to reciprocity which must be invariably satisfied for set-off to take place. See DELOZIÈRE-LE FUR (2003) 60; PICHONNAZ (2001) 516. According to Pichonnaz, set-off in this case has a constitutive effect, rather than an extinctive effect. *Ibid.* 17.

39 DALHUISEN (2019), Volume 3, 386.

40 ANDREU (2016) 89. Andreu states that this development was advocated by a number of French jurists such as Roger Mendegris, in *La Nature juridique de la compensation*, (L.G.D.J., 1969), Alexis Collin, in 'Du caractère volontaire du dèclenchement de la compensation', RTD Civ. 2010, nº 2 at p 229 and Jérôme François, in *Les obligations, Régime général*, Economica, 3e Edition, 2013, nº 75. *Ibid.*

41 Rapport au Président de la République relatif à l'ordonnance n° 2016-131 du 10 février 2016 portant réforme du droit des contrats, du régime général et de la preuve des obligations, JORF n°0035 du 11 février 2016. Although the French Code of 1804 envisaged the automaticity of set-off in the bilateral operations of two parties, the general interpretation of jurists of those times was that set-off had to be invoked in the courts in order for the judge to take cognizance of it. See PICHONNAZ (2001) 505. Pichonnaz himself confirms that set-off should depend on the will of the parties. *Ibid.* 510.

public order and hence it is up to the debtor who is being sued to raise it in defence. As a result, Andreu expresses the opinion that it is therefore not a procedural rule which has been sacrificed but a substantive one as a result of which set-off only produces extinctive effects subject to the condition that the debtor manifests the will to trigger it.[42] Hontebeyrie also criticises this new requirement which was a late insertion in the drafting proposal but states that it has not changed the extinctive characteristics of set-off. The reason for this is that in any case the law provides that the set-off operates not from the date of the invocation but retroactively from the date when all the requirements of legal set-off are met, indicating that the extinctive character continues to operate from this moment. According to this author, this indicates that although set-off is now conditioned by the invocation, it does not ensue from it.[43]

The invocation requirement is thus one 'new' requirement of legal set-off. The other requirements pertain to the 'traditional' concept of legal set-off provided under the former article 1289 of the Civil Code and reproduced in article 1347 of the Civil Code. Article 1347 provides that set-off is the simultaneous extinction of reciprocal obligations between two persons ('*l'extinction simultanée d'obligations entre deux personnes*') up to the lower amount and, subject to invocation, becomes effective on the date when all applicable conditions are fulfilled. Article 1347-1 of the Civil Code lists these conditions as referring to two obligations which are fungible, certain, liquid and payable ('*entre deux obligations fongibles, certaines, liquides et exigibles*'). The co-existence of these elements, together with the requirement of reciprocity, permitted the automatic operation of set-off under the former law since these were deemed typical characteristics of payment.[44]

The fungibility requirement gives rise to the extinctive effect and is a requirement that can be remedied by intervention since the French courts have long recognised valuation mechanisms agreed to by the parties in their agreements in order to give value to their obligations. For instance, whilst in the past it was not possible to set off monetary debts expressed in different currencies, it is now possible to agree on a technique to convert the amounts in the same currency. This possibility is now incorporated in article 1347-1 of the Civil Code.

---

42 ANDREU (2016) 89.

43 HONTEBEYRIE (2016) 163. Hontebeyrie states that Pothier had already advocated against this voluntarist thesis, and was in favour of automatism, indicating that this argument had already been raised at the time of the drafting of the Napoleonic Code. *Ibid.* 164. With this requirement of invocation, French law, similar to German and Swiss law, creates what Pichonnaz calls a 'suspensive condition' ('*condition suspensive*') dependent on the will of the parties for the realisation of the extinctive effect of set-off. See PICHONNAZ (2001) 514.

44 DELOZIÈRE-LE FUR (2003) 60. Delozière-Le Fur makes a distinction between the requirements of certainty, liquidity and payability which are of the essence for payment, and the requirements of fungibility and reciprocity which are not required for payment but are necessary to render set-off a means of payment. *Ibid.*

The certainty requirement was not specifically mentioned in the old law and was included in the new article 1347-1 of the Civil Code to import a condition from jurisprudence whereby if a debtor claimed that his creditor owed him another connected debt, the debtor would be asked to prove the existence of the claimed debt. The certainty requirement therefore refers to the likeliness or proof of the existence of a connected debt.[45]

The liquidity requirement means that the mutual debts must be of the same kind, actual and ascertainable. Even though the debt has not been ascertained, it may still be taken into account in instances where the remainder of the debt has yet to be calculated or a court has still to make a definite order setting out the sum that is due. The set-off is then effective once the valuation can take place.[46]

Finally, a debt is deemed to be payable whenever the creditor has a right to immediate payment. A debt subject to a condition or a term that is not matured cannot be subject to legal set-off.[47]

In addition to the notion of legal set-off, the revised Civil Code also provides for the notions of judicial set-off under articles 1348 and 1348-1, and contractual set-off under article 1348-2. Judicial set-off may be pronounced by the judge even if one of the obligations, although certain, is not yet liquid and payable. Unless the judge decides otherwise, the set-off in this case is effective from the date of the decision. When these obligations are connected with each other, then the law states that the judge cannot refuse their setting off on the basis that one of the obligations is not liquid or payable. In this case the set-off takes place on the day when the first debt becomes payable.[48] According to the French Supreme Court (*Cour de cassation*), obligations are connected when resulting from the same contract[49] or when carried out pursuant to different contracts which constitute a single global business relationship arrangement.[50] In relation to contractual set-off, the parties are free to agree to extinguish all their reciprocal obligations, both present and future, through set-off. The set-off in this case takes place upon the date of the agreement or, in case of future obligations, on the date of their coexistence. Hontebreyie comments that the reference to reciprocal obligations indicates that the requirement of certainty of existence of the

45 HONTEBEYRIE (2016) 157.

46 *Ibid* 159.

47 Olivier Hubert, 'Chapter 14: France', in JOHNSTON *et al.* (2018), para 14.08. In terms of article 1347-3 of the Civil Code, when a grace period is given by the judge to the debtor, this is not an obstacle for the creditor to set-off that claim.

48 Hontebeyrie explains that although the judge will pronounce the set-off in principle in the circumstances mentioned by law, it will become effective once the liquidity and payability requirements materialise. HONTEBEYRIE (2016) 159.

49 Cassation commérciale, 12 December 1995, Bull. Civ. IV 293. According to Delozière-Le Fur, the effects of connexity are compatible with due observation of the condition of reciprocity in relation to the operation of set-off. See DELOZIÈRE-LE FUR (2003) 81; PELTIER (1994) 55.

50 Cassation commérciale, 5 April 1994, Bull. Civ. IV no 142 and Cassation commérciale, 9 May 1995, Bull. Civ. IV no 130.

debts is mandatory for conventional set-off. On the contrary, the requirements of fungibility, liquidity and payability may be dispensed with under contractual set-off. For instance, contractual set-off may be resorted to in the case of debts whose object is not fungible so that an 'artificial' contractual fungibility may be agreed upon.[51]

French insolvency law restricts the enforcement of set-off upon the insolvency of one of the parties since it is not generally in favour of the enforcement of contractual pre-insolvency rights.[52] Thus, whilst French law does not provide for the notion of mandatory insolvency set-off, article L.622-7, I of the Commercial Code protects set-off from the opening of insolvency procedures by exempting the set-off of connected claims arising prior to the observation period from the general prohibition of payment of pre-insolvency claims. Obligations arising after the judgment opening insolvency proceedings may be set off if this is necessary for the execution of the proceedings in terms of article L.622-17 of the Commercial Code. Pursuant to article L.622-24 of the Commercial Code, a creditor whose debt arose before the opening of insolvency proceedings must file a declaration of debt with the creditors' representative which should include the total amount due on the date of the judgment opening the insolvency proceedings. The French courts have held that a set-off may not occur if the creditor has failed to declare its debt in the insolvency process.[53] Thus, contrary to English law where insolvency set-off is considered a matter of public order and is mandatory, this is not the case under French law where set-off is considered a simplified means of payment and may even be renounced or, in the case of insolvency, not declared to the creditors' representative.

5.2.2 Insolvency Close-out Netting and Insolvency Set-off Compared

Since the concept of insolvency set-off does not formally exist under French law, a comparison between the concepts of *insolvency* close-out netting and *insolvency* set-off cannot, strictly speaking, be made. As a consequence, the comparison between these concepts in relation to French law will take place on two levels, first on the level of the relationship between close-out netting and the three types of set-off stipulated under the Civil Code, and secondly on the treatment of these concepts under the rules on collective proceedings.

