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Close-out netting: Summary of Australian Netting Legislation and Insolvency Proceedings

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Part A **Introduction**

This memorandum provides a summary of the sections of the *Netting Act* that validate the process under *close-out netting contracts* by which particular obligations of the parties terminate or may be terminated, the termination values of the obligations are calculated or may be calculated and the termination values are netted, or may be netted, so that only a net cash amount is payable. It also considers the insolvency proceedings to which an *Australian company* or a foreign company may be subject under *Australian law*. This memorandum does not consider whether any agreement comprises a *close-out netting contract*, or the sections of the *Netting Act* that protect the enforcement of security given over financial property, in respect of obligations of a party to the *close-out netting contract*, where certain requirements and safeguards are satisfied.

This memorandum is given in respect of entities which are within the definition of *Australian company*. For the purposes of this memorandum, *Australian company* means a company which is registered as a company under the *Corporations Act*. The term *Australian company* includes all *Australian banks*, *general insurers*, *life companies*, building societies, credit unions, trustees of *superannuation entities* and trustees of unit trusts (including managed investment schemes), in each case which are registered as a company under the *Corporations Act*.[1] The term *Australian company* refers to a company that has its centre of main interests (for the purposes of the *Model Law*) in Australia.[2]

This memorandum supersedes and replaces the version dated 19 October 2017, and considers the following:

(a) the *Crisis Resolution Powers Amendment Act* which came into effect on 5 March 2018; and

(b) the impact of ipso facto reforms enacted in late 2017 which commenced on 1 July 2018.

The *Crisis Resolution Powers Amendment Act* amended the *Netting Act* and a number of other Acts, including to:

(i) provide for enhanced stay provisions (including new "direction stay provisions", "specified stay provisions", and "specified provisions" for the purposes of the *Netting Act*), and amendments to various Acts to ensure that the exercise of *APRA*'s powers does not trigger certain rights in the contracts of entities within the same corporate group (that is, stays on certain cross-default triggers).

The effect of these amendments is considered in Part D; and

(ii) (A) provide for a statutory management proceeding (which previously applied only to an Australian incorporated *authorised deposit-taking institution*) to apply to:

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[1] Under *Australian law*, superannuation funds, managed investment schemes and trusts are not legal entities. The relevant legal entity is the superannuation trustee acting in its capacity as trustee of the superannuation fund, the responsible entity acting in its capacity as responsible entity of the managed investment scheme, or the trustee of the trust (as applicable).

[2] An *Australian company* does not include the Crown and statutory corporations organised under Australian law, private health insurers or related bodies corporate of them, friendly societies or a company which does not have its centre of main interests in Australia for the purposes of the *Model Law*. Although foreign companies may need to be registered under the *Corporations Act*, due to the structure of that legislation, such companies are not included in the reference to companies registered under the *Corporations Act* and are not "*Australian companies*" for the purposes of this memorandum.

(I) a *life company*;

(II) a *general insurer*;

(III) an Australian incorporated *NOHC* or *subsidiary* which satisfies certain conditions; and

(IV) the Australian business assets and liabilities of a foreign *authorised deposit-taking institution*, foreign general insurer or eligible foreign life insurance company;

(B) provide enhancements to the statutory management proceeding to which an Australian incorporated *authorised deposit-taking institution* may be subject; and

(C) facilitate the judicial management of the Australian business assets and liabilities of an eligible foreign life insurance company or foreign general insurer.

The effect of these amendments is considered in paragraphs 1.5 to 1.9 of Schedule 1 below.

Terms appearing in *italics* have the meaning given to them in the Glossary contained in Part F of this memorandum.

The assumptions and qualifications to which this memorandum is subject are in Part E of this memorandum.

Part B **Summary of the *Netting Act***

The *Netting Act* came into force in Australia on 2 July 1998. The *Netting Act* was enacted to remove certain legal doubts as to the efficacy of netting operations under *Australian law*. In addition to close-out netting, the *Netting Act* validates certain market netting contracts, approved real time gross settlement payment systems and the multilateral netting arrangements used by Australian clearing banks.

In this memorandum we are only concerned with the effect of Part 4 of the *Netting Act* which deals with *close-out netting contracts*.

1.1 *Close-out netting contracts*

The *Netting Act* defines a "close-out netting contract" as follows:

"(a) a contract under which, if a particular event happens:
(i) particular obligations of the parties terminate or may be terminated; and
(ii) the termination values of the obligations are calculated or may be calculated; and
(iii) the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable; or

(b) a contract declared by the regulations to be a close-out netting contract for the purposes of this Act;

but does not include:

(c) a contract that constitutes, or is part of, an approved netting arrangement; or

(d) a contract in relation to which a declaration under section 15 is in force; or

(e) a contract declared by the regulations to not be a close-out netting contract for the purposes of this Act."

Subsection (c) is designed to prevent overlap with other sections of the *Netting Act* dealing with multilateral netting arrangements used by Australian clearing banks and approved by the Reserve Bank of Australia. Subsections (d) and (e) are designed to provide a mechanism for specific contracts to be excluded either by a declaration by the Reserve Bank of Australia (on the basis of risk of systemic disruption) or by regulation passed under the *Netting Act*. We are not aware of any such declarations or regulations.[3]

It is not necessary for a contract to use the precise words of the definition of *close-out netting contract* in order for it to be a *close-out netting contract*.

In *Opes Prime*,[4] Finkelstein J held that the Australian standard-form securities lending agreement comprises a *close-out netting contract* on the following basis:

> "In my view, clause 7.4 results in the SLA being a close-out netting contract as defined in s 5 of the Netting Act for the following reasons.
> To satisfy the requirements of s 5, certain things must occur in specified circumstances. First, netting must be triggered on the happening of "a particular event". Here, the operation of cl 7.4 is triggered by an event of default. An event of default is "a particular act". Once cl 7.4 comes into operation, "the Parties' delivery and payment obligations [are] accelerated" and must be performed on the day the event of default occurred (the performance date). But the clause does not require actual performance of those obligations. Instead, each obligation must be given its "Relevant Value" as at the performance date. "[E]ach Party's claim against the other ... equals the Relevant Value [of the claim]". No payment is required. Instead, "the sums due from one Party [are to be] set-off against the sums due from the other" and only the balance is payable.
> Coming back to the definition contained in cl 6, the delivery obligation has been "terminated", in the sense that the obligation has come to an end as required by para (a)(i) of s 5 of the Netting Act. I appreciate that the word "terminate" is a troublesome word and can bear different meanings dependent upon the context. When the inquiry is whether a contractual obligation terminates in this context, however, it can only bear the meaning I have ascribed to the word – namely, the meaning that the obligation has come to an end by being accelerated and liquidated (ie converted into a money debt). The "Relevant Value" which cl 7.4 requires to be given to the "terminated obligations" is the "termination value" referred to in para (a)(ii) of s 5. The requirements of cl 7.4 that termination values be set off against each other, satisfies para (a)(iii)."

1.2 The effect of the *Netting Act* on a *close-out netting contract* prior to *external administration*

Section 14(1)(c) of the *Netting Act* provides that, in respect of a *close-out netting contract*:

- obligations under the *close-out netting contract* may be terminated;
- termination values may be calculated; and
- a net amount become payable,

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[3] In addition, the Explanatory Memorandum to the Payment Systems and Netting Bill 1998 (Cth) provided that: "It is envisaged that the Reserve Bank would make a declaration under [section] 15 in only the most exceptional circumstances".

[4] *Lindholm, Re Opes Prime Stockbroking Ltd (Admins appointed) (Receivers and managers appointed)* (2008) 171 FCR 473; [2008] FCA 1425, 481, [39]–[41].

in accordance with the *close-out netting contract*, subject to any specified stay provision that applies to the contract.[5]

Section 14(1)(d) provides that the events described in section 14(1)(c) may take place despite, relevantly:

- any disposal of rights that may be netted under the *close-out netting contract*; or
- the creation of any encumbrance, or any other interest, in relation to those rights; or
- the operation of any encumbrance, or any other interest, in relation to those rights that is created after the commencement of this section,

in contravention of a prohibition in the *close-out netting contract* or the security.[6]

See paragraph 1.10 of Part B of this memorandum with respect to the constitutional scope of section 14(1).

Section 14(1)(e) provides that, for the purposes of any law, the assets of a party to the *close-out netting contract* are taken:

- to include any net obligation owed to the party under the contract; and
- not to include obligations terminated under the contract.

Sections 14(1)(d) and (e) are intended to clarify that netting will not be affected by the interests of third parties in the obligations being netted.

Section 14(1)(e) goes further than section 14(1)(d) by providing that the obligations owed to a party to which a third party may seek to attach an interest cease to be assets of the party upon netting taking effect. As a result, the interests which purport to attach to those assets will also cease to exist. Because section 14(1)(e) does not rely on the presence of any prohibition in the contract, it has a wider effect than section 14(1)(d). We consider that the combined effect of section 14(1)(c) and (e) is such that section 14(1)(d) is technically unnecessary.

Sections 14(4) and 14(5) of the *Netting Act* provide that a person may not rely on section 14(1) in certain circumstances (see paragraphs 1.4 and 1.5 below).

1.3 The effect of the *Netting Act* on *close-out netting contracts* during *external administration*

Section 14(2)(c) of the *Netting Act* provides that, in respect of a *close-out netting contract* where a party goes into *external administration*:

- obligations under the *close-out netting contract* may be terminated;
- termination values may be calculated; and
- a net amount become payable,

in accordance with the *close-out netting contract.*[7]

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[5] The "specified stay provisions" do not allow the close-out of transactions with a body corporate due to specified events, and are considered in detail in paragraph 1.8 of Part B and Part D of this memorandum.

[6] The term "the security" refers to a security given over financial property, in respect of obligations of a party to the contract.

[7] Assuming the availability of section 14(2) of the *Netting Act* and calculation of a net amount payable, the net obligation is provable or recoverable in the *external administration*. The fulfilment of the payment obligation will be stayed until the *external administration*

In addition subsections 14(2)(d) to (f) provide that:

- obligations that are, or have been, netted or terminated under the *close-out netting contract* are to be disregarded in the *external administration*;
- any net obligation owed by the party under the *close-out netting contract* that has not been discharged is provable in the *external administration*;
- any net obligation owed to the party under the *close-out netting contract* that has not been discharged may be recovered by the *external administrator* for the benefit of creditors.

In addition, section 14(2)(g) provides that, relevantly, the netting or termination of obligations under the contract and a payment made by a party to discharge a net obligation under the contract are not to be void or voidable in the *external administration* of that party.

The protection afforded to close-out netting under the *Netting Act* applies despite:

- any disposal of rights that may be netted under the contract; or
- the creation of any encumbrance, or any other interest, in relation to those rights; or
- the operation of any encumbrance, or any other interest, in relation to those rights,

in contravention of a prohibition in the contract or the security.[8] The inclusion of this provision was intended to ensure that close-out netting on an *external administration* is not affected by the interests of third parties which arise in contravention of a prohibition in the contract, subject to any specified stay provision that applies to the contract.[9]

Sections 14(4) and 14(5) of the *Netting Act* provide that a person may not rely on section 14(2) in certain circumstances (see paragraphs 1.4 and 1.5 immediately below).

See paragraph 1.10 of Part B of this memorandum with respect to the constitutional scope of section 14(2).

1.4 What circumstances could affect the availability of sections 14(1) and 14(2) of the *Netting Act*?[10] — Section 14(4) of the *Netting Act*

Under section 14(4), a person may not rely on the application of sections 14(1) or 14(2) to a right or obligation under a *close-out netting contract* if:

- the person acquired the right or obligation from another person with notice that that other person, or the other party to the contract, was at the time unable to pay their debts as and when they became due and payable; and

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is complete. Therefore where there is a net amount owed to the *solvent party*, the *solvent party* will need to lodge a proof of debt for the net amount payable in the *external administration* of the *insolvent party*.

8 Section 14(2)(h) of the *Netting Act*. Section 14(2)(h) of the *Netting Act* does not apply to disposals of rights or property, or the creation or operation of encumbrances or interests, before 1 June 2016.

9 *2016 Explanatory Memorandum*, [1.124].

10 The unavailability of the *Netting Act* in respect to a *close-out netting contract* does not preclude the netting from being enforceable on other grounds (for example, insolvency set-off under section 553C of the *Corporations Act*). However, the presence of facts which preclude reliance on the *Netting Act* is also likely to preclude reliance on section 553C of the *Corporations Act*. In addition other conditions must be met, such as mutuality (see paragraph 1.6(c) below).

- the person acquired the right or obligation otherwise than as a result of the operation of section 22, 35 or 36R of the *Business Transfer Act*.

The expression "acquiring" in the context of a transaction is intended to mean both obtained by grant or creation and by transfer.[11]

Accordingly, any profit or loss arising in respect of a transaction acquired by a *solvent party* at a time when the *solvent party* had notice of the *insolvent party's* insolvency will not be permitted to be netted against profits and losses under other transactions.

1.5 What circumstances could affect the availability of sections 14(1) and 14(2) of the *Netting Act*? — Section 14(5) of the *Netting Act*

Section 14(5) of the *Netting Act* provides that sections 14(1) or 14(2) of the *Netting Act* do not apply to an obligation owed by a party to a *close-out netting contract* to another person if:

(a) the party goes into *external administration*; and

(b) the party acquired the obligation otherwise than as a result of the operation of section 22, 35 or 36R of the *Business Transfer Act*; and

(c) section 14(6) of the *Netting Act* is satisfied.

Section 14(6) is satisfied if any of the following are satisfied:

(i) the other person did not act in good faith in entering into the transaction that created the terminated obligation; or

(ii) when that transaction was entered into, the other person had reasonable grounds for suspecting that the party was insolvent at that time or would become insolvent because of, or because of matters including:

(A) entering into the transaction; or

(B) doing an act, or making an omission, for the purposes of giving effect to the transaction; or

(C) the other person neither provided valuable consideration under, nor changed their position in reliance on, the transaction.

