

## PERFORMANCE OF DERIVATIVE TRANSACTIONS THROUGH THE CENTRAL COUNTERPARTY

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*The article is devoted to the contractual models designed to formalize the legal relationship between the clearing participants (parties to the original derivative transaction) and the central counterparty (“CCP”). The authors deal with the legal concepts of novation, so-called “open offer” and assignment, which are commonly used in international practice. Taking into consideration some Russian legal peculiarities and comparative law experience, the authors come to the conclusion that the concept of assignment is best suited to the Russian legal framework.*

*Keywords: central counterparty; novation; open offer; assignment; abstract contract; clearing; OTC derivative contract; EMIR; Dodd-Frank Act.*

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### Introduction

One of the main problems of the legal regime governing derivative transactions is the mechanism for their performance. On the one hand, this is because Russian legislators are traditionally cautious towards acknowledging the legal effect of obligations arising out of so-called aleatory transactions, and are conscious of the high risk of non-performance of such contracts, which are not secured by a traditional set of collateral due to their economic mission.<sup>1</sup> Indeed, a derivative transaction usually represents a mass financial product, which leads to its standardization. The existence of additional manners of collateralization in such a transaction is closely connected to the creditworthiness of third parties (surety, independent guarantee) or the economic assessment of the entity acting as a collateral (pledge, for instance) provided by one of the parties to a transaction, but this significantly increases the so-called counterparty risk. This does not always correspond to the initial intentions of the parties – for instance, to use derivative transactions to hedge the risks of other contracts.

One of the mechanisms designed to advance the “enforceability” of derivatives is central clearing. The idea is that certain types of derivative transactions are performed with the assistance of a special financial intermediary named a “central counterparty.”<sup>2</sup> The central counterparty’s function is to release the parties to a derivative contract from risks connected with the paying capacity of the debtor, as after an obligation with a certain content becomes effective, the central counterparty “replaces” the debtor for the creditor and the creditor for the debtor respectively. Usually, such a case is described as the termination of the principal obligation under a derivative transaction and its replacement by two other creditor-debtor relationships, identical in content. In these two new relationships, the central counterparty represents a debtor (in one of the obligations) and a creditor (in the other obligation), so that on the outside it

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<sup>1</sup> It suffices to remember the well-known court cases from 2011–2013 concerning performance of interest rate swap contracts made between OOO Ermitazh Development and OOO Agrotterminal and the defendant ZAO UniCredit Bank (see Определение Высшего Арбитражного Суда Российской Федерации от 23 ноября 2012 г. № ВАС-15181/12 по делу № А40-92297/11-46-801 [Order of the Supreme Arbitration Court of the Russian Federation No. VAS-15181/12 of 23 November 2012 in the case No. A40-92297/11-46-801]).

<sup>2</sup> Jon Gregory, *Central Counterparties: Mandatory Central Clearing and Initial Margin Requirements for OTC Derivatives* 6 (West Sussex: John Wiley & Sons, 2014); Philipp J. Gergen, *Rechtsfragen der Regulierung ausserbörslicher derivativer Finanzinstrumente: Zur neuen Marktinfrastruktur in der Europäischen Union, den Vereinigten Staaten von Amerika und Singapur* 54 (Frankfurt am Main: Peter Lang GmbH, 2015).

appears as if the debtor in the original obligation, instead of performing the obligation to the initial creditor, transfers what he owes to a third party, a special intermediary, which in turn transfers the same to the previous creditor. And it is essential that this intermediary demands performance from the original debtor as a creditor in a new separate obligation, which is identical in content to the initial obligation under the derivative transaction. Equally, the original creditor demands performance from the intermediary as if from a new debtor (on a new basis) since the first obligation disappears and is replaced by two separate ones, "mirror-like" in content.

Such a model reduces the traditional counterparty risk in contractual relationships as each party to a derivative transaction is opposed by a professional participant specializing in the fulfillment of such contracts. Needless to say, the central counterparty will only perform its role if it is a sufficiently stable trader and possesses assets which will cover the liabilities it owes to parties to these transactions. It is also essential for it to possess effective ways of enforcing its claims, or it is destined to be an "eternal debtor" in derivative obligations.<sup>3</sup>

This model of "transfer" of a derivative transaction to a central counterparty was officially recommended by the International Organization of Securities Commissions' (IOSCO) Committee on Payment and Settlement Systems in the so-called Recommendations for Central Counterparties (CPSS-IOSCO) in 2004.<sup>4</sup> The Principles for Financial Market Infrastructures, issued by the same committee 8 years later, have maintained a similar approach.<sup>5</sup>

The first document specifically states that central counterparties should act on the basis of a stable legal concept of transfer of a derivative transaction to clearing (*see, e.g.,* sec. 4 "Recommendations"). Two models are suggested for this purpose: novation and so-called "open offer." Under IOSCO terminology the first of these models means "a process through which the original obligation between a buyer and seller is discharged through the substitution of the central counterparty as seller to buyer and buyer to seller, creating two new contracts" (*see* Annex 3: Glossary to the aforementioned Recommendations). The so-called "open offer" in the sense of the Recommendations implies that the central counterparty makes an "open offer" to market participants to act as a counterparty in derivative transactions. As a result, it is interposed directly and immediately between participants at the time that the terms and conditions of the transaction are agreed upon. In this case, essentially no original obligation occurs between the parties. On the outside, it looks like they have initially agreed on the terms and conditions of a future derivative through an

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<sup>3</sup> Gregory 2014, at 28–29.

<sup>4</sup> Recommendations for Central Counterparties (Bank for International Settlements, November 2004) (Jan. 8, 2018), available at <http://www.bis.org/cpmi/publ/d64.pdf>.

<sup>5</sup> Principles for Financial Market Infrastructures (Bank for International Settlements, April 2012) (Jan. 8, 2018), available at <http://www.bis.org/cpmi/publ/d101a.pdf>.

intermediary, which has led to the formation of two “mirror-like” obligations between the latter and two market participants (see Annex 3: Glossary and sec. 4.1.2 of the Recommendations).

The Principles for Financial Market Infrastructures 2012 also recommend that states use the mechanisms of novation or “open offer,” the descriptions of these two mechanisms being almost identical to those specified in the 2004 Recommendations.<sup>6</sup> In the meantime, the IOSCO’s approach is more flexible in this document: in particular, it highlights that the mechanism of “transfer” of a derivative to clearing may differ from one jurisdiction to another, “analogous legally binding arrangements” and “similar legal devices” being admissible mechanisms as well.<sup>7</sup> The reason for such flexibility is evidently the idea that the main purpose of national legal systems is to ensure that the system of measures ensuring the performance of obligations connected with the central counterparty works smoothly (see sec. 3.1.9 and further). Not surprisingly, a more recent edition of the “roadmap” on the optimization of regulation in the derivative market intentionally left this issue to the national legislator’s discretion. As an example, it states that legal succession may be used to transfer the contract to the central counterparty (see the reference to sec. 3.1.8).

The documents described above caused a well-known discordance of opinions within the professional debate concerning the most favorable legal form of structuring relations between a financial intermediary and the parties to a derivative transaction. The situation was complicated by the fact that the aforementioned documents did not provide for any information or clarification in this respect. It comes as no surprise that legal acts somehow inspired by these recommendations also avoided the issue. For instance, EU Regulation No. 648/2012 of the European Parliament and Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (better known as EMIR (European Market Infrastructure Regulation)), which contains detailed provisions on the internal structure and organization of activity of the central counterparty, only mentions cursorily that a derivative contract may be “entered into or novated.”<sup>8</sup> The well-known Dodd-Frank Act<sup>9</sup> adopted on 21 October 2010 in the USA (which entered into force on 15 July 2011), in its Title VII, which is dedicated to a detailed reorganization of over-the-counter derivative market, leaves this issue to the discretion of market participants. The Act states that a derivative transaction “shall be submitted” to a central counterparty for clearing

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<sup>6</sup> See secs. 1.13, 3.1.8 of the Principles for Financial Market Infrastructures, as well as Annex D.

<sup>7</sup> See the same sections.

<sup>8</sup> See secs. 16, 92 of the Preamble and sec. 4 of the Regulation (Jan. 8, 2018), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF>.

<sup>9</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111–203, H.R. 4173 (Jan. 8, 2018), also available at <https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>.

but nothing more.<sup>10</sup> European national legal systems do not specifically regulate this issue. The same can be said about Russia.

