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The *ISDA Master Agreements* — enforceability of close-out netting against an *insolvent party*

CONTENTS

Part A **Introduction and executive summary**

1 Introduction and instructions

This legal opinion deals with the enforceability of close-out netting under the laws of various *Australian jurisdictions*.

It covers close-out netting under both the *1992 ISDA Master Agreement* and the *2002 ISDA Master Agreement*. It also deals with close-out netting where a party operates as a multibranch party. This legal opinion does not cover the *1987 ISDA Master Agreement*.

Terms appearing in *italics* have the meaning given to them in the Dictionary contained in Part L of this opinion.

Capitalised terms not otherwise defined have the meaning given to them in the *1992 ISDA Master Agreement* and the *2002 ISDA Master Agreement*, as the case may be.

2 Executive summary

On the basis of the facts we have been asked to assume and subject to the various qualifications we express, under the laws of the *Australian jurisdictions*:

(a) the termination rights and the rights flowing from an early termination which are given to the *solvent party* under either of the *Master Agreements* following the *external administration* of an *Australian company*[1] are enforceable,[2] subject to any specified stay provision which is applicable to the *Master Agreement*. A specified stay provision which applies to a *Master Agreement* will prevent the contract or a counterparty from closing out *transactions* relating to the *Master Agreement* on the grounds specified in the relevant specified stay provision. However, a specified stay provision does not prohibit the close-out *transactions* under a *Master Agreement* for any other reason. The specified stay provisions are discussed in paragraphs 2.5 and 2.6 of Part B and Part J;

(b) the conclusion in paragraph 2(a) applies whether or not:

- Automatic Early Termination is selected; or
- the *Australian company* operates as a Multibranch Party, including in one or more jurisdictions in which the rights referred to in paragraph 2(a) are not enforceable;

(c) if a foreign bank operating a branch in an *Australian jurisdiction* were to become subject to *external administration*, an *Australian court* would neither require nor permit the close-out provisions under either of the *Master Agreements* to be applied separately in relation to groups of *transactions* depending on where those *transactions* were entered into by the foreign bank. It

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[1] An *Australian company* does not include the Crown and statutory corporations organised under Australia law, private health insurers, or a company which does not have its centre of main interests in Australia for the purposes of the *Model Law*. Please refer to our qualifications set out in Part K. 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 opinion.

[2] Consideration should be given to making the termination currency Australian dollars when the *Australian company* becomes subject to *external administration* (see paragraph 4.3 below).

is not possible to advise beforehand on whether a foreign bank operating a branch in an *Australian jurisdiction* would be ordered by an *Australian court* to become subject to *external administration* — this would turn on factual matters relating to the operation of the branch in Australia.

This opinion is given in respect of entities which are within the definition of *Australian company* contained in Part L of this opinion. In summary these are companies which are registered as a company under the *Corporations Act* which have their centre of main interests (for the purposes of the *Model Law*) in Australia. This includes all *Australian banks*. Also most *life companies*, trustees of *superannuation entities*, trustees of unit trusts (including managed investment schemes), building societies, credit unions and other Australian business entities likely to be trading in derivatives are companies registered as a company under the *Corporations Act*. However, this needs to be confirmed in each case.

We set out in Appendix B (dated September 2009) further information on whether entities meeting particular descriptions would, or could, be *Australian companies*.

Although this opinion is limited to answering the specific questions asked, additional comments are also provided (eg with respect to *Master Agreements* governed by *Australian law*).

See Part K for some general assumptions and qualifications.

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Part B **Brief summary of the *Netting Act***

1 Summary

The *Netting Act* came into force in Australia on 2 July 1998 and was significantly amended in 2016. We conclude that the *Netting Act* is applicable to the *Master Agreements*. This is because we consider that such *Master Agreements* are "*close-out netting contracts*" as defined in the *Netting Act* (see paragraph 2.1).

2 Detailed reasoning

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 multi-lateral netting arrangements used by Australian clearing banks.

