THE LEGAL ASPECTS OF NON-FINANCIAL MARKET CENTRAL COUNTERPARTIES (CCP): A CASE COMMENT ON IATA V. ANSETT

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The Legal Aspects of Non-Financial Market Central Counterparties (CCP): A Case Comment on IATA v. Ansett

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ABSTRACT

International Air Transportation Association (IATA) v. Ansett (2008) was decided correctly by the High Court of Australia. However, the reasoning of the judges was unsound due to their apparent unfamiliarity with the operation of Central Counterparty (CCP) systems. The judges failed to recognize that ‘open offer’ was the mechanism of counterparty substitution used in the IATA clearing rules to create mutuality and guarantee multilateral insolvency set-off. This article analyses the Ansett decision and describes the legal principles that should have been used to decide the case. Only financial market CCPs receive special statutory protections from burdensome corporate insolvency laws. Therefore, it is argued that the new transnational lex mercatoria confers analogous protections on the arrangements of non-financial market CCPs such as IATA. The High Court would have reached the same outcome they did by applying this legal framework to the facts in Ansett.

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1. INTRODUCTION

This article examines the Australian High Court decision in International Air Transportation Association (IATA) v. Ansett\textsuperscript{1} and reviews the House of Lords decision in British Eagle International Airlines Ltd v. Compagnie Nationale Air France.\textsuperscript{2} These cases both dealt with the enforceability of a non-financial market Central Counterparty (CCP) arrangement\textsuperscript{3} (IATA) where a clearing member became insolvent. The IATA clearing arrangement aimed to create mutuality between the clearing members through ‘open offer’ in order to guarantee multilateral insolvency set-off\textsuperscript{4} upon a clearing member insolvency.

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\textsuperscript{1} [2008] H.C.A. 3 (Austl.) [Ansett].
\textsuperscript{2} [1975] 2 All. E.R. 390 (H.L.) (U.K.) [British Eagle].
\textsuperscript{3} A non-financial market CCP is a CCP which does not operate in the financial markets context. E.g., the IATA CCP operates in the aviation industry. Non-financial market CCPs are distinct from financial market CCPs because they generally clear ‘debts’ (monetary obligations) instead of ‘executory contracts’ (non-monetary obligations). Furthermore, unlike financial market CCPs, they do not receive special statutory protections from corporate insolvency laws.
\textsuperscript{4} This tool is called multilateral close-out netting in the context of financial market CCPs. It takes effect if a participant becomes insolvent or a specified default event occurs. The terms ‘netting’ and ‘set-off’ are used interchangeably in the legal literature because they serve the same function. They both discharge gross claims to a single net amount. E.g., if X owes $10 to Y, and Y owes $5 to X, then after netting or set-off, X will pay $5 to Y. The key difference is that ‘set-off’ deals with debts, whereas ‘netting’ often deals equivalent fungible claims under executory contracts. See PHILIP R. WOOD, SET-OFF AND NETTING, DERIVATIVES, CLEARING SYSTEMS (2d ed., Sweet & Maxwell, 2007), at paras. 1-006, 1-022. Since the IATA CCP dealt with claims for performed services, which were debts, it is more accurate to describe the clearing process of the IATA clearing systems as set-off rather than netting. However, the terms are used interchangeably in this article.
Although the Ansett decision was decided correctly and in accordance with the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) Recommendations for Central Counterparties 2004 (RCCP), the majority judges failed to explain the legal aspects of CCP arrangements, especially the issue of counterparty substitution. This article argues that mutuality was created between Ansett and IATA before Ansett entered into insolvency proceedings. The judges failed to identify that the IATA CCP used ‘open offer’ as a method for counterparty substitution to create mutuality before Ansett became insolvent.

Furthermore, since the new legislative reforms on CCPs in the U.S.\textsuperscript{5} and the E.U.\textsuperscript{6} only cover ‘financial market’ CCPs, this article examines the legal framework governing the operations of ‘non-financial market’ CCPs.\textsuperscript{7} This legal regime is known as the new transnational lex mercatoria.

2. THE LEGAL NATURE OF A CCP

A ‘central counterparty’ clearing system is a \textit{sui generis} financial risk management institution which provides a form of insurance to its members by ensuring the performance of all the obligations they have entered into. The main operations involve risk management, clearing and settlement, and collateral arrangements. The CCP operates by interposing itself between a group of merchants, known as clearing members, who have contractually entered into the CCP scheme in order to multilaterally clear and set-off the transactions they have entered into.

The CCP assumes the contractual rights and obligations of the clearing members through either \textit{open offer} or \textit{multilateral netting by novation and substitution}\textsuperscript{8} in order to guarantee that every clearing member performs its obligations, thereby eliminating counterparty risk.\textsuperscript{9} This is known as the counterparty substitution process.\textsuperscript{10} The clearing rules should specify the exact time during the day that contracts are cleared and when counterparty substitution occurs.

\textbf{(a) CCPs are \textit{Sui Generis} Financial Risk Management Institutions}

CCPs have evolved to become \textit{sui generis} financial risk management institutions, distinct from the traditional corporation. This has allowed them and their clearing members to gain super-priority creditor status\textsuperscript{11} and carry out their operations without being hindered by

\textsuperscript{5} Dodd–Frank Wall Street Reform and Consumer Protection Act 2010, H.R. 4173.
\textsuperscript{7} Nevertheless, the legal principles outlined apply to all CCP systems.
\textsuperscript{9} This is the risk that a counterparty to a financial transaction will default because of insolvency or other related reasons.
\textsuperscript{11} \textit{See below}, section 9 (a).
burdensome corporate insolvency laws.\textsuperscript{12} The financial markets carve-out statutes\textsuperscript{13} reflect a policy for protecting financial market CCPs. These are special statutes which protect and exempt the arrangements of financial market CCPs from domestic corporate insolvency laws by conferring them with super-priority status. Since non-financial market CCPs have not been expressly exempted by special legislation, the new transnational lex mercatoria confers analogous protection on them by exempting their arrangements from corporate insolvency laws.

Firstly, CCPs have evolved from being ordinary corporations into \textit{sui generis} financial risk management institutions which fall outside the scope of corporate insolvency laws altogether. CCPs, like banks, “have distinct characteristics that justify a separate bankruptcy regime, allowing greater regulatory intervention... In most jurisdictions bank bankruptcy is dealt with either by separate legislation from corporate bankruptcy or within the same legislative framework with modifications”.\textsuperscript{14} As a result of their risk management function, CCPs have evolved through their customs and practices to become \textit{sui generis} financial risk management institutions with a separate bankruptcy regime.

In the context of financial market CCPs, the carve-out statutes are an express recognition by the legislature of the \textit{sui generis} character of CCP systems due to the important role they play in mitigating risk in the financial system. The legislation protects their netting agreements and the CCP rules against invalidation by insolvency laws.