It is thus important to consider the advantages and disadvantages for Russia's legal system of transferring derivatives to central clearing.

### **1. Transfer of a Derivative Transaction to a Central Counterparty Through Novation**

One cannot say that Russia's legislation completely avoids the problem of transferring contracts by the party to it to central clearing. According to Art. 4(12) of the Federal law of 2 February 2011 No. 7-FZ "On Clearing and Clearing Activities" (hereinafter Clearing Law), clearing rules may cover situations when an obligation (obligations) existing between the parties to the contract made without the participation of the central counterparty shall be terminated through their replacement by a new obligation (obligations) between each party of the said contract and the central counterparty. At the same time, this new obligation (obligations) must provide for the same subject-matter and the same manner of performance as the original contract made without the participation of the central counterparty.

Based on the literal meaning of the law, it seems that the replacement of the existing obligation by a new one between each party to the contract and a third party must proceed as a result of the termination of the initial relationship between the parties to a derivative contract. However, it should be noted that the mechanism of this replacement of an obligation existing between the parties to clearing by a new obligation, between each of them and a central counterparty, provided by Art. 4(12) of the Clearing Law, lacks research in Russian literature.

For instance, Pavel Soloviev only notices that

on the over-the-counter derivative market contracts are made with a central counterparty on a bilateral basis. After the terms and conditions of the contract are agreed upon, it is transferred (through novation or other mechanism depending on jurisdiction) to a central counterparty. This means that the contract initially agreed upon between two contractors is replaced by two "mirror-like" contracts – between a central counterparty and each party to the initial contract.<sup>11</sup>

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<sup>10</sup> See secs. 721, 723, 728 of the Act (Jan. 8, 2018), available at <https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>.

<sup>11</sup> Соловьев П.Ю. Регулирование и централизованный клиринг внебиржевых деривативов // Управление в кредитной организации. 2013. № 2. С. 97–112 [Pavel Yu. Soloviev, *Regulation and Central Clearing of Over-the-Counter Derivatives*, 2 Management in a Financial Organization 97 (2013)].

However there are two prevailing views within this scant literature on the nature of such a replacement: the novation model<sup>12</sup> and the assignment model.<sup>13</sup>

In order to analyze the termination of obligations out of a derivative transaction in novation terms, it is necessary to refer to current legislation.

According to Art. 414 of the Civil Code of the Russian Federation, novation is understood as a ground for termination of an obligation implying the replacement of the initial obligation existing between two parties with another obligation between the same parties. Unless otherwise agreed between the parties, novation terminates any additional obligations.

The following features of novation have been pointed out by court practice:

- it is the parties to the initial transaction who are entitled to replace the subject-matter and undertake new obligations terminating the legal effect of the initial ones<sup>14</sup>;
- the essence of novation is the replacement of the initial obligation existing between the parties with a new obligation, accompanied by the termination of the initial obligation<sup>15</sup>;

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<sup>12</sup> It should be noticed that some sources determine novation as replacement of one party to the transaction with another person with the consent of both parties. See Лукашов А.В. Расчетно-клиринговая система и глобальная фондовая архитектура [Andrey V. Lukashov, *Clearing and Settlement System and Global Stock Architecture*] (Jan. 8, 2018), available at [http://www.gaap.ru/articles/raschetno\\_kliringovaya\\_sistema\\_i\\_globalnaya\\_fondovaya\\_arkhitektura/](http://www.gaap.ru/articles/raschetno_kliringovaya_sistema_i_globalnaya_fondovaya_arkhitektura/).

<sup>13</sup> Хоменко Е.Г., Игнатьева Е.А., Подкопаева Е.Е., Слесарев С.А. Комментарий к Федеральному закону от 7 февраля 2011 г. № 7-ФЗ “О клиринге и клиринговой деятельности” (постатейный) [Elena G. Khomenko et al., *Commentary on the Federal Law of 2 February 2011 No. 7-FZ “On Clearing and Clearing Activities” (Itemized)*] 35 (ConsultantPlus Legal Database, 2012).

<sup>14</sup> Определение Высшего Арбитражного Суда Российской Федерации от 16 февраля 2012 г. № ВАС-1110/12 по делу № А13-12757/2010 [Order of the Supreme Arbitration Court of the Russian Federation No. VAS-1110/12 of 16 February 2012 in the case No. A13-12757/2010]; Определение Высшего Арбитражного Суда Российской Федерации от 26 сентября 2011 г. № ВАС-12364/11 по делу № А50-25949/2010 [Order of the Supreme Arbitration Court of the Russian Federation No. VAS-12364/11 of 26 September 2011 in the case No. A50-25949/2010]; Определение Верховного Суда Российской Федерации от 25 декабря 2000 г. № 2-В00-20 [Order of the Supreme Court of the Russian Federation No. 2-V00-20 of 25 December 2000]; Постановление Тринадцатого арбитражного апелляционного суда от 19 марта 2015 г. по делу № А21-9250/2012 [Resolution of the Thirteenth Arbitration Court of Appeal of 19 March 2015 in the case No. A21-9250/2012].

<sup>15</sup> Информационное письмо Президиума Высшего Арбитражного Суда Российской Федерации от 21 декабря 2005 г. № 103 [Information Letter of the Presidium of the Supreme Arbitration Court of Russian Federation No. 103 of 21 December 2005], р. 2; Постановление Арбитражного суда Дальневосточного округа от 30 октября 2014 г. № Ф03-4686/2014 по делу № А51-7839/2014 [Resolution of the Arbitration Court of the Far Eastern District No. F03-4686/2014 of 30 October 2014 in the case No. A51-7839/2014]; Постановление Федерального арбитражного суда Северо-Кавказского округа от 25 января 2013 г. по делу № А32-17542/2011 [Resolution of the Federal Arbitration Court of the North Caucasian District of 25 January 2013 in the case No. A32-17542/2011]; Постановление Федерального арбитражного суда Центрального округа от 14 декабря 2012 г. по делу № А09-6721/2011 [Resolution of the Federal Arbitration Court of the Central District of 14 December 2012 in the case No. A09-6721/2011]; Постановление Девятнадцатого арбитражного апелляционного суда от 9 июня 2012 г. по делу № А64-5425/2009 [Resolution of the Nineteenth Arbitration Court of Appeal of 9 June 2012 in the case No. A64-5425/2009].

– novation implies a change in the type of obligation (replacement of a loan obligation with issuing a bill, replacement of an obligation to transport goods with a custody obligation, replacement of a bill obligation with an obligation to hand over goods and so on)<sup>16</sup>;

– novation only terminates an obligation when the agreement to replace the initial obligation with a new one meets all legal requirements, i.e., it is made in an appropriate form, the parties have agreed all the major conditions of the obligation and the transaction is valid<sup>17</sup>;

– the term of the novation agreement providing for the additional obligations of the pledger connected to the initial obligation to remain in force will be null and void<sup>18</sup>.

1. It should be noted that the above features of novation do not correspond completely to those proposed by the legislator to replace a derivative obligation by two “mirror-like” obligations between the clearing participants and a central counterparty. Firstly, novation implies the replacement of the initial obligation with a new one between the same parties. On the contrary, according to Art. 4(12) of the Clearing Law the obligation(s) existing between the parties to the contract made

<sup>16</sup> Постановление Федерального арбитражного суда Московского округа от 13 февраля 2001 г. № КГ-А40/365-01 [Resolution of the Federal Arbitration Court of the Moscow District No. KG-A40/365-01 of 13 February 2001]; Постановление Федерального арбитражного суда Восточно-Сибирского округа от 15 мая 2003 г. № А33-16110/02-С2-Ф02-1432/03-С2 [Resolution of the Federal Arbitration Court of the East Siberian District No. A33-16110/02-S2-F02-1432/03-S2 of 15 May 2003]; Постановление Федерального арбитражного суда Центрального округа от 14 мая 2003 г. № А36-229/6-02 [Resolution of the Federal Arbitration Court of the Central District No. A36-229/6-02 of 14 May 2003]; Постановление Федерального арбитражного суда Восточно-Сибирского округа от 17 марта 2014 г. по делу № А33-7120/2013 [Resolution of the Federal Arbitration Court of the East Siberian District of 17 March 2014 in the case No. A33-7120/2013]; Постановление Федерального арбитражного суда Восточно-Сибирского округа от 9 октября 2013 г. по делу № А10-4338/2012 [Resolution of the Federal Arbitration Court of the East Siberian District of 9 October 2013 in the case No. A10-4338/2012].