In this opinion we are only concerned with the effect of Part 4 of the *Netting Act* which deals with *close-out netting contracts*. These provisions have been subject to judicial interpretation[3], which we believe, together with relevant discussion in the *1998 Explanatory Memorandum,* supports our conclusions. In particular, we refer to the following statements from the *1998 Explanatory Memorandum*:

> "The Payment Systems and Netting [Act] 1998 will ... enhance legal certainty for netting in financial market transactions …
>
> Part 4 will put the following matters beyond doubt:
>
> (a) A master agreement for close-out netting is not contrary to any public policy rule against divestment on insolvency.
>
> (b) A master agreement for close-out netting can effectively make the alienation of interests under a financial markets contract subject to the netting provisions.
>
> (c) The 'single contract' approach taken in some master agreements for financial markets transactions is effective to prevent the liquidator of a failed counterparty from 'cherry-picking' by disclaiming unfavourable contracts.
>
> (d) Amounts payable in a foreign currency can be converted to Australian currency at the rate of exchange applicable at the time of close-out, and non-debt obligations can be converted to debts by being valued at the time of close-out in accordance with the financial markets contract.
>
> (e) The appointment of an administrator does not inhibit close-out netting."

[3] See, for example, *Re Opes Prime Stockbroking Limited (Administrators Appointed) (Receivers and Managers appointed)* (2008) 171 FCR 473.

2.1 What is a *close-out netting contract*?

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 multi-lateral netting arrangements used by Australian clearing banks and approved by the Reserve Bank of Australia. These other sections are inapplicable to the *Master Agreements*. 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*. After inquiry we are not aware of any such declarations or regulations.[4]

2.2 When the *Master Agreements* are *close-out netting contracts*

We consider that both the *1992 ISDA Master Agreement* and the *2002 ISDA Master Agreement* are *close-out netting contracts* for the purposes of the *Netting Act*, provided that in the case of the *1992 ISDA Master Agreement*, "Second Method" is chosen. This is important because the definition of *close-out netting contract* requires that "a net cash amount is payable". If "First Method" is chosen so that the net cash amount is only payable under the *1992 ISDA Master Agreement* if the payee is the Non-defaulting Party, then the *1992 ISDA Master Agreement* would not satisfy the definition of *close-out netting contract*.

2.3 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

[4] In addition, the *1998 Explanatory Memorandum* provides that: "It is envisaged that the Reserve Bank would make a declaration under [section] 15 in only the most exceptional circumstances".

- a net amount become payable,

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] But see paragraph 2.8.

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)(d) deals specifically with the purported creation of interests in contravention of prohibitions like Section 7 of the *Master Agreement.*

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 on 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.

2.4 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 an *Australian company* that is an *ADI*, a *life company* or a *general insurer* due to specified events, and are considered in detail in paragraph 2.6 of Part B and Part J.

[6] The term "the security" refers to a security given over financial property, in respect of obligations of a party to the contract which is considered in more detail in our *Collateral Opinion*.

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] [9] 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.[10]

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 Part D, paragraphs 3.5 and 3.6).

2.5 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 *Master Agreement*. 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 discussed in the relevant specified stay provision. However, a specified stay provision does not prohibit a counterparty from closing out *transactions* under a *Master Agreement* for any other reason. The specified stay provisions are considered in Part J and paragraph 2.6 below.

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[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* 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*. The term "the security" refers to a security given over financial property, in respect of obligations of a party to the contract, and is considered in more detail in our *Collateral Opinion*.

[9] 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.

[10] *2016 Explanatory Memorandum*, [1.124].

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*);
- 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* 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.*[11] 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 an *ADI*, *general insurer*, or *life company* (or other specified entity) to be relieved of their obligations under that contract if the regulated entity is prevented from fulfilling its contractual obligations. In other words, the counterparty can close-out *transactions* under the contract, rather than being merely relieved of their obligations under the contract.[12]
- 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*).[13]

2.6 Specified stay provisions

To the extent the *Netting Act* would permit a party to close-out a *Master Agreement* in accordance with its terms, the protection is subject to any specified stay provision that applies to the *Master Agreement*. The "specified stay provisions" do not allow the close-out of *transactions* with an *Australian company*

[11] 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*.

[12] *2016 Explanatory Memorandum*, [1.166].

[13] *2016 Explanatory Memorandum*, [1.167].

that is an *ADI*, a *life company* or a *general insurer* due to specified events, and are considered in detail in Part J.

We expect that the most relevant "specified stay provision" in the context of the *Master Agreements* is the stay that applies on *the appointment of a statutory manager* or the *appointment of a judicial manager*.