Professor Goode has stated that the carve-outs are designed to “insulate” the relevant transactions from the corporate insolvency laws and “replace them with the approved rules of the exchange or clearing house”.\textsuperscript{15} Furthermore, he suggests that “the broad effect is to substitute the approved rules of... the clearing house for the insolvency distribution rules, thus in effect creating a \textit{self-contained mini-insolvency distribution system} for... [the relevant] contracts and charges”.\textsuperscript{16} In the context of non-financial market CCPs, the bankruptcy regime will be determined contractually or through the customs and practices of the relevant CCP system.

Secondly, the \textit{sui generis} nature is evident in the risk neutral role of CCPs. They provide a form of \textit{sui generis} insurance protection to their clearing members with their risk management functions. Thirdly, the \textit{sui generis} nature of the system is evident in the special relationship of the participants, which is a principal-to-principal relationship between the clearing members \textit{vis-à-vis} the CCP.

\textsuperscript{12} E.g., the zero-hour rule and retroactivity could lead to the unwinding of settled transactions; the mutuality requirement could prohibit multilateral insolvency set-off or netting if unfulfilled; \textit{pari passu} distribution could affect the ladder of priorities; and insolvency freezes could cause legal uncertainty and enhance liquidity or systemic risk.


\textsuperscript{16} Id., para. 1-29. Emphasis added.
Therefore, CCPs have become *sui generis* financial risk management institutions which confer super-priority status upon their clearing members and guarantee multilateral insolvency set-off under a separate insolvency regime.

3. **THE FACTS IN ANSETT**

The *Ansett* case dealt with the enforceability of the IATA CCP system upon the insolvency of a clearing member (Ansett). Ansett entered into administration on 12 September 2001. Ansett remained a clearing member, and the CCP performed a series of clearings during the months of August to December 2001 for services performed and received by Ansett. Subsequently, Ansett ran into financial difficulties, and Ansett’s administrators executed a Deed of Company Arrangement (DOCA) on 2 May 2002 to commence insolvency proceedings and wind Ansett up.

After Ansett’s insolvency, the CCP wanted to settle the claims which had been cleared during the administration period. After the last clearance that took place on December 2001, IATA claimed a net sum of $4,370,989 from Ansett. However, Ansett’s liquidator argued that the DOCA had retroactive effect, which took priority over the clearances that were performed during the administration period. They argued that that the clearing rules purported to circumvent or dislocate the order of priorities set out in the DOCA.

They also argued that the “mutuality” requirement under the Australian Corporations Act 2001 was not satisfied, thereby prohibiting IATA from performing multilateral insolvency set-off after insolvency proceedings had commenced. The liquidator claimed $11 million from 13 separate airlines. Therefore, the issue was whether the IATA clearing arrangement was enforceable against the DOCA. An ancillary issue was the time of counterparty substitution and whether mutuality was created between Ansett and the CCP.

According to the Australian High Court judges, the basic *modus operandi* of the clearing system was to multilaterally set-off the debits and credits in the accounts of the participating airlines with IATA at the end of every month to avoid numerous payments. The majority of the court held that the clearances that took place during the administration period through the

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18 The *Ansett* decision fell under Australian jurisdiction since Ansett was an airline incorporated in Australia. The IATA clearing rules contained a conflict of laws term allowing claimants to bring actions in the jurisdiction of the defaulting clearing member in order to comply with the local corporate insolvency laws of the insolvent party.

19 At 44 (H.C.).

20 The dissentient Kirby J. incorrectly argued that the *sui generis* debts before a clearing were cross-claims between the member airlines themselves (at 97). This would have undesirably resulted in Ansett’s administrator bringing 13 separate claims against 13 separate airlines for $11 million (at 106), which would have been more costly and time consuming than bringing one claim against one central counterparty.

21 See below, section 6 (e).


23 At 10, 32-34 (H.C.).

24 Gummow, et.al.
process of multilateral novation netting were valid because mutuality was created between Ansett and the IATA before Ansett commenced insolvency proceedings. Therefore, IATA could demand settlement of the net sum from Ansett after it had become insolvent. There was no need to perform a multilateral insolvency set-off after Ansett commenced insolvency. Furthermore, the court held that the clearing arrangement satisfied the requirements of the Corporations Act.

The judges were not clear in their reasoning, and they failed to recognize that the IATA clearing rules implied that ‘open offer’ was the mechanism intended for achieving counterparty substitution between the CCP and the clearing members. Open offer is a practice that was developed by CCP systems as a method of counterparty substitution in order to guarantee that the mutuality requirement is always satisfied and to protect themselves from the burdensome requirements of corporate insolvency laws, especially in common law countries.

The British Eagle decision, which also dealt with the IATA CCP, but with slightly modified clearing rules, cast doubts on the enforceability of CCP arrangements in insolvency situations. The legislatures in several jurisdictions recognized that the operations of financial market CCPs should operate unhindered in order to safeguard the smooth functioning of the financial system. Consequently, the legislature codified the practices of financial market CCPs and exempted their operations from corporate insolvency laws in order to protect their arrangements.

However, non-financial market CCPs have not received the same statutory protections. The High Court judges in Ansett should have taken the opportunity to argue that the common law courts are willing to adhere to the express and implied customs and practices of non-financial market CCPs and allow their arrangements to supersede or be exempted from corporate insolvency laws. They failed to note that non-financial market CCPs developed the practice of ‘open offer’ to protect their arrangements. As a potential solution to this legislative gap, it is argued that the new transnational lex mercatoria can protect the operations of non-financial market CCPs through recognition of their customs and practices.25

(a) The Significance of the Ansett Decision

The Ansett decision’s importance lies in its protection of non-financial market CCPs operating in multiple jurisdictions. The High Court protected the IATA clearing arrangement because of the important role which CCPs have in risk management and increasing efficiency within a particular market sector. If a CCP arrangement is not specifically carved-out by statute, the common law courts should give priority to the CCP arrangement over conflicting corporate insolvency laws.

It is recognized that non-financial market CCPs do not receive statutory protection due to their small size and the low value of the transactions they clear. These CCPs do not have the potential to cause systemic risk in the global financial system. Nevertheless, these systems require legal certainty.

25 CCP practices have been noted in the RCCP, which is the official industry manual for all CCP systems. The RCCP aims to provide legal certainty to CCPs.
(b) Criticisms of Ansett

The academics who have commented on the Ansett decision have argued that the case was decided correctly because it recognized the enforceability of a CCP arrangement where a clearing member became insolvent. However, the academics did not explain that ‘open offer’ was the mechanism used for counterparty substitution in the IATA clearing rules. Furthermore, they should have criticized the High Court’s judgment for presenting it in a vague and disorganized manner and for not developing the reasoning behind its decision. This decision is a source of legal uncertainty.

Firstly, the High Court judges failed to outline the legal principles governing non-financial market CCP operations. They failed to describe the main customs and practices of CCPs, such as properly explaining the legal difference between novation and open offer, the function of set-off and netting, and the impact of insolvency laws on CCPs.