<sup>17</sup> Информационное письмо Президиума Высшего Арбитражного Суда Российской Федерации от 21 декабря 2005 г. № 103 [Information Letter of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 103 of 21 December 2005], p. 3; Определение Высшего Арбитражного Суда Российской Федерации от 15 августа 2013 г. № ВАС-10417/13 по делу № А40-130125/11-133-1115 [Order of the Supreme Arbitration Court of the Russian Federation No. VAS-10417/13 of 15 August 2013 in the case No. A40-130125/11-133-1115]; Постановление Федерального арбитражного суда Центрального округа от 1 апреля 2013 г. по делу № А48-1873/2012 [Resolution of the Federal Arbitration Court of the Central District of 1 April 2013 in the case No. A48-1873/2012].

<sup>18</sup> Информационное письмо Президиума Высшего Арбитражного Суда Российской Федерации от 21 декабря 2005 г. № 103 [Information Letter of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 103 of 21 December 2005], p. 6; Постановление Четырнадцатого арбитражного апелляционного суда от 26 июля 2011 г. по делу № А13-12758/2010 [Resolution of the Fourteenth Arbitration Court of Appeal of 26 July 2011 in the case No. A13-12758/2010]; Постановление Четырнадцатого арбитражного апелляционного суда от 22 июля 2011 г. по делу № А13-12757/2010 [Resolution of the Fourteenth Arbitration Court of Appeal of 22 July 2011 in the case No. A13-12757/2010]; Постановление Восемнадцатого арбитражного апелляционного суда от 11 февраля 2010 г. № 18АП-12239/2009 по делу № А76-11548/2009 [Resolution of the Eighteenth Arbitration Court of Appeal No. 18AP-12239/2009 of 11 February 2010 in the case No. A76-11548/2009].

without the participation of the central counterparty, is (are) terminated by their replacement with a new obligation (new obligations) between each of the parties of the said contract and the central counterparty, i.e., a third party. In other words, clearing changes the parties to the initial contractual obligation.

However, as is noticed in the literature, the essence of novation is that such an agreement is valid only for the parties involved. In particular, this logic is implied in the idea that collateral provided by a third party cannot be reserved for the purposes of a new obligation, which has arisen on the basis of the previous contract.<sup>19</sup> Thus, the construction provided by the Clearing Law can be treated at best as a mixed contract. This is inappropriate for legal analysis as in general, under any qualification resulting from the above replacement, no new obligation between clearing participants arises (*see below*).

2. Secondly, novation by its nature implies passage to an obligation of another type as compared with the initial one.<sup>20</sup> For instance, the previous version of the Civil Code of the Russian Federation specified that novation implies another subject matter or manner of performance (novation). As stated by the drafters of amendments to the Civil Code of the Russian Federation, the previous wording used to confuse the reader since the parties to the contract could change the manner of performance as well as the subject-matter within the existing obligation by changing the contract. This is why the new wording of Art. 414 of the Civil Code of the Russian Federation (which mentions replacement of one obligation with *another* one) is designed to highlight that the new legal relationship must be different to the initial one.<sup>21</sup>

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<sup>19</sup> See, e.g., *Егорова М.А.* Некоторые вопросы прекращения залоговых обязательств // *Законы России: опыт, анализ, практика.* 2012. № 5. С. 9 [Maria A. Egorova, *Certain Issues Concerning Termination of Collateralized Obligations*, 5 *Laws of Russia: Experience, Analyses, Practice* 8, 9 (2012)].

<sup>20</sup> *Витрянский В.В.* Проектируемые общие положения об обязательствах в условиях реформирования гражданского законодательства // *Кодификация российского частного права 2015* [Vasilii V. Vitryansky, *Projected General Provisions Concerning Obligations in the Conditions of Reforming Civil Law in Private Law Codification 2015*] 121 (P.V. Krashennnikov (ed.), Moscow: Statut, 2015).

<sup>21</sup> *Id.* Generally this idea is supported by court practice. See Определение Верховного Суда Российской Федерации от 19 марта 2015 г. по делу № 310-КГ14-5185, А48-3437/2013 [Order of the Supreme Court of the Russian Federation of 19 March 2015 in the case No. 310-KG14-5185, A48-3437/2013]; Постановление Арбитражного суда Волго-Вятского округа от 18 июня 2015 г. № Ф01-1915/2015 по делу № А39-366/2013 [Resolution of the Arbitration Court of the Volga-Vyatka District No. F01-1915/2015 of 18 June 2015 in the case No. A39-366/2013]; Постановление Арбитражного суда Волго-Вятского округа от 14 мая 2015 г. № Ф01-1359/2015 по делу № А43-16460/2014 [Resolution of the Arbitration Court of the Volga-Vyatka District No. F01-1359/2015 of 14 May 2015 in the case No. A43-16460/2014]; Постановление Арбитражного суда Волго-Вятского округа от 7 мая 2015 г. № Ф01-648/2015 по делу № А17-5311/2012 [Resolution of the Arbitration Court of the Volga-Vyatka District No. F01-648/2015 of 7 May 2015 in the case No. A17-5311/2012]; Постановление Арбитражного суда Дальневосточного округа от 30 июня 2015 г. № Ф03-2036/2015 по делу № А16-529/2014 [Resolution of the Arbitration Court of the Far East District No. F03-2036/2015 of 30 June 2015 in the case No. A16-529/2014]; Постановление Арбитражного суда Западно-Сибирского округа от 21 июля 2015 г. № Ф04-20552/2015 по делу № А81-1136/2014 [Resolution of the Arbitration Court of the West-Siberian District No. F04-20552/2015 of 21 July 2015 in the case



However, according to Art. 4(12) of the Clearing Law it is the replacement of one party to the contract with a central counterparty that serves as a ground for termination of the initial obligation,<sup>22</sup> and this does not provide for the change in the essence of the initial relationship: “the new relationship(s) must provide for the same subject matter and the same manner of performance” (Art. 4(12) of the said act). This means that in theory, the transfer of a transaction to the central counterparty should not change the essence of the obligation. Otherwise, the initial creditor will not obtain the expected consideration (in case of actual delivery) or it will hinder the multilateral clearing procedure for the central counterparty.

3. Thirdly, the legal literature notes the derivative nature of a relationship which has arisen, as a result of novation, out of the initial obligation. Should the novation agreement be rendered void, the initial relationship remains effective.<sup>23</sup> Obviously, the general consequences surrounding the invalidity of transactions are not intended to cover the declared specificity of clearing relationships.

As is clear from the Civil Code of the Russian Federation, the main consequence of holding a transaction invalid (unless otherwise prescribed by law) is bilateral restitution (mutual restitution) (Art. 167(2) of the Civil Code of the Russian Federation), which implies the return of the parties to their initial positions, i.e., each party is obliged to return to the other what they have received under the

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No. A81-1136/2014]; Постановление Арбитражного суда Поволжского округа от 14 июля 2015 г. № Ф06-25421/2015 по делу № А55-17453/2014 [Resolution of the Arbitration Court of the Povolzhskiy District No. F06-25421/2015 of 14 July 2015 in the case No. A55-17453/2014]; Постановление Девятого арбитражного апелляционного суда от 22 июня 2015 г. № 09АП-22464/2015 по делу № А40-199003/14 [Resolution of the Ninth Arbitration Court of Appeal No. 09AP-22464/2015 of 22 June 2015 in the case No. A40-199003/14].

<sup>22</sup> Khomenko et al. 2012, at 35.