A reading of French law and literature gives the impression that set-off is central to the netting mechanism under French law. Thus, the drafting of article L.211-36-1 of the Financial Code indicates that the determination of a close-out amount is based on the set-off methodology. Paragraph I of this article refers to financial obligations being terminated and the claims resulting from such termination being set off, resulting in a single amount. Paragraph II of the same article then provides that the modalities of termi-

51 HONTEBEYRIE (2016) 161.
52 Olivier Hubert, 'Chapter 14: France', in JOHNSTON *et al.* (2018), para 14.19 *et seq.*
53 Cassation commérciale, 15 October 1991, Bull. Civ. IV No. 290.

nation, valuation and set-off of obligations may be opposed to third parties and that any operation relating to termination, valuation or set-off carried out on account of civil enforcement proceedings or the exercise of a right to oppose is deemed to have taken place prior to such procedures, thus creating retroactive effects.

From the perspective of French doctrine, and consistent with the legal drafting of article L.211-36-1 of the Financial Code, the term '*résiliation-compensation*' coined by French authors to refer to netting is indicative of the approach that the close-out netting concept is considered a combination of two basic existing concepts under French law, namely termination (*résiliation*) and set-off (*compensation*).[54] This may also signify that close-out netting may have been, at least initially, considered as a simplified means of payment, although the positioning of article L.211-36-1 in the Financial Code under the heading of financial instruments ('*Les instruments financiers*') does not really justify this argument. The law itself does not use this term, or any other term to refer to netting, so that the term '*résiliation-compensation*' may in the end not be a legal term but a practical way for French jurists to refer to close-out netting for lack of existence of a technical term. In fact, in more recent literature, the terms 'netting' and 'close-out netting' in their English version are being widely used, possibly as a result of the fact that with experience gained in the use of this new mechanism, it is felt that the old term '*résiliation-compensation*' may not be adequate to describe the more complex steps involved in the close-out netting process.

Before proceeding to the comparative analysis of the constitutive elements of the two concepts, the following statements made by French jurists in relation to this comparison may help to set the scene for the more detailed commentary. Citing the old netting provision promulgated by the law of 31 December 1993, Peltier states that this law did not bring about any revolution in French law since the principle of conventional set-off did not raise any real uncertainties taking into account the favourable evolution of jurisprudence. However, Peltier admits that the law has provided statutory certainty to the set-off of claims in the financial markets. In addition, the law permits the setting off of different types of transactions and thus allows what he terms '*superglobalisation*'. According to this author, an important certainty brought about by netting law is to allow a party to lawfully terminate transactions in particular upon the occurrence of insolvency of the counterparty, consistent with the practice in financial markets to liquidate positions in case of a default by one of the parties.[55]

---

54 According to Gaudemet, this term is preferable to the term '*compensation avec déchéance du terme*' (set-off with expiry of term) sometimes used since this presupposes that the contract under which the obligations arose remains current with the defaulting party only losing the benefit of the suspensive condition, leading to the immediate payability of its obligations. The contract is then extinguished prematurely due to the payment of the obligations. See GAUDEMET (2010) para 467.

55 PELTIER (1994) 56.

Caillemer du Ferrage states that the concept of close-out netting, composed as it is of a contractual mechanism permitting the termination of current contracts and the calculation of the economic value of the terminated transactions, is not set-off since set-off does not contemplate the termination of reciprocal obligations. According to him, close-out netting is more similar to a pre-established contractual method to determine the loss which may be suffered by one party in relation to unforeseen defaults by the other party.[56] This is also confirmed Gaudemet and Auckenthaler. The latter adds that the juridical nature of netting cannot be totally reduced to the notion of set-off as regulated by the Civil Code since it encompasses more juridical mechanisms, such as novation, to achieve a single amount due in relation to reciprocal claims by two parties.[57] Caillemer du Ferrage concludes that set-off is more similar to the notion of global netting which foresees the setting off of termination amounts due under different agreements to one single amount. In this sense, this author considers that global netting is truly a set-off mechanism as envisaged under French law.[58]

By way of preliminary observations, there seems to be a common understanding that there are significant differences between close-out netting and set-off, even though this may be less so in the case of contractual set-off. Whilst set-off is primarily a mechanism to extinguish reciprocal debts, close-out netting has been ascribed the characteristics of an indemnification mechanism which permits the termination and liquidation of positions of counterparties upon default, in line with practices applicable in financial markets.[59] It is understood (though not stated in the law) that close-out netting may involve mechanisms other than set-off to determine a final close-out amount, such as novation or replacement values. On the other hand, the set-off mechanism will invariably apply in the global netting of close-out amounts determined for different transactions or different agreements. Further comparative analysis of the two concepts is made below, with a view to assessing whether close-out netting can be considered as a contractual enhancement of set-off.

Scope of Application

On a statutory level, there is a difference in relation to the scope of application of the set-off and close-out netting regimes so that whilst set-off is intended to apply generally to all obligations, close-out netting is restricted to financial obligations. In terms of article 1347 of the Civil Code set-off is described as the simultaneous extinction of obligations which are reciprocal

56 CAILLEMER DU FERRAGE (2013) para 2.
57 GAUDEMET (2010) para 468; AUCKENTHALER (2001) para 3.
58 CAILLEMER DU FERRAGE (2001) 4.
59 This is confirmed in the ISDA French Law Opinion at p 11.

between two parties ('*l'extinction simultanée d'obligations réciproques entre deux personnes*'). There is no limitation on the type of obligations that may be set off so that even claims based on damages and tort may be included provided the obligations remain fungible, certain, liquid and payable. Given the practicalities of this concept as a means of payment, the concept has developed in a way that, either judicially or contractually, it is possible to set off even obligations which are not yet liquid or payable, provided they are connected[60] and are reciprocal.[61] In terms of personal scope, there is no restriction as to the type of parties who may benefit from set-off, so that these may be individuals, corporates or any type of entities. By contrast, under article L.211-36 of the Financial Code close-out netting rules apply in relation to financial obligations but which may vary in scope, depending on the nature of the parties. Thus, close-out netting is available in relation to financial obligations resulting from all types of contracts ('*tout contrat*') giving rise to payment of cash or delivery of securities if both parties are eligible entities in terms of article L.211-36, I of the Financial Code, and in relation to financial obligations resulting from transactions in financial instruments listed in articles L.211-1 or L.211-36, II of the Financial Code if only one of the parties is an eligible entity. The more restricted material and personal scope is in keeping with the idea expressed earlier that the close-out netting mechanism is considered by some French authors as a form of indemnification which is typically available in the financial markets to cover for losses that may be suffered by financial market players on account of the default of their counterparties.

Basic Requirements

A number of conditions need to be fulfilled in relation to both the set-off and close-out netting concepts for these to be effective. First, it has been seen already that reciprocity of the obligations is a *sine qua non* for both concepts. Both concepts permit setting off claims which are non-fungible provided that the parties have provided the valuation of these claims in their pre-existing contractual arrangements in relation to close-out netting and contractual set-off, or if it can be determined through other means in relation to legal[62] and judicial set-off. The condition of certainty of obligations necessarily needs to be fulfilled in relation to both concepts, but whilst this may need to be proved in particular in relation to judicial set-off, in both close-out netting and contractual set-off the contractual mechanism will record the reciprocal obligations of the parties which are subject to the netting or set-off mechanism, thus satisfying this requirement. The law foresees the possibility in the case of judicial and legal set-off to allow set-off

60 See article 1348 of the Civil Code in the case of judicial set-off.

61 See article 1348-2 of the Civil Code in the case of contractual set-off.

62 For instance, see article 1347-1 of the Civil Code in relation to the fungibility of obligations expressed in different currencies.

even in respect of obligations which are not yet liquid or payable or in respect of future obligations, but in these cases the set-off occurs when these conditions have been met. In close-out netting, on the contrary, the parties may agree on modalities how to accelerate and terminate these obligations, thus bypassing the requirement of liquidity and payability.

Second, and following from the foregoing, the law on close-out netting permits the termination and closing out of outstanding transactions. Article 1347 of the Civil Code permits the setting off of obligations when all statutory conditions have been satisfied, implying that the obligations should have become payable. Exceptions apply in relation to judicial set-off where the set-off is effective from the date of judgment even if one of the debts is not liquid or payable or from the time when one of the debts becomes due in the case of connected debts.[63] However, these exceptions do not amount to termination as such of the pending obligations and in any case are not based on the contractual freedom of the parties but are determined by the judge presiding over the case. In fact, although the judge will declare the set-off applicable as stipulated by law, it can only become effective once the liquidity or payability materialises.[64] Under contractual set-off the parties are given the contractual freedom to set off present or future obligations, but this does not result in a termination and acceleration of outstanding obligations since the set-off can only take place once the future obligations coexist. On the other hand, article L.211-36-1 of the Financial Code recognises the contractual freedom of the parties to establish the termination modality and this is protected under the rules of collective proceedings. This freedom, as will be seen in the next part of this chapter, may now be curtailed by the implementation of bank resolution measures.