Secondly, the term ‘CCP’ was used only once in the High Court decision, notwithstanding that the final decision was reached on the basis that IATA was a CCP. They failed to note that agent ‘clearing houses’ and CCPs are two distinct types of clearing system with different legal obligations. A failure to distinguish between the two types of clearing system resulted in confusing and conflicting judgments in the lower and upper courts in the British Eagle and Ansett decisions.

The terms “clearing house” and “CCP” are legally distinct, and they should not be used interchangeably, as is often the case in the literature in this area. An ordinary clearing house operates as the ‘agent’ of the clearing members in the clearing process and it does not perform counterparty substitution. The type of clearing performed by an ordinary clearing house is known as ‘position netting’, which does not involve any novation or counterparty substitution of any kind. Therefore, unlike a CCP, which operates as the ‘principal’ to every transaction entered into by the clearing members, an ordinary clearing house remains an agent and does not assume liability for any of the transactions that it clears.

4. THE ISSUE IN BRITISH EAGLE

Professor Geva noted in his analysis of the British Eagle decision in ‘The Clearing House Arrangement’ that “from a legal perspective, the issue was the effective time of substitution” of claims and the counterparties to whom those claims were owed. The IATA clearing arrangement in British Eagle substituted the clearing members for the CCP through multilateral netting by novation and substitution at the time of clearing. In other words, before a clearance, the claims

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27 At 137.

28 Professor Geva has stated that in “position netting, there is no substitution”, infra note 30, at 147. Therefore, there is no counterparty substitution in ordinary clearing house arrangements.

for services performed were outstanding *vis-à-vis* member airlines, whereas *after* a clearance, the member’s claims were netted multilaterally and substituted\(^\text{30}\) for a single ‘net net’ amount, which was either owed to or owed by the CCP. IATA became the CCP after clearing occurred.

The House of Lords held that the clearing system rules were ineffective for multilaterally setting-off claims of British Eagle that had not been substituted with IATA before its liquidation since there was no mutuality between British Eagle and the CCP. Consequently, these claims had to be distributed according to the *pari passu*\(^\text{31}\) method of distributing an insolvent party’s estate under section 302 of the U.K. Companies Act 1948.

A confusing judgment resulted from poor drafting of the IATA clearing rules. The time of counterparty substitution remained uncertain. Legal uncertainty can be avoided by clearly outlining in the clearing rules the time of counterparty substitution and the mechanism used to achieve it.

(a) **Contractual Innovations since British Eagle**

The House of Lords in *British Eagle* presumed that the time of counterparty substitution in the IATA CCP arrangement occurred through netting by novation and substitution at the time of clearing. The clearing arrangement did not state otherwise. Since British Eagle became insolvent before the date of clearing, mutuality was not created between British Eagle and IATA for claims that arose between British Eagle and other member airlines during the time of the previous clearance and the insolvency date. Therefore, their Lordships held that “the *private contractual arrangements* by which *British Eagle* had bound itself to IATA and other IATA members before insolvency could not prevail over, or effect a *contracting out* of, the rules for the general liquidation of a company provided by the public of the U.K.”\(^\text{32}\) The corporate insolvency laws prevailed over the clearing arrangement for uncleared (non-mutual) claims.

Subsequently, CCPs created ‘open offer’ and ‘continuous and immediate netting by novation and substitution’ in order to guarantee the creation of mutuality and exempt their arrangements from corporate insolvency laws. *Ansett* was decided differently because IATA amended the clearing rules\(^\text{33}\) after *British Eagle* to overcome the burdensome effects of that decision on CCP arrangements. Therefore, the courts dealt with two different versions of the IATA clearing rules.

It is important for courts to recognize the express and implied terms in a CCP arrangement, which are contained in a CCP’s clearing rules. The main express and implied terms of the clearing arrangement in *Ansett* were contained in Regulations 9, 10 and 12. These terms represent a set of core principles that govern CCP operations and which are derived from their commercial practices.

\(^\text{30}\) The bilateral gross or net amounts are discharged and replaced (novated) by a new ‘net net’ claim.

\(^\text{31}\) *Pari passu* requires the equal treatment of creditors within the same class in an insolvency situation.

\(^\text{32}\) At 120 (H.C.). Emphasis added.

\(^\text{33}\) Regulation 9 (a).
5. THE ISSUE IN ANSETT

In *Ansett*, uncertainty over the time of counterparty substitution also led to a confusing judgment. The IATA clearing rules remained vague over the mechanism used to effect a counterparty substitution. It is argued that IATA modified its clearing rules after *British Eagle* to change\(^\text{34}\) the counterparty substitution mechanism from *multilateral netting by novation and substitution*, which occurred at the time of clearing, to *open offer*, which occurred at the time a service was performed by one clearing member for another clearing member.

Regulation 9 (a) provided that there were never debts or claims outstanding between member airlines *vis-à-vis* each other.

**Regulation 9 (a):** No liability for payment and no right of actions to recover payment shall accrue between members of the Clearing House. In lieu thereof members shall have liabilities to the Clearing House for balances due by them resulting from a clearance or rights of action against the Clearing House for balances in their favour resulting from a clearance and collected by the Clearing House from debtor members in such clearance”.

This term implies that ‘open offer’ was the mechanism intended for counterparty substitution.\(^\text{35}\)

6. THE TIME OF COUNTERPARTY SUBSTITUTION

(a) Open Offer

It is now common practice for a CCP to assume obligations and become the principal to every transaction by means other than novation. Open offer is a contractual innovation that was created in order to avoid the requirements of ‘notice’ and ‘consent’ for performing a valid novation.

A CCP using open offer automatically and immediately interposes the CCP in a transaction at the moment the buyer and seller agree on the terms of the transactions entered into, i.e. at the point of execution, or at any point stated in the clearing rules. If all pre-agreed conditions are met, there is never a bilateral contractual relationship between the buyer and the seller. Therefore, Regulation 9 (a) implies open offer as the mechanism for counterparty substitution in IATA, since “no liability nor right of action shall accrue between the Clearing House members”.

Open offer is a unilateral contract in the form of an ‘offer’ to enter into a contractual relation which is ‘open’ to the clearing members of the CCP to *accept* by conduct. The CCP (the promisor) undertakes to assume the rights and obligations of a clearing member (the promisee) as the central counterparty if the clearing member accepts the CCP’s offer by entering into a transaction of the kind stipulated in the clearing arrangement.

\(^{34}\) "The new Regulation 9 is significantly different from the corresponding Regulation 18 with which the House of Lords [in *British Eagle*] was concerned”. At 55 (V.S.C.A.).