It follows that it is important that the *solvent party*:

(I) enters into each transaction in good faith. Good faith would be absent if there were fraud or if there subsisted an intention on the part of the *solvent party* to obtain an advantage vis a vis the other creditors of the *insolvent party*. A transaction entered into as part of the ordinary course of business would not of itself result in the inference that there was an absence of good faith;

(II) at the time when it became a party to the transaction, had no reasonable grounds for suspecting that the *insolvent party* was insolvent (in the sense that the *insolvent party* was unable to pay all its debts as and when they become due and payable) or would become insolvent if it entered into the transaction. The notion "reasonable grounds for suspecting"

[11] *2016 Explanatory Memorandum*, [1.174].

embodies something which, in all the circumstances, would create in the mind of a reasonable person in the position of a *solvent party* (as payee) an actual apprehension or fear that the *insolvent party* was unable to pay its debts when they became due and payable. The notion also embodies a mistrust of the *insolvent party's* ability to pay its debts as they become due, and an appreciation of the advantage which the *solvent party's* acceptance of the payment would have as between the *solvent party* and other creditors of the *insolvent party*; and

(III) provided valuable consideration under the transaction or changed its position in reliance on the transaction. In this context the valuable consideration must be real and not colourable in the sense of being contrived or without substance. In our view, the incurrence of the mutual obligations of each party to a transaction to make payments or deliveries would constitute valuable consideration for these purposes.

1.6 What circumstances would not affect the availability of sections 14(1) or 14(2) of the *Netting Act*?

(a) **Assignments and other interests**

Section 14(2)(d) of the *Netting Act* provides that terminated obligations are to be disregarded in the *external administration* of a party to a *close-out netting contract*.

This means that the existence of interests of any third party in the transactions terminated and netted under the *close-out netting contract* do not prevent netting and termination conducted in accordance with the *close-out netting contract*.

The protection afforded to close-out netting under the *Netting Act* applies despite, relevantly:

- any disposal of rights that may be netted under the contract; or
- the creation of any encumbrance, or any other interest, in relation to those rights; or
- the operation of any encumbrance, or any other interest, in relation to those rights,

in contravention of a prohibition in the contract or the security.[12] The inclusion of this provision was intended to ensure that close-out netting on an *external administration* is not affected by the interests of third parties which arise in contravention of a prohibition in the contract.[13]

(b) **Liquidator's right to disclaim unprofitable contracts**

Section 568(1) of the *Corporations Act* allows a liquidator to disclaim unprofitable contracts.

As discussed above, section 14(2)(c) of the *Netting Act* provides that obligations under a *close-out netting contract* may be terminated in accordance with the contract. Section 14(2)(d) also provides that terminated obligations are to be disregarded in the *external administration* of a party to a *close-out netting contract*. This means that a liquidator of an *insolvent party* would not be entitled to disclaim any individual transactions under the *close-out netting contract* and would

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[12] Section 14(2)(h) of the *Netting Act*. The term "the security" refers to a security given over financial property, in respect of obligations of a party to the contract. Section 14(2)(h) of the *Netting Act* does not apply to disposals of rights or property, or the creation or operation of encumbrances or interests, before 1 June 2016.

[13] *2016 Explanatory Memorandum*, [1.124].

only be entitled to disclaim any net amount payable by the *insolvent party* following the operation of the termination and netting in accordance with the *Netting Act*.[14]

(c) **Mutuality**

The *Netting Act* requires only the presence of a *close-out netting contract* between the parties and does not require that the parties to that contract are acting in the same capacity. In other words, unlike the insolvency set-off provisions in the *Corporations Act*, the *Netting Act* does not require that mutuality be present for netting to take place. Where a valid single *close-out netting contract* exists between two parties, the *Netting Act* operates in such a way that transactions entered into between them can be netted even where some transactions were entered into by a party as agent for another person or as trustee for beneficiaries of a trust. Accordingly, where a single netting agreement is to be used to cover a number of different relationships between the parties (eg where an investment manager enters transactions for a number of principals) it is important that appropriate "separate agreement wording" is used. Such wording would effectively provide for a separate *close-out netting contract* to be in existence for each particular relationship.

Although mutuality is not required for the operation of the *Netting Act*, it is important to note that for the *Netting Act* to be applicable the *close-out netting contract* must be a valid contract. As a result, issues such as the power of trustees to enter into the *close-out netting contract* will still be relevant as will other issues such as compliance by directors with their fiduciary duties in entering into *close-out netting contract*.

1.7 Relationship with other law (other than the *PPSA* and the specified stay provisions)

Section 14(3) of the *Netting Act* provides that section 14(1) and section 14(2) have effect in relation to a *close-out netting contract* "despite any other law (including the specified provisions)", but subject to any specified stay provision that applies to the *close-out netting contract*. A specified stay provision which applies to a *close-out netting contract* will prevent the contract or a counterparty from closing out transactions relating to the contract on the grounds specified in the relevant specified stay provision. However, a specified stay provision does not prohibit a counterparty from closing out transactions under a *close-out netting contract* for any other reason. The specified stay provisions are considered in Part D and paragraph 1.8 below.

The *2016 Explanatory Memorandum* explained that the "specified provisions" definition is an inclusive list of the provisions of other laws over which the *Netting Act* prevails and is inserted for transparency and ease of reference. The laws included in the definition of "specified provisions" include laws providing for the following:

- the assets of *Australian banks* and other *authorised deposit-taking institutions* being available to meet the obligations to depositors before other creditors (section 13A(3) of the *Banking Act*);
- the assets of foreign *authorised deposit-taking institutions* in Australia being available to meet Australian liabilities before other liabilities (section 11F of the *Banking Act*);

[14] The *solvent party* aggrieved by the operation of disclaimer is taken to be a creditor of the *insolvent party* to the extent of any loss suffered by it because of the disclaimer and may prove for such loss as a debt in the winding up of the *insolvent party* under the *Corporations Act*.

- the priority of an *Australian bank's* debts to the Reserve Bank of Australia over the other debts owed by the bank (other than those owed to depositors);
- the allocation of assets of a *life company* or the Australian business assets and liabilities of an eligible foreign life insurance company on its insolvency; and
- the winding up or dissolution of trustees of *superannuation entities*.

Specific reference is also made to the insolvency provisions of the *Corporations Act* (essentially those provisions concerning voidable and void transactions) and certain provisions of the *Bankruptcy Act*. A note is made in the legislation to the effect that the express recognition given to close-out netting in sections 14(1) and 14(2) of the *Netting Act* is to remove the basis for arguing that *close-out netting contracts* are void as contrary to public policy embodied in insolvency law.

The term "specified provisions" also includes the references to sections of the following Acts:

- the *Banking Act, Insurance Act* and the *Life Insurance Act.*[15] These provisions were included to clarify that the protections afforded in the *Netting Act* prevail over the regimes set out in those Acts which allow for counterparties under a contract with a body corporate to be relieved of their obligations under that contract if the body corporate is prevented from fulfilling its contractual obligations because of a specified direction under the relevant *Industry Act*. In other words, the counterparty can close-out transactions under the contract, rather than being merely relieved of their obligations under the contract.[16]
- the *PPSA* and the *Corporations Act*, which were included to clarify that the protection afforded in the *Netting Act* would prevail over these provisions of those Acts, which may otherwise impose a stay on enforcement of security in certain circumstances (section 440B of the *Corporations Act*), which set out certain priority payments (section 556 of the *Corporations Act*) and which provide for circumstances in which security interests will vest (section 588FL of the *Corporations Act* and sections 267 and 267A of the *PPSA*).[17]

1.8 Specified stay provisions

To the extent the *Netting Act* would permit a party to close-out transactions under a *close-out netting contract* in accordance with its terms, the protection is subject to any specified stay provision that applies to the *close-out netting contract*. The "specified stay provisions" do not allow the close-out of transactions with a body corporate due to specified events, and are considered in detail in Part D.

We expect that the most relevant "specified stay provisions" in the context of many industry standard master agreements (including ISDA Master Agreements[18] and Global Master Repurchase Agreements[19]) are the stays that apply on the *appointment of a statutory manager* and on the

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[15] Sections 230C(2) and (3) of the *Life Insurance Act;* sections 105(2) and (3) of the *Insurance Act*; sections 11CD(2) and (3) of the *Banking Act*.

[16] *2016 Explanatory Memorandum*, [1.166].

[17] *2016 Explanatory Memorandum*, [1.167].

[18] Being a Master Agreement (Multicurrency – Cross Border) or the Local Currency – Single Jurisdiction Master Agreement, or the 2002 ISDA Master Agreement (Multicurrency – Cross Border), in each case, published by the International Swaps and Derivatives Association, Inc.

[19] Being the 2011 version of the ICMA/SIFMA Global Master Repurchase Agreement, the 2000 version of the TBMA/ISMA Global Master Repurchase Agreement and the 1995 version of the PSA/ISMA Global Master Repurchase Agreement.

appointment of a judicial manager, but this needs to be considered in respect of each agreement. We consider the implications of these stays further below.

Each specified stay provision only relates to the relevant event described in that specified stay provision. The stay framework does not prohibit a counterparty from closing out transactions under a *close-out netting contract* for any other reason. For example, to the extent that an event of default under the relevant *close-out netting contract* has occurred due to an event that is not described in a specified stay provision (eg a failure to make a payment or perform an obligation), then the counterparty may still close out transactions under a *close-out netting contract* if it has a right to do so in accordance with the terms of the *close-out netting contract* due to that event of default occurring and continuing.

Duration of stay on the appointment of a judicial manager or the appointment of a statutory manager

The amendments to the *Netting Act* provide a framework under which the stay on the *appointment of a statutory manager* or the *appointment of a judicial manager* may cease where an obligation under the *close-out netting contract* is either (i) an eligible obligation or (ii) is of another prescribed kind.

The stay on closing-out transactions under a *close-out netting contract* on the grounds of the *appointment of a statutory manager* or the *appointment of a judicial manager* ends at midnight[20] at the end of the first business day after the day on which the statutory manager or the judicial manager was appointed (being the end of the "resolution period"), unless *APRA* makes a declaration that:

(a) the stay ceases to apply before that time; or

(b) the stay is extended. This may only occur where *APRA* is satisfied of certain solvency- and licensing-related matters in relation to the trigger body as set out in paragraph 3.3 of Part D. The *2016 Explanatory Memorandum* explained that these matters:

> "are intended to reflect international developments such as the [ISDA 2015 Universal Resolution] Stay Protocol as closely as possible, particularly the requirements set out in the elements of paragraph (e) of the definition of 'Protocol-eligible Regime' in the Stay Protocol which relates to any 'Close-out Stay' (as that term is defined in the Stay Protocol), whilst also reflecting concepts recognised in Australian law."[21]

If the stay ceases to apply either at the end of the resolution period, or before that time (as referred to in paragraph (a) above), then a counterparty may close-out transactions under the *close-out netting contract* on the grounds of the *appointment of a statutory manager* or the *appointment of a judicial manager*.

The cessation and extension of the stay is considered further in paragraphs 3.1, 3.2 and 3.3 of Part D.

1.9 Constitutional reach of the *Netting Act*

The Commonwealth of Australia is a federation of the various Australian States and Territories. The power of the Commonwealth Government (as opposed to the State governments) is limited by reference to specific heads of power in the Australian Constitution. Section 14 of the *Netting Act* was

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[20] By legal time in the Australian Capital Territory.

[21] *2016 Explanatory Memorandum*, [1.236] (footnote omitted).

drafted with the intention that it only applies to *close-out netting contracts* which can be regulated pursuant to the Commonwealth's constitutional power.

1.10 Constitutional scope of section 14(1)

Section 14(1), which deals with the operation of close-out netting prior to *external administration,* applies only if:

- Australian law governs the *close-out netting contract*; and
- the contract is entered into in circumstances that are within "Commonwealth constitutional reach".

Section 14(1) will not apply to *close-out netting contracts* governed by New York, English or another non-Australian law.

Where Australian law governs a *close-out netting contract*, it is also necessary for the *close-out netting contract* to fall within "Commonwealth constitutional reach" for section 14(1) to be applicable. One of the circumstances which satisfies the requirement for a *close-out netting contract* being within the Commonwealth constitutional reach is that a constitutional corporation is a party to the contract. A constitutional corporation is defined as a "foreign corporation" or a "trading or financial corporation formed within the limits of the Commonwealth".[22] The *Netting Act* does not contain a definition of "foreign corporation". However, the High Court of Australia has held that the phrase "foreign corporation" as contained in the Australian Constitution means an entity incorporated in a country other than Australia.[23] It follows that an entity incorporated under the laws of a foreign country would amount to a foreign corporation for the purposes of the *Netting Act* and thereby fall within section 14(1). However, if the foreign entity has not been incorporated (for example, a non-incorporated voluntary association or a statutory body) further consideration would need to be given to determine whether or not such an entity would fall within the scope of the *Netting Act*.

However, the mere fact that a foreign entity does not fall within the definition of "foreign corporation" will not be problematic so long as the entity is trading with a "trading or financial corporation formed within the limits of the Commonwealth of Australia" (ie a corporation under the second limb of the above definition).

1.11 Constitutional scope of section 14(2)

Section 14(2), which deals with the operation of close-out netting on the *external administration* of a party, applies only if either:

- Australian law governs the *close-out netting contract*; or
- Australian law governs the *external administration*.

If either New York or English law governs the *close-out netting contracts*, the application of the *Netting Act* to the *external administration* of an *Australian company* will depend upon the *external administration* being governed by Australian law. The extent to which Australian law governs an *external administration* of an *Australian company* is discussed in Part C below.

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[22] The use of "Commonwealth" in this context should not be confused with the Commonwealth of Nations of which Queen Elizabeth II is head.

[23] *New South Wales v Commonwealth* (1990) 169 CLR 482 at 497–8.

The *Netting Act* may not apply to an *external administration* commenced outside Australia such as where an *Australian company* is wound up pursuant to an ancillary liquidation under English law. The application of the *Netting Act* in those circumstances depends on whether an English court would apply English law or Australian law as the substantive law regulating the ancillary insolvency proceedings.

If Australian law governs the *close-out netting contract*, the *Netting Act* will, as a matter of *Australian law*, apply to the *close-out netting contract* where a party to the contract is subject to *external administration* proceedings governed by foreign law. However, the applicability of the *Netting Act* to proceedings conducted in a foreign jurisdiction will be determined by the conflict of laws rules in the foreign jurisdiction.

1.12 Retroactivity of the *Netting Act*

Subject to the paragraph below, the *Netting Act* has effect in respect of any netting under a *close-out netting contract* which takes place after 2 July 1998.[24] This is the case even where the *close-out netting contract* was entered into prior to this date. However, the *Netting Act* will not affect netting which took place prior to 2 July 1998.[25]

1.13 Interaction with the *PPSA*

The *PPSA* established a national system for the registration of security interests in personal property. Were it not for an applicable exclusion from the *PPSA*, the breadth of the definition of "security interest" under the *PPSA* could encompass the close-out netting provisions of a *close-out netting contract*.