Third, netting under article L.211-36-1 of the Financial Code is operative at either one or two levels. In the first instance, there is netting in relation to obligations resulting from one agreement and, if global netting is applicable, in second instance there is set-off in relation to the close-out amounts derived under two or more distinct agreements. The set-off mechanism is, therefore, an intrinsic element of global netting. The set-off of amounts due under the various netting agreements to achieve global netting is possible if this has been specifically agreed to by the parties so that it is a contractually agreed set-off and not the legal set-off envisaged under article 1347 of the Civil Code. The relevant set-off clause may feature in each netting agreement concluded between the parties or in only one of the agreements which cross-refers to the other agreements. Alternatively, it may be included in a separate master netting agreement (‘*une convention chapeau*’) which specifically incorporates all the netting agreements concluded between the parties.[65] Set-off is also the mechanism applied when enforcing the

63 See articles 1348 and 1348-1 of the Civil Code.
64 See HONTEBEYRIE (2016) 159.
65 JURISCLASSEUR (2013) Fasc. 2050, para 86; LE GUEN (2001) 39.

collateral securing financial obligations under a close-out netting provision falling within the scope of article L.211-36 of the Financial Code. In this case enforcement takes place without the prior written notice of the other party and without court authorisation.[66]

Fourth, it has been stated above that following the amendments to the provisions on set-off whereby the automatic trigger of the set-off mechanism has been replaced by a requirement to invoke the set-off once all requirements have been fulfilled, the operability of legal set-off has become dependent on the will of the parties. In a sense, this has brought the concept of set-off closer to that of close-out netting which is typically also triggered by the notification of one of the parties in terms of the relevant agreement. A question which arises is whether the invocation requirement in relation to set-off has now affected the automatic trigger of the close-out netting provision sometimes made applicable under master agreements upon the insolvency of the counterparty. The possibility to apply the automatic trigger of close-out netting under certain master agreements has been expressly recognised.[67] It could be argued that since a close-out netting provision is regulated by the provisions of article L.211-36-1 of the Financial Code, the invocation requirement arising under a different provision of law in respect of set-off, namely article 1347 of the Civil Code, should not affect the automatic trigger of close-out netting provisions so long as these relate to financial obligations and fall within the scope of article L.211-36 of the Financial Code. The situation may be less clear in the case of global netting where the set-off mechanism applies to close-out amounts determined under different netting agreements. However, the same argument made above could also apply in this case in the sense that the applicable provision remains article L.211-36-1 of the Financial Code and it is this article, and not article 1347 of the Civil Code, which will regulate the global netting and any automatic application of it. As remarked above, the set-off mechanism used in global netting is not the legal set-off regulated under article 1347 of the Civil Code but is a mechanism foreseen in article L.211-36-1 of the Financial Code which may achieve the determination of a single close-out amount.

Collective Insolvency Proceedings

In terms of article L.622-7 of the Commercial Code pre-insolvency claims should be connected in order for set-off to be permitted following the commencement of collective procedures, otherwise they fall under the general prohibition of payment of pre-insolvency claims. It has been seen that for the purposes of set-off, claims are connected if they result from the same contract or are comprised in a global economic relationship. Post-insolvency claims may be set off if this is necessary for the continuation

66 Olivier Hubert, 'Chapter 14: France', in JOHNSTON *et al.* (2018), paras 14.14 & 14.32.
67 See ISDA French Law Opinion at p 10.

of the insolvency proceedings.[68] The question arises whether the same requirements need to be fulfilled in the case of netting agreements. Firstly, article L.211-36-1 of the Financial Code does not differentiate whether the obligations were entered into before or after the opening of insolvency proceedings. Secondly article L.211-40 of the Financial Code protects netting arrangements, including global netting arrangements, if these fall within the scope of application of article L.211-36-1 of the Financial Code. Bonneau *et al.* state that all that is required is for the transactions to be linked together to one or more master agreement or agreements.[69] Article L.211-40 does not impose any conditionality for the protection to apply, such as the lack of knowledge or constructive knowledge of the pending insolvency as was the case under English law.

The interrelation between set-off and close-out netting in insolvency proceedings is delineated by Gaudemet when he states that once the indemnity arising under the terminated contracts is liquidated in close-out netting, then the legal set-off of the liquidated amounts becomes effective since the reciprocal debts become liquid, fungible and payable, and thus fulfil the basic requirements of legal set-off. Gaudemet bases his argument on the old article 1290 of the Civil Code, cited in part 5.2.1 above, which provides that legal set-off '*a lieu de plein droit, par la seule force de loi, même à l'insu des débiteurs*'.[70] Even if for the moment the argument of the change in law requiring invocation is put aside, it is contended that this statement is incorrect. First, legal set-off under French law is not mandatory so that it does not necessarily apply if the conditions of set-off are met. It has been seen that even under the old article 1290 the courts required set-off to be invoked in order to be taken cognisance of and it could even be renounced by the parties. Second, close-out netting is based on party autonomy which is given statutory recognition so that it is more logical to interpret the set-off of liquidated amounts under close-out netting to be a reference to contractual set-off rather than legal set-off as has been done under English law doctrine. Indeed, the termination of contracts does not in itself include the valuation aspect thereof which can be undertaken more liberally under contractual, rather than legal, set-off. Finally, set-off is not the only modality which may be resorted to in order to achieve a single close-out amount. For instance, novation is another possibility. Thus, it cannot be stated that legal set-off will invariably apply once the transactions are terminated under close-out netting since this depends on the contractual modality selected by the parties for determining a single amount.

68 See article L.622-17 of the Commercial Code.

69 BONNEAU (2017) para 934.

70 Translated: 'has legal effect, by the sole force of the law, even without the knowledge of the debtors.' GAUDEMET (2010) para 470.

5.3 The Recognition of Close-out Netting Provisions Before and After the Adoption of a Bank Resolution Regime

French law on close-out netting pre-dates the enactment of the EU's Financial Collateral Directive and possibly for this reason is not tied to a financial collateral arrangement. Since its inception, the netting regime and consequential derogation from the law of collective procedures have been restricted to the financial sector. Initially, there were three separate close-out netting regimes. The regime which served as the basis for today's close-out netting provision is that emanating from a general rule of 1993 which provided the possibility for clearing houses and their members to carry out close-out netting in the futures market. French close-out netting law is one characterised by various changes. Only those changes relevant to the research question will be mentioned.

Three Netting Regimes

The first netting regime governed the securities lending market. Article 33 of the Act of 17 June 1987[71] permitted the termination and close-out netting of operations in securities lending. The law required that the close-out netting arrangement was made in accordance with the provisions of a market master agreement organising the relationships between two parties. There are no special conditions regarding the status of the parties. This was later codified as article L.432-8 of the Financial Code.

The second netting regime, and which later formed the basis for the single amalgamated netting regime, was regulated by the law of 31 December 1993,[72] introducing a new article 2 in the law of 28 March 1885 on the futures market ('*marchés à terme*') providing that the debts and credits relating to the futures market which conform to the regulations of the *Conseil des marchés à terme* or are governed by a master agreement conforming to the general provisions of the relevant national or international master agreement concluded by at least two parties, one of which is an eligible entity, may be set off according to modalities foreseen by such regulations or master agreement. If one of the parties is undergoing corporate restructuring or liquidation procedures, the termination of these transactions is fully enforceable. Four observations may be made. First, the derogation from collective proceedings is at this stage restricted to the futures market, possibly on account of the speculative nature of these contracts and the significant consequences that the insolvency of one of the parties could entail for the other party.[73] Although not expressly stipulated, there may already be primordial considerations of systemic risk in the mind of the legislator. Second, the rules of the relevant regulatory body of that market

71 Law no. 87-416 of 17 June 1987, subsequently amended by the Law of 2 July 1996.
72 See article 8 of Law no 93-1444 of 31 December 1993.
73 ROUSSILLE (2006) 399.

and of the terms of the master agreement which is based on the national or international standard agreement determine the modalities of termination and compensation. Thus, close-out netting modalities based on pure private agreements are not yet recognised so that modalities must conform to market regulations or market agreement standards. Third, it is envisaged that the master agreement is concluded between at least two parties (*'entre deux parties au moins'*) which may imply that multilateral netting is possible. It is important to note that this terminology is used in the context of the futures market traded on an exchange and the reference to multiple parties may be more in relation to the fact that there will be multiple parties to such trading agreements rather than to the fact that the set off or netting as such will be multilateral, as opposed to bilateral. Fourth, the derogation applies only in respect of corporate entities which, as a rule, is in line with the type of transactions protected by the provision, namely futures, which are typically settled between corporate entities on a trade exchange. In the course of the modernisation of the financial activities, article 52 of the law of 2 July 1996[74] amended the 1993 provision and extended the scope of applicability generally to operations of financial instruments.