\(^{35}\) Although the majority High Court judges implied that ‘open offer’ was intended as the method for counterparty substitution, they did not mention it. This suggests they were unfamiliar with the concept.
The CCP’s open offer will generally be subject to a condition subsequent. This means that the contracts entered into between the CCP and the clearing members can be cancelled in specified circumstances; for example, where the transactions are not of the kind that fall within the scope of a clearance. Furthermore, the acceptance must be in the form of objectively identifiable conduct, e.g. through the performance of a service for a clearing member and a concurrent receipt of a service by a clearing member.

(b) Novation and Substitution

A ‘novation’ involves the termination of an earlier contractual agreement that was entered into between two clearing members and a substitution with a new agreement and a new counterparty (the CCP). For operational reasons, an insolvency may intervene before counterparty substitution occurs. Consequently, multilateral insolvency set-off would not be permitted due to a lack of mutuality. Therefore, open offer is a superior method for achieving counterparty substitution.

(c) Open Offer as an Implied Term

Regulation 9 (c) states that the “current clearance procedures” can change from time to time, so that once the commercial community recognizes and follows a new procedure, it represents the current market practice at that time. The IATA clearing rules in Ansett imply that open offer was the current method intended for counterparty substitution.

The fact that the clearing rules are vague or unclear is irrelevant provided that the alleged practice is generally accepted among merchants and the contract is not expressly contradictory to the alleged practice. The practice of open offer is notorious, certain, and reasonable; therefore, it qualifies as an implied term.

36 Regulation 9 (b).
37 The clearing members accepted that all the transactions between the member airlines that fell within the scope of a clearance under Regulation 12 required mandatory clearing (Regulation 10).
38 Nettle J.A. was incorrect in suggesting that novation was implied in Regulation 9 (a) as the method for counterparty substitution (at 94 (V.S.C.A.)). There is no express or implied language in the clearing rules intending for novation to be used, such as ‘annihilation’, ‘replacement’ or ‘termination’. Furthermore, the claims for the services performed between clearing members in the IATA clearing arrangement could not be immediately novated to the CCP until these claims were reported and notified to the CCP (Regulation 9 (b)). The IATA arrangement could not have intended for counterparty substitution through novation, since the amounts for services performed between the member airlines were not reported until the end of the month (Regulation 8.2.4.2.). Substitution through novation would have defeated the purpose of having a CCP arrangement, since it would have left the clearing members exposed to each other’s counterparty risk for a month.
39 The RCCP recognizes open offer as a valid CCP practice for effecting counterparty substitution. See Recommendation 4.
(d) Insolvency Set-Off

As mentioned above, IATA did not have to perform insolvency set-off in the case of Ansett. Nevertheless, a CCP’s clearing rules must always ensure that mutuality is created so that the set-off facility is available upon the insolvency of a clearing member.

The set-off facility is a financial tool that “discharges reciprocal [debt] obligations to the extent of the smaller obligation” as “an alternative method for extinguishing a debt”. It benefits the CCP members by increasing efficiency through a reduction in the number of transactions and claims available, thereby freeing up capital and increasing liquidity.

The set-off facility is particularly important for CCP systems in the context of a clearing member insolvency. Insolvency set-off arises where one of the counterparties is insolvent. Professor Roderick Wood describes it as “extinguishing” the insolvent debtor’s claim against the solvent creditor and “reduction” of the solvent creditor’s claim against the insolvent debtor.

The requirements for insolvency set-off in common law jurisdictions are ‘mutuality’, ‘capacity’, and ‘maturity’. The fulfillment of these requirements to perform insolvency set-off is crucial for risk reduction in CCP systems so that creditors will be paid notwithstanding the debtor’s insolvency. The automatic and mandatory nature of insolvency set-off in many jurisdictions means that all the requirements must be met before it can be performed.

Insolvency set-off protects creditors, achieves “justice” and prevents “unfairness” by avoiding situations where a creditor of a bankrupt party has to pay the bankrupt party and is left to prove only for a dividend from the bankrupt’s estate. The defaulter pays the solvent counterparty where it otherwise might not, and it ensures that an insolvent debtor is not bankrupted on a debt which it does not owe after applying set-off.

(e) Mutuality

The mutuality doctrine requires two claimants, each who must be a beneficial owner of the claim owed to him and be personally liable for the claim owed by him, i.e. not liable in some

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41 See WOOD, supra note 4, at para.1-003.
42 See generally, Re Maxwell Communications, [1994] 1 All. E.R. 737 (Eng.).
43 Basel II (June 2006) allows capital adequacy reductions for institutions using a CCP. Annex 4, Section 6.
44 See WOOD, supra note 4, at 5.
45 RODERICK WOOD, BANKRUPTC & INSOLVENCY LAW 91 (Irwin Law Inc., 2009).
46 CCPs must always act in the same capacity.
47 Claims must be mature debts.
representative capacity, e.g. as trustee or agent.\textsuperscript{52} Mutuality is created through counterparty substitution, and it is an essential requirement for a CCP to be able to perform multilateral insolvency set-off if a clearing member becomes insolvent.

Regulation 12 of the IATA clearing rules provided for the mutuality requirement. This Regulation was the subject of much controversy amongst the judges at the different court levels, since it was uncertain how mutuality was being created.

It stated that:

All transactions within the scope of clearance are hereby \textit{deemed mutual} debts of the parties involved. Unless otherwise agreed to by the parties a claim for such transactions shall arise upon the performance of the services rendered therefor \textsuperscript{sic}.\textsuperscript{53}

Regulation 12 implies that mutuality is created between all the clearing members and the CCP through open offer as soon as services are performed by one clearing member for another clearing member. It suggests that mutuality is created automatically upon the performance of a service within the scope of clearance. The High Court found that mutuality existed between the clearing members and the CCP at the time Ansett became insolvent.

\textbf{(f) Creating Mutuality}

The requirements of mutuality cannot be fictional under the law. Open offer created a real state of indebtedness in the form of a \textit{sui generis} debt between the clearing members and the CCP as of the moment a service was performed. There was \textit{actual mutuality} between Ansett and IATA which existed in fact and law. There was no legal fiction as suggested by IATA’s liquidator. The debts were outstanding between Ansett’s liquidator \textit{vis-à-vis} IATA, and not between Ansett’s liquidator \textit{vis-à-vis} Ansett’s other (unsecured) creditors.

It is arguable that the \textit{contractual link} between all the clearing members and the CCP in the form of the clearing arrangement replaces the need for mutuality. Alternatively, it is argued that CCPs always guarantee the creation of mutuality through their clearing rules. It should be assumed in every CCP arrangement that mutuality exists as a matter of commercial necessity, which is created expressly or implicitly by ‘novation and substitution’ or ‘open offer’. Therefore, CCP arrangements can guarantee the instantaneous creation of mutuality through their customs and practices in the form of implied terms, notwithstanding that the CCP rules are unclear or vague over the exact point in time of counterparty substitution.