The exclusion from the *PPSA* which is particularly relevant to close-out netting is in section 8(1)(e), which provides that the *PPSA* does not apply to:

> "any right or interest held by a person, or any interest provided for by any transaction, under any of the following (as defined in section 5 of the *Payment Systems and Netting Act 1998)*:
>
> (i) an approved netting arrangement;
>
> (ii) a close-out netting contract;
>
> (iii) a market netting contract;"

The exclusion is not expressly limited only to the right to close out and net obligations. However, in our view, the *close-out netting contracts* exclusion is not so extensive that it excludes any interest which happens to be created under either the terms of a *close-out netting contract* or a transaction under that *close-out netting contract*. Such an interpretation would, for example, exclude from the operation of the *PPSA* interests created under a charge if the terms of that charge were included

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[24] Subject to the following sentence, the amendments made to the *Netting Act* in 2016 apply to *close-out netting contracts* entered into after 1 June 2016, or that were in existence immediately before 1 June 2016. However, section 14(2)(h) of the *Netting Act* does not apply to disposals of rights or property, or the creation or operation of encumbrances or interests, before 1 June 2016: see further paragraphs 1.2 and 1.6 of Part B.

[25] There is a technical argument that the *Netting Act* will not be effective where its operation purports to deprive a person of property other than on just terms (because of section 51(xxxi) of the Constitution of the Commonwealth of Australia). This could be the case where a third party has taken a valid interest in an obligation owing under a *close-out netting contract* and the *Netting Act* has the effect of terminating that obligation and, as a result, the third party's interest.

within the terms of the *close-out netting contract*. Rather, we consider that the *close-out netting contract* exclusion excludes from the operation of the *PPSA* rights and interests which are either:

- rights and interests which are created, and held, solely under and as an elemental part of a *close-out netting contract*; or
- interests created by transactions under a *close-out netting contract* if those transactions (and therefore those interests) are subject to the close-out netting process contained in that *close-out netting contract*.

Another way of describing this is that a provision within the body of a *close-out netting contract* which creates a security interest in relation to personal property which is "outside" of the *close-out netting contract* and which survives close-out netting should fall outside of the *close-out netting contract* exclusion, and thus is capable of being a security interest for the purposes of the *PPSA*.

We consider that this interpretation is consistent with the wording and purpose of the *close-out netting contract* exclusion whilst also avoiding an operation of the provision which could frustrate the operation of the *PPSA*. It is also important to note that it is possible for particular transactions to themselves give rise to a security interest under the *PPSA*.

Accordingly, we would expect that the close-out netting exclusion is effective to exclude any security interest created by the close-out netting provisions of a *close-out netting contract* from the operation of the *PPSA*. This can be seen also by the presence of another section of the *PPSA* which provides that the *Netting Act* prevails over the *PPSA* to the extent of any inconsistency. This provision has the effect of rendering close-out netting in accordance with the *Netting Act* effective despite the *PPSA*.

KING&WOOD MALLESONS

Part C **Brief summary of insolvency proceedings under *Australian law***

1 Insolvency proceedings

1.1 Summary

For the reasons given below, all insolvency proceedings to which an *Australian company* or a company organised outside the *Australian jurisdictions* may become subject in the *Australian jurisdictions* are covered by the definition of "*external administration*" in the *Netting Act.*

This means that section 14(2) of the *Netting Act* will apply in respect of netting conducted under the *close-out netting contracts* following the initiation of any insolvency proceedings under *Australian law*.

1.2 Definition of *external administration*

Under the *Netting Act*, a person that is not an individual goes into *external administration* if, relevantly:

(a) the person becomes a body corporate that is a Chapter 5 body corporate within the meaning of the *Corporations Act*;

(b) someone takes control of the person's property for the benefit of the person's creditors because the person is, or is likely to become, insolvent;

(c) a Banking Act statutory manager takes control of the person's business under the *Banking Act*;

(d) an Insurance Act statutory manager takes control of the person's business under the *Insurance Act*;

(e) a Life Insurance Act statutory manager takes control of the person's business under the *Life Insurance Act*;

(f) the person comes under judicial management under the *Insurance Act*; or

(g) the person, or a part of the person's business, comes under judicial management under the *Life Insurance Act*.

1.3 *Australian companies*

The insolvency proceedings to which an *Australian company* may become subject under *Australian law* are:

(a) winding up;

(b) compromise or arrangement with creditors;

(c) administration;

(d) receivership;

(e) *appointment of a statutory manager* to an *ADI, life company*, or *general insurer*, or a *NOHC* or *subsidiary* which satisfies certain conditions;

(f) *appointment of a judicial manager* to a *life company* (or part of the business of a *life company*) or a *general insurer*; and

(g) appointment of an acting trustee of a *superannuation entity* under the *SIS Act* where the acting trustee is appointed because the trustee of the *superannuation entity* is, or is likely to become, insolvent.[26]

These proceedings are described in paragraph 1 of Schedule 1.

Each of the insolvency proceedings referred to above falls within the definition of "*external administration*" in the *Netting Act*. Each of these proceedings is governed by Australian law. As a result, section 14(2) of the *Netting Act* is enlivened on the occurrence of each of these proceedings.

1.4 Foreign companies

The insolvency proceedings to which a foreign company could become subject under *Australian law* are:

(a) statutory management of the Australian business assets and liabilities of a foreign *ADI*, foreign general insurer or eligible foreign life insurance company;

(b) judicial management of the Australian business assets and liabilities of an eligible foreign life insurance company or foreign general insurer;

(c) proceedings under the *Model Law*;

(d) letter of request;

(e) ancillary liquidation;

(f) winding up under Part 5.7 of the *Corporations Act*;

(g) compromise or arrangement with creditors; and

(h) order recognising foreign liquidation order.

These proceedings are described in paragraph 2 of Schedule 1.

Each of the insolvency proceedings referred to above falls within the definition of "*external administration*" in the *Netting Act*. Each of these proceedings is also governed by Australian law. As a result section 14(2) of the *Netting Act* is applicable on the occurrence of each of these proceedings.

Part D **New framework for stays on close-out rights**

1 Stays in the *Industry Acts*

In 2016, the *Financial System Legislation Amendment (Resilience and Collateral Protection) Act 2016* (Cth) amended a number of stays which may apply to an *Australian company* under the *Industry Acts.* The stays framework in the *Industry Acts* was further amended by the *Crisis Resolution Powers Amendment Act* in March 2018.

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[26] If such an acting trustee is appointed for other reasons and the trustee of the *superannuation entity* is not insolvent, or likely to become insolvent, we consider that the *Netting Act* would not apply. This is discussed in further detail in paragraph 1.10 of Schedule 1.

The amended stays have the effect that none of the following matters allow a contract to which a body corporate[27] is a party, or a counterparty to the contract, to deny any obligations under that contract, accelerate any debt under that contract, close out any transaction relating to that contract or enforce any security under that contract:

(a) the body corporate or member of the corporate group[28] being given a direction by *APRA* under the relevant sections of the *Industry Acts*;[29]

(b) the body corporate or member of the corporate group being subject to a recapitalisation direction;[30]

(c) certain capital instruments issued by the body corporate or member of the corporate group, or to which such entity is a party or for which it is a conversion entity, being converted or written off, or *APRA* making a determination that results in the instrument being required to be converted or written off, in each case, in accordance with the terms of the relevant instrument,[31]

(together, the stays in paragraphs (a) to (c) are defined in the *Netting Act* as the "direction stay provisions" and are referred to in this memorandum as "**direction stays**"),

(d) the *appointment of a statutory manager* or the *appointment of a judicial manager* to the body corporate or a member of the corporate group (or, in the case of the *appointment of a judicial manager* to a *life company*, part of its business), or the Federal Court making an order for the appointment of such a judicial manager;[32]

(e) a statutory manager or judicial manager of the body corporate or member of the corporate group doing certain acts to facilitate recapitalisation;[33]

(f) an act being done for the purposes of Division 2 or 3 of Part 4 of the *Business Transfer Act*, or a certificate of transfer coming into force under Division 3 of Part 4 of the *Business Transfer Act*, in connection with a body corporate or member of the corporate group,[34]

(together, the stays in paragraphs (d) to (f) are referred to in this memorandum as "**non-direction stays**").

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[27] Or, in the case of paragraph (c) below, the "conversion entity" for a relevant capital instrument which is converted, being the entity whose ordinary shares or mutual equity interests the instrument is converted into in accordance with the terms of the instrument.

[28] For the purposes of the *Industry Acts*, a *regulated body* and its *subsidiaries* together constitute a "relevant group of bodies corporate" and a *NOHC* and its *subsidiaries* together also constitute a "relevant group of bodies corporate". References in this memorandum to a "member of the corporate group" in respect of a body corporate refer to any member of such a group of which the relevant body corporate is a member.

[29] See, relevantly, section 11CD(1A) of the *Banking Act*, section 105(1A) of the *Insurance Act* and section 230C(1A) of the *Life Insurance Act*.

[30] See section 13N(2) of the *Banking Act*, section 103K(2) of the *Insurance Act* and section 230AJ(2) of the *Life Insurance Act*.

[31] See section 11CAC(2) of the *Banking Act*, section 36C(2) of the *Insurance Act* and section 230AAD(2) of the *Life Insurance Act*.

[32] See section 15C(2) of the *Banking Act*, sections 62V(2) and 62ZOX(2) of the *Insurance Act* and sections 165B(2) and 179AX(2) of the *Life Insurance Act*.

[33] See section 14AC(2) of the *Banking Act*, sections 62ZB(2) and 62ZOH(2) of the *Insurance Act* and sections 168C(2) and 179AH(2) of the *Life Insurance Act*.

[34] See section 36AA(2) of the *Business Transfer Act*. Subject to the manner in which stays cease under the *Netting Act*, the stay under section 36AA(2) of the *Business Transfer Act* applies if a body corporate that is, or is proposed to become, a transferring body (as defined under the *Business Transfer Act*) is or was party to a contract.

Each of the stays referred to above (including both the direction stays and the non-direction stays) is defined in the *Netting Act* as a "specified stay provision".

If it applies, the *Netting Act* provides that obligations may be terminated, termination values may be calculated and a net amount become payable in accordance with the *close-out netting contract* "despite any other law" (including the specified provisions),[35] subject to any specified stay provision that applies to the contract.

However, even if one or more of these stays apply, a specified stay provision should not prevent a counterparty to a contract from exercising any rights under that contract which do not involve the denial of obligations, the acceleration of any debt, the closing out of any transaction or the enforcement of any security interest. For example, a specified stay provision should not prevent a party exercising a right to call for additional margin from the body corporate in accordance with the contract assuming that the exercise of such a right does not involve any of these things.

Please see paragraph 4 of this Part below regarding the stays framework that applies in the case of a transfer under the *Business Transfer Act*.

See also paragraph 3.4 of this Part for our commentary in relation to closing out transactions for any other reason.

2 Direction stays

2.1 Direction stays do not cease

Direction stays are not subject to the provisions under the *Netting Act* that set out the circumstances in which non-direction stays may cease and are considered in paragraphs 3.1 to 3.3 below. Accordingly, the direction stays apply permanently.

Therefore, if a direction stay applies, a counterparty would not be able to close out any transaction relating to that *close-out netting contract* on the grounds of the direction by *APRA*, the recapitalisation direction or the conversion or write-off of the relevant capital instrument or *APRA* making a determination that results in the instrument being required to be converted or written off. However, see paragraph 3.4 for our commentary in relation to closing out transactions for any other reason.

3 Non-direction stays

3.1 Circumstances in which non-direction stays may cease

The *Netting Act* sets out the circumstances in which non-direction stays may cease.

A non-direction stay may cease in relation to a *close-out netting contract* to which a *regulated body* or a related body corporate[36] of a *regulated body* is a party, if:

(a) an obligation under the contract of a party to the contract is:

(i) an "eligible obligation" in relation to the contract; or

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[35] Section 14(3) of the *Netting Act*. The *Netting Act* also clarifies the way in which these stays interact with the protections otherwise provided to the enforcement of security. However, this is beyond the scope of this memorandum.

[36] For the purposes of the *Netting Act*, the question whether a body corporate is related to another body corporate is to be determined in the same way as that question is determined for the purposes of the *Corporations Act*.

(ii) an obligation of another prescribed kind; and

(b) a non-direction stay applies to a trigger event[37] that happens in relation to the contract.

Eligible obligation in relation to the contract

Under the *Netting Act* an obligation is an "eligible obligation" in relation to a *close-out netting contract* if the obligation is any of the following:

(A) an obligation under the contract of a party to the contract that relates to a derivative[38] or foreign exchange contract[39] or is of another prescribed kind;[40]

(B) an obligation that results from the netting of two or more obligations that are created under the contract that:

(i) must include at least one obligation covered by paragraph (A) above; and

(ii) may include one or more incidental obligations that, taken together, do not form a material part of the net obligation; or

(C) an obligation declared by the *Netting Regulations* to be an eligible obligation in relation to a *close-out netting contract*.[41]

However, an obligation is not an eligible obligation in relation to a *close-out netting contract* if it is declared by the *Netting Regulations* not to be an eligible obligation in relation to the contract for the purposes of the *Netting Act*.[42]

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[37] A "trigger event" for a *close-out netting contract* is defined in the *Netting Act* to mean an event of a kind mentioned in paragraph (a) of the definition of *close-out netting contract*. Paragraph (a) of that definition provides that "a contract under which, if a particular event happens: (i) particular obligations of the parties terminate or may be terminated; and (ii) the termination values of the obligations are calculated or may be calculated; and (iii) the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable". Simply, a trigger event is an event which gives rise to a close-out right under the relevant *close-out netting contract*.

[38] The term "derivative" in the *Netting Act* has the same meaning as in Chapter 7 of the *Corporations Act*.

[39] The term "foreign exchange contract" in the *Netting Act* has the same meaning as in Chapter 7 of the *Corporations Act*.

[40] In this regard, the *Financial System Legislation Amendment (Resilience and Collateral Protection) Regulation 2016* (Cth) amended the *Netting Regulations* to prescribe as an eligible obligation an obligation that relates to an arrangement that is a forward, swap or option, or any combination of those things, in relation to one or more commodities.

[41] As at the date of this memorandum, no such declaration has been made.

[42] Under the *Netting Regulations*, each of the following obligations have also been declared not to be an eligible obligation:

(a) an obligation under a credit facility (which has meaning given in the regulations made for the purposes of subparagraph 765A(1)(h)(i) of the *Corporations Act*), including:

(i) a margin lending facility which has the meaning given in Chapter 7 of the *Corporations Act*;

(ii) an obligation under a financial product that is declared by the Australian Securities and Investments Commission under section 761EA(9) of the *Corporations Act* not to be a margin lending facility;

(b) an obligation under a deposit-taking facility;

(c) an obligation under a contract of insurance, including a life policy or a sinking fund policy within the meaning of the *Life Insurance Act;*

(d) an obligation under a managed investment scheme (which has the meaning given in the *Corporations Act*);

(e) an obligation under a lease or licence;

(f) an obligation under a guarantee;

(g) an obligation to pay money under a cheque, an order for the payment of money or a bill of exchange; and

(h) an obligation under a reciprocal purchase agreement (otherwise known as a repurchase agreement), a sell-buyback arrangement or securities loan arrangement.