The third netting regime applied in relation to the repos market and was introduced by the law of 8 August 1994 which inserted an article 12 V in the law of 31 December 1993, stipulating a similar provision on close-out netting mechanisms for repos with the difference that the agreements had to be approved by the Governor of the *Banque de France* in his or her capacity as chairperson of the *Commission Bancaire*. This ensured that any derogation from the provisions of collective insolvency proceedings was subject to acceptable conditions.[75] There were also no particular conditions regarding the status of the parties. This provision was later codified as article L.432-16 of the Financial Code.

A Unified Regime

Article 52 of the 1996 Act applied to transactions relating to financial instruments which, although broadly defined, excluded spot transactions relating to assets other than securities, such as spot foreign exchange transactions. The close-out netting arrangement also had to comply with the framework of the regulation of the *Conseil des marchés financiers*[76] or the general principles of a national or international market agreement. Thus, whilst this provision extended the scope of application of financial instruments, it was still required that the modalities of close-out netting are subject to regulation

74 Law no 96-597 of 2 July 1996 (called Loi MAF, derived from its name *'Loi […] de modernisation des activités financières'*.

75 LE GUEN (2001) 42.

76 Now replaced by the *Autorité des marches financiers* (AMF) which is an independent authority and regulates participants and products in France's financial markets. See the website of the AMF at < http://www.amf-france.org>.

by market associations or to standard master agreements in order to benefit from the derogation of the collective procedures when terminating transactions. Article 52 applied to the extent that at least one of the parties was an eligible entity. Thus, it did not apply to a master agreement concluded between two unregulated entities such as commercial corporates.

This provision was later incorporated as article L.431-7 of the Financial Code,[77] the predecessor of today's article L.211-36-1, following the codification of various laws into the Financial Code in 2000[78] and included a slight widening in scope of application to include netting agreements concluded by public entities. Moreover, at the time set-off was permitted product by product since cross-product netting was still not permitted. The parties had to negotiate different agreements for each product even though the applicable agreements tended to provide for the same core provisions.[79] This situation brought increased risks in case of the insolvency of the counterparty which had implications for regulatory capital requirements. This state of affairs became difficult to explain and to justify[80] which led to the unification of the three regimes by the law of 15 May 2001.[81] This law extended the application of the former article L.431-7 of the Financial Code to cover also the set-off of securities lending and of repos, hitherto regulated under former articles L.432-8 and L.432-16, respectively, of the Financial Code.[82]

Global Netting

Former article L.431-7 of the Financial Code was amended on several occasions, each time serving to widen either the scope of its application or the scope for party autonomy. The more significant of these amendments regard the introduction in 2001[83] of global netting ('*compensation globale*') in relation to financial entities, which at this point was restricted to setting off the close-out amounts calculated under two or more master agreements concluded between eligible parties provided the parties could create a link between these agreements. At this stage it excluded global netting of interbank loans and deposits.[84] In 2003[85] global netting was extended

77 See Ordinance No. 2000-1223 of 14 December 2000.

78 *Le Code monétaire et financier* annexed to Ordinance no. 2000/1223 of 14 December 2000 which entered into force on 1 January 2001.

79 ROUSSILLE (2001) 312; CAILLEMER DU FERRAGE (2001) 6.

80 LE GUEN (2001) 43.

81 Law no. 2001-420 of 15 May 2001 (called Loi NRE after its name '*Loi […] relatives aux nouvelles regulations économiques*').

82 For a description of certain limitations applying in respect of repos and securities lending, notwithstanding this unification of regimes, see Auckenthaler (2001) paras 11, 12 & 15.

83 Article 29 of Law no. 2001-420 of 15 May 2001. Without these provisions, it is doubtful how a connexity could have been otherwise created between the agreements which would have satisfied the provisions of article 622-7 of the Commercial Code. See AUCKENTHALER (2001) para 18.

84 LE GUEN (2001) 45.

85 Article 39 of Law no. 2003-706 of 1 August 2003.

to situations where only one of the parties was an eligible entity. Further amendments were affected in 2005[86] by way of implementation of the EU's Financial Collateral Directive. This transposition led to an increase in the type of financial obligations that may be subject to close-out netting.[87] The law initially excluded from the benefit of this provision those agreements concluded between parties one of whom was a physical person, but covered agreements between an eligible entity and an unregulated corporate entity.[88] The close-out netting provision was no longer required to be governed by the regulations of the *Autorité des marches financiers* or be based on a national or international master agreement.[89] This implies that the parties could freely determine the terms and conditions of their rights and obligations in any type of contract. However, given that the standard master agreements are judicially tested as to their enforceability, it is assumed that the parties continued to model their private agreements on the basis of these master agreements for the sake of legal certainty.[90] As noted in part 5.1, the French legislator adopted a partial opt-out under Article 1(3) of the FCD in that if both parties were eligible, the provision extended to all contracts concluded between them for the settlement of cash or delivery of financial instruments so that netting was no longer restricted to operations in financial instruments.[91] On the contrary, where one of the parties is an unregulated commercial enterprise, the requirement remained that the obligations had to arise from operations on financial instruments concluded with an eligible entity.

By and large, former rules relating to close-out netting and global netting were retained,[92] although it has to be noted that global netting was not tied to a particular master agreement and was increased to cover also financial collateral besides financial obligations into what has been termed universal global set-off ('*la compensation globale universelle*').[93] This global netting has been safeguarded not only from the provisions of collective proceedings but, following the transposition of the FCD, also from executive

86 Article 2 of Law no. 2005-171 of 24 February 2005.

87 For an explanation of the type of instruments which may be subject to netting following the transposition of the FCD into French law, see ELIET & GAUVIN (2005) 47.

88 JURISCLASSEUR (2010) Fasc. 1550, para 52.

89 ELIET & GAUVIN (2005) 47.

90 JURISCLASSEUR (2013) Fasc. 2050, para 79.

91 TERRET (2005) 52.

92 *Rapport au Président de la République relative à l'ordonnance no 2005-171 du 24 février 2005 simplifiant les procedures de constitution et de realisation des contrats de garantie finacière*, NOR: ECOX0400308P.

93 TERRET (2005) 52. This notwithstanding the rule under French law that collateral is considered ancillary to the main transaction and is not due on early settlement. Hence, collateral is not typically included in the set-off of obligations. The ancillary nature of collateral is also reflected in *Convention-Cadre FBF Relative aux Operations sur Instruments Financiers à Terme* of the Federation Bancaire Française. Clause 11.6 thereof (English version) provides that 'The Parties may agree at any time to grant or provide and potentially segregate, any security or guarantee in respect of all or any of the Transactions.'

civil procedure measures. The reference to collective proceedings was also extended to similar proceedings regulated by foreign laws.[94] The inclusion of physical persons originally removed in the February 2005 amendments was reintroduced a few months later.[95]

Former article L.431-7 of the Financial Code was deleted by article 3 of Ordinance No. 2009-15 of 8 January 2009 and replaced by article L.211-36-1 by means of article 1 of the same Ordinance. The main change resulting from article L.211-36-1 is the widening of the list of financial instruments that may be subject to a close-out netting provision by the addition of a new provision contained in §II of this article. Articles L.211-36 and L.211-36-1 have been amended on a few occasions, the latest being in 2019.[96] Every amendment to the close-out netting regime has served to widen the scope of application and scope for party autonomy, even though the concept remained firmly anchored to protect arrangements in the financial markets.

Two main derogations protect close-out netting provisions falling within the scope of article L.211-36-1. It has been seen in part 5.1 that article L.211-40 of the Financial Code provides that the law on collective insolvency proceedings falling under Book VI of the Commercial Code should not hinder, *inter alia*, the application of article L.211-36-1 on the enforceability of close-out netting provisions and rules on the compounding of interest in article 1343-2 of the Civil Code should not affect netting arrangements protected under article L.211-36 -1 of the Financial Code. Further protection is afforded by Article L.211-36-1, II, which provides that the contractual modalities of close-out netting are enforceable against third parties and gives retroactive effect to these modalities in case of action brought by third parties to oppose these modalities. According to Gaudemet, this derogation is meant to protect close-out netting from the so-called 'claw back rules' which are individual actions based on either executive title such as seizure orders or on precautionary title such as the *actio pauliana*.[97] In addition, given that there is no mandatory set-off principle under French law, any restrictions imposed by set-off law should not apply to close-out netting provisions regulated by article L.211-36-1, other than that the provision should regard only bilateral and reciprocal obligations.

Since these derogations are widely termed[98] and do not impose any conditionality, it might be assumed that the protection given to close-out netting provisions is extensive. To a great extent it is. However, since these derogations specifically target insolvency law and third party execution

94 ELIET & GAUVIN (2005) 47.

95 See article 31 of Law no 2005-842 of 26 July 2005. Under a previous version of this article L.431-7, article 2 of Ordonnance no. 2005-171 of 24 February 2005 had excluded physical persons from benefitting from the close-out netting regime when contracting with an eligible entity.