\textbf{(g) Multilateral Set-Off}

Multilateral set-off is the essence of the CCP arrangement.\textsuperscript{54} The concern for common law lawyers is that a lack of mutuality may defeat multilateral set-off in insolvency situations. It is argued that the mutuality requirement is burdensome in the context of CCP systems since it does not satisfy their modern business needs. Therefore, CCPs have developed contractual

\begin{itemize}
\item \textsuperscript{52} See WOOD, \textit{supra} note 4, at para. 4-001.
\item \textsuperscript{53} Emphasis added.
\item \textsuperscript{54} See Geva, \textit{supra} note 28, at 142.
\end{itemize}
innovations to guarantee the creation of mutuality so that they can always perform multilateral insolvency set-off upon the insolvency of a clearing member.

7. CLEARING AND SETTLEMENT

Under the IATA clearing arrangement in Ansett, IATA became the principal through open offer at the time services were performed by one clearing member airline for another clearing member airline (the counterparty substitution stage). This created bilateral rights and obligations vis-à-vis each member and the CCP for services performed. Subsequently, the mutual bilateral amounts between the members and the CCP were discharged at the end of the month through multilateral novation netting to produce new ‘net net’ amounts (the clearing stage). Finally, the ‘net net’ amounts were discharged through payment by the ‘net net’ debtors to the ‘net net’ creditors (the settlement stage).

(a) The Counterparty Substitution Stage in Ansett

When Ansett performed a service for another clearing member, which was a class of transaction that “shall” be cleared, the clearing house automatically became the CCP through open offer at the very moment the service was performed. A claim for such a transaction arose upon the performance of the service rendered. Since no liability for payment and no right of actions to recover payment accrued between the clearing members vis-à-vis the other clearing members, the claims that arose before a clearance must have existed between the clearing members vis-à-vis IATA operating as the CCP.

Therefore, Ansett had a debt claim for the gross amount against IATA for any services it rendered to another clearing member. The claim was for the gross amount until multilateral novation netting occurred at the clearing stage. Clearing could not occur until all of a clearing member’s claims had been notified to the CCP at the billing date. Therefore, mutuality was created between the clearing members and the CCP before the clearing period as a safeguard so that multilateral insolvency set-off would be permitted upon the insolvency of a clearing member.

55 Regulation 9 (c) suggested that IATA was the principal since it had the right to sue and be sued on transactions that fell within the scope of a clearance: “IATA shall be entitled to recover any balances due to the Clearing House by legal action”.
56 Regulation 9 (c) stated that “effecting of a clearance... shall constitute a satisfaction and discharge of every claim dealt with in such a clearance”. Multilateral novation netting novates and nets all the transactions that fall within the scope of a clearance to produce a single ‘net net’ balance owing one way. The netting is ‘multilateral’ from the perspective of the CCP vis-à-vis all the clearing members. The netting is ‘bilateral’ from the perspective of the individual clearing members vis-à-vis the CCP.
57 Regulation 10.
58 Regulation 12.
59 Regulation 9 (a), i.e. no claims may accrued between the members themselves.
60 Multilateral novation netting requires notification of the relevant claims to the CCP in order to perform the necessary calculations.
(b) The Nature of the Claims before Clearing

The crucial question in Ansett was between which counterparties a claim existed before the clearance period; between member airlines vis-à-vis each other or between the member airlines vis-à-vis IATA? Furthermore, what was the nature of the claim?

It was presumed under IATA’s default procedures that if a member went insolvent after performing and receiving services, but before a clearance at the end of the month, that member had a contractual right to have the amounts it owed the CCP and the amounts the CCP owed it cleared at the end of the month. Gleeson C.J. stated that:

in the case of the transactions the subject of the monthly clearances in question, the property of Ansett did not include debts owed by it to other airline operators. The relevant property of Ansett was the contractual right to have a clearance in respect of all services which had been rendered on the contractual terms and the right to receive payment from IATA if on clearance a credit in favour of the company resulted.\(^{61}\)

The amounts that represented the relevant contractual claims were notified by the clearing members to IATA through a monthly statement of invoices.\(^{62}\) The process of open offer created a debtor-creditor and principal-principal relationship consisting of bilateral claims owing between each member and IATA operating as the CCP, instead of the debts being owed between the members themselves. The gross bilateral claims were subsequently discharged\(^{63}\) through multilateral novation netting\(^{64}\) in the clearing process to produce a new ‘net net’ claim either owing to or owed by the CCP.\(^{65}\)

The facts imply that IATA became the CCP for all the clearing member’s claims before the clearing process began because counterparty substitution occurred before the clearing date. The claims before clearing were “innominate choses in action, having some but not all the characteristics of debts”.\(^{66}\) Prior to clearing, and after the performance of services, “the Clearing House system gave rise to procedural and substantive rights and obligations... as between airlines, [which] did not have the character or quality associated with the relationship of debtor and creditor, as ordinarily understood”.\(^{67}\) Therefore, the legal rights and obligations before a clearance were sui generis claims that were outstanding between each clearing member vis-à-vis the CCP.

Regulation 8.2.3 of the clearing rules provided that “the right to payment arises at the time the services are performed”. This clause did not mention as between whom these claims arose. Read in the context of the other regulations, it is suggested that these claims arose between the clearing members and IATA as soon as the services were performed. This is because the services performed and received by Ansett during the administration from August to December

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\(^{61}\) At 23 (H.C.). Emphasis added.
\(^{62}\) Regulation 8.2.
\(^{63}\) Regulation 9 (c).
\(^{64}\) The gross claims are firstly netted, i.e. the new amount is calculated, and then novated, meaning that the bilateral claims are discharged to create a single new netted amount (the ’net net’).
\(^{65}\) Depending on whether the clearing member is a ’net net’ debtor or a ’net net’ creditor.
\(^{66}\) At 778, per Lord Cross.
\(^{67}\) At 62 (H.C.).
2001 were classes of transactions that “should”\(^{68}\) be cleared through the clearing system. As such, “no liability for payment and no right of action to recover payment shall accrue between the members of the Clearing House”.\(^{69}\)

Read in conjunction with Regulation 38, the CCP was entitled to recover the claims that were created at the time services were rendered. In addition, Regulation 12 supported this interpretation and provided that unless otherwise agreed, “a claim for such a transaction shall arise upon the performance of the services rendered thereof”. Regulation 38 stated that IATA had the right to recover claims created at the time services are rendered, and was liable to the ‘net net’ creditors, subject to payment of the net balances due by the ‘net net’ debtors.\(^{70}\) This is consistent with IATA being a CCP before the clearing period.

(c) The Clearing Stage in Ansett

At the clearing stage,\(^{71}\) the bilateral gross amounts of each clearing member vis-à-vis the CCP were cleared through the process of multilateral novation netting.\(^{72}\) This process discharged and replaced the bilateral gross amounts with a single new netted obligation owed either to the CCP or owed by the CCP. This new ‘net net’ claim\(^{73}\) was settled through a payment by the ‘net net’ debtor to the ‘net net’ creditor.\(^{74}\)

Diagram 1.A.

Diagram 2.A.