<sup>23</sup> Постатейный комментарий к Гражданскому кодексу Российской Федерации, части первой [Itemized Commentary on Part One of the Civil Code of the Russian Federation] 778 (P.V. Krasheninnikov (ed.), Moscow: Statut, 2011); Комментарий к Гражданскому кодексу Российской Федерации (часть первая) (постатейный) [Commentary on the Civil Code of the Russian Federation (Part One) (Itemized)] 391 (T.E. Abova & A.Yu. Kabalkin (eds.), Moscow: Yurait, 2002). This is also supported by current court practice, which considers that resurrection of the previous obligation is a special consequence of invalidity of the novation agreement. See, e.g., Постановление Федерального арбитражного суда Поволжского округа от 28 августа 2013 г. по делу № А55-6219/2012 [Resolution of the Federal Arbitration Court of the Povolzhskiy District of 28 August 2013 in the case No. A55-6219/2012]; Постановление Федерального арбитражного суда Уральского округа от 15 сентября 2009 г. № Ф09-6900/09-СЗ по делу № А60-39930/2008-С11 [Resolution of the Federal Arbitration Court of the Ural District No. F09-6900/09-S3 of 15 September 2009 in the case No. A60-39930/2008-S11]; Постановление Пятого арбитражного апелляционного суда от 2 сентября 2011 г. № 05АП-4810/2011 по делу № А51-20022/2010 [Resolution of the Fifth Arbitration Court of Appeal No. 05AP-4810/2011 of 2 September 2011 in the case No. A51-20022/2010]; Постановление Семнадцатого арбитражного апелляционного суда от 13 июля 2009 г. № 17АП-602/2009-ГК по делу № А60-39930/2008 [Resolution of the Seventeenth Arbitration Court of Appeal No. 17AP-602/2009-GK of 13 July 2009 in the case No. A60-39930/2008]; Постановление Семнадцатого арбитражного апелляционного суда от 17 ноября 2008 г. № 17АП-8310/2008-ГК по делу № А50-8519/2008 [Resolution of the Seventeenth Arbitration Court of Appeal No. 17AP-8310/2008-GK of 17 November 2008 in the case No. A50-8519/2008].

relevant transaction. The consequences of invalidity may also include prohibition of restitution, compensation for real damage, compensation for losses and others.<sup>24</sup>

However, the consequences of invalidity of a contract made with the central counterparty are defined differently by the Clearing Law, and the obligation in this situation is terminated in the above manner. In the presence of interconnected contracts and in the absence thereof the law (Art. 14 of the Clearing Law) expressly excludes the implication of restitution where the contract made with the central counterparty is invalid. The only way of protecting civil rights provided by the Law is compensation for the losses (and only if the person knew, or ought to have known, that the contract was invalid and intentionally or negligently failed to act properly in connection with this awareness of the invalidity of the contract).<sup>25</sup> Whether it should be considered that Art. 14 of the Clearing Law is *lex specialis* in relation to the Civil Code of the Russian Federation and that the initial relation “resurrects” is a disputable matter. There appear to be two ways of interpreting this. In particular, it may hypothetically be concluded that in the case of invalidity of the transfer of an obligation to the central counterparty, the initial obligation between clearing members does not arise again since the Clearing Law provides for special rules on this issue.

4. Besides, it should be taken into consideration that Russian doctrine and court practice negatively treat the conclusion of novation agreements before the obligation, which the parties intend to terminate in the future, has arisen. This issue will inevitably appear provided that the transfer of the initial transaction to the central counterparty is exercised on the basis of some framework agreement between the clearing members and the central counterparty.

The possibility of incorporating automatic novation of the debt, in the case of improper performance or non-performance of the obligation by the debtor, into the main contract is not obvious. There are two opposite approaches in the literature. On the one hand, scholars point out that the “advance” formation of a novation agreement is possible because:

Firstly, Art. 414 of the Civil Code of the Russian Federation does not specify whether the novation agreement may be formed before the debt arises (for instance, supply agreement) or only after it has arisen.

Secondly, one of the fundamental principles of civil law states that individuals and legal entities are free to establish their rights and obligations on the basis of

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<sup>24</sup> Гражданский кодекс Российской Федерации. Сделки. Решения собраний. Представительство и доверенность. Сроки. Исковая давность. Постатейный комментарий к главам 9–12 [Civil Code of the Russian Federation. Transactions. Decisions of the Meetings. Representation and Power of Attorney. Time Limits. Statute of Limitations. Article-for-Article Commentary on Chapters 9–12] (P.V. Krashennikov (ed.), Moscow: Statut, 2013).

<sup>25</sup> Мухаметшин Т.Ф. Современная инфраструктура российского рынка ценных бумаг: научно-практический комментарий законодательства [Timur F. Mukhametshin, *Current Russian Securities Market Infrastructure: Scientific-Practical Commentary on the Legislation*] (Moscow: Yustitsinform, 2014).

a contract and to determine any conditions of the contract which do not contradict the law (Art. 1(2) of the Civil Code of the Russian Federation).

Thirdly, by virtue of Art. 421(3) the main contract should be considered as a mixed contract. It comprises elements of various contracts: the main contract and the obligation, omitted in the legislation, that is connected with the automatic novation of a pecuniary obligation into the loan in the case of non-performance of the former within a certain time.

On the other hand, the protective function of novation is notable and the impossibility of incorporating this construction into the main contract before the debt has arisen is clear. Moreover, novation differs from another ground of termination of obligations – break-up fee – in that the legal effect of novation occurs right after the parties have reached an agreement but not at any other moment.<sup>26</sup>

As for court practice, it rather denies<sup>27</sup> than admits<sup>28</sup> the possibility of incorporating into the main contract a condition providing for automatic novation. Court practice also highlights the impossibility of incorporating a condition concerning future novation through a suspensive condition in a transaction (Art. 157(1) of the Civil Code of the Russian Federation) in respect of which it is not clear whether this condition will occur or not, since the debtor's omission, connected with its failure to pay the creditor, cannot be considered as such a condition.<sup>29</sup>

5. Another important aspect of the regime of novation is the future role of collateral. In replacing one obligation by another one with the central counterparty, it is not clear what should happen to collateral, which may still exist in a derivative transaction. In this case, according to Art. 141(2) of the Civil Code of the Russian Federation, novation

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<sup>26</sup> *Бациев В.В., Щербаков Н.Б.* Комментарий правовых позиций Высшего Арбитражного Суда РФ по вопросам, связанным с применением норм Гражданского кодекса РФ о прекращении обязательств // Вестник гражданского права. 2006. № 2. С. 95–108 [Victor V. Batsiev, Nikolay B. Shcherbakov, *Commentary on the Legal Opinion of the Supreme Arbitration Court of the Russian Federation on Issues Concerning Application of the Rules of the Civil Code of the Russian Federation on Termination of Obligations*, 2 Civil Law Review 95 (2006)].

<sup>27</sup> Постановление Федерального арбитражного суда Западно-Сибирского округа от 13 января 2010 г. по делу № А03-6718/2009 [Resolution of the Federal Arbitration Court of the East Siberian District of 13 January 2010 in the case No. A03-6718/2009]; Постановление Четвертого арбитражного апелляционного суда от 7 августа 2014 г. по делу № А19-5547/2014 [Resolution of the Fourth Arbitration Court of Appeal of 7 August 2014 in the case No. A19-5547/2014]; Решение Арбитражного суда Иркутской области от 20 мая 2014 г. по делу № А19-5547/2014 [Decision of the Arbitration Court of the Irkutsk Region of 20 May 2014 in the case No. A19-5547/2014].

<sup>28</sup> Постановление Федерального арбитражного суда Западно-Сибирского округа от 9 июня 2011 г. по делу № А03-6686/2010 [Resolution of the Federal Arbitration Court of the East Siberian District of 9 June 2011 in the case No. A03-6686/2010].

<sup>29</sup> Постановление Федерального арбитражного суда Московского округа от 29 октября 2008 г. № КГ-А40/9883-08 по делу № А40-64187/07-83-570 [Resolution of the Federal Arbitration Court of the Moscow District No. KG-A40/9883-08 of 29 October 2008 in the case No. A40-64187/07-83-570]; Определение Мосгорсуда от 6 июля 2010 г. по делу № 33-18394 [Order of the Moscow City Court of 6 July 2010 in the case No. 33-18394].

terminates all additional obligations unless otherwise provided for by the agreement. In addition, if collateral in a derivative transaction has been provided by a third party, then, according to p. 6 of the Informational Letter of the Presidium of the Supreme Arbitration Court of the Russian Federation of 21 December 2005 No. 103,<sup>30</sup> a novation agreement condition, which may provide for additional obligations of a third party which is not a debtor, shall be considered invalid. Thus, in viewing the transfer of a derivative transaction to a centralized clearing in terms of novation, there will be no *a priori* transfer of collateral mechanisms to a new party (the central counterparty).