Obligation of another prescribed kind

An obligation of a party to a *close-out netting contract* to which a *regulated body* is a party is a "prescribed obligation" for the purposes of the provisions related to the ceasing of non-direction stays, if the obligation is under a reciprocal purchase agreement (otherwise known as a repurchase agreement), a sell-buyback arrangement or a securities loan arrangement.[43]

3.2 When non-direction stays cease

A non-direction stay ceases to apply to a *close-out netting contract*:

(a) at the time when a particular declaration made by *APRA* (namely, that the non-direction stay is to cease) takes effect in relation to the contract; or

(b) at the end of the "resolution period" for the trigger event, if no declaration has been made by *APRA* extending the non-direction stay in relation to the contract during that period.

With respect to paragraph 3.2(a) above, *APRA* may make such a declaration if *APRA* is satisfied that it will not make a declaration extending the non-direction stay in relation to a party before the end of the resolution period for the trigger event.

APRA may, before the end of the resolution period for the trigger event, declare that the non-direction stay is to cease to apply to, relevantly, all *close-out netting contracts* of the party and all securities given over financial property in respect of obligations of the party under all *close-out netting contracts* of the party.

With respect to paragraph 3.2(b) above, the "resolution period" for a trigger event begins when the relevant trigger event happens and ends at midnight (by legal time in the Australian Capital Territory) at the end of the first business day after the day on which the trigger event happens.

At the end of the relevant resolution period, the non-direction stay ceases to apply provided that *APRA* has not made a declaration extending the stay beyond the resolution period, as considered below.

3.3 Permanent non-direction stay only if *APRA* declares satisfaction of solvency- and licensing-related matters

A non-direction stay may continue to apply permanently if *APRA* makes a declaration extending the stay.

Relevantly, where a trigger event to which a non-direction stay applies is an event that involves a *regulated body* (being the "**trigger body**"), such a declaration may be made in respect of *close-out netting contracts* to which either the trigger body, or a related body corporate of the trigger body, is a party.

APRA may only make the declaration if, relevantly:

However, we note that the obligations referred to in paragraph (h) of this footnote are obligations of a prescribed kind for the purposes of section 15A(1) of the *Netting Act*, as considered in this paragraph. As a result, the carve-out of obligations referred to in paragraph (h) from the definition of "eligible obligations" is not relevant to this memorandum.

[43] Regulation 7 of the *Netting Regulations*. As noted in the paragraph above, an obligation under a reciprocal purchase agreement (otherwise known as a repurchase agreement), a sell-buyback arrangement or a securities loan arrangement is excluded from the definition of "eligible obligation".

(a) *APRA* is satisfied that certain solvency- and licensing-related matters (considered below) will be satisfied in relation to the trigger body at the time the declaration will be made;

(b) the trigger body is not in *external administration* (other than statutory management or judicial management); and

(c) *APRA* has not already made a declaration that the non-direction stay ceases to apply in relation to the trigger event happening in relation to the contract.[44]

If the conditions referred to in (a), (b) and (c) above are satisfied, then *APRA* may, before the end of the resolution period for the trigger event, declare that the non-direction stay is to continue to apply to, relevantly:

- all *close-out netting contracts* to which the trigger body is a party and all securities given over financial property, in respect of obligations under those *close-out netting contracts*; or
- each *close-out netting contract* to which a related body corporate of the trigger body is a party that is specified in the declaration and all securities given over financial property, in respect of obligations under those *close-out netting contracts. APRA* may specify in the declaration either or both of (i) one or more such contracts; and (ii) one or more classes of such contracts.

The solvency- and licensing-related matters of which *APRA* must be satisfied in relation to the trigger body, which are referred to in paragraph (a) above, are:

- that the trigger body is able to meet all its liabilities under *close-out netting contracts* to which it is a party and securities given over financial property in respect of obligations of it under those contracts as and when they become due and payable;
- that the trigger body is solvent (within the meaning of the *Corporations Act*);
- if the trigger body is an *ADI*, *general insurer*, *life company*, foreign general insurer or eligible foreign life insurance company, it has each material authorisation (however described) necessary for its regulated business;[45] and
- if minimum capital requirements under the *Banking Act,* the *Insurance Act* or the *Life Insurance Act* apply to the trigger body, either:
  - the trigger body's level of capital complies with the minimum capital requirements that apply to it under the *Banking Act*, the *Insurance Act* or the *Life Insurance Act* (as the case requires) and the applicable prudential standards made under the relevant Act; or
  - both:
    - arrangements are in place to ensure that the trigger body performs all its obligations under *close-out netting contracts* to which it is a party and securities given over financial

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[44] The *2016 Explanatory Memorandum* explains at [1.232] that this limb is to provide certainty, so that *APRA* cannot make a declaration extending the application of the relevant stay if it has previously made a declaration that the stay ceases to apply.

[45] The *2016 Explanatory Memorandum* stated at [1.235] that the term "authorisations" should be interpreted to include any licences (eg an Australian financial services licence) and other authorisations upon which the *regulated body* relies to carry out its regulated business. The term "regulated business" is defined in section 5 of the *Netting Act* to mean:

- in relation to an *ADI* — the *ADI's* banking business (within the meaning of the *Banking Act*); or
- in relation to a general insurer — the general insurer's insurance business (within the meaning of the *Insurance Act*); or
- in relation to a life company — the life company's life insurance business (within the meaning of the *Life Insurance Act*).

property in respect of obligations of the trigger body under those contracts as and when they are due to be performed; and

- those arrangements will remain in place until at least the earliest day on which the trigger body complies with the relevant minimum capital requirements that apply to it, or the statutory management or judicial management comes to an end under the relevant Act.[46]

The *2016 Explanatory Memorandum* explained that these requirements:

> "are intended to reflect international developments such as the [ISDA 2015 Universal Resolution] Stay Protocol as closely as possible, particularly the requirements set out in the elements of paragraph (e) of the definition of 'Protocol-eligible Regime' in the Stay Protocol which relates to any 'Close-out Stay' (as that term is defined in the Stay Protocol), whilst also reflecting concepts recognised in Australian law."[47]

If *APRA* makes a declaration extending the stay, rights to close out transactions due to the relevant trigger event described in the non-direction stay may be permanently stayed.

A regulation-making power is included in the *Netting Act* with respect to the declaration powers referred to above. The regulation-making power is in substantially the same form for each of these declarations. As at the date of this memorandum, no regulations with respect to these declaration powers have been made.

3.4 Close-out for any other reason

The direction stays and non-direction stays only relate to the relevant trigger event described in the specified stay provisions and the framework does not prohibit a party from closing out transactions under the *close-out netting contract* (whether or not an obligation under the contract of a party to the contract is an eligible obligation or an obligation of a prescribed kind) for any other reason. That is to say, a party may, in accordance with the terms of the contract, deny obligations under that contract, accelerate a debt under that contract, close out a transaction relating to that contract or enforce security under that contract where their right to do so arises on the basis of an action other than the *appointment of a statutory manager* or the *appointment of a judicial manager* or relevant fact referred to in the other specified stay provisions.

For example, a counterparty may still close out transactions under a *close-out netting contract* if it has a right to do so in accordance with the *close-out netting contract* because the body corporate fails to make a payment or perform an obligation.[48]

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[46] In explaining what would be required to satisfy this requirement, the *2016 Explanatory Memorandum* stated at [1.237] that section 15C(5) of the *Netting Act* is "focussed on the outcome of the arrangements, not the mere fact that assurances or arrangements are in place" and "there must be a high degree of certainty that those arrangements will ensure performance". In listing examples, it was stated that "it is not expected that a guarantee from a commercial guarantor of insufficient creditworthiness would satisfy the requirement" but that the requirement may be satisfied if "the Commonwealth were to provide a guarantee which covered all the regulated body's obligations (including payment and delivery obligations) under close-out netting contracts to which it is a party as and when they are due to be performed and which remained in place until at least the earliest day on which the circumstances set out in paragraph 15C(5)(b) occurred".

[47] *2016 Explanatory Memorandum*, [1.236].

[48] *2016 Explanatory Memorandum*, [1.209].

The *2016 Explanatory Memorandum* states that:

> "No specified stay provision, including a direction stay provision, has any effect in respect of any other close-out event or trigger for the enforcement of security given in relation to the close-out netting contract happening in relation to the contract or security (e.g. a failure to comply with an obligation under the contract). The stays in the Industry Acts do not prevent a counterparty from closing-out transactions relating to a close-out netting contract or enforcing security on the basis of an action other than the appointment of a statutory or judicial manager or relevant fact referred to in the other specified stay provisions. For example, counterparties may close-out transactions relating to such an arrangement or contract or enforce security because the Regulated Entity or private health insurer is insolvent, or if a Regulated Entity or private health insurer under statutory or judicial management or subject to a direction from APRA (as applicable) fails to satisfy any substantive obligations under a close-out netting contract, market netting contract or security (including any payment and delivery obligations). These other events generally constitute separate events of default which could trigger the close-out or enforcement rights under the contract, arrangement or security which would be protected under the [*Netting Act*] notwithstanding the specified stay provisions."[49]

3.5 Protection from certain things being void or voidable

The *Netting Act* also provides that none of the following things done by a party to a *close-out netting contract*, while it is under statutory or judicial management[50] and a "specified stay provision" applies to the contract, is to be void or voidable in an *external administration*:

(a) making a payment, or transferring property, to another person to meet an obligation under the contract;

(b) creating rights or obligations in another person under the contract;

(c) giving any security to another person in relation to the contract;

(d) entering into one or more *close-out netting contracts* with another person;

(e) doing anything mentioned in paragraphs (a) to (c) under a *close-out netting contract* mentioned in paragraph (d).[51]

However, this protection does not apply to a thing mentioned in paragraphs (a) to (e) done by a party to the *close-out netting contract* in relation to another person if:

(i) the transaction did not result from the operation of section 22, 35 or 36R of the *Business Transfer Act*; and

(ii) either of the following is satisfied:

(A) the other person did not act in good faith in entering into the transaction; or

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[49] *2016 Explanatory Memorandum*, [1.202] (footnote omitted).

[50] In this context, a person is under statutory or judicial management if: (a) a *Banking Act* statutory manager takes control of the person's business under the *Banking Act*; or (b) an *Insurance Act* statutory manager takes control of the person's business under the *Insurance Act*; or (c) a *Life Insurance Act* statutory manager takes control of the person's business under the *Life Insurance Act;* (d) the person comes under judicial management under the *Insurance Act;* or (e) the person, or a part of the person's business, comes under judicial management under the *Life Insurance Act*.

[51] Section 14(7) of the *Netting Act*.

(B) the other person neither provided valuable consideration under, nor changed their position in reliance on, the transaction.[52]

Section 5 of the *Netting Act* provides that an action or thing is voidable in an *external administration* if it is:

(a) for an *external administration* that is a winding up under the *Corporations Act* — voidable under Division 2 of Part 5.7B of the *Corporations Act*; or

(b) for an *external administration* that is a bankruptcy under the *Bankruptcy Act* — void as against the trustee in bankruptcy; or

(c) in any other case — void as against the *external administrator* or voidable under the law governing the *external administration*.

4 Transfers under the *Business Transfer Act*

4.1 Effect of stays framework in the case of a transfer under the *Business Transfer Act*

The stays framework that applies in the case of a transfer is broadly the same as that summarised in paragraphs 2 and 3 of Part D above, subject to the following with respect to non-direction stays:

(a) with respect to when non-direction stays may cease, for the purposes of paragraph 3.2(b) above the "resolution period" with respect to the non-direction stay referred to in paragraph 1(f) above (which relates to certain acts being done, and certificates of transfers coming in effect, under the *Business Transfer Act*) ends just after the certificate of transfer comes into force;[53] and

(b) with respect to paragraph 3.3 above and a declaration that a non-direction stay is to continue, where a certificate of transfer will come into force under the *Business Transfer Act* for a transfer of business from a trigger body to a receiving body:

(i) if a related body corporate of the trigger body is a party to the trigger contract, for the purposes of the matters referred to in paragraphs 3.3(a) and (b) above only, references to the "trigger body" are, in the case of a total transfer of business, to the receiving body, and in the case of a partial transfer of business, are to either or both of the trigger body or the receiving body, as specified in a determination made by *APRA*;

(ii) *APRA* must be satisfied that the solvency- and licensing-related matters referred to in paragraph 3.3(a) above will be satisfied in relation to the trigger body just after that certificate coming into force; and

(iii) if the conditions referred to in paragraph 3.3 above are satisfied, then *APRA* may, before the end of the resolution period for the trigger event, declare that the non-direction stay is to continue to apply to:

(A) in relation to contracts to which a *regulated body* is a party, (I) all *close-out netting contracts* to which the trigger body is a party, and to which either (aa) it will remain a party immediately after the transfer, or (bb) the receiving body will

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[52] Section 14(8) of the *Netting Act*.

[53] However, where the trigger event is an act being done for the purposes of Division 2 or 3 of Part 4 of the *Business Transfer Act*, and *APRA* is satisfied that it will not issue a certificate of transfer under that Act, *APRA* may declare that the "resolution period" for that trigger event ends.

become a party immediately after the transfer, or (cc) in relation to a partial transfer only, both (aa) and (bb), and (II) all securities given over financial property, in respect of obligations under those *close-out netting contracts*; and

(B) in relation to contracts to which a related body corporate of the trigger body is a party, each *close-out netting contract* to which a related body corporate of the trigger body is a party that is specified in the declaration and all securities given over financial property, in respect of obligations under those contracts. *APRA* may specify in the declaration either or both of (a) one or more such contracts; and (b) one or more classes of such contracts. However, *APRA* must not make such a declaration, unless it is satisfied that the declaration will not have a detrimental effect on any counterparty to a contract to which the declaration would apply.

The stays framework that applies in the case of a transfer under the *Business Transfer Act* is complex. In the event of such a transfer, we recommend that separate advice is obtained regarding the effect of a stay.