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68 Regulation 10.
69 Regulation 9 (a).
70 Regulation 39.
71 See Regulation 9 (c). This occurred during the administration period in Ansett.
73 See Diagram 2. See Geva, supra note 28, at 146.
74 The amount for settlement was disputed in court in Ansett.
8. THE ADMINISTRATION PERIOD IN ANSETT

The Ansett decision was also decided different than British Eagle because the clearing period in Ansett took place whilst it was in administration, and not in insolvency. An ‘administration’ is different from a liquidation. A ‘liquidation’ has the aim of dissolving the company and ending its business. An ‘administration’ generally includes a reconstruction and a moratorium before either a full recovery or a liquidation of the company. Therefore, insolvency laws could not affect the clearing period that took place during Ansett’s administration. A CCP arrangement should operate unhindered in the administration of one of its clearing members.

The administration under Part 5.3A of the Companies Act 2001 had the purpose of reconstructing Ansett, which is evident from the fact that the DOCA for commencing liquidation was only executed a few months after first entering into administration. Ansett’s administration did not change the nature or content of the rights and obligations created under Regulation 9 (a) of the clearing rules, and the administrators took those rights and obligations as they found them.77

Nettle J.A. incorrectly argued that the DOCA “binds all creditors of the company so far as concerns claims arising on or before the day specified in the deed”.80 Firstly, it is submitted that a CCP is not a “company” under this definition. It is a sui generis financial risk management institution operating under its own legal regime – the new transnational lex mercatoria. Secondly, the DOCA purported to have retroactive effect on the clearing arrangement. However, CCPs receive protection from the retroactive effect of insolvency laws. Retroactivity is a great source of legal uncertainty, especially if transactions that have already been paid or settled are unwound.

If Ansett had paid IATA for the amounts cleared between August and December 2001 (the administration period), the DOCA would have sought to unwind the transactions that had already been settled, which is contrary to the policy of settlement finality. The essence of the CCP arrangement is to ensure that the claims in favor of and against the CCP are settled first in the ladder of priorities. Therefore, corporate insolvency laws could not affect the CCP clearing that took place during Ansett’s administration.

75 Commenced 12 September 2001.
76 Ansett’s clearing membership at IATA was not suspended until 2 May 2002 because it was believed that Ansett would recover.
77 Regulation 9 (e) stated that “the contract created hereby and the obligations created hereunder shall be binding upon the successors in interest, including administrators, trustees, and receivers, of each member”.
78 At 72 (V.S.C.A).
79 The DOCA defined a “claim” as “a debt payable by, and all claims against, the Company (present or future, certain or contingent, ascertained or sounding only in damages), being debts or claims the circumstances giving rise to which occurred on or before the Appointment Date”. The “Appointment Date” was the date of the appointment of the administrators (September 12, 2001).
80 Section 444D (1), Corporations Act. Emphasis added.
81 The retroactive effect of DOCA operated in a similar manner to the zero-hour rule in the financial markets, which has been prohibited by specific legislation. E.g., Article 7, E.C. Settlement Finality Directive 1998.
(a) The Clearing Timeline during the Administration Period

Mandie J. held that notwithstanding the appointment of the administrators on September 12, 2001, the clearing arrangement continued to apply with contractual force between IATA, Ansett and the other CCP members. The facts indicate that five separate clearances were performed between the months of August to December for services performed and received by Ansett during its administration. IATA continued to provide clearing services to Ansett, since the aim of entering into administration was to revive the company and keep it operating as a going concern.

The clearances were performed on a monthly basis. Ansett failed to pay and was not paid by IATA the ‘net net’ amounts for each month after entering into administration. Therefore, a new clearing was performed in December to consolidate all of Ansett’s outstanding positions into one new ‘net net’ amount. This new ‘net net’ claim was owed by Ansett to IATA.

The High Court held that the monthly clearances performed by IATA for amounts outstanding between itself and Ansett constituted property between IATA and Ansett because the clearing process had occurred before Ansett had entered into insolvency proceedings. However, the judgment does not describe the clearing procedure.

The following part describes the intricate details involved in the clearing process of this particular case. It demonstrates that mutuality was created between Ansett and IATA before Ansett entered into insolvency proceedings.

i. The Clearances between August and November

The August clearance showed a debit balance of $359,208 due by Ansett to IATA; the September clearance showed a credit balance of $10,169,045 due by IATA to Ansett; and the October and November clearances showed debit balances of $5,954,559 and $2,707,912 respectively, due by Ansett to IATA. These figures represented the amounts that IATA cleared for Ansett, but which, for reasons unknown, were not settled by the parties after clearing.

82 See para. 46 (H.C.).
83 See para. 40 (H.C.).
84 Represented as ‘W’ in Diagram 2.A.
85 Represented as ‘X’ in Diagram 2.B.
86 Represented as ‘Y’ in Diagram 2.C.
87 Represented as ‘Z’ in Diagram 2.D.
88 It is likely that IATA gave Ansett a period of credit since Ansett probably faced liquidity problems during the September-December period.
The Monthly Clearances: ‘Net Net’ Claims after Multilateral Novation Netting

Diagram 2.A

AUGUST 2001

Diagram 2.B

SEPTEMBER 2001

Diagram 2.C

OCTOBER 2001

Diagram 2.D

NOVEMBER 2001
ii. The November and December Clearances

IATA was a ‘net net’ debtor for $1,147,366 after the November clearance,\(^89\) which it owed to Ansett. Subsequently, IATA became a ‘net net’ creditor for $4,370,989\(^90\) (the new ‘net net’ claim) after the December clearance, which Ansett owed IATA. The facts do not provide the amount for the final December clearance that was performed between Ansett and IATA for claims arising that month. This amount is needed to understand how the new ‘net net’ was calculated. The following paragraph calculates the amount of the claim by filling in the gaps with the facts that were provided.\(^91\)

It was calculated that IATA owed Ansett $1,147,366 after the November clearance,\(^92\) and Ansett owed IATA $4,370,989 after the December clearance. Therefore, the December clearance involved a ‘net net’ claim in the amount of $5,518,355,\(^93\) which was owed by Ansett to IATA. The claims of $5,518,355 and $1,147,366 were bilaterally netted and discharged in December to create a new ‘net net’ claim of $4,370,989\(^94\) owed by Ansett (net net debtor) to IATA (net net creditor).\(^95\)