96 Article 77(V) of Law No. 2019-486 of 22 May 2019.

97 GAUDEMET (2010) para. 519.

98 With the exception of the derogation from the provisions of article 1343-2 of the Civil Code.

action, and since article L.211-36-1 of the Financial Code does not expressly protect close-out netting provisions 'in accordance with their terms', protection may not be available in respect of other measures which do not fall under the insolvency or third party civil action regimes. At least three such measures have been identified in doctrine. First, articles 1244-1 and 1244-2 of the Civil Code permit the judge to grant a grace period by postponing or scaling back a payment due for a period of two years. This measure, if applied, may affect the early termination mechanism of a close-out netting provision.[99] Second, the derogations also do not cover the third-party holder procedure under articles L.262 and 263 of the Book on Fiscal Procedures ('*Livre des procedures fiscales*') so that the risk exists that an amount which a creditor thinks it can use to set off amounts due by its counterparty is seized by the tax administrator under this procedure.[100] Third, the applicable derogations do not cover the conservatory acts that may be exercised under powers granted to the ACPR in relation to institutions falling under its supervision in order to protect the interest of consumers under article L.612-33 of the Financial Code. These measures may include the temporary suspension, restriction or prohibition of the free transfer of all or part of the assets of the supervised institution.

Another regime which has affected the enforceability of close-out netting provisions is the introduction of bank resolution law, aimed to give supremacy to the fulfilment of the objectives pursued by this law. Contrary to the other laws mentioned above which escape the specific derogations protecting the close-out netting regime, resolution law expressly addresses and modifies the application of the close-out netting regime.

Resolution Measures

The role of party autonomy in the enforceability of close-out netting arrangements has been significantly affected by Ordinance no. 2015-1024 of 20 August 2015, now codified in article L.613-34 *et sequens* of the Financial Code. This was preceded by Law no. 2013-672 of 26 July 2013 which established the first resolution regime based on the BRRD proposal being negotiated at the time. The 2013 law provided a few basic principles of the resolution regime and already incorporated rules on the temporary suspension of contractual or termination rights, bail-in, the no-creditor-worse-off principle, the rule against partial transfers in relation to close-out netting

99 Gaudemet, who is a proponent of this view, states that given that this is a rule of a public nature there is nothing in the law to stop the judge from applying it in relation to a termination or resolution clause. He considers that the fact that articles 1244-1 to 1244-3 of the Civil Code are referred to in article L.611-7 of the Commercial Code is not sufficient to consider that these are covered by the article L.211-40 derogation given that the award of a grace period is established by said articles of the Civil Code and it would be necessary to disapply the Civil Code articles for the derogation in this respect to be effective. GAUDEMET (2010) para 483 & 527.

100 *Ibid.* para 530.

arrangements and the non-trigger of termination clauses.[101] The report presented in parliament during the discussion of the 2015 Ordinance confirms that the latter law completes ('*reprend, complète et précise*') the transposition of the BRRD originally initiated by the 2013 law and aligns it with the framework of the EU resolution mechanism, such as by removing internal domestic provisions which did not permit the recognition of foreign resolution measures.[102]

Current French resolution law imposes a number of restrictions on the enforceability of close-out netting arrangements. Most of these result from the transposition of the BRRD. Foremost among these is that parties cannot trigger the operation of close-out netting provisions following the exercise of resolution measures, if contractual obligations continue to be performed.[103] These restrictions apply taking into account a number of factors mentioned in article L.613-34-2 of the Financial Code which may indicate that the institution concerned is of systemic importance. The other restrictions are outlined below.

Bail-in

The resolution college of the ACPR is empowered under article L.613-55-6 of the Financial Code to exercise the bail-in tool in relation to financial contracts[104] and derivatives, and may for this purpose terminate such financial contracts or derivatives or liquidate their positions, except where these contracts have been exempted under article L.613-55-1 of the Financial Code.[105] Although close-out netting provisions incorporated in financial contracts have not escaped the bail-in provision, however some protection is afforded in relation to the valuation of the obligations. Thus, whilst in normal cases the valuation is calculated by an independent expert,[106] under

101 See in particular the former article L.613-31-16 of the Financial Code, which codifies in part the provisions of article 26 of the law of 26 July 2013 setting out the resolution regime.

102 *Rapport au Président de la République relative à l'ordonnance no 2015-1024 du 20 août 2015 portant diverses dispositions d'adaptation de la legislation au droit de l'Union européene en matière financière*, JORF nº0192 du 21 août 2015, page 14646 texte nº 18. See also BONNEAU (2015), comm. 166.

103 See article L.613-50-4 of the Financial Code. This rule is rendered mandatory in terms of the provisions of Article 9 of EC Regulation No. 593/2008. See also in this respect article L.613-56-3, III of the Financial Code in relation to the exercise of the bail-in tool, and article L.613-56-5, IV of the Financial Code, in relation to the suspension of termination rights.

104 A wide definition of financial contracts ('*contrats financiers*') is provided in article L.613-34-1-12º of the Financial Code. This definition includes all types of contracts covered by the French netting regime.

105 Bail-in of financial contracts may be avoided if collateral is put in place and if transactions are entered into for less than seven days, what are termed as '*contrats à exécution successives*' or '*spontanés*'.

106 See article L.613-47 of the Financial Code.

article L.613-55-6 of the Financial Code the valuation must be in accordance with existing netting arrangements. This contrasts with the former article L.613-31-16, IV of the 2013 regime in terms of which valuation of obligations was based solely on expert valuation. In addition, under article L.613-55-6 of the Financial Code the respective obligations owed between the parties must be settled on a net basis as foreseen by the netting arrangements. In this way the close-out netting provision itself is protected and the bail-in provision is only exercised on the net amount determined as originally agreed by the parties.[107]

Temporary Suspension of Termination Rights

Article L.613-56-5 of the Financial Code empowers the resolution college to impose a temporary suspension on termination rights arising under contacts concluded not only by the institution under resolution but also by a member of the group of that institution whenever the institution under resolution has a connection with that contract as specified in article L.613-56-5, I of the Financial Code. In this case the law provides a safeguard to the extent that termination rights may continue to be exercised after the expiration of the period of suspension if, following a transfer of the contract, there subsists an event of default which may trigger the termination of the contract and the resolution college has not exercised the power to recapitalise it in terms of paragraph 1º of article L.613-55, I of the Financial Code. A counterparty may exercise rights of termination before the expiry of the suspension if the resolution college informs it that the contract concerned will not be transferred or that it will not be subject to recapitalisation measures. It may be noted that the law is not clear whether the suspension is solely tied to transfer measures or is of wider scope since the reference to transfer measures is only made in paragraph III of this article.

Partial Transfers

The resolution college may decide to transfer in one or more occasions all or part of the rights or liabilities of an institution under resolution to one or various acquirers under article L.613-52 or to a bridge institution under article L.613-53 of the Financial Code. In both instances, the law provides that notwithstanding any provision to the contrary, the contracts transferred will remain fully effective without any right of termination being exercised solely on account of said transfer. Safeguards are provided by article L.613-57-1 of the Financial Code in relation to the exercise of these powers, in terms of which netting and set-off arrangements cannot be the subject of

107 In terms of the ISDA French Law Opinion, in terms of a delegated regulation issued adopted by the European Commission on 23 March 2016 'if a liability is fully secured and governed by contractual terms that oblige the debtor to maintain the liability fully collateralized on a continuous basis […] it should be excluded from [bail-in].' *Ibid.* 60.

a partial transfer or be modified or terminated by the resolution college when exercising resolution powers in terms of articles L.613-56-2, L.613-56-3, II and III, and L.613-56-6 of the Financial Code, insofar as concerns the rights and obligations that may be set off or, following their termination, may be set off and converted to one single amount.[108] In order to guarantee the availability of funds in relation to insured deposits in terms of article L.312-4 of the Financial Code, the resolution college may by way of derogation of the above, transfer funds derived from a netting arrangement without transferring the other rights or obligations arising from the same contract or transfer, modify or terminate rights or obligations arising from such arrangements without transferring the funds derived from such arrangements.

5.4 Rationale of French Insolvency Law

The impact which the exercise of close-out netting rights has on the general principles of French insolvency law, including bank resolution law, will be analysed in this part of Chapter 5 with a view to analysing the resulting impact in the light of national insolvency law and state insolvency goals. This is preceded by a brief overview of the purposes aimed to be achieved by insolvency law.