4.2 Effect of partial transfers under the *Business Transfer Act*

In relation to partial transfers under the *Business Transfer Act*, these may be void if, relevantly:

(a) a certificate of transfer comes into force in respect of a partial transfer;

(b) just before the partial transfer, the transferring body is a party to a *close-out netting contract* or a security given over financial property, in respect of an obligation of the transferring body under a *close-out netting contract*; and

(c) the partial transfer covers some (but not all) of:

(i) the assets and liabilities the transferring body has, under the *close-out netting contract*, with respect to another party to the contract (the "**counterparty**"); and

(ii) those assets that are property over which security is given in respect of an obligation of the transferring body under the *close-out netting contract*.

However, the partial transfer is only void:

(d) to the extent of the assets or liabilities the transferring body has, just before the partial transfer, under the *close-out netting contract*, with respect to the counterparty; and

(e) if security is given over financial property in respect of an obligation of the transferring body under a *close-out netting contract* — to the extent that, just before the partial transfer, the assets are financial property in the possession or control of the counterparty or another person (who is not the transferring body) on behalf of the counterparty, under the terms of an arrangement evidenced in writing.[54]

The effect of this is that any such purported partial transfer of some, but not all, of the obligations under an agreement would be void.

[54] Section 36AB of the *Business Transfer Act*.

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5 Ipso facto reforms

The *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (Cth) was passed by the Australian Parliament in late 2017 and the relevant part of the Act came into force on 1 July 2018. Part 2 of Schedule 1 to the Act amended the *Corporations Act* and the *Netting Act* from 1 July 2018. Relevantly and in summary, the effect of the amendments to the *Corporations Act* are that "ipso facto" rights cannot be enforced against a body, corporation or company due to:

(a) the entity becoming subject to (i) administration or (ii) receivership over the whole or substantially the whole of the entity's property; or

(b) the occurrence of certain events related to the entity being the subject of a compromise or arrangement; or

(c) the entity's financial position, if the entity is subject to the events referred to in paragraphs (a) or (b) above.

Broadly, an "ipso facto" right refers to a right that arises under an express provision (however described) of a contract, agreement or arrangement upon the occurrence of some specific event, regardless of the continued performance of the counterparty.

These stays on enforcement will apply in relation to rights arising under, or self-executing provisions of, contracts, agreements or arrangements entered into at or after 1 July 2018.

However, the amendments to the *Corporations Act* expressly provide that the *Netting Act* prevails over the ipso facto reforms referred to immediately above to the extent of inconsistency, and the amendments to the *Netting Act* provide that the ipso facto stay provisions referred to above are included in the definition of "specified provisions" in the *Netting Act*.

Further, the amendments to the *Corporations Act* also provide that regulations may be made under that Act which may, amongst other things, prescribe that the ipso facto stay provisions do not apply to a right contained in a kind of contract, agreement or arrangement prescribed in the regulation. The *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (Cth) which commenced on 1 July 2018 exclude a contract, agreement or arrangement that is, or is directly connected with, a derivative or a securities financing transaction, and *close-out netting contracts*, from the ipso facto stay provisions.[55] Consequently, in our view, the ipso facto reforms should not adversely impact our conclusions in this memorandum.

[55] Regulation 5.3A.50(2)(g), (h) and (zh) of the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (Cth).

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Part E **Assumptions and qualifications**

1 Assumptions

We have assumed that:

(a) each party to the *close-out netting contract* is validly incorporated and in existence under the laws of its place of incorporation;

(b) the *close-out netting contract* and each transaction is a legal, valid, binding and in all respects (except as expressly opined on in this memorandum) enforceable obligation of each party under all applicable laws in accordance with its terms;

(c) each party to the *close-out netting contract* has duly authorised, executed and delivered the relevant agreement or transaction in accordance with all applicable laws prior to the commencement of any *external administration* against it and has the requisite capacity and corporate power to enter into and perform its respective obligations under the relevant agreement or transaction and has taken all necessary steps to enter into and perform its obligations under the relevant agreement or transaction;

(d) no *external administration* of a party to the *close-out netting contract* has commenced, or is taken to have commenced, at the time that a transaction is created in connection with the *close-out netting contract*;

(e) if an obligation is to be performed in a jurisdiction outside the *Australian jurisdictions*, its performance will not be contrary to an official directive, impossible or illegal under the laws of that jurisdiction;

(f) each party to the *close-out netting contract* and each transaction was solvent when and immediately after it entered into the *close-out netting contract* and each transaction;

(g) no person has been, or will be, engaged in conduct that is unconscionable, dishonest, misleading or deceptive or likely to mislead or deceive;

(h) each party to the *close-out netting contract* and each transaction who carries on a financial services business in Australia and who provides a financial service in connection with the *close-out netting contract* or transaction has complied with all its obligations in that regard under the *Corporations Act*;

(i) the circumstances needed for the application of the *Netting Act* exist and that none of the circumstances are present which could cause the *Netting Act* not to apply as described in paragraphs 1.4 and 1.5 of Part B; and

(j) in relation to a party to the *close-out netting contract* who has entered the *close-out netting contract* in the capacity of a trustee:

  (i) that the relevant trust has been duly established and continues at all times in full force and effect;

  (ii) that the party is the only trustee of the trust at the time it executes the *close-out netting contract* and each transaction;

  (iii) that the party has been and remains at all times validly appointed as trustee of the trust and no action has been taken or proposed to remove it as trustee of the trust;

(iv) that the trust deed discloses all terms of the trust;

(v) that no action has been taken or proposed to terminate the trust;

(vi) that the party has not exercised its powers under the trust deed to release, abandon or restrict any power conferred on it by the trust deed;

(vii) none of its rights or powers as trustee (including its indemnity and lien) have been or will be prejudicially affected in any way;

(viii) all requirements under its trust deed or elsewhere have been properly completed for the trustee to enter into and perform the *close-out netting contract* and each transaction, exercise its rights under the *close-out netting contract* and each transaction, and enter into and conduct the transactions contemplated by the *close-out netting contract* and each transaction;

(ix) its entry into, exercise of rights under, and performance of, the *close-out netting contract* and each transaction and the transactions contemplated by the *close-out netting contract* and each transaction, and its performance of those transactions are, and will be, in proper performance of its duties and obligations as trustee (including, without limitation, under statute); and

(x) it will exercise its rights under, and perform the transactions contemplated by, the *close-out netting contract* and each transaction in accordance with its powers as trustee.

We have not taken any steps to verify these assumptions.

2 Qualifications

This memorandum does not deal with matters related to power, authority, use of power for a proper purpose or for the benefit of beneficiaries, compliance with any constituent documents, any matters related to security granted in connection with a *close-out netting contract* (including under the *close-out netting contract*) or general enforceability of contracts or security. Also, this memorandum is not an enforceability opinion.

Our memorandum is subject to the following qualifications:

(a) the insolvency-related analysis in this memorandum is restricted to the position where the relevant insolvency proceedings are governed by *Australian law*. We express no opinion as to whether Australian law would, in fact, govern such proceedings, whether or not conducted in the courts of an *Australian jurisdiction*;

(b) the nature and enforcement of rights and obligations may be affected by lapse of time, failure to take action or laws (including, without limitation, laws relating to the enforcement of security interests, unfair contract terms or insolvency), certain equitable remedies and defences generally affecting creditors' rights;

(c) the rights of a party to enforce its rights under the *close-out netting contract* or a transaction may be limited or affected by:

(i) breaches by that party of its obligations under the *close-out netting contract* or a transaction, or misrepresentations made by it in, or in connection with, the *close-out netting contract* or a transaction;

(ii) conduct of that party in relation to the *close-out netting contract* or a transaction which is unlawful including without limitation the failure to hold an Australian financial services licence if required to do so or the failure to comply with obligations in connection with that licence; or

(iii) conduct of that party in relation to the *close-out netting contract* or a transaction which gives rise to an estoppel or claim against that party by the party against whom it is seeking to enforce its rights under the *close-out netting contract* or a transaction;

(d) an unsecured creditor's right of recourse to trust assets to satisfy a trustee's liability depends on the availability of the trustee's right of indemnity out of those assets (and each creditor's right of subrogation to the trustee's right of indemnity). The trustee's right of indemnity may not be available to the extent that the liability was not properly incurred or was beyond the trustee's authority or the trustee is, or has been, in breach of trust (including an existing or future breach which is not related to the transactions contemplated by the *close-out netting contract*);

(e) the beneficiaries of a trust who have full legal capacity and whose interests have vested may terminate the trust and require the trustee to transfer the trust property to them (or as they direct) despite any provision to the contrary in the documents creating or evidencing the trust, or any other document. However, a trustee has a right to be indemnified out of, and an equitable lien over, trust assets in respect of debts and liabilities properly incurred by it as trustee, and those rights normally have priority over the claims of the beneficiaries. This priority benefits the creditors in respect of those debts and liabilities if and to the extent they are entitled to be subrogated to that right of indemnity and lien. These outcomes assume no disentitling conduct on the part of the trustee or a relevant creditor;

(f) a creditor's rights may be affected by a specific court order obtained under laws and defences generally affecting creditor's rights;

(g) the availability of certain equitable remedies (including, without limitation, injunctions and specific performance) is at the discretion of a court in the *Australian jurisdictions*;

(h) this memorandum does not consider the impact of laws other than the laws of the *Australian jurisdictions*;

(i) an obligation which imposes a detriment on a party may be unenforceable in its entirety or to the extent that the detriment exceeds the amount of the relevant loss or damage, if that detriment is held to constitute a penalty;

(j) a provision that a statement, opinion, determination or other matter is final and conclusive will not necessarily prevent judicial enquiry into the merits of a claim by an aggrieved party;

(k) the term "enforceable" as used in this memorandum means that the relevant obligations are of a type that the courts in the *Australian jurisdictions* enforce and does not mean that these obligations will necessarily be enforced in all circumstances in accordance with their terms. The power of the courts of the *Australian jurisdictions* to order specific performance of an obligation or to order any other equitable remedy is discretionary and, accordingly, such a court might make an award of damages where specific performance of an obligation or any other equitable remedy was sought. Further, if a company is subject to insolvency proceedings, provisions of the *Corporations Act* restrict the steps that may be taken against an insolvency officer in the event of insolvency proceedings and prescribe the manner in which claims may be made

against an entity the subject of insolvency procedures in the *Australian jurisdictions*, for example, by prescribing the procedure for making a claim against a company in liquidation;

(l) the laws of the *Australian jurisdictions* may require that:

(i) parties act reasonably, honestly and in good faith in their dealings with each other;

(ii) discretions are exercised reasonably; and

(iii) opinions are based on good faith;

(m) the question whether a provision of the *close-out netting contract* which is invalid or unenforceable may be severed from other provisions is determined at the discretion of a court in the *Australian jurisdictions*;

(n) an indemnity for legal costs may be unenforceable;

(o) we express no opinion as to:

(i) any particular *close-out netting contract*, transaction or any particular payment or delivery made in connection with a transaction;

(ii) provisions precluding oral amendments or waivers;

(iii) the creation, validity, perfection, enforceability, enforcement or priority of any security interest (including any security interest created in connection with the *close-out netting contract*);

(iv) penalty interest, post-insolvency interest, conclusivity clauses, the availability of specific performance or injunction, the efficacy of liability exculpation clauses, severability clauses or indemnities for litigation costs;

(v) the taxation or stamp duty consequences of a party entering the *close-out netting contract* or a transaction (including whether goods and services tax is payable in connection with the transactions contemplated by the *close-out netting contract*);

(vi) the regulatory capital treatment of the transactions envisaged by the *close-out netting contract*, or regulatory law generally (including any unfair terms legislation);

(vii) the obligations of an Australian financial services licensee or any other licensee in connection with its licence;

(viii) the date on which or the rate of exchange at which a conversion from foreign currency into Australian dollars would be made for the purpose of enforcing a judgment;

(ix) whether a court in the *Australian jurisdictions* would decide to give a judgment for a monetary amount in a currency other than Australian dollars (although there are decisions indicating it has power to do so);

(x) the accuracy, completeness or suitability of any formula, equation or mathematical calculation. If any formula is inaccurate, incomplete or unsuitable for the purpose of determining the amounts or matters for which it has been included, then a court may find that the relevant formula is void for uncertainty;

(xi) whether the assets of a trust are sufficient to satisfy the trustee's right to be fully indemnified out of those assets in respect of obligations incurred by it under the *close-out*

netting contract to which it is a party and all other obligations in respect of which the trustee has a right to be indemnified out of those assets;

(xii) whether a court would determine that the exercise by a trustee of powers set out in the documents creating or evidencing that trust was a valid exercise of those powers for the benefit of the beneficiaries of that trust;

(xiii) whether a court will give effect to a choice of laws to govern the *close-out netting contract* or a transaction to the extent that the choice of laws applies to non-contractual obligations arising out of, or in connection with, the *close-out netting contract* or a transaction (including, without limitation, non-contractual obligations within the meaning of Regulation No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (known as "Rome II")); or

(xiv) whether a foreign judgment in relation to a non-contractual obligation would be enforced in the *Australian jurisdictions*;

(p) regulations in Australia restrict or prohibit payments, transactions and dealings with assets having a prescribed connection with certain countries or named individuals or entities subject to international sanctions or associated with terrorism;

(q) court proceedings may be stayed if the subject of the proceedings is concurrently before a court;

(r) a party entering into the *close-out netting contract* or a transaction may, in doing so, be acting, or later be held to have acted, in the capacity of a trustee under an undocumented or partially documented constructive, implied or resulting trust which may have arisen as a consequence of that party's conduct;

(s) a document may not be admissible in court proceedings unless applicable stamp duty has been paid;

(t) a payment made under mistake may be liable to restitution;

(u) a court will not give effect to a currency indemnity, a choice of laws to govern the *close-out netting contract* or a submission to the jurisdiction of certain courts if to do so would be contrary to public policy in the *Australian jurisdictions*, but we are not aware of any such public policy which would be applicable as at the date of this memorandum;

(v) a court in an *Australian jurisdiction* will not necessarily accept without question the express provisions of an agreement. In other words, it will look to the substance of the provision, not merely the form. If an agreement does not accurately reflect the intended legal relationships between the parties to it, the court will admit extrinsic evidence to prove the nature of the agreement. Similarly, if the parties do not apply the agreement in practice, but act inconsistently with it, the court may decide that they have by implication varied the terms of the agreement;

(w) as a matter of law of the *Australian jurisdictions*, claims may become barred under the Limitation Acts;

(x) we do not comment on the possible impact of a party failing to comply with a regulatory requirement applicable to it (for example, failing to obtain an Australian financial services licence if it were required to do so) on the enforceability of the *close-out netting contract*;

(y) we express no opinion as to whether or not a foreign court (applying its own conflict of laws rules) will act in accordance with the parties' agreement as to jurisdiction, arbitration or choice of law;

(z) we express no opinion in relation to:

(i) any proposal to introduce or change a law, or any pending change in law;

(ii) any law which has been enacted and has not commenced, or if it has commenced, has not started to apply;

(iii) any pending judgment, or the possibility of an appeal from a judgment, of any court; or

(iv) the implications of any of them; and

(aa) the enforceability against a small business of an agreement to which they are a party may be affected if the terms of the agreement are unfair or unconscionable. A statutory unfair contract terms regime is imposed by the *Australian Securities and Investments Commission Act 2001* (Cth). A term of a standard form contract is able to be challenged as unfair under this regime if each of the following apply:

(i) at the time the agreement is entered into, at least one of the parties to the relevant contract is a business that employs less than 20 people and the upfront price payable under the contract is $300,000 or less, or $1,000,000 or less if the contract is for more than 12 months; and

(ii) the term was either varied after 12 November 2016 or is contained in an agreement entered into or renewed after 12 November 2016.