6. To sum up the analysis of transfers of a derivative transaction to a centralized clearing through novation, it should be noted that such a transfer leads to the creation of two obligations but not one. Court practice is silent about the possibility of concluding such agreements. This allows for the interpretation of the discussed agreement between clearing participants and the central counterparty as a mixed or non-defined contract. However, the risk exists that courts may consider such agreements from the point of view of unlawful transactions (Art. 168 of the Civil Code of the Russian Federation), since Art. 414 of the Civil Code of the Russian Federation expressly provides for the replacement of one obligation with only one other obligation.

Taking into account the above, one more important conclusion should be made. A novation agreement only binds the parties to the initial obligation, who have an exclusive power to make such an agreement. A novation agreement is by nature a manner of terminating obligations by the parties' agreement. This is why the termination of an obligation by the will of two parties and the simultaneous "accession" to this obligation by a third party (the central counterparty) is impossible due to the very construction of novation.

We may certainly try to interpret the transfer of a transaction to the central counterparty as a mixed contract construction (Art. 421(3) of the Civil Code of the Russian Federation), which includes features of several contracts of a different nature, or a non-defined contract.

But what kind of contracts will such a mixed contract display features of? The transfer of a derivative transaction to centralized clearing in this case will theoretically look like this: agreement on termination of the original derivative transaction and simultaneous agreement on the establishment of two mirror-like obligations with the same subject matter as the initial derivative transaction. Neither the former, nor the latter are directly regulated by civil law (whereas the existence of the former is assumed by the general provisions of the Civil Code of the Russian Federation,

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<sup>30</sup> Информационное письмо Президиума Высшего Арбитражного Суда Российской Федерации от 21 декабря 2005 г. № 103 "Обзор практики применения арбитражными судами статьи 414 Гражданского кодекса Российской Федерации" [Informational Letter of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 103 of 21 December 2005. Review of the Practical Experience of Application by Arbitration Courts of Article 414 of the Civil Code of the Russian Federation].

the latter is only mentioned in the Clearing Law without any details of the regime of such an agreement). Thus, the application of Art. 421(3) of the Civil Code of the Russian Federation as a justification of the existence of such a construction seems unacceptable. On the other hand, it seems like in this case such an agreement should be construed as non-defined.

Indeed, Art. 421(2) of the Civil Code of the Russian Federation specifies that the parties may conclude an agreement provided for by laws or other regulations as well as an agreement which is not provided for by such laws or regulations. Rules on particular types of contracts provided for by laws or other regulations shall not apply to contracts not provided for by laws or other regulations in the absence of the characteristics specified in part 3 of this Article. This, however, does not exclude the possibility of applying rules on the analogy of law (Art. 6(1)) to certain relationships between the parties to the contract. However, it follows from this rule that the risk of applying rules regulating similar relations to a non-defined transaction remains. It seems that the application by the courts of Art. 414 on novation to this relationship may be assumed, which in its turn will render this transaction invalid, since the major elements of the transfer of a derivative contract to a central counterparty contradict the very concept of novation in civil legislation, as mentioned above.

Moreover, court practice, which deals with certain aspects of freedom of contract, is quite fragmented, although based in general on approaches developed by the Supreme Arbitration Court of the Russian Federation in the Resolution of the Plenum of 14 March 2014 No. 16.<sup>31</sup> This Resolution espouses a substantially liberal approach, orienting courts towards the presumption of the discretionary character of civil law rules. Notably, courts are called on to allow provisions of contracts which depart from legal regulations even where the law does not directly grant the parties the right to do so (p. 2 of this Resolution). Meanwhile, the Supreme Arbitration Court of the Russian Federation noted that freedom of contract is limited by implicit boundaries, which include the substance of legal regulation (p. 3 of this Resolution). This means that the discretion of the parties in formulating the terms and conditions of their contract cannot distort the sense of legal constructions which may be deduced from the law. Thus, when determining the nature of the mechanism of transfer of a derivative transaction to centralized clearing, a risk exist that courts, taking into consideration p. 3 of the above mentioned Resolution, will interpret an agreement between the parties to clearing and the central counterparty as an invalid transaction, which distorts the legal regime of novation.

Given the above, it would be useful to compare effective Russian legislation with the fundamental argument expressed in German legal doctrine in favor of qualifying the discussed contract as an abstract novation allowed on the basis of

<sup>31</sup> Постановление Пленума Высшего Арбитражного Суда Российской Федерации от 14 марта 2014 г. № 16 "О свободе договора и ее пределах" [Resolution of the Plenum of the Supreme Arbitration Court of the Russian Federation No. 16 of 14 March 2014. On the Freedom of Contract and Its Extent].

the principle of freedom of contract.<sup>32</sup> Novation is discussed here precisely as an abstract transaction, which means that it remains in force even where the principal agreement, obligations under which are subject to novation, is rendered invalid, and the creditor in this relationship is exempted from the need to prove the grounds of its claim (the debtor is also deprived of an opportunity to make appropriate objections). This approach allows us to maintain the transfer of the debt to the central counterparty as valid, and to keep clearing performed by this intermediary safe from requalification. However, the idea of the abstract character of a transaction implying the transfer of a derivative contract to the central counterparty should be examined in detail because its admissibility directly affects the arguments concerning the non-defined character of the said agreement.

First of all, attention should be paid to the fact that it is the construction of an abstract transaction that would help to understand why two “mirror-like” obligations, which the central counterparty has entered into as a result of the “transfer” of a derivative transaction on it, are essentially not connected with any consideration: this is atypical for civil law due to the inadmissibility of unjust enrichment (Art. 1102 of the Civil Code of the Russian Federation) and inadmissibility of gifts between commercial organizations (Art. 575(1)(4) of the Civil Code of the Russian Federation).<sup>33</sup> Accordingly, obligational relations between the parties to clearing, providing a possibility to transfer something to the central counterparty or to demand transfer from it, could be theoretically justified as formally gratuitous only because of their abstract nature.<sup>34</sup>

## **2. Qualification of a Transaction for Transfer of Over-the-Counter Derivatives to the Central Counterparty as an Abstract Non-Defined Transaction (*Sui Generis*)**

In light of the above, let us consider the question of whether the transfer of a transaction to the central counterparty can be qualified as an abstract non-defined transaction *sui generis* under Russian law.

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<sup>32</sup> André Alfes, *Central Counterparty – Zentraler Kontrahent – Zentrale Gegenpartei: Über den Vertragsschluss an der Frankfurter Wertpapierbörse mittels des elektronischen Handelssystems Xetra unter Einbeziehung einer Central Counterparty* 104 (Berlin: Duncker & Humblot, 2005); Stefan Jobst, *Börslicher und ausserbörslicher Derivatehandel mittels zentraler Gegenpartei*, Institute for Law and Finance, Working Paper Series No. 120 (September 2010), at 28 (Jan. 10, 2018), available at [http://www.ilf-frankfurt.de/fileadmin/\\_migrated/content\\_uploads/ILF\\_WP\\_120.pdf](http://www.ilf-frankfurt.de/fileadmin/_migrated/content_uploads/ILF_WP_120.pdf); Gergen 2015, at 67.

<sup>33</sup> The latter is important since court practice, unfortunately, treats all gratuitous transactions as gift contracts by virtue of Art. 572(2) of the Civil Code of the Russian Federation.

<sup>34</sup> The issue is about the gratuitous nature of “mirror-like” obligations of the parties to centralized clearing since these parties certainly pay the central counterparty for its services. However it seems the ground for this payment is not the contract as it is, as a result of which the original obligations of the parties to clearing are terminated, but two “mirror-like” relations which appear.

This qualification, as mentioned above, could be based firstly on Art. 421 of the Civil Code of the Russian Federation, as well as on p. 5 and others of the Resolution of the Plenum of the Supreme Arbitration Court of the Russian Federation “On the Freedom of Contract and Its Extent.” It should also be mentioned that the legislation does not directly regulate abstract obligations. So, we may try to qualify an agreement on the transfer of a derivative transaction to centralized clearing as an abstract obligational agreement.