\(^89\) See Diagram 3.A. This figure was calculated by subtracting X (the claim owed by IATA to Ansett) from W, Y and Z (the claims owed by Ansett to IATA). In other words, $10,169,045 (X) minus $9,021,679 (W+Y+Z) equals $1,147,366. See Diagram 3.C.
\(^90\) At 46 (H.C).
\(^91\) The claims provided for the monthly clearances (W, X, Y, Z) represent ‘net net’ amounts that were outstanding between Ansett and IATA as the CCP. The monthly bilateral gross amounts were not provided in the facts of Ansett. However, they are not necessary for this analysis.
\(^92\) See Diagram 3.A.
\(^93\) See Diagram 3.B. This figure is calculated by adding $1,147,366 to $4,370,989.
\(^94\) $1,147,366 is set-off (subtracted) from $5,518,355 in the December clearance to reach a claim of $4,370,989.
\(^95\) The new ‘net net’ includes the sums of W, X, Y, Z ($1,147,366) plus the multilateral ‘net net’ amount for services performed and received by Ansett in December (- $5,518,355).
Diagram 2.E

\[ W = -$359,208 \]
\[ X = $10,169,045 \]
\[ Y = -$5,954,559 \]
\[ Z = -$2,707,912 \]

\[ W + X + Y + Z = $1,147,366 \]

**December** = -$5,518,355

**New ‘net net’** = -$4,370,989

(The negative figures represent a debit balance due by Ansett to IATA).
Diagram 3.A: November Clearance

Gross Amounts

\[
\text{ANSETT} \rightarrow \text{CCP} \quad \text{\$9,021,679}
\]

\[
\text{\$10,169,045}
\]

Net Net Amount

\[
\text{\$1,147,366}
\]

\[
\text{ANSETT} \rightarrow \text{CCP}
\]

\[\text{96 The top part of Diagrams 3.A and 3.B show the bilateral gross amounts, whereas the bottom parts show the net amount.}\]
Diagram 3.B: December Clearance

Gross Amounts

ANSETT → CCP

$5,518,355

($1,147,366 + $4,370,989 = $5,518,355)

$1,147,366

Net Net Amount

ANSETT → CCP

$4,370,989
Diagram 3.C: Result of the December Clearance

9. INSOLVENCY LAW ISSUES

(a) Super-Priority Creditors

The new transnational lex mercatoria acknowledges that CCPs and their clearing members are ‘super-priority’ creditors. Professor Philip Wood has described these as “creditors who are paid in full (or up to the amount of their asset) and who are broadly outside the bankruptcy in the sense that they can take assets out of the estate, free of the pari passu rule". They include secured creditors, title finance creditors, creditors with a set-off, and beneficiaries under a trust. This definition encompasses CCPs and their clearing members because set-off and netting schemes are the essence of their arrangements.

97 PHILIP WOOD, LAW AND PRACTICE OF INTERNATIONAL FINANCE 60 (University Ed., Sweet & Maxwell, 2008).
CCPs have altered their customs and practices to gain super-priority status. They achieve this status by guaranteeing the creation of mutuality, which in turn guarantees multilateral insolvency set-off. This places them at the top of the insolvency ladder of priorities, meaning that they and their clearing members get paid before all the other creditors of an insolvent clearing member.

CCPs and their members need to be able to discharge their claims first to avoid counterparty risk, liquidity risk and multiple claims arising from different jurisdictions. Insolvency distributions may take years to complete and the amounts returned tend to be a small fraction of what was owed by the insolvent party.

(b) The Downfall of Pari Passu

A failure to satisfy the mutuality requirement before a clearing member insolvency means that the assets of the insolvent member will be distributed by its liquidator according to the bankruptcy ladder of priorities under the relevant corporate insolvency laws. In general, once the claims of the creditors at the top of the ladder are satisfied, the remainder of the estate will be distributed pari passu among the remaining ordinary (unsecured) creditors.

The pari passu rule requires the equal treatment of creditors within the same class in an insolvency situation by distributing the insolvent party’s assets on a pro rata basis. Kirby J. incorrectly argued that the IATA arrangement attempted to contract out of pari passu by including a term for mandatory multilateral clearing of all claims.

It is argued that CCPs have altered their customs and practices to exempt their arrangements from the pari passu principle altogether. CCP arrangements turn their clearing members into super-priority creditors, who take first in the ladder of priorities in an insolvency distribution by discharging their cross-claims through multilateral novation netting.

The pari passu rule has become outdated and does not fit within the modern framework of CCP arrangements. In support of this view, Mr. Mokal argues in ‘The Pari Passu Myth’ that equality has become a residual rule in insolvency proceedings. He criticizes pari passu for occasionally reaching unequal results when a more equal distribution could be reached contractually by not applying a pro rata distribution among ordinary creditors in insolvency.

Furthermore, pari passu distribution causes an injustice to the clearing members of a CCP who set up the arrangement with the expectation of minimizing credit risk losses through multilateral insolvency set-off upon an intervening default or insolvency. A study by the Association of Business Recovery Professionals demonstrated that pari passu distribution can have harsh consequences on creditors. They found that in:

- an overwhelming majority of formal insolvency proceedings, nothing is distributed to general unsecured creditors...
- On average ordinary creditors receive 7% of what they are owed...
- It is also likely that in most if not all liquidations, hardly any claimant is paid pari passu. Given these

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98 I.e., the secured and preference creditors.
99 Regulation 10. At 174 (H.C.).
101 Id., 615.
102 Supra note 50.
reasonable deductions, one might perhaps be forgiven for questioning whether it is fair to describe the *pari passu* principle as the normal rule in a corporate insolvency.\(^{104}\)

This study demonstrates that Ansett’s general creditors, which included the clearing members, would have suffered upon the denial of multilateral set-off in an insolvency situation. They could have lost out to the full extent of their claims. This could have also affected the liquidity of one or more of the clearing members. Therefore, the intention of the clearing members for entering into the CCP arrangement was to have a guarantee of insolvency set-off and to receive more than 7% of the insolvent member’s estate if a clearing member became insolvent.

Therefore, CCP arrangements supersede the *pari passu* rule by guaranteeing mutuality and creating super-priority status for the CCP and their clearing members. Otherwise, such a rule would prohibit a CCP from performing multilateral insolvency set-off. The *pari passu* policy is outdated and has been replaced by a new policy which protects CCP arrangements from corporate insolvency laws.

### 10. Public Policy Changes

The different outcomes in the *Ansett* and *British Eagle* decisions should be considered in light of the market developments and changes in public policy since *British Eagle* was decided. Non-financial market CCPs do not receive statutory protections. Therefore, they have developed their own legal protections, which can be recognized and enforced by the new transnational lex mercatoria.

(a) **The New Transnational Lex Mercatoria**

The Australian Payment Systems and Netting Act did not specifically carve-out IATA’s CCP from the Corporations Act. However, due to the important risk management function that the IATA CCP performs, it requires protection from corporate insolvency laws. It is submitted that the new transnational lex mercatoria\(^{105}\) can provide legal certainty and protection to non-financial market CCPs.

The common law courts can apply the new transnational lex mercatoria by adhering to the customs and practices of CCPs. These practices can be recognized in the form of implied terms contained in the clearing rules. This allows the court to protect the arrangements of non-financial CCPs by adhering to practices such as ‘open offer’ and ‘instantaneous and immediate novation and substitution’, which were designed to ensure that mutuality is created so that a CCP can perform multilaterally insolvency set-off in a clearing member insolvency. This new legal framework can achieve a satisfactory outcome without the need for implementing any legislative changes.