A term of an agreement will be unfair if:

(a) it would cause a significant imbalance in the parties' rights and obligations arising under the agreement; and

(b) it is not reasonably necessary in order to protect the party's legitimate interests; and

(c) it would cause detriment (whether financial or otherwise) to the other party if it were to be applied or relied on.[56]

If the term of an agreement is found to be unfair it will be void. However, the agreement continues to bind the parties if it is capable of operating without the unfair term.

[56] *Australian Securities and Investments Commission Act 2001* (Cth), section 12BG. Section 12BG provides several factors relevant to determining whether a term of a consumer contract is unfair. Section 12BH provides examples of unfair terms.

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Part F **Glossary**

In this memorandum, the following terms have the following meaning.

2016 Explanatory Memorandum means the explanatory memorandum published by the Commonwealth Government when the Financial System Legislation Amendment (Resilience and Collateral Protection) Bill 2016 (Cth) was introduced in Federal Parliament.

ADI or *authorised deposit-taking institution* means a body corporate in relation to which an authority to carry on banking business in Australia is in force (as required under and in accordance with the *Banking Act*).

appointment of a judicial manager means the vesting of the management of (a) a *life company* (or part of the business of a *life company*), (b) a *general insurer*, (c) the Australian business assets and liabilities of an eligible foreign life insurance company or (d) the Australian business assets and liabilities of a foreign general insurer, in a judicial manager, as the context requires.

appointment of a statutory manager means a statutory manager taking control of (i) the business of an Australian incorporated *ADI*, a *general insurer*, a *life company*, or an Australian incorporated *NOHC* or *subsidiary* which satisfies certain conditions, or (ii) the Australian business assets and liabilities of a foreign *ADI*, foreign general insurer or foreign life company, as the context requires.

APRA means the Australian Prudential Regulation Authority.

Australian bank means an *ADI* that is a bank organised under *Australian law*.

Australian company means a company which is registered as a company under the *Corporations Act*. The term *Australian company* includes all *Australian banks*, *general insurers*, *life companies*, building societies, credit unions, trustees of *superannuation entities* and trustees of unit trusts (including managed investment schemes), in each case which are registered as a company under the *Corporations Act*.[57] The term *Australian company* refers to a company that has its centre of main interests (for the purposes of the *Model Law*) in Australia.

Australian court means a court of the *Australian jurisdictions* including the High Court of Australia and the Federal Court of Australia.

Australian jurisdictions means the Commonwealth of Australia, the States of New South Wales, Victoria, Queensland and Western Australia and the Australian Capital Territory.

Australian law means the law of the *Australian jurisdictions*.

Banking Act means the *Banking Act 1959* (Cth).

Bankruptcy Act means the *Bankruptcy Act 1966* (Cth).

Business Transfer Act means the *Financial Sector (Transfer and Restructure) Act 1999* (Cth).

close-out netting contract has the meaning given to it in the *Netting Act* (as described in paragraph 1.1 of Part B).

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[57] Under *Australian law*, superannuation funds, managed investment schemes and trusts are not legal entities. The relevant legal entity is the superannuation trustee acting in its capacity as trustee of the superannuation fund, the responsible entity acting in its capacity as responsible entity of the managed investment scheme, or the trustee of the trust (as applicable).

Corporations Act means the *Corporations Act 2001* (Cth).

Crisis Resolution Powers Amendment Act means the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018* (Cth).

Cross-Border Insolvency Act means the *Cross-Border Insolvency Act 2008* (Cth).

external administration has the meaning given in paragraph 1.2 of Part C of this memorandum.

external administrator means the person who takes control of the property, part of the property, the business, or part of the business, of the person under an *external administration*.

general insurer means a body corporate which is an *Australian company* that is authorised under section 12 of the *Insurance Act* to carry on an insurance business in Australia.

Industry Acts means the *Banking Act*, *Business Transfer Act*, *Insurance Act* and the *Life Insurance Act.*

insolvent party means an *Australian company* party to a *close-out netting contract* which has become subject to *external administration*.

Insurance Act means the *Insurance Act 1973* (Cth).

life company means an *Australian company* that is a "life company" as defined under the *Life Insurance Act*.[58]

Life Insurance Act means the *Life Insurance Act 1995* (Cth).

Model Law means the UNCITRAL Model Law on Cross-Border Insolvency.

Netting Act means the *Payment Systems and Netting Act 1998* (Cth).

Netting Regulations means the *Payment Systems and Netting Regulations 2001* (Cth).

NOHC means an authorised non-operating holding company of an *ADI* (as defined in the *Banking Act*) or of a general insurer (as defined in the *Insurance Act*) or a registered non-operating holding company of a life company (as defined in the *Life Insurance Act*), as the context requires.

PPSA means *Personal Property Securities Act 2009* (Cth).

regulated body means a body corporate that is an *ADI*, a general insurer (as defined in the *Insurance Act*), a life company (as defined in the *Life Insurance Act*), a *NOHC*, or a *subsidiary*, as the context requires.

RSE licensee means an *Australian company* that holds an RSE licence (as that term is defined under the *SIS Act*) granted by *APRA* under section 29D of the *SIS Act*.

SIS Act means the *Superannuation Industry (Supervision) Act 1993* (Cth).

solvent party means the solvent counterparty to an *insolvent party* under a *close-out netting contract*.

subsidiary means a subsidiary of an *ADI*, a general insurer (as defined in the *Insurance Act*), a life company (as defined in the *Life Insurance Act*) or a *NOHC*, as the context requires. Relevantly, for

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[58] The *Life Insurance Act* defines a "life company" to be a company that is carrying on life insurance business in Australia. A life insurance business is essentially a business that consists of the issuing of life policies or sinking fund policies or the undertaking of liability under such policies and related business. A detailed definition is contained in section 11 of the *Life Insurance Act*.

the purposes of the *Netting Act* and the *Industry Acts*, the question of whether a body corporate is a subsidiary of another body corporate is to be determined in the same way as that question is determined for the purposes of the *Corporations Act*.

superannuation entity means a regulated superannuation fund (other than a self-managed superannuation fund), an approved deposit fund, or a pooled superannuation trust (each as those terms are defined in the *SIS Act*).

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Part G **Benefit**

This memorandum is addressed to you personally and may not, without our prior written consent, be:

(a) relied on by another person;

(b) disclosed, except to members of AFMA, subscribers to the AFMA Guide to Australian OTC Transactions and persons who in the ordinary course of your or their business have access to your or their papers and records. Such disclosure is only made on the basis that such persons will make no further disclosure; or

(c) filed with a government or other agency or quoted or referred to in a public document.

This memorandum is given in respect of the laws of the *Australian jurisdictions* which are in force at 9.00am local time on the date of this memorandum and we are not obliged to update it.

Yours faithfully

KING&WOOD MALLESONS

Schedule 1

In this Schedule 1, we set out further description of each of the insolvency proceedings to which an *Australian company* or a foreign company may be subject under *Australian law*.[59]

1 *Australian companies*

1.1 Winding up

An *Australian company* may become subject to winding up under Parts 5.4, 5.4A, 5.4B, 5.4C and 5.5 of the *Corporations Act*. This may be:

(a) a winding up effected by the court (including a winding up in insolvency);

(b) a voluntary winding up approved by special resolution of members of an *Australian company*; or

(c) a winding up ordered by the Australian Securities and Investments Commission.

1.2 Compromise or arrangement

An *Australian company* may become subject to a compromise or arrangement under Part 5.1 of the *Corporations Act*. Under this procedure, proposals between the *Australian company* and its creditors (or a class of them) for a compromise or arrangement in satisfaction of its debts can, if resolved by the requisite number of creditors (and sanctioned by the court), bind all its creditors (or the relevant class).

1.3 Administration

An *Australian company* may become subject to administration in accordance with Part 5.3A of the *Corporations Act*. An administrator may be appointed by the *Australian company* by writing if its board of directors have resolved by majority that the *Australian company* is insolvent or likely to become insolvent at some future time and that an administrator should be appointed. In addition, an administrator may be appointed by a liquidator, provisional liquidator or (where there is no liquidator or provisional liquidator in office) a person who is entitled to enforce a security interest over the whole or substantially the whole of the *Australian company's* property if the security interest has become and is still enforceable.

During the time from the commencement of the administration to the adoption by the *Australian company* and its creditors of a deed of company arrangement, there are a number of restrictions imposed on the *Australian company* and its creditors. All of the *Australian company's* assets are subject to the administrator's control, except for property subject to security interests which were already being enforced as at the commencement of the administration. Even then a court may restrict the action of secured creditors if such action may prejudice the administration. Such an order would however contain provisions protecting the interests of the secured creditor. By way of exception a person who holds a security interest over the whole or substantially the whole of the *Australian*

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[59] An *Australian company* may also be subject to some of the insolvency proceedings applicable to a foreign company referred to below. In particular:

(a) insolvency proceedings under the *Model Law* where the foreign proceeding is taking place in a jurisdiction in which the *Australian company* has an establishment or its centre of main interests;

(b) a letter of request; or

(c) winding up under Part 5.7 of the *Corporations Act* as a Part 5.7 body that is a registrable Australian body that is registered under Division 1 of Part 5B.2 of the *Corporations Act*.

company's property can enforce that security interest provided that the security interest is enforced in relation to all that property within 13 business days from the commencement of the administration.

1.4 Receiver

A receiver or receiver and manager may be appointed to an *Australian company*. Such appointment would usually be made by a secured creditor of the *Australian company*. The receiver would act to realise the secured assets of the *Australian company* and to manage the *Australian company's* affairs with a view to satisfying the secured creditor's debts. The power to appoint a receiver or receiver and manager will normally originate from a security interest granted by the *Australian company* to the secured creditor.

1.5 *Appointment of a statutory manager* in respect of an Australian *ADI*

APRA has the power to assume control of an Australian *ADI* in difficulty under the *Banking Act*.

APRA may appoint a *Banking Act* statutory manager (which may be *APRA* itself or an administrator appointed by it) to take control of the business of the Australian *ADI*, where:

(a) the *ADI* informs *APRA* that the *ADI* considers that it is likely to become unable to meet its obligations or that it is about to suspend payment;

(b) *APRA* considers that, in the absence of external support:

  (i) the *ADI* may become unable to meet its obligations;

  (ii) the *ADI* may suspend payment; or

  (iii) it is likely that the *ADI* will be unable to carry on banking business in Australia consistently with the interests of its depositors or with the stability of the financial system in Australia;

(c) the *ADI* becomes unable to meet its obligations or suspends payment; or

(d) an external administrator has been appointed to a holding company of the *ADI* (or a similar appointment has been made in a foreign country in respect of it), and *APRA* considers that the appointment poses a significant threat to:

  (i) the operation or soundness of the *ADI*;

  (ii) the interests of depositors of the *ADI*; or

  (iii) the stability of the financial system in Australia.

Such control must continue until:

- *APRA* considers that it is no longer necessary for the *Banking Act* statutory manager to remain in control of the *ADI's* business; or
- *APRA* has applied for the *ADI* to be wound up.

The *Banking Act* statutory manager has the power and functions of the members of the board of directors (collectively and individually), including the board's powers of delegation. In addition, the *Banking Act* statutory manager has specific powers, including to sell or otherwise dispose of the whole or any part of the *ADI's* business on any terms and conditions that the *Banking Act* statutory manager considers appropriate.

There are restrictions on beginning or continuing court and tribunal proceedings against the *ADI*, and other restrictions apply, while a statutory manager is in control of the *ADI's* business. In addition, the appointment of any liquidator, provisional liquidator, receiver or administrator is terminated when a statutory manager takes control of an *ADI* and no such official may be appointed while the statutory manager is in control of the *ADI's* business unless *APRA* approves the appointment.

1.6 Statutory management of an Australian *life company* or *general insurer*

The *Crisis Resolution Powers Amendment Act* amended the *Life Insurance Act* and the *Insurance Act* to enable an *Insurance Act* statutory manager or *Life Insurance Act* statutory manager to be appointed under those Acts to take control of the business of the *general insurer* or *life company*, respectively.[60]

The process for statutory management of a *general insurer* or *life company* is broadly modelled on the statutory management arrangements in place for *ADIs*, as summarised in the preceding paragraph, subject to the following.

The *appointment of a statutory manager* to take control of the business of a *general insurer* or *life company* may occur where *APRA* is satisfied:

(a) of the matters of which the Federal Court is required to be satisfied to make an order that a *life company* (or part of the business of a *life company*) or *general insurer* be placed under judicial management;[61] and

(b) that at least one of the following situations exists (among other things):

(i) both (I) a statutory manager has taken control of a body corporate under the *Banking Act*, the *Life Insurance Act* or the *Insurance Act* or *APRA* intends for that to occur) and (II) the *general insurer* or *life company* and the body corporate are related bodies corporate;

(ii) both (I) the *general insurer* or *life company*'s financial position is deteriorating rapidly, or is likely to deteriorate rapidly, and (II) failure to respond quickly to the deterioration would be likely to prejudice the interests of policy owners of the *general insurer* or *life company*;

(iii) it is likely that the *general insurer* or *life company* will be unable to carry on insurance business or life insurance business (as applicable) in Australia consistently with the stability of the financial system in Australia; or

(iv) an external administrator has been appointed to a holding company of the *general insurer* or *life company* (or a similar appointment has been made in a foreign country in respect of it), and the appointment poses a significant threat to (I) the operation or soundness of the *general insurer* or *life company*, (II) the interests of policy owners of the *general insurer* or *life company* or (III) the stability of the financial system in Australia.

1.7 *Appointment of a judicial manager* in respect of an Australian *life company*

On an application from *APRA* or the *life company*, an *Australian court* may appoint a judicial manager to a *life company* (or part of the business of a *life company*).