Along with this, in respect of the abstract character of the above mentioned concepts the following should be noted. Legal doctrine defines abstract obligational agreements as not requiring evidence of the existence of grounds for the creditor’s claim (the so-called causal moment) when enforcing them. Consequently, the invalidity of the grounds is irrelevant for the realization of an abstract right. If the debtor does not agree and challenges the existence of the obligation, it bears the burden of rebutting the creditor’s powers.<sup>35</sup>

It should also be realized that despite all the advantages of abstract obligations, in most legal systems they are treated with caution. In legal systems where the establishment of abstract obligations is admissible, and thus isolated performance by the debtor is admissible, this is allowed provided that strict formal requirements are met (*see, e.g.*, § 780 of the German Civil Code<sup>36</sup> or the exceptions to the general English legal rules concerning the provision of consideration). Some legal systems admit the conclusion of abstract agreements only in cases specified by law.

Nowadays, Russian law covers these issues primarily on the doctrinal level. Court practice treats abstract obligations very cautiously, unless securities are involved.<sup>37</sup> For instance, a well-known case may be mentioned in which the court considered the question of the so-called “parallel” abstract obligation in a contract for syndicated lending and could not make a firm conclusion as to whether such obligations are admissible under Russian law.<sup>38</sup> Perhaps the reason for such cautious treatment by

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<sup>35</sup> *See, e.g.*, this classic research – *Кривцов А.С. Абстрактные и материальные обязательства в римском и современном гражданском праве* [Alexander S. Krivtsov, *Abstract and Material Obligations in Roman and Modern Civil Law*] 243 ff. (Moscow: Statut, 2003).

<sup>36</sup> In particular, in Germany conclusion of abstract transactions is subject to strict requirements as to their form and some relations can only be formed as causal transactions. *See, e.g.*, *Palandt, Bürgerliches Gesetzbuch (BGB), Kommentar* 1311–1313 (73<sup>rd</sup> ed., Munich: C.H. Beck, 2014).

<sup>37</sup> *See, e.g.*, Постановление Арбитражного суда Московского округа от 17 августа 2015 г. № Ф05-9451/2015 по делу № А41-62884/14 [Resolution of the Arbitration Court of the Moscow District No. F05-9451/2015 of 17 August 2015 in the case No. A41-62884/14]; Постановление Федерального арбитражного суда Московского округа от 20 апреля 2009 г. № КГ-А40/3011-09 по делу № А40-69970/08-125-422 [Resolution of the Federal Arbitration Court of the Moscow District No. KG-A40/3011-09 of 20 April 2009 in the case No. A40-69970/08-125-422].

<sup>38</sup> Постановление Федерального арбитражного суда Московского округа от 25 ноября 2011 г. по делу № А40-62359/10-38-293 Б [Resolution of the Federal Arbitration Court of the Moscow District of 25 November 2011 in the case No. A40-62359/10-38-293 B].

parties to civil transactions of non-defined abstract transactions (including drawing a bill or independent guarantee) is the unwillingness of the parties to take a risk in concluding non-defined abstract transactions in the absence of the law's express specification.

As a result, it should be said that there is no express prohibition in Russian law to concluding abstract transactions; however, the risks of such agreements being invalidated on the basis of Art. 168 of the Civil Code of the Russian Federation should be borne in mind. In fact, the theory that an abstract transaction not expressly specified by law (such as a bill or an independent guarantee) cannot be created by agreement between the parties on the basis of Art. 421 of the Civil Code of the Russian Federation should be recognized as reasonable. It seems that an implied prohibition is meant here, as can be deduced from Art. 1102 of the Civil Code of the Russian Federation: since the concept of an abstract transaction (the content is not important) represents an exception of sorts to the general rules concerning the invalidity of transactions and the presumption of unjust enrichment in Art. 1102, the parties to the contract cannot endow it with an abstract character by their own initiative.

Attention should be paid to the fact that the above arguments concerning abstract transactions may also address the idea of qualifying the relations between parties to clearing and the central counterparty as relations of a "special," abstract novation. It should be stressed that most Russian courts and authors consider novation as a contract with consideration, the invalidity of which leads to automatic "renovation" of the principal obligation and *vice versa* – invalidity of the principal contract inevitably leads to invalidity of the new obligation, which has arisen on the basis of the novation.

In connection with the above, it is interesting to mention that German law uses the concept of novation in this case. This is because novation as a manner of terminating obligations is not regulated by the German Civil Code and its concept derives from §§ 311–311a of the German Civil Code concerning grounds for the creation of obligations. Thus, German law does not focus on the effect of the termination of obligations, but focuses on the consequences of implementing the will of the parties. It is logical that two types of novation are pointed out: causal and abstract (reference to the latter is based on the aforementioned § 780 of the German Civil Code). The effect of causal novation directly depends on the validity of the previous (original) obligation – for instance, the debtor may declare that since it did not owe any obligation (to transfer something, for example) under the previous obligation, it does not owe anything under the new claim. In abstract novation the debtor is deprived of such objections; however, the existence of this novation cannot be assumed.<sup>39</sup> From the point of view of German law, the novation regime does not prohibit the parties from creating two obligations when performing one.

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<sup>39</sup> *Palandt* 2014, at 491.



Most German researchers agree that the transfer of a derivative transaction to the centralized clearing may be described by the mechanism of an abstract novation, by virtue of features stemming from the regulation of novation and abstract transactions in Germany. However, this is not necessarily the only possible way.<sup>40</sup>

### 3. Open Offer

As mentioned above most jurisdictions, when constructing the transfer of a transaction to the central counterparty, choose between novation and open offer (see the Principles for Financial Market Infrastructures at the beginning of this article).

As for open offer, it is obvious that Russian legislation tries to describe it through the offer mechanism. In the case of an open offer, provided by international standards, the central counterparty automatically enters the transaction as soon as the buyer and seller agree upon its terms; if all preliminary agreements are performed, there are no contractual relations between the seller and buyer anymore. In other words, this alternative model provides that the central counterparty enters the transaction immediately.<sup>41</sup>

As mentioned, both novation and open offer give the parties a legal assurance that the central counterparty, in conducting payments, uses only those methods which correspond to the legal base. Let us consider this mechanism from the point of view of its compatibility with Russian legislation.

It seems that an alternative option in the form of an open offer, which is proposed by international standards, will be quite difficult to justify from the point of view of Russian legislation. This is firstly due to the fact that Russian legislation does not expressly provide for such a mechanism. The common model of concluding a contract through offer and acceptance provides that the offeror forwards an offer addressed to one or several persons, which expresses the offeror's intention to be bound if the offer is accepted.

Accordingly, in the context of the transfer of a transaction to the centralized clearing, the derivative transaction should firstly give rise to a mutual obligation, then be transferred through offer and acceptance in some way or another. "Automatic" entrance of a third party cannot be seen admissible since in this case it is not clear what the initial expression of will is designed to do – to establish an obligation

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<sup>40</sup> See Jobst, *supra* note 31; Gergen 2015, at 67–68.

<sup>41</sup> In particular, this concept is common for the USA along with novation. It is believed that in this case, the central counterparty may protect itself against the invalidation of the original derivative obligation and challenge the results of clearing, since it does not arise between the parties at all. Meanwhile, it is interesting that some authors tend to consider this mechanism as novation, but "immediate." See Byungkwon Lim & Aaron J. Levy, *Contractual Framework for Cleared Derivatives: The Master Netting Agreement Between a Clearing Customer Bank and a Central Counterparty*, 10(7) *Pratt's Journal of Bankruptcy Law* 509, 528 (2014).

or to terminate it through the “transfer”. It seems that such an agreement will be interpreted by a court as a non-concluded contract, since the parties failed to reach agreement on all of the conditions, as is required by law (Art. 432 of Civil Code of the Russian Federation), or as a sham transaction (Art. 170 of the Civil Code of the Russian Federation), which conceals some other structure of contractual relations between the parties.

Thus, Russian legislation does not provide for a mechanism for the immediate entrance of the counterparty in a derivative transaction between the parties to clearing. However, nothing impedes the parties from formulating an offer and acceptance after the establishment of the obligation in a derivative transaction.<sup>42</sup> Moreover, nothing impedes them from using this offer and acceptance to transfer the transaction to the central counterparty before the occurrence of the principal obligation, since the parties to any contract are at liberty to suspend the creation of obligations under a transaction until a certain date (Art. 190 of the Civil Code of the Russian Federation) or until the fulfilment of a certain condition (Art. 157 of the Civil Code of the Russian Federation).

Since the offeror should be clearly determined, the following method of structuring the transfer of a transaction may be used.

1. Creation of a transaction for the transfer of derivatives to the central counterparty through an offer of the party to clearing.