Initially, the principal focus of the Commercial Code of 1807 was the body of creditors. From the moment of the opening of insolvency proceedings, the creditors lost the right to act individually against the debtor and could only notify their claims to the court so that distribution of proceeds was done on a *pari passu* basis. Certain privileged creditors such as holders of a specific security *in rem* remained outside the body so that these could enforce their rights on the insolvent debtor's estate. An important turning point took place under the law of 13 July 1967 which provided that secured creditors had to have their claims verified. Further changes in objectives were made by Law no. 85-98 of 25 January 1985 where the law placed the rescue of the business at the forefront of its concerns and abandoned the notion of the body of creditors so that secured or unsecured creditors were treated without distinction, resulting also in a serious deterioration in the position of holders of securities *in rem*.[109] The Act of 26 July 2005 strengthened this stance by the introduction of the safeguard procedure which took place earlier in time than the older proceedings of reorganisation and

108 Under article L.613-56-2, I of the Financial Code collateral securing a transfer may not be separated from the transaction when a transfer is made.

109 Hervé Synvet, 'The Exclusion of Certain Creditors from the Law of Collective Proceedings', in RINGE *et al.* (2009) 161. Synvet notes that this deterioration in the rights of secured creditors gave rise to a controversy on the constitutionality of the reform. *Ibid.* See also Decision 84-183 DC of the Constitutional Council, 18 January 1985 where the Court dismissed the complaint of retrospective effect of the Act on mortgages.

winding-up. The introduction of the accelerated financial safeguard procedure in 2014 further adapted the safeguard procedure for use by debtors in the banking and financial sector who were undergoing a conciliation procedure. Similar to the safeguard procedure, it also draws on the practice in the US and UK with regard to the pre-pack procedures and is characterised by the more concise timeframe within which the procedure is concluded. All this shows a clear tendency to have in place more expedient options and solutions to handle enterprise difficulties.

The prohibition of the individual pursuit of credit claims introduced in the 1980s significantly enhanced the rescue culture since it permitted a debtor in financial difficulties to propose and implement a plan to restructure its business. Thus, in the reform of 1985, article 1 provided that the aim of the Act was firstly to save the enterprise, secondly to protect employment, and thirdly to pay creditors. Under more recent amendments, in particular those instituted by Ordinance No. 2014-326 of 12 March 2014, this order was modified, so that the objectives of the new law were stated to be first to facilitate the anticipation of the aggravation of financial difficulties, second to enforce expedient procedures to deal with creditors, the debtor and associated entities and finally to take into account irremediable situations insofar as they effect rights of creditors and of the debtor and for this reason to put in place a procedure which is secure, simple and efficacious. Thus, although a slight amelioration in the plight of creditors can be detected, modern French insolvency proceedings continue to evolve around the enterprise and not around the payment of creditors, and for this reason the proceedings in place are more of an economic, rather than egalitarian, nature.[110]

The derogation given to protect the enforceability of close-out netting is clearly an exception to both the concepts of the *pari passu* treatment of the body of creditors and the idea of restructuring or rescuing the failing enterprise. The individual action taken by netting creditors could frustrate the effectiveness of safeguard proceedings initiated at a time when the debtor is not yet in a state of cessation of payments and therefore when obligations can still be performed. Indeed, the simple fact that a type of safeguard proceeding has been instituted is typically sufficient to trigger the close-out netting provision of standard master agreements and to lead to the exercise of termination rights. This preference given to netting creditors has a link with the legislative movement commenced in 1987 and pronounced more recently with the implementation of the EU's FCD to give special protection, and hence more rights, to creditors in financial operations. The realisation that overriding interests need to be protected in the enforcement of resolution measures in relation to banks and investment firms led to the containment of the exercise of netting rights, although, as has been seen,

110 See *Rapport au Président de la République relative à l'ordonnance no 2014-326 du 12 mars 2014 portant réforme de la prévention des difficultés des entreprises et des procédures collectives,* JORF n°0062 du 14 mars 2014, page 5243 text n° 2.

a number of safeguards were also implemented so as not to prejudice the netting creditor unduly. But these considerations are only made in relation to two types of institutions that may be particularly susceptible to systemic risk, namely banks and investment firms. For the other institutions, the 'old' regime applies and netting creditors are free to exercise their netting rights notwithstanding any rule of French insolvency law.

5.4.1 Principles Upheld by French Insolvency Law

In this part, the interaction of the role given to party autonomy in close-out netting provisions is examined in the light of the fundamental principles of French insolvency law related to pre-insolvency contractual entitlements, which are considered more relevant for this analysis. Arguably two of the more important principles upheld by French insolvency law in this scenario, and which have been briefly alluded to earlier in this chapter, relate to the continuation of contracts and the stay of individual action, both intended to facilitate the safeguard or restructuring of the enterprise in financial difficulties, or its orderly liquidation. A brief explanation of each principle is made initially, followed by an understanding of the impact of the enforceability of close-out netting provisions on these principles.

Principles

In relation to the principle of continuation of contracts, article L.622-9 of the Commercial Code provides that the activity of the enterprise continues during the period of observation. This is based on the understanding that the restructuring of an economic entity may not be feasible unless it continues trading. In order to give force to this rule, article L.622-13 of the Commercial Code provides that the administrator may demand the pursuit of contractual relationships by forcing the other party to perform its obligations notwithstanding that the debtor was not performing its obligations prior to the opening of insolvency proceedings and provided the administrator has sufficient funds to execute the delivery or payment promised by the debtor. In case of non-payment, the contract is terminated by operation of the law. The contract may also be terminated by the judge upon the request of the administrator if this is necessary for the rescue of the debtor and does not excessively affect the interests of the creditor. This principle applies to both the restructuring and safeguard proceedings and is a form of cherry-picking recognised by French law, although some level playing field has been incorporated in the law.[111] A similar procedure applies in relation to judicial liquidation in article L.641-11-1 of the Commercial Code. Financial collateral arrangements and operations relating to financial instruments

111 SAINT-ALARY-HOUIN (2013) 360.

totally escape the application of article L.622-13 of the Commercial Code in terms of article L.211-40 of the Financial Code.

The rule on the stay of individual creditor action is set out in article L.622-21 of the Commercial Code which prohibits the continuation or initiation of enforcement proceedings taken by creditors. As a result, whilst the contracts are expected to continue during the observation period unless they are detrimental to the interests of the debtor, creditors are obliged to suspend any rights of pursuit for payment or for enforcement of other rights. A distinction has traditionally been made between creditors whose claims originated prior to the opening of insolvency proceedings and those whose claims originated after the judgment opening insolvency proceedings.[112] Until the Act of 26 July 2005, only the *prior creditors* were subject to the constraints of the proceedings. They were grouped together in the general body of creditors into an entity which was given legal personality and which made it possible to treat them in the same way. To share in the distributions, prior creditors were required to declare their claims within strict time limits. Conversely, *subsequent creditors* retained their rights as if the debtor was not in financial difficulties. The reason for this was that the rescue of business could not be contemplated if trading could not be financed after proceedings were opened. Thus, as a general rule, subsequent creditors remained free to secure their credit and to have the charged assets sold in accordance with the terms of their arrangements. This distinction was partly undermined by the Act of 26 July 2005 whereby protection for subsequent creditors was only made available to creditors who *stricto sensu* financed the activity of the business. As a consequence, the subsequent creditors were made virtually subject to the constraints of the proceedings. In particular, they had to declare their claims if they wished to share in the distributions. Under the current article L.622-21 of the Commercial Code the stay is imposed on claims arising both before and after the judgment opening insolvency proceedings except those considered privileged in terms of article L.622-17 of the Commercial Code. These are debts originating regularly after the opening of insolvency proceedings for the purposes of the same proceedings or of the observation period, or which have been entered into for the benefit of the debtor during the said period. These are paid either as they become due or are given privileged status in an eventual distribution. This strengthening of the stay of individual action represents a change in approach and renders possible the determination of the financial state of affairs of the debtor in order to facilitate the elaboration of a plan of safeguard or rescue.[113]

112 THÉRY (2009) 12.

113 SAINT-ALARY-HOUIN (2013) 428.

Impact of Close-out Netting

As reiterated above, article L.211-40 of the Financial Code excludes close-out netting provisions regulated by article L.211-36 *et sequens* of the Financial Code from the law on collective proceedings. Synvet questions how can a system which puts emphasis on rescuing enterprises in difficulty be reconciled with the favourable treatment given to certain creditors and whether it is truly the case that only considerations of general interest have led to the law of collective proceedings being set aside or whether such considerations have sometimes served as a cover for the promotion of self-interest by the financial sector.[114] Former French law permitted, as a general rule, the settlement of obligations arising after the opening of collective proceedings on the understanding that continued trading by the failing enterprise is necessary for its rescue. This approach may help to explain the apparent lack of, or little, concern expressed by French jurists on the impact of close-out netting on the principle of *pari passu* and on the existence of actual or constructive knowledge of the impending insolvency. It may thus be the case that French jurists are 'accustomed' to the legal situation where subsequent creditors, including those whose rights arise after the opening of collective proceedings, are given prior rights for payment and the preferential rights given to the netting creditors may be just one other preference given to the detriment of the *pari passu* principle whose effectiveness was already significantly diluted by law. Although the scope of the principle of favouring subsequent creditors in terms of article L.622-17 of the Commercial Code is today substantially curtailed, it does not appear to have affected the application of the general derogation given by article L.211-40 of the Financial Code to close-out netting provisions, since the law does not distinguish whether the obligations arose before or after the opening of collective proceedings.