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[60] Please see paragraph 2.1 of Schedule 1 below with respect to statutory management of the Australian business assets and liabilities of a foreign general insurer an eligible foreign life insurance company.

[61] Please see paragraphs 1.7 and 1.8 of Schedule 1 below with respect to this.

The court may make an order that a *life company* (or part of the business of a *life company*) be placed under judicial management if it is satisfied that (among other things):

- in the absence of external support,[62] the company is, or is likely to become, unable to meet its policy or other liabilities as they become due;
- the company has failed to comply with the prudential standards in relation to solvency or certain directions given by *APRA*;
- an external administrator has been appointed to a holding company of the company (or a similar appointment has been made in a foreign country in respect of it), and the appointment poses a significant threat to the operation or soundness of the company, the interests of owners of policies issued by the *life company*, or the stability of the financial system in Australia; or
- there are reasonable grounds to believe that the financial position or management of the company may be unsatisfactory.

The judicial management commences at the time specified in the order as the time at which the judicial management is to commence or, if no time is specified, when the order is made. Judicial management terminates on the occurrence of certain specified events including the winding up of the *life company*.

A person with the powers and functions of an officer of the company immediately before the *appointment of a judicial manager* ceases to have those powers and functions and the judicial manager starts to have those functions. There are restrictions on beginning or continuing court and tribunal proceedings against the *life company*, and other restrictions apply, for the duration of the judicial management.

1.8 *Appointment of a judicial manager* in respect of an Australian *general insurer*

The process of appointing a judicial manager to a *general insurer* under the *Insurance Act* is broadly modelled on the judicial management arrangements in place for *life companies* described above.

1.9 Statutory management of an Australian *NOHC* or *subsidiary* which satisfies certain conditions

The *Crisis Resolution Powers Amendment Act* amended the *Banking Act*, the *Life Insurance Act* and the *Insurance Act* to enable a statutory manager to be appointed under those Acts to a "target body corporate" (as defined in each of those Acts), being:

(a) a *NOHC*; or

(b) a *subsidiary*,

in each case, which is incorporated in Australia and which satisfies the conditions described in section 13A(1B) of the *Banking Act*, section 62ZOA(3) of the *Insurance Act* or section 179AA(3) of the *Life Insurance Act*. Our analysis of the statutory management framework in paragraphs 1.5 and 1.6 of Schedule 1 above is broadly applicable to a target body corporate.

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[62] The regulations may specify that a particular form of support for a company is not to be considered external support for these purposes.

1.10 Appointment of an acting trustee to an Australian *superannuation entity* under the *SIS Act*

This applies to a trustee which is an *Australian company* and a trustee of a *superannuation entity* subject to the *SIS Act*.

Under the *SIS Act*, with the written consent of the Minister, *APRA* can suspend or remove the trustee (or all of the trustees) of a *superannuation entity* if, relevantly:

- the trustee, or any of the trustees, is a disqualified person pursuant to Part 15 of the *SIS Act* (because, for example, a receiver, administrator or provisional liquidator has been appointed to it);
- it appears to *APRA* that conduct that has been, is being, or is proposed to be, engaged in by the trustee or any other trustees of the entity may result in the financial position of the entity or of any other superannuation entity becoming unsatisfactory;
- if the trustee is a trustee of a registrable superannuation entity, the trustee is not an *RSE licensee* or a member of a group of individuals that is an *RSE licensee*; or
- if the trustee is an *RSE licensee*, the *RSE licensee* breaches any of the conditions of its RSE licence.

If *APRA* suspends all of the trustees of a *superannuation entity*, then it must appoint a constitutional corporation or an individual to act as the trustee during the period of the suspension. If *APRA* removes all of the trustees of a *superannuation entity*, then it must appoint a constitutional corporation or an individual to act as the trustee until the vacancy in the position of trustee is filled. The trustee appointed in either of these circumstances is called the "acting trustee".

If a person is appointed as acting trustee, *APRA* must make a written order vesting the property of the *superannuation entity* concerned in the acting trustee. Subject to such property vesting orders, an acting trustee may exercise all of the rights, title and powers and must perform all of the functions and duties of the trustee. The *superannuation entity's* governing rules, the *SIS Act* and regulations under it, and any other law apply to the acting trustee as if that person were the trustee of the *superannuation entity*.

APRA may terminate the appointment of an acting trustee at any time.

In our view, the appointment of an acting trustee under the *SIS Act* falls within the definition of "*external administration*" under the *Netting Act* where the acting trustee is appointed because the trustee of the *superannuation entity* is, or is likely to become, insolvent. However, if an acting trustee is appointed for other reasons and the trustee of the *superannuation entity* is not insolvent, or likely to become insolvent, the *Netting Act* would not apply.[63]

If a person is appointed as acting trustee, then *APRA* may, by legislative instrument, formulate a scheme for the winding up or dissolution, or both, of the *superannuation entity* under section 142 of the *SIS Act*. However, we consider that this does not override the operation of section 14(2) of the *Netting Act* because (as described in paragraph 1.7 of Part B) section 14(3) of the *Netting Act* expressly provides that it is to take effect "despite any other law" including the "specified provisions", the definition of which includes section 142 of the *SIS Act*.

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[63] An enquiry needs to be made of *APRA* to find out whether an acting trustee has been appointed because the trustee of the *superannuation entity* is insolvent or likely to become insolvent. However, it would be reasonable to expect that there would be publicity attached to such an appointment.

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2 Foreign companies

The insolvency proceedings to which a foreign company could become subject under *Australian law* are:

2.1 Statutory management of the Australian business assets and liabilities of a foreign *ADI*, foreign general insurer or eligible foreign life insurance company

The *Crisis Resolution Powers Amendment Act* amended the *Banking Act*, the *Life Insurance Act* and the *Insurance Act* to enable a statutory manager to be appointed under those Acts to the Australian business assets and liabilities[64] of a foreign *ADI*, foreign general insurer or eligible foreign life insurance company (each, a "**foreign regulated body**"). Upon such appointment, the statutory manager is vested with powers of control over the Australian business assets and liabilities of the foreign regulated body.

Subject to the following, our analysis of the statutory management framework in paragraphs 1.5 and 1.6 of Schedule 1 above is broadly applicable to a foreign regulated body.

The statutory management provisions are only applicable to the Australian business assets and liabilities of a foreign regulated body. As such, a statutory manager appointed to a foreign regulated body does not replace the board of directors of the foreign regulated body. However any acts of the directors of the foreign regulated body that relate to its Australian business assets and liabilities are invalid and of no effect.

In addition to the circumstances referred to in paragraphs 1.5 and 1.6 of Schedule 1, *APRA* may appoint a statutory manager to take control of the business of a foreign regulated body where (i) an external administrator has been appointed to the foreign regulated body, or a similar appointment has been made in respect of it, in a foreign country, or (ii) an application for such appointment, or for a similar procedure, has been made in a foreign country.

2.2 Judicial management of the Australian business assets and liabilities of an eligible foreign life insurance company or foreign general insurer

The *Crisis Resolution Powers Amendment Act* amended the *Life Insurance Act* and the *Insurance Act* to facilitate a judicial manager being appointed under those Acts to the Australian business assets and liabilities of an eligible foreign life insurance company or foreign general insurer.

Subject to the following, our analysis of the judicial management framework in paragraph 1.7 of Schedule 1 above is broadly applicable to the Australian business assets and liabilities of an eligible foreign life insurance company or foreign general insurer.

In addition to the circumstances referred to in paragraph 1.7 of Schedule 1, the Federal Court may order judicial management if:

(a) in the case of a foreign general insurer in the absence of external support, it is, or is likely to become, unable to meet, from its assets in Australia (other than any assets or amount excluded

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[64] The phrase "Australian business assets and liabilities" of a foreign regulated body is defined in each of the *Banking Act*, *Insurance Act* and *Life Insurance Act* as the assets and liabilities of the relevant foreign regulated body in Australia and any other assets and liabilities of the foreign regulated body that are related to its operations in Australia, and, if regulations are made for the purposes of the relevant subsection of such Act, are of a kind specified in those regulations. As at the date of this memorandum, there are no such regulations.

by the prudential standards for certain purposes), its liabilities in Australia other than pre-authorisation liabilities as they become due;

(b) an external administrator has been appointed to a eligible foreign life insurance company or foreign general insurer, or a similar appointment has been made in respect of it, in a foreign country; or

(c) an application for such appointment, or for a similar procedure, has been made in a foreign country.

2.3 Insolvency proceedings under the *Model Law*

The *Cross-Border Insolvency Act* gives effect to the *Model Law*. The *Model Law* does not apply to *ADIs*, *life companies*, *general insurers,* foreign general insurers or eligible foreign life insurance companies.[65]

Under Article 15 of the *Model Law*, a foreign insolvency official[66] can apply to an *Australian court* for recognition of the "foreign proceeding" in respect of which that foreign insolvency official has been appointed.[67]

Such a foreign proceeding will be recognised as a matter of course by an *Australian court* if the application is properly lodged by the foreign insolvency official in the prescribed form and is accompanied by the prescribed evidence, unless to do so would be "manifestly contrary" to public policy under *Australian law*. The *Australian court* must decide whether the foreign proceeding should be recognised as the primary (or "main") or ancillary (or "non-main") foreign proceeding.[68]

A foreign proceeding will be the foreign main proceeding if it is taking place in the jurisdiction in which the foreign company has the centre of its main interests.[69] A foreign proceeding will be a foreign non-main proceeding if it is not a foreign main proceeding and is taking place in a jurisdiction in which the foreign company has an "establishment".[70] It follows that, if a foreign proceeding is taking place in a jurisdiction other than the one in which the foreign company has either its centre of main interests or an establishment, that foreign proceeding is not capable of recognition by an *Australian court* under Article 15 of the *Model Law*.

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65 Article 1, paragraph 2 of the *Model Law*, section 9 of the *Cross-Border Insolvency Act* and regulation 4 of the *Cross-Border Insolvency Regulations 2008* (Cth).

66 The *Model Law* uses the expression "foreign representative", defined as "a person or body, including one appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding".

67 A "foreign proceeding" is a collective judicial or administrative insolvency proceeding (including interlocutory proceedings) in which the assets and affairs of the foreign company are subject to the control or supervision of a foreign court or other competent foreign authority: see Article 2(a) of the *Model Law*.

68 Until an application for recognition is determined by the appropriate *Australian court*, that court has broad powers to grant provisional relief upon the request of the foreign insolvency official where such relief is urgently needed to protect the assets of the foreign company or the interests of its creditors.

69 Under the *Model Law*, a foreign company's centre of main interests, in the absence of evidence to the contrary, will be presumed to be the jurisdiction in which the foreign company's registered office is located.

70 An "establishment" is defined as "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services".

If a foreign proceeding is recognised as the foreign main proceeding, then (unless an Australian insolvency proceeding is taking place at the time the application for recognition is filed)[71]:

(a) the commencement or continuation of individual actions or individual proceedings concerning the foreign company's assets, rights, obligations or liabilities is automatically stayed;

(b) execution against the foreign company's assets is automatically stayed;

(c) the right to transfer, encumber or otherwise dispose of any assets of the foreign company is automatically suspended,

in each case to the same extent as if such a stay or suspension arose under the relevant applicable parts of Chapter 5[72] of the *Corporations Act*.[73] In our opinion, a stay or suspension under Article 20 of the *Model Law* would not affect the application of the *Netting Act* (to the extent that the *Netting Act* is applicable).[74]

If a foreign proceeding is recognised as a foreign non-main proceeding or the foreign main proceeding at a time when an Australian insolvency proceeding has commenced, then an *Australian court* may grant relief upon request from the foreign insolvency official where it is necessary to protect the assets of the foreign company or the interests of its creditors.[75] In these circumstances, the foreign insolvency official does not have the benefit of the automatic stays and suspension provided by Article 20 of the *Model Law* and any relief that may be granted by an *Australian court* must be consistent with the concurrent Australian insolvency proceeding.[76]

Such relief may include entrusting the administration or realisation or distribution of all or part of the foreign company's assets located in Australia to the foreign insolvency official or another person designated by the court, provided the court is satisfied that the interests of Australian creditors are adequately protected.[77]

In addition, upon recognition of a foreign proceeding by an *Australian court*, the foreign insolvency official has standing to:

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71 The *Model Law* provides guidance to an *Australian court* to address circumstances where a foreign company is concurrently subject to a recognised foreign proceeding and an Australian insolvency proceeding. Where an Australian insolvency proceeding is pending at the time of the application for the foreign proceeding to be recognised by an *Australian court*, the foreign proceeding (if recognised as the foreign main proceeding) does not benefit from the automatic stays and suspension provided by Article 20 of the *Model Law*.

72 The *Model Law* does not apply to Part 5.2 (which concerns receivers and other controllers) or Part 5.4A (which concerns winding up effected by the court other than in insolvency) of the *Corporations Act*.

73 Article 20 of the *Model Law* and section 16 of the *Cross-Border Insolvency Act*.

74 This is because these rights under the *Model Law* are to apply to the same extent as if they arose under the *Corporations Act*. The *Corporations Act* would not preclude a close-out of transactions under a *close-out netting contract*. In any case, the *Netting Act* is expressed to apply "despite any other law", and the *Cross-Border Insolvency Act* is expressed to prevail only over the *Corporations Act* and the *Bankruptcy Act* (from which may be implied an intention that it is not intended to prevail over the *Netting Act*).

75 See Article 21(1) of the *Model Law*.

76 Article 29 of the *Model Law*. This is consistent with the expressed intention of the drafters of the *Cross-Border Insolvency Act* that the *Model Law* is "in addition to, and not in derogation of, section 601CL of the Corporations Act 2001". As a result, any relief granted by an *Australian court* under the *Model Law* should not adversely affect the ability of a foreign liquidator to obtain an ancillary liquidation order under section 601CL of the *Corporations Act*.

77 Article 21 of the *Model Law*.

(i) intervene in any proceedings to which the debtor is a party, provided that other requirements under *Australian law* are met;[78]

(ii) participate in Australian insolvency proceedings regarding the foreign company under Chapter 5 of the *Corporations Act* (other than under Parts 5.2 and 5.4A);[79]

(iii) initiate certain actions in respect of voidable transactions under the *Corporations Act*,[80] provided that, in circumstances where the foreign proceeding is recognised as a foreign non-main proceeding, the *Australian court* is satisfied that the action relates to assets that, under *Australian law*, should be administered in that proceeding.[81]

The above rights of standing do not vest the foreign insolvency official with any specific powers or rights in respect of such proceedings; rather, the effect of these rights of standing are to place the foreign insolvency official in the same position as an Australian insolvency official would be in respect of an *Australian company* in the same circumstances.

