Paech on Close Out Netting and Insolvency

Philipp Paech (LSE Law) has posted Close-Out Netting, Conflict of Laws and Insolvency on SSRN.

> *Close-out netting is a risk mitigation tool globally employed by financial market participants. It affords a special protection to those being able to use it and is remotely comparable to a super-priority or a security interest. It therefore potentially conflicts with the pari passu principle and its emanations. A number of jurisdictions, often called 'netting-friendly', have solved that conflict more or less comprehensively. As a consequence, close-out netting agreements are generally enforceable in these jurisdictions, even in the event of insolvency of one of the parties.*
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> *However, the financial market is global and the parties, their branches and assets might be located in different jurisdictions. Even if all relevant jurisdictions are netting friendly they differ in their approach to solving the conflict between granting the privilege of close-out netting on the one hand, and preserving the core of pari passu on the other hand. At the core of the issue is the question of whether and to what extent the lex contractus, ie. law governing the close-out netting agreement determines the limits of enforceability in insolvency — or whether the lex fori concursus alone is relevant.*
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> *Countries failed to agree on an international standard for conflict-of laws rules and did not include a relevant principle in the 2013 Unidroit Principles on the operation of of close-out netting provisions. As a result, legal uncertainty will persist in this area despite the fact that the EU is currently improving its regime in this regard.*
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> *This paper shows that it is a fallacy to believe that maintaining ambiguity in the conflict-of-laws regime governing cross-jurisdictional insolvencies of financial institutions is necessary for the sake of preventing the erosion of national mandatory law. States must acknowledge that globalised financial markets cannot work properly and safely against a backdrop of heterogeneous and thus*

potentially conflicting national frameworks. They should relax their insistence on the primacy of their own insolvency law in cross-jurisdictional situations, at least to some small extent, in exchange for a comprehensive and consistent international framework better able to serve the aims of certainty and stability. Such framework is to be provided by EU law or, ideally, by a global standard.