An offer may be seen as a transfer of data about the primary derivative transaction to the central counterparty through the electronic system performing secondary functions (usually called an “acknowledged offeror” (anerkannter Anbieter)).<sup>43</sup>

Defining acceptance in this case presents certain difficulties. The key moment in determining acceptance is supposed to be the moment when the transaction for the transfer of a derivative to the central counterparty has legal effect, i.e., the moment when the central counterparty gives the parties access to the report on the transaction in the electronic system.<sup>44</sup> Accordingly, it would be logical to consider that the publication of the report is deemed as an acceptance by the central counterparty, since the acceptance has to be received by the offeror.

2. Creation of a transaction for the transfer of derivatives to the central counterparty through an offer by the central counterparty.

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<sup>42</sup> It should be remembered that the existence of the original obligation between the parties to clearing to some extent guarantees their interests – in case there is some defect of will in a derivative contract between them, it would be fair to let them challenge the relations between themselves first and not between them and the central counterparty.

<sup>43</sup> Gergen 2015, at 67–68.

<sup>44</sup> There are many theories in German law describing how to qualify the mechanism of acceptance of the central counterparty; in particular, one theory states that the “acknowledged offeror,” i.e., the administrator of the electronic system, acts as a representative or *nuntius*. See Gergen 2015, at 75–79.

Supposing that an open offer may take place in this case, the situation will proceed as follows. The offer is made by the central counterparty. It should be noted that, supposing the opposite situation (i.e., that the offer is made by the parties to clearing), it is impossible to explain how two mirror-like transactions could have been concluded independently – this is because the parties to clearing, when making this offer, do not know exactly whether they will take the position of the debtor or of the creditor in the original obligation which will be transferred to the central counterparty. This means that the content of their offers addressed to the central counterparty is not clear enough. This problem is evidently eliminated if the transfer of the transaction to the centralized clearing is possible only after “actualization” of the obligation out of the derivative transaction.

Accordingly, if the offer is made by the central counterparty, this offer can be described as a public offer: it should be accepted in accordance with Art. 438 of the Civil Code of the Russian Federation.

The problem in this context is that the central counterparty technically does not possess information about all the terms and conditions of the transaction when he makes an offer (in general – these are any over-the-counter transactions of a certain type), whereas the Civil Code of the Russian Federation requires an offer to contain all conditions of the future contract (Art. 435 of the Civil Code of the Russian Federation). However, in the context of the Code, if the parties to clearing are treated as acceptors, the central counterparty as an offeror may consider various types of public offers in respect of over-the-counter transactions of various types. At any rate, this must lead to even more artificial standardization of derivatives, which does not always have a positive impact of the market.

#### **4. Intermediate Constructions**

Determination of the offeror and the acceptor in the agreement for the transfer of the transaction to the centralized clearing does not answer the question of what the nature of such a contract is. Thus, by examining the construction of an open offer it may be concluded that it does not determine the legal nature of the transfer of a transaction to the central counterparty in the context of Russian law. It only explains a “technique” for the conclusion of some kind of agreement between the parties to a derivative and a financial intermediary. Another alternative may also be possible (apart from novation, examined above, and succession of the principal obligation (see below)): entrance of the central counterparty into the principal transaction as a classic intermediary. This option seems to explain what the central counterparty “enters into” the original transaction for at the moment of its conclusion – in this case it will look like the parties to clearing have decided to agree upon a special procedure to perform the future obligation – through the intermediary.

Such constructions seem to include agency agreements, representation and possibly performance of an obligation by a third party as well (Art. 313 of the Civil Code of the Russian Federation).

It should be noted that this last mechanism is of little use for several reasons. Indeed, it may be supposed that the counterparty enters into the original transaction as a person who has to perform the obligation of the debtor to the creditor on the debtor's instruction. In this case, the creditor must accept the debtor's performance (Art. 313(1) of the Civil Code of the Russian Federation). In the meantime, the creditor has the right to demand performance only from the debtor, but not from the central counterparty, against whom it would obtain the right to claim by means of subrogation only after actual performance to the creditor by the debtor (Art. 313(5) of the Civil Code of the Russian Federation). This does not conform to the world standards governing the transfer of a transaction to the centralized clearing. In fact, no risks of non-performance of a derivative transaction are reduced in this case, though it would explain the aforementioned "momentary" entrance of the central counterparty into a transaction.

As to the applicability of representation, it may be noted that the idea of the counterparty acting as a representative of the parties would be unlikely to work under the concept of representation,<sup>45</sup> since in our case it presents all the disadvantages of the mechanism of performance by a third party, described above. Nevertheless, it may be no accident that in German literature the concept of representation is often used to explain the manner in which the counterparty enters the transaction, since it is often quite difficult to fix the moment of meeting of the minds of all three parties in respect of the transfer of the transaction to the centralized clearing, separately from the original contract. The central counterparty, which deals with a number of transactions every business day, has to work according to some standard of expression of the will of the parties. Some German authors say that this is done through a special electronic system as a representative of the parties.<sup>46</sup>

Putting aside the German doctrine, let us "try on" the characteristics of the representative as if he had performed a derivative transaction in the creditor's interest.

On the one hand, the idea that the central counterparty, when it enters the original derivative contract, acts in the interests of the creditor and on its instructions, if possible. This allows us to presume the existence of a relationship of representation in the meaning of the Civil Code of the Russian Federation.

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<sup>45</sup> Reflected, in particular, in Chapter 10 of the Civil Code of the Russian Federation, as well as noted in p. 121–132 of the Resolution of the Plenum of the Supreme Court of the Russian Federation of 23 June 2015 No. 25 "On Application by Courts of Certain Provisions of Part One of the Civil Code of the Russian Federation" [Постановление Пленума Верховного Суда Российской Федерации от 23 июня 2015 г. № 25 "О применении судами некоторых положений раздела I части первой Гражданского кодекса Российской Федерации"].

<sup>46</sup> See Gergen 2015.

In the meantime, when characterizing acts of the central counterparty, attention should be paid to the fact that the central counterparty does not express the will of any of the parties to clearing, which is essential in representation. Moreover, the inadmissibility of qualifying the central counterparty's actions as those of a representative is supported by a lack of the counterparty's freedom to choose the form and content of the principal's will. Besides, it is hard to imagine that the offeror itself becomes a party to the transaction if the central counterparty fails to express the offeror's will properly or exceeds his authority (this means that the concept referred to in Art. 183 of the Civil Code of the Russian Federation is not applicable here).

In theory it is possible to make an assumption that the parties, when they transfer the transaction to the central counterparty, act as its representatives. However, when considering this option more deeply, it becomes clear that this assumption is wrong. In fact, if the parties to clearing acted as the central counterparty's representatives, the transaction would be made by the counterparty in respect of itself and this would contradict Art. 182(3) of the Civil Code of the Russian Federation; or the transaction would be made by the party to the original contract acting as the counterparty's representative, with another party to the original contract on the transfer of a debt to a third party.<sup>47</sup> In this case the mechanism would look absurd, since one of the parties to clearing would act as a two-faced Janus – as an independent party to clearing and as the representative of the central counterparty. It should also be remembered that in order to apply the rules on representation, a clearly expressed transfer of authority to the central counterparty is essential and must be based on a power of attorney, the law or acts of an authorized state/local body or on the circumstances, which is impossible in this case.

As we can see, this "representation" transfer of the transaction to the central counterparty first of all entails serious risks of failure to obtain remedies from the court and, secondly, unjustifiably complicates the whole process.

Based on the above, it may be concluded that qualifying the counterparty's actions as those of a representative is impossible. This also serves as an additional argument confirming that novation may be inconvenient: as mentioned, novation requires an additional expression of will and this creates unjustifiable difficulties for the parties.

Now let us consider if it is possible to qualify the central counterparty's actions as those of an agent. On the one hand, the agency contract seems quite a convenient contract model to explain the functioning of the central counterparty. The subject-matter of the contract includes legal and actual actions of the agent for the benefit of the principal; the agent is free enough in performing its mission (see Art. 1005 of the Civil Code of the Russian Federation).

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<sup>47</sup> Such models may be possible since as a result of performance of a derivative obligation one party may become both a creditor and a debtor.