2.4 Letter of request

Section 581(3) of the *Corporations Act* provides in effect that where a letter of request from a court of a country other than Australia, requesting aid in an external administration matter,[82] is properly lodged with the appropriate *Australian court*, the *Australian court* may exercise such powers with respect to that matter which it could exercise if that matter had arisen within the *Australian court's* own jurisdiction.

If the letter of request is received from a court of a prescribed country, the *Australian court* must act in aid of, and be auxiliary to, that foreign court.[83]

If the letter of request is received from a court of a non-prescribed country, the *Australian court* has discretion whether to assist.[84] However, we believe that, as the purpose of the letter of request provisions is to facilitate co-operation between *Australian courts* and foreign courts in external administration matters, an *Australian court* would require cogent reasons to refuse its assistance.

The effect of the letter of request mechanism is to place the foreign liquidator in a position of being able to exercise the powers available to Australian liquidators under the *Corporations Act*. That means that the foreign liquidator would have to deal with assets of the foreign company in liquidation in the same way as an Australian liquidator would in the liquidation of an *Australian company* under *Australian law*.

Both sections 581(2)(a) and 581(2)(b) are (to varying degrees) inconsistent with Article 25 of the *Model Law*, which requires the appropriate *Australian courts* to cooperate to the maximum extent

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78 Article 24 of the *Model Law*.

79 Article 12 of the *Model Law*.

80 See section 588FE of the *Corporations Act*.

81 Article 23 of the *Model Law*.

82 "External administration matter" is a term which is defined in the *Corporations Act* and includes winding up and insolvency of a registrable body that is a foreign company which is registered under Division 1 of Part 5B.2 of the *Corporations Act* or which carries on business in Australia: section 580 of the *Corporations Act*.

83 Section 581(2)(a) of the *Corporations Act*. Prescribed countries are those countries which are prescribed by regulation 5.6.74 of the *Corporations Regulations 2001* (Cth) and include Canada, Malaysia, Singapore, New Zealand, Switzerland, the United Kingdom, the United States of America, Papua New Guinea and Jersey.

84 Section 581(2)(b) of the *Corporations Act*.

possible with foreign courts and foreign insolvency officials in connection with cross-border insolvency matters. As a result, Article 25 of the *Model Law* prevails over sections 581(2)(a) and (b) to the extent of the inconsistency.[85]

2.5 Ancillary liquidation order pursuant to section 601CL(14) of the *Corporations Act*[86]

A foreign liquidator appointed in the foreign company's home jurisdiction can obtain a concurrent Australian liquidation order under section 601CL(14), apparently as of right, provided that the following three preconditions are satisfied:

(a) the foreign company must be registered under Division 2 of Part 5B.2 of the *Corporations Act* (which makes it a "registered foreign company");[87]

(b) the registered foreign company must have commenced to be wound up, or otherwise be dissolved or deregistered, in its home jurisdiction; and

(c) the foreign liquidator must have been appointed in, and not merely recognised by, the foreign company's home jurisdiction.[88]

However, where an ancillary winding up under section 601CL(14) is commenced, the local liquidator is subject to a positive statutory duty to recover and realise the property of the foreign company in Australia and to pay the net amount so recovered and realised to the liquidator of the foreign company for its place of origin.[89] There is no requirement to pay ordinary local creditors first.[90] The property which the local liquidator must recover means all property, movable or immovable, in Australia, whether or not the foreign liquidation order vested property in the foreign liquidator.[91]

The requirement of section 601CL(15) that the "net amount" be paid to the liquidator of the foreign company for its place of origin means the proceeds derived from the collection and realisation of property (whether movable or immovable) in Australia, minus those amounts necessary to satisfy all claims entitled to preferential treatment under *Australian law*.[92]

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85 Section 22(1)(a) of the *Cross-Border Insolvency Act*.

86 Section 22 of the *Cross-Border Insolvency Act* specifies that the *Model Law* is in addition to, and not in derogation of, section 601CL of the *Corporations Act*.

87 Section 601CD of the *Corporations Act* provides in effect that a foreign company may not carry on business in Australia unless it is registered under that Division or has a registration application pending under that Division.

88 Section 601CL(14)(b) of the *Corporations Act* provides that the Court shall, on application by the person who is the liquidator for the foreign company's place of origin, or by the Australian Securities and Investments Commission, appoint a liquidator of the foreign company.

89 Section 601CL(15) of the *Corporations Act*.

90 *Re Standard Insurance Co Ltd* [1968] Qd R 118.

91 Although this point is not without doubt. See for example AD Grace, "Law of Liquidations: The Recognition and Enforcement of Foreign Liquidation Orders in Canada and Australia — a Critical Comparison" (1986) 35 *International & Comparative Law Quarterly* 664 at 690, especially note 246, where it is suggested that a concurrent liquidation order under section 350(14) (the relevant predecessor provision) would have no effect in respect of movable property vested in a foreign liquidator. However, the author of that article argues that the positive statutory duty to recover property and pay the net proceeds to the foreign liquidator must override any recognition afforded in common law to vesting of movable property.

92 *Re Air Express Foods Pty Limited* (1977) 2 ACLR 523. Claims entitled to preferential treatment include various costs of winding up and payments due to employees (see section 556 of the *Corporations Act*).

Moreover, it appears that an *Australian court* might not allow funds to be remitted to a foreign liquidator to the detriment of local creditors.[93]

2.6 Winding up under Part 5.7 of the *Corporations Act*

To establish jurisdiction for an independent winding up of a foreign company under Part 5.7 it must be shown that the foreign company is either registered in Australia as a foreign company or carries on business in Australia.[94] A foreign company may not be wound up voluntarily under Part 5.7. However, it may be wound up on the application of, among other persons, a creditor[95] or foreign liquidator.

The grounds for winding up a foreign company under Part 5.7 are:

(a) the foreign company is not able to pay its debts (inability to pay debts may be established with the assistance of certain statutory presumptions in section 585 of the *Corporations Act*),[96] has been dissolved or deregistered, has ceased to carry on business in Australia or has a place of business in Australia only for the purpose of winding up its affairs;

(b) the court is of the opinion that it is just and equitable; or

(c) the Australian Securities and Investments Commission has stated in a report that the foreign company cannot pay its debts and should be wound up or that it is in the interests of the public, of the members (of the foreign company), or of the creditors, that the foreign company be wound up.[97]

In addition to the statutory grounds listed in paragraphs (a), (b) and (c), an application to wind up a foreign company under Part 5.7 will only be effective if the following additional common law requirements are fulfilled:

- there is a sufficient connection between the activities of the foreign company and Australia;[98] and
- there is a reasonable possibility that a benefit will result from the winding up. A benefit may, for example, accrue if there are local assets.[99]

A foreign company may be wound up under Part 5.7 whether or not it is being wound up or has been dissolved or has otherwise ceased to exist under the laws of its home jurisdiction.[100] However, the

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93 *Re Standard Insurance Co. Limited; Re Northland Services Pty Limited* (1978) 18 ALR 684; see also *Akers and Others v Deputy Commissioner of Taxation* (2014) 223 FCR 8 (albeit in the context of the *Model Law*).

94 Section 582(3) and section 9 (definition of "Part 5.7 body") of the *Corporations Act*.

95 Article 13 of the *Model Law* provides that foreign creditors have the same rights regarding the commencement of, and participation in, certain insolvency proceedings, including those under Part 5.7 of the *Corporations Act*.

96 If an *Australian court* has recognised a foreign insolvency proceeding as being the "foreign main proceeding" for the purposes of the *Model Law*, then (in the absence of evidence to the contrary) such recognition is proof of the foreign company's insolvency for the purposes of commencing a winding up under Part 5.7: see Article 31 of the *Model Law*.

97 Section 583 of the *Corporations Act*.

98 *Mercantile Credits Ltd v Foster Clark (Aust) Ltd* (1964) 112 CLR 169; *International Westminster Bank Plc v Okeanos Maritime Corp* [1987] 3 All ER 137.

99 *Mercantile Credits Ltd v Foster Clark (Aust) Ltd* (1964) 112 CLR 169.

100 Section 582(3) of the *Corporations Act*. If the foreign company has been dissolved in its place of incorporation it will be treated as though it is still in existence and subject to existing rights and obligations which can be enforced on its behalf or proved against it (unless the debts have been discharged according to their proper law or confiscated according to the law of the place where the debts are located: *Russian and English Bank v Baring Bros & Co Ltd* [1936] AC 405; *TM Burke Estates Pty Ltd v PJ Constructions (Vic) Pty Ltd* [1991] 1 VR 610; (1990) 1 ACSR 743).

appointment of a liquidator in the foreign company's home jurisdiction may be a reason for an *Australian court* to decline to order a local winding up under Part 5.7.[101] Furthermore, if an *Australian court* has recognised the winding up of a foreign company under the laws of its home jurisdiction as being the "foreign main proceeding" for the purposes of the *Model Law*,[102] then a winding up under Part 5.7 may be commenced only if the foreign company has assets located in Australia and the effect of the winding up will be restricted to those Australian assets.[103]

Where a foreign company is wound up under Part 5.7, the local winding up is governed by Australian insolvency law even though there may be a liquidation in the place of incorporation of the foreign company.[104] While under Part 5.7 the court has discretion in determining whether to wind up a foreign company, if there are assets in Australia, a creditor has a prima facie right to a winding up order if the grounds for jurisdiction are established.[105]

A local liquidator appointed under Part 5.7 would endeavour to wind up the foreign company, in effect, as though it were an Australian-incorporated company. Hence, claims of creditors which are given priority under Australian insolvency law may be admitted in the same way as in a local liquidation of an Australian-incorporated company. The usual Australian insolvency rules apply such that ordinary creditors, wherever they are and wherever the debts were contracted, share equally in the funds, if any, remaining after realisation of assets and distribution to preferred creditors.[106]

In our opinion, if foreign liquidation proceedings have been commenced in the foreign company's home jurisdiction, it is unlikely that a liquidator would be appointed under Part 5.7. That is because a successful Part 5.7 application in those circumstances would result in competing insolvencies of the same foreign company where more appropriate statutory arrangements exist specifically to deal with those circumstances (namely, the letter of request and ancillary liquidation procedures). However, the *Model Law* does contain provisions that address the existence of concurrent foreign and Australian insolvency proceedings, including in circumstances where the foreign proceeding is subject to an application for recognition or has been recognised under *Australian law*. Additionally, we note that nothing in Article 20 of the *Model Law* prevents a local insolvency proceeding from being commenced.[107]

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[101] *Re The New England Brewing Co Ltd* [1970] QWN 123.

[102] It is likely that a winding up of a foreign company that is taking place in the jurisdiction in which the foreign company's registered office is located will be recognised as the "foreign main proceeding" for the purposes of the *Model Law*. This is because, under Article 17(2)(a) of the *Model Law*, a foreign insolvency proceeding to which the *Model Law* applies will be recognised by an *Australian court* as the "foreign main proceeding" if it takes place in the jurisdiction in which the foreign company has its "centre of main interests". In the absence of evidence to the contrary, a company's centre of main interests will be presumed to be its registered office: see Article 16(3) of the *Model Law*.

[103] Article 28 of the *Model Law*. The effect of the winding up under Part 5.7 may extend to assets of the foreign company other than those located in Australia but only to the extent necessary to implement any cooperation or coordination under the *Model Law* and only to the extent that (as a matter of *Australian law*) those other assets should be administered in the winding up.

[104] *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385; *Re Suidair International Airways Limited* [1951] 1 Ch 165; *Re Standard Insurance Co. Limited* [1968] Qd R 118.

[105] *Mercantile Credits Limited v Foster Clark (Australia) Limited* (1964) 112 CLR 169.

[106] Sections 555 and 583 of the *Corporations Act*.

[107] Chapter V of the *Model Law* deals with concurrent proceedings. Article 28 deals with commencement of proceedings under *Australian law* in respect of insolvency after recognition of a foreign main proceeding. Article 29 deals with coordinating a proceeding under a local insolvency law and a foreign proceeding where those proceedings are taking place concurrently regarding the same debtor. Article 30 deals with coordinating more than one foreign proceeding. Article 31 deals with a presumption of insolvency based on the recognition of a foreign main proceeding. Article 32 deals with a rule of payment in concurrent proceedings. See Articles 29 and 30 of the *Model Law*, which require any relief granted by an *Australian court* to a foreign

2.7 Compromise or arrangement

A foreign company that is a registrable body that is registered under the *Corporations Act* may become subject to a compromise or arrangement under Part 5.1 of the *Corporations Act*. Under this procedure, proposals between the foreign company and its creditors (or a class of them) for a compromise or arrangement in satisfaction of its debts can, if resolved by the requisite number of creditors (and sanctioned by the court), bind all its creditors (or the relevant class).

2.8 Order recognising foreign liquidation order

It is possible that a foreign liquidator could obtain an order from an *Australian court* allowing the foreign liquidator to deal with property in Australia without taking any of the seven kinds of action referred to above.

An *Australian court* would only possibly give such an order if the foreign liquidation order had actually vested the Australian property in the foreign liquidator.[108]

Even if a foreign liquidator had property vested in them, we consider it is unlikely that an *Australian court* would allow a foreign liquidator to deal with property in Australia without following one of the seven procedures we have outlined above.

insolvency official in respect of a recognised foreign proceeding to be consistent with the concurrent Australian insolvency proceeding. See also *Akers and Others v Deputy Commissioner of Taxation* (2014) 223 FCR 8, 20–24.

[108] It is clear that a foreign liquidation order will not operate to pass an interest in immovable property in Australia, whether or not that order purports to vest that property in the foreign liquidator: *AMP Society v Gregory* (1908) 5 CLR 615. However, it is unclear whether a foreign liquidation order will be given effect in Australia to the extent that it purports to divest a foreign company of its movable property and to vest that movable property in the foreign liquidator. Most authority in Australia supports the proposition that a foreign winding up order creates no enforceable property rights in respect of any property located in Australia (see *Primary Producers Bank of Australia v Hughes* (1931) 32 SR (NSW) 14 and *Sack v Lord Aldenham* (1911) 7 Tas LR 84), but this proposition is not without criticism. See for example the commentary in AD Grace, "Law of Liquidations: The Recognition and Enforcement of Foreign Liquidation Orders in Canada and Australia — a Critical Comparison" (1986) 35 *International & Comparative Law Quarterly* 664 at 685. Hence, if *Australian courts* recognised a foreign winding up order which purported to vest property in a foreign liquidator, *Australian courts* would on one view allow that liquidator to deal with movable property situated in Australia, but not with immovable property in Australia.