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\(^{104}\) Mokal, *supra* note 100, 587-589.  
Furthermore, these practices are outlined in the recommendations of transnational institutions such as the CPSS and IOSCO. These can be used as *persuasive* sources of law to determine and enforce the relevant rules governing CCP operations.

(b) **Construction of the CCP Arrangement**

The courts must ensure the proper operation of CCPs operating across borders by giving effect to the intentions of the clearing members. The intention in creating IATA was to establish a clearing system to mitigate counterparty risk. Therefore, it was necessary to create mutuality to convert IATA into the central counterparty of all the clearing members to guarantee multilateral insolvency set-off upon a clearing member insolvency.

When construing a CCP arrangement, the court must look at the clearing rules, the customs and practices of the clearing members, the surrounding circumstances known to the members, and the purpose or object of the transactions. Lord Wilberforce in *Reardon Smith Line Ltd. v. Hansen-Tangen* stated that a court should know the “commercial purpose” of a commercial contract, which “presupposes knowledge of the genesis of the transaction, the background, the context, [and] the market in which the parties are operating”.

In *British Eagle*, the House of Lords failed to interpret the IATA clearing arrangement according to the orthodox principles for construing commercial contracts, which resulted in a confusing judgment. On the other hand, the majority High Court judges in *Ansett* correctly recognized that “the risk of insolvency, which stands behind many commercial agreements, undoubtedly formed part of the context in which the Clearing House system was devised and intended to operate”.

Placed into context, the IATA CCP was created, *inter alia*, to raise confidence between international market participants who could deal with one CCP instead of several unknown counterparties around the world. It is also important to take into consideration the nature of the business in question. The airline industry suffers from a high degree of counterparty risk. Airlines are continuously going into administration as their business reacts adversely to fluctuations in the price of oil. Therefore, it must have been the intention of the IATA member airlines to create a CCP arrangement.

(c) **Exemption from Corporate Insolvency Laws**

The *Ansett* decision suggests that where there is a conflict between a particular statutory provision and a contractual term of a CCP arrangement, the contractual term prevails. The *Ansett* decision demonstrated that domestic corporate insolvency laws are not designed to deal with the claims of the insolvent clearing members of a non-financial market CCP that

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106 Pacific Carriers Ltd. v. BNP Paribas, [2004] H.C.A. 35 (Eng.).
107 [1976] 3 All. E.R. 570 (Eng.).
108 Emphasis added.
109 At 7.
110 “The [IATA] Regulations are part of a world-wide scheme… designed to give effect in *many different legal systems*...”. At 84 (H.C.). Emphasis added.
111 In *Ansett*, the conflict arose between Part 5.3A of the Companies Act and Regulation 9 (e) of the clearing rules.
operates across borders. An application of domestic corporate insolvency laws could defeat the legal certainty that a participant seeks when entering into such an arrangement, since insolvency laws vary greatly from jurisdiction to jurisdiction.

Ansett’s liquidator submitted that there is a certain incompatibility between a private contractual arrangement and the public policy inherent in domestic corporate insolvency laws.\textsuperscript{112} It is argued that the policies governing ordinary corporate insolvencies do not encompass the arrangements of non-financial market CCPs. These CCPs have their own policy objectives and rules. Insolvency law policies such as \textit{pari passu}, mutuality and retroactivity are burdensome and may hinder the proper operations of CCPs. Therefore, non-financial market CCPs, especially those operating in multiple jurisdictions, should be exempted from domestic corporate insolvency laws.

\textbf{(d) Transnational Legal Principles for CCPs}

There is a set of core principles and risk management functions that are universally performed by all CCPs. This includes guaranteed ‘counterparty substitution’ and ‘multilateral novation netting’. The universal adoption of a common set of practices by CCP systems across the globe means that national courts should recognize these transnational principles to reach consistent decisions.

A domestic court dealing with an international CCP can apply the new transnational lex mercatoria in the same way that the domestic European Union member state courts apply European law in the E.U. However, the courts in both Ansett and British Eagle failed to establish a common set of core transnational legal principles for CCP arrangements due to the complex and esoteric nature of CCP systems. The High Court should have explicitly drawn out these legal principles in order to create legal certainty and establish a useful precedent for future courts to follow.

Alternatively, global policy-makers at the World Legal Forum have suggested establishing an expert tribunal to resolve intricate global financial disputes if judges at the national court level do not have the necessary expertise to decide cases involving complex financial arrangements. The tribunal would consider disputes involving CCP arrangements, \textit{inter alia}, and would resolve them by using a process of mediation by financial experts.\textsuperscript{113}

\section*{11. CONCLUDING REMARKS}

In Ansett, all the disputed claims were substituted and netted before Ansett became insolvent. Therefore, insolvency law could not disrupt the enforcement of the IATA clearing arrangement. However, legal uncertainty arose because the time of counterparty substitution was not specifically pinpointed in the clearing arrangement. Legal risk can be avoided by expressly identifying the method and the time of counterparty substitution in the clearing rules.

\textsuperscript{112} At 111 (H.C.).

The CCP arrangement is essential for enhancing the overall financial welfare of its members in the long-term and minimizing the losses of insolvency. Like their counterparts in the financial markets, non-financial market CCP arrangements are exempted from domestic corporate insolvency laws. They can achieve exemption through the aid of the new transnational lex mercatoria.

The customs and practices of CCPs suggest that mutuality is always created between all the clearing members and the CCP either through open offer or immediate and continuous novation and substitution, even though this may not be expressly stated in a clearing arrangement. This guarantees the availability of multilateral insolvency set-off upon the insolvency of a clearing member. In the context of non-financial market CCPs, open offer is preferable to novation for achieving counterparty substitution. It is a simpler way of creating mutuality because it bypasses unnecessary steps that are involved in novation.

Using a CCP system has proven to lead to a decrease in counterparty risk. If the Ansett decision had been decided the same way as the House of Lords decision in British Eagle, it would have had a serious adverse consequence; 13 member airlines would have had to pay $11 million to Ansett’s administrator without being able to receive the full amount for their claims. The clearing members might have received around 10% of their claims instead of receiving the full net amount of $4,370,989, which Ansett owed IATA as the ‘net net’ debtor. This would have resulted in the airlines having direct dealings with Ansett to potentially face millions of dollars in losses.

The benefits of multilateral insolvency set-off outweigh the costs of bypassing the pari passu principle in the context of CCP arrangements. CCPs are sui generis financial risk management institutions, and not ordinary corporations. Therefore, ordinary corporate insolvency laws should not apply to them. Due to the nature of the operations that CCPs perform and the benefits that they confer on their members and society as a whole, CCPs are important enough to be governed by their own legal regime, possibly in the form of the new transnational lex mercatoria.
12. BIBLIOGRAPHY