According to Art. 1005(1), under the agency contract one party (the agent) undertakes to perform, for consideration, legal and other actions on the other party's (the principal's) instructions, in its own name, but at the principal's expense, or in the principal's name and at its expense. The relevant rules relating to the engagement agreement (Chapter 49 of the Civil Code of the Russian Federation) or the commission contract (Chapter 51 of the Civil Code of the Russian Federation) apply, depending on whether the agent acts under the contract in the principal's name or in its own name, so long as these rules do not contradict the rules on agency or the essence of the agency contract (Art. 1011 of the Civil Code of the Russian Federation).

Provided that the central counterparty acts as an agent and acts in its own name, the only possible applicable construction is the agency contract, modeled as a commission contract. However, this qualification is impeded by the fact that, according to many authors and courts, provisions of the Civil Code related to commissions are designed for another type of transaction: in particular, commission cannot authorize the intermediary to perform or change another person's obligation in its own name.<sup>48:49</sup> Therefore, the central counterparty cannot exercise someone else's right, which would happen when the initial derivative transaction is transferred onto it.

### **5. Succession Construction as the Model of Transfer of an Over-the-Counter Transaction to the Central Counterparty**

Thus, qualifying the termination of the obligations between the parties to clearing as a replacement of the initial obligation with an obligation where each of the parties to the contract enters into legal relations with the central counterparty, using novation, mixed not-named contracts or intermediary contracts does not have any serious grounds.

In connection with this, it may be supposed that the ground provided by Art. 4(12) of the Clearing Law more resembles a substitution of the parties to an obligation, since the very subject-matter and mode of performance of new "mirror-like" obligations remain the same when compared to the initial obligation between the parties to clearing. In particular, some German authors use similar argumentation.

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<sup>48</sup> Информационное письмо Президиума Высшего Арбитражного Суда Российской Федерации от 17 ноября 2004 г. № 85 "Обзор практики разрешения споров по договору комиссии" [Information Letter of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 85 of 17 November 2004. Review of the Dispute Settlement Practice in Connection with the Commission Contract], p. 22.

<sup>49</sup> Егоров А.В. Сделки как предмет договора комиссии // Вестник Высшего Арбитражного Суда Российской Федерации. 2001. № 10. С. 75–89 [Andrey V. Egorov, *Transactions as the Subject Matter of Commission Contract*, 10 Bulletin of the Supreme Arbitration Court of the Russian Federation 75 (2001)]; Егоров А.В. Предмет договора комиссии // Актуальные проблемы гражданского права: Сборник статей. Вып. 5 [Andrey V. Egorov, *Subject Matter of Commission Contract in Current Problems of Civil Law: Compilation of Articles. Issue 5*] 86 (V.V. Vitryansky (ed.), Moscow: Statut, 2002).

Supporters of this point of view explain this, in particular, by the fact that if the central counterparty refuses to accept the transaction for clearing or if the contract is not concluded with the central counterparty by some other reason, qualifying the relationship between the parties as assignment allows us to conclude that the initial derivative transaction between the parties remains in force (“der ursprüngliche Vertrag erneut Wirkung entfalten sole”).<sup>50</sup> This, in its turn, allows the legal order to react to the invalidity of the principal derivative transaction.<sup>51</sup>

This legal construction resembles the mechanism of substitution of the parties to an obligation provided by Chapter 24 of the Civil Code of the Russian Federation. In order to analyze the institution of substitution of the parties to an obligation, as it applies to the replacement of the initial contract between the buyer and seller with two new contracts – between the central counterparty and the buyer and between the central counterparty and the seller, the following should be noted. Reform of the provisions of the Civil Code of the Russian Federation concerning substitution of persons to an obligation was designed to significantly liberalize the provisions of the Code relating to the assignment of rights and transfer of debts. As a result, these rules have become very flexible, which allows parties to transactions to use them to structure their relations with the central counterparty in accordance with the needs of each particular situation.

Firstly, according to Art. 392(3) of the Civil Code of the Russian Federation, a simultaneous transfer of rights and obligations under the contract to a third party, which becomes a new party to this contract instead of the former, is now possible. The rules on assignment and on transfer of a debt accordingly apply to the transfer transaction. Along with this, it should be noted that the new debtor, which received a new obligation as a result of this debt transfer agreement, may, by virtue of this provision, retain the security interest, which existed in the original transaction, if it is provided with the agreement of all the parties.

Secondly, the basis for the transformation of an obligation in the assignment of an enforceable right is the change of an authorized person (the creditor). As for the rest, as a general rule, the obligation remains the same (the same debtor, the same rights

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<sup>50</sup> Thomas Tiedemann, *Die Stellung des zentralen Kontrahenten im deutschen und englischen Effektenhandel: Untersucht am Beispiel der Eurex Clearing AG und LCH.Clearnet* 89 (Norderstedt: Books on Demand GmbH, 2011).

<sup>51</sup> To be fair, it should be said that the preservation of the effect of the transfer of a transaction to the central counterparty in the case of invalidity of this transaction is not provided, either by the IOSCO recommendations, the EMIR requirements or the Dodd-Frank Act. It is a different matter that the formal compensation of damages on which, as was shown above, the Russian legislator focuses, in this case may be harmonized with dogmatic considerations either through an abstract transfer, or through an argument about a special rule which has priority over general provisions on the consequences of invalidity of transactions and so on. Nevertheless, as it seems, in general this matter should be resolved by analogy with recognition of the set-off to be invalid – since there was no derivative transaction, the central counterparty did not have any claims, which were terminated with the help of the clearing mechanism.

and obligations). The law or the contract may, though, provide otherwise. The basic idea of transfer of a debt is also the preservation of the original obligation. All of this allows us to explain why the new “mirror-like” obligations of the central counterparty remain identical to those in the original derivative transaction. Indeed, according to Art. 4(12) of the Clearing Law, in cases provided by clearing rules the party to the original contract is substituted by the central counterparty. As for the rest, the previous obligation arising out of the original contract between the parties remains the same: the same subject-matter and the same mode of performance are provided.

Thirdly, Art. 338.1(1) of the Civil Code of the Russian Federation provides for the possibility of assigning a future claim, which will arise in the future, including the claim under the contract, which will also be concluded in the future. Along with this, the future claim must be defined in the assignment agreement in away which allows this claim to be identified at the moment of its occurrence, or assignment to the assignee. A quite liberal approach to this identification is admissible, as already established by the practice of the Supreme Arbitration Court of the Russian Federation.<sup>52</sup>

Accordingly, parties to clearing may provide, in the framework agreement or in a particular agreement with the central counterparty, for the transfer to it of their rights and debts, which will arise in the future. According to Art. 22(2) of the Clearing Law, obligations allowed for clearing are secured by individual clearing security or individual and collective clearing security. It is fair to assume that individual clearing security is designed to secure not only one obligation but several different obligations of the parties to clearing, including future obligations arising out of one or several derivative transactions, as well as out of derivatives concluded in the future.

Fourthly, according to Art. 388(3) of the Civil Code of the Russian Federation, a monetary claim may be transferred in spite of a contractual prohibition or restriction of the assignment, which makes the model of succession more attractive for central counterparties. Indeed, it is fair to assume that, in circumvention of the contractual prohibition to transfer a monetary claim or a debt, the party to a derivative transaction may assign this claim to the central counterparty. Along with this, according to Art. 388 of the Civil Code of the Russian Federation, assignment of such rights to the central counterparty cannot be challenged, either by the other party to clearing or by its creditors.

Finally, according to Art. 391(1),(2), the transfer of debt in obligations connected with the business activity of the parties is possible without the participation of the debtor: the creditor and the new debtor may conclude an agreement, as a result of

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<sup>52</sup> Информационное письмо Президиума Высшего Арбитражного Суда Российской Федерации от 30 октября 2007 г. № 120 “Обзор практики применения арбитражными судами положений главы 24 Гражданского кодекса Российской Федерации” [Information Letter of the Presidium of the Supreme Arbitration Court of the Russian Federation No. 120 of 30 October 2007. Review of the Practice of Application by Arbitration Courts of Provisions of Chapter 24 of the Civil Code of the Russian Federation].



which the first and second debtors will bear joint and several liability, though the parties are free to provide for subsidiary liability of the first debtor or to release it from its obligation. As it seems, a modification of this construction could be used to transfer, to the central counterparty, transactions of clients/parties to clearing who entered into a derivative transaction with the party to clearing.

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