Another factor which could have contributed to this approach in relation to the *pari passu* principle is that the protection of creditors' rights is not the primary aim of modern collective proceedings laws. The primary aim is in most cases the rehabilitation of the debtor. Observance of the principles of continuity of contracts and of the stay of individual creditor actions are in fact intended to protect the debtor, at times to the detriment of the creditor. Thus, other reasons need to be sought to help explain why close-out netting arrangements concluded within the ambit of the financial sector are given a full exemption from the collective proceedings regime, thus prejudicing the rights of other creditors and reducing the chances of rescuing the failing enterprise. Even the reverse situation operating under bank resolution law, whereby restrictions on the exercise of close-out netting rights are reinstated, aims to give preference to the social and economic factors linked to

114 Hervé Synvet, 'The Exclusion of Certain Creditors from the Law of Collective Proceedings', in RINGE *et al.* (2009) 175.

the financial sector by protecting the critical functions of banks and investment firms, financial stability and the assets of their clients. Conversely, if this reversal negatively affects the orderly functioning of the market, it is the protection of the close-out netting provision that again prevails in order to ensure the stability of the financial sector against systemic risk. An understanding of the rationale for the preferences given to financial sector creditors and their netting arrangements may be sought by reference to the state goals which typically shape exceptions to general rules and by the economic dynamics which have been attributed to French commercial law. This aspect will be considered in more detail in the next part of this chapter.

5.4.2 Effect of State Goals on French Insolvency Law

Referring to the various changes to French law on collective proceedings, Omar views this as 'a constant, but somewhat vain, attempt to find the right solution'.[115] A different viewpoint is expressed by Saint-Alary-Houin who considers these changes as a trajectory course of French insolvency law to affirm the primacy enterprise rehabilitation whereby insolvency procedure is translated in terms of the enterprise and not of its creditors.[116]

Arguably, the principal aim of French insolvency law is still nowadays to save the business with a viable and sustainable solution, although more recent amendments have tended to strengthen creditors' rights generally, especially in safeguard proceedings as regards formulation of a restructuring plan agreed with creditors. At the turn of the millennium a clear choice was made by the French legislator to consider importing foreign insolvency-related structures into French law. This is reflected in an address delivered by the former President Sarkozy in 2007 at the Paris Commercial Court to commemorate the bicentenary of the Commercial Code, where he declared that commercial justice should first and foremost be at the service of the dynamism of the French economy ('*la justice commerciale doit être d'abord au service du dynamisme de l'économie française*').[117] Specifically in relation to collective proceedings, President Sarkozy required further amendments to be inspired by the US Chapter 11 model so as to encourage entrepreneurs to further develop initiative and the taste for risk.

As a result of this public policy, French law, which is based on the civil law heritage and is traditionally pro-debtor, has nowadays incorporated legal devices into its commercial law from common law (or hybrid common law) jurisdictions such as the UK and the US. Omar remarks that in the reforms commencing from 2005 the French legislator embarked on

115 OMAR (2014) 220. It may be argued that it is difficult for the legislator to make the right choice if the same collective proceedings apply to both corporate and individual debtors, given the different perspectives which need to be covered.

116 SAINT-ALARY-HOUIN (2013) 34.

117 Speech by former President Nicolas Sarkozy, *Allocution à l'occasion du bicentenaire du Code de Commerce*, Tribunal de commerce de Paris – 6 September, 2007.

a process of comparing French laws to those in other jurisdictions and adopting foreign law structures insofar as these were perceived to have been successful for the economy.[118] Saint-Alary-Houin, on the other hand, believes that the impetus to change started with the implementation of the EU's Insolvency Regulation in 2000 which regulated cross-European insolvency proceedings since it was recognised that French insolvency law had to develop in line with other European laws. Since this Regulation provided for both primary and secondary proceedings, it was considered that this would lead to forum shopping and in this scenario it was felt that French law should not be more penalising or stigmatising than the law of other member states. This background and the changing economic environment led the French legislator to make the necessary legislative changes to adapt to this new context.[119]

Considering the particular situation of the development of the French netting regime, the tendency for French law to be conservative is evident in the way in which it initially implemented the EU's Financial Collateral Directive. Thus, the latter gives a very wide definition of the obligations that may be secured by a financial collateral arrangement, namely obligations 'which give a right to cash settlement and/or delivery of financial instruments'[120] and which is applicable to arrangements between public or regulated institutions and 'a person other than a natural person, including unincorporated firms or partnerships'.[121] On the other hand, under French law the largest category of financial obligations that may be secured by a financial collateral arrangement, namely that covering any settlement, applies only to contracts concluded between institutions in the financial sector.

On the other side of the coin, Synvet criticises even the more restricted protection given by French law to financial arrangements concluded between a regulated entity and a corporate. He states that the main reason for the derogations of the FCD relates to the systemic risk which parties to a financial collateral arrangement may be exposed to if the close-out netting provision is not enforceable following the insolvency of one of the parties. This justification is absent where the arrangement is with a corporate, or at best will depend on the circumstances such as the size of the company in question, the amount of the liabilities undertaken, the number of transactions concluded, *etc.* Synvet further considers that whilst it is the case that French law reserves preferential treatment for transactions in financial instruments and not ordinary loans, still banks can relatively easily restructure their financial operations to fall within the ambit of article L.211-36 of the Financial Code, such as in the form of prepaid futures contracts, and concludes that this is a matter of 'giving French banks a competitive

118 OMAR (2011) 263.
119 SAINT-ALARY-HOUIN (2013) 52.
120 See Article 2(1)(f) of the FCD.
121 See Article 1(2)(e) of the FCD.

advantage in international competition, even at the price of sacrificing the interests promoted by the law of businesses in difficulty'.[122]

This dilemma is reflected in the debate of the French parliamentary Senate at the time when global netting was originally introduced into French law and was restricted to regulated institutions. This restriction on the nature of the parties was not included in the original version of the proposed law. In the end it was restricted since it was considered unfair to the other creditors to extend it to any type of creditor benefiting from close-out netting arrangements.[123] Roussille states that this helps maintain an equilibrium between the economic imperative justifying a derogation from the law of collective proceedings and the will to maintain the principle of equality of treatment of creditors in the non-financial world. Thus, banks and other financial institutions were under former law not allowed the privilege of entering into derivatives with persons external to the financial world and having these protected under global netting. Roussille, however, notes that it is probably when contracting with these entities, who are not constrained by any prudential rules, that banks and other financial institutions face the greatest risks since the former are not subject to any regulatory restriction.[124] Roussille further remarks that the French legislator has to be aware of what its neighbouring legislators are doing since if, for instance, German law allows global netting to all creditors, it would be necessary for the French legislator to be more liberal for the financial professionals.[125] In fact, today article L.211-36-1 of the Financial Code has opened the applicability of global netting also to persons, including physical persons, entering into netting arrangements with eligible entities.

One trend which has been consistent throughout the various reforms of the French close-out netting regime is the general liberalisation of this regime. As pointed out by the French authors cited above, this process is arguably in the direction of bringing French law in line with developments in other jurisdictions. It will be observed in the concluding part of this chapter that in so doing the French legislator may not have adequately put in balance the various interests affected by the close-out netting regime. This is evident in the absolute, 'condition-free' protection given to close-out netting arrangements from the application of the law on collective proceedings, save for those restrictions introduced in view of the transposition of the BRRD. The 'taste for risk' developed by the French legislator in line with public policy direction may put into question the consistency of this regime

122 Hervé Synvet, 'The Exclusion of Certain Creditors from the Law of Collective Proceedings', in RINGE *et al.* (2009) 179.

123 For a detailed analysis of the parliamentary debate on the global netting proposal, see CAILLEMER DU FERRAGE (2001) 7.

124 ROUSSILLE (2001) 313. Although, it may also be remarked that banks and other institutions will, in normal instances, be in a stronger bargaining position and should be able to protect their interests in other ways, such as by asking for collateral or reflecting their risks by charging higher interest rates.

125 *Ibid.* 315.

with protection given to the enterprise which is characteristic of French insolvency law.

5.5 Preliminary Conclusions

It is difficult nowadays to decide whether the French netting regime may be classified as liberal or conservative. On the one hand, its scope is more restrictive than that of the FCD since the French legislator opted out partially under its Article 1(3). The French legislator also did not incorporate into the law the FCD standard that close-out netting provisions are enforceable 'in accordance with their terms', which would signal the supremacy given to party autonomy in the recognition of close-out netting provisions. On the other hand, the partial opt-out is extended to include also physical persons, and the law allows the parties total freedom to agree on the modalities of termination, valuation and set-off of their close-out netting arrangements which, when taking into account that these three elements in fact constitute the close-out netting mechanism, is essentially equivalent to the FCD standard of enforcing close-out netting provisions 'in accordance with their terms'.

Originally developed as an offshoot of the termination and set-off ('*résiliation-compensation*') concepts, legislation on close-out netting arrangements under French law was adopted earlier than the EU's Financial Collateral Directive. It can thus be said that under French law the regulation of close-out netting is 'home-grown' but also incorporates characteristics which, as stated above, are not different from those of the FCD. Initially, the law regulating close-out netting did not recognise full contractual freedom in bilateral relations since the close-out netting provision had to be based on the applicable framework rules of the relevant market association or on international or national market standard agreements. At this stage, this amounted to self-regulation by the market which was granted recognition by law. In relation to the repo market, the parties were even required to obtain the clearance of the central bank Governor as chairperson of the *Commission Bancaire* prior to operating their close-out netting arrangement.

A process of successive amendments to the law led to its gradual liberalisation. At first, the close-out netting provision operated product by product, based on the set-off requirement of connexity between the obligations being netted. As a result, three different regimes existed for the regulation of different products. This segregation was later questioned as it did not serve any purpose related to close-out netting as a concept and this led to its gradual liberalisation from the constraints of both the set-off requirements as well as of the frameworks of market associations. The three regimes were thus amalgamated, and conditions began to be standardised and liberalised. Global netting was recognised and legislated upon specifically, though initially a contractual link between the obligations had to be established for global netting to be effective, reminiscent of the connexity

requirement of set-off. Nowadays article L.211-36-1 of the Financial Code recognises the total freedom of the parties to determine the mechanisms for the termination, valuation and determination of a net amount in their contractual arrangements, the only restrictions being that the applicable agreement has to fall within the scope of application of article L.211-36 of the Financial Code. The link with set-off continued to diminish and connexity between obligations which are netted is no longer so restrictive.[126] Indeed, given the invocation requirement imposed on set-off, it is arguable that for agreements qualifying under article L.211-36 of the Financial Code, the parties can opt to enforce their netting rights rather than invoke set-off, not only in cases where set-off conditions are not met such as in relation to the connexity requirement, but possibly also when they are met, given that set-off is not a mandatory principle under French law.

First Sub-question

It has been noted that the reference to set-off ('*compensation*' or '*compensables*') in article L.211-36-1 of the Financial Code is *prima facie* central to the regulation of close-out netting. But as noted above this reference has not restricted the pace for the contractual enhancement on which the close-out netting concept is based. Thus, the original notion of close-out netting was founded on the existing concepts of termination and set-off. With the further liberalisation of this concept, the ties with set-off are nowadays more limited, these being the reciprocity requirement and the fact that set-off is the modality used to determine a single amount in the case of global netting. Thus, beyond the requirement of reciprocity, the type of contractual enhancements permitted by French law in the recognition of close-out netting provisions leads to the preliminary conclusion in relation to the first sub-question of the Introduction that French set-off rules have not, generally speaking, influenced the more recent development or the interpretation of close-out netting rules.

Close-out netting bears the closest affinity with the concept of contractual set-off. Both regimes appear to allow the parties significant discretion to set the terms of valuation of obligations, and both seem to contemplate the possibility of compensating with future obligations. However, contractual set-off lacks the three-step process which constitutes close-out netting. Thus, termination rights are enforceable only in relation to close-out netting provisions, since under contractual set-off future obligations need to materialise before set-off can be effective. Likewise, the law on contractual set-off does not specifically recognise the discretion of the parties to consider different permutations in achieving a single net amount. The law on close-

126 This is confirmed in the ISDA French Law Opinion where it is stated that the close-out amount may include 'termination values of different types of transactions, taken either separately or as a portfolio, whether cash or physically settled, and different currencies related or denominated products […]'. See ISDA French Law Opinion at p 11.

out netting, on the other hand, gives full freedom to the parties to establish ways how to determine the close-out amount. Set-off is one of these ways. Other possibilities include the novation of old obligations into a single new obligation owed by one party to the other, or the replacement value of the outstanding obligations. These options are not contemplated under the law regulating set-off, though mechanisms such as novation may derive from other provisions of French law.

Another significant departure from set-off is that the close-out netting process goes beyond the payment functionality attributed to set-off and includes the termination and enhanced valuation mechanisms exercisable on the basis of contractual arrangements. These contractual enhancements of the close-out netting principle have resulted in the creation of a loss indemnification mechanism which, except for the reciprocity requirement, is not tied to the fulfilment of the requirements of set-off and which is fully protected from the law of collective proceedings without the need to establish connexity (as required for set-off) between the various obligations. The only requirement to be met is that the various obligations are linked to the close-out netting provisions by a contractual provision.

Second Sub-question

As a preliminary conclusion to the second sub-question, it is deemed that French insolvency law has not affected the recognition given to close-out netting provisions. Thus, article L.211-40 of the Financial Code exempts close-out netting provisions from the provisions on collective proceedings without imposing any conditions similar to those of Article 8(2) of the FCD relating to the lack of actual or constructive awareness of the impending insolvency.

Perhaps because it is fundamentally a pro-debtor jurisdiction, there is no strong sentiment among French authors on the preservation of the *pari passu* principle. This may have led to the unexpected result that the liberalisation of the close-out netting concept was not met with significant controversial debate, at least in relation to the *pari passu* principle. Indeed, in the environment whereby in the 1980s creditors' rights were being significantly restricted, the reverse situation whereby the rights of a particular class of creditors, namely those with close-out netting rights, were given preferential rights would not have caused significant debate from the point of view of the *pari passu* principle which, in any case, was secondary to the principal aim of enterprise rescue.

The French legislator provided broad derogations from insolvency law and third-party action in articles L.211-40 and L.211-36-1, II respectively of the Financial Code. However, other laws not captured by these derogations such as the law on conservatory measures adopted by the ACPR under article L.612-33 of the Financial Code continue to apply. Thus, whilst the French legislator was liberal in the derogations granted under two specific regimes (*i.e.* insolvency law and civil execution action), no consideration

seems to have been given to other regimes which could affect the recognition granted to close-out netting. Indeed, contrary to English law which has a strong tradition of protecting pre-insolvency contractual entitlements, the general understanding is that French law would not consider such entitlements favourably under general law and the application of these laws may ultimately affect or even prevent the enforceability of close-out netting provisions.

Third Sub-question

Insofar as concerns banks and investment firms, the enactment of resolution law also brought some modifications in the enforcement of close-out netting provisions. There is a close similarity with the restrictions imposed under the English resolution regime, also considering that ultimately both the French and English regimes had to adhere to the EU's BRRD. Thus, also affected by the French regime is the exercise of termination rights. First, termination rights cannot be triggered solely by the exercise of resolution measures if payment and delivery obligations continue to be performed. Furthermore, resolution law also imposes a suspension on termination to allow for the effective imposition of resolution measures, in particular in relation to the transfer of contracts. In the case of bail-in of financial contracts or derivatives, the resolution college is empowered to itself exercise the right of termination in order to proceed with the liquidation of outstanding transactions. On the other hand, a number of safeguards have been implemented to protect the close-out netting mechanism. Thus, termination rights can only be suspended if obligations continue to be performed. The contractual valuation methodology is to be respected by the resolution college when exercising the bail-in tool, so that this can only be exercised in relation to net amounts, rather than single transactions. There can be no partial transfers which could dismember the netting mechanism and any decision to suspend the termination of netting agreements has to take into account the orderly functioning of the market. There are evidently a number of interests that have to be taken into account and which are being balanced out. At all times, however, the close-out netting mechanism itself remains intact (even if its application is postponed or some elements of it are enforced by the resolution college rather than the solvent party), so that an amount of protection has been given even in the ambit of public policy regimes such as the resolution regime.

The regulation of close-out netting provisions and the restriction of the scope of regulation to the financial sector has existed in its basic form since 1987 but has since been gradually liberalised. It can be surmised that this is a case where the French legislator emulated foreign systems in developing this concept, and, in addition, the legislator seemed willing to go a step further and not require that the close-out netting provision forms part of a financial collateral arrangement or impose any conditions for the applicability of the derogation from the law on collective proceedings. French law

therefore has a dedicated close-out netting regime which would presumably render the French jurisdiction more competitive in terms of other jurisdictions which have implemented the FCD more faithfully. This may result in France having gone even further than other jurisdictions to liberalise the close-out netting regime and may have earned the classification of being relatively liberal in this respect.