This opinion is given on the basis that the *Master Agreements* are governed by the laws of England or the laws of New York and are not governed by Australian law. Accordingly, the construction of the rights created under them is not a question of Australian law. However, our expectation is that the *appointment of a statutory manager* or the *appointment of a judicial manager* should trigger an Event of Default under the *Master Agreements* where the Events of Defaults under the *Master Agreements* include the unamended Bankruptcy Event of Default in Section 5(a)(vii) of the *Master Agreements*, but this depends on the terms of the *Master Agreement*. In light of this, we consider the implications of the stay that applies on *appointment of a statutory manager* or the *appointment of a judicial manager* 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 *Master Agreement* for any other reason. For example, to the extent that an Event of Default or Termination Event under the relevant *Master Agreement* 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 *Master Agreement* if it has a right to do so in accordance with the terms of the *Master Agreement* due to that Event of Default or Termination Event 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 *Master Agreement* is either (i) an eligible obligation or (ii) is of another prescribed kind. We expect that an obligation under a *transaction* should fall within one of these concepts, as considered further in paragraph 3.1 of Part J.

The stay on closing-out *transactions* under a *Master Agreement* on the groups of the *appointment of a statutory manager* or the *appointment of a judicial manager* ends at midnight[14] 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 the *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 party in respect of which the declaration will be made (that party being the *ADI*, the *life company* or *general insurer* in this context) as set out in paragraph 3.3 of Part J. The *2016 Explanatory Memorandum* explained that these matters:

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

> "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."[15]

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 *Master Agreement* 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 J.

2.7 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 constitution of Australia. Section 14 of the *Netting Act* was drafted with the intention that it only applies to *close-out netting contracts* which can be regulated pursuant to the Commonwealth's constitutional power.

2.8 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 *Master Agreements* governed by New York, English or another non-Australian law.

Where Australian law governs a *Master Agreement*, it is also necessary for the *Master Agreement* to fall within "Commonwealth constitutional reach" for section 14(1) to be applicable. One of the circumstances which satisfies the requirement for a *Master Agreement* 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".[16] 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.[17] 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

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[15] *2016 Explanatory Memorandum*, [1.236] (footnote omitted).

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

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

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). In this context, we note that the list of counterparty types referred to in the Executive Summary in paragraph 2 of Part A above would each fall within this limb.

Although it is ultimately a matter of fact (and consideration of the relevant constitutional law), we consider that a *Master Agreement* would rarely be entered by parties which did not include a foreign corporation or an Australian trading or financial corporation (particularly due to the types of *transactions* which are to be governed by a *Master Agreement*).

2.9 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 *Master Agreements*, 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 of the opinion below.

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.

Although this issue is not raised by the question asked of us, if the *Master Agreement* were to be governed by Australian law, the *Netting Act* will, as a matter of *Australian law*, apply to the *Master Agreement* where foreign parties are involved and to *external administration* proceedings outside Australia governed by foreign law. However, the applicability of the *Netting Act* to proceedings conducted in a foreign jurisdiction will be determined by the conflicts of law rules in the foreign jurisdiction.

2.10 Retroactivity of the *Netting Act*

Subject to the paragraph below, the *Netting Act* has effect in respect of any netting under a *Master Agreement* which takes place after 2 July 1998.[18] This is the case even where the *Master Agreement*

[18] 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 2.4 of Part B and 3.7 of Part D.

is a *1992 ISDA Master Agreement* which was entered into prior to this date. However, the *Netting Act* will not affect netting which took place prior to 2 July 1998.[19]

2.11 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 the *Master Agreements*.

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)*:
>
> - an approved netting arrangement;
> - a close-out netting contract;
> - 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 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*.

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[19] 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 *Master Agreement* and the *Netting Act* has the effect of terminating that obligation and, as a result, the third party's interest.

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 the *Master Agreements* 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*.

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

1 Summary

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 *Master Agreements* following the initiation of any insolvency proceedings under *Australian law*.

2 Detailed reasoning

2.1 Definition of *external administration*

Under the *Netting Act*, an *Australian company* goes into *external administration* if, relevantly:

(a) they become a body corporate that is an externally administered body corporate within the meaning of the *Corporations Act*;[20]

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

(c) an *ADI* statutory manager takes control of the *Australian company*'s business under the *Banking Act*;

(d) the *Australian company* comes under judicial management under the *Insurance Act*; or

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

2.2 *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*;

(f) *appointment of a judicial manager* to a *life company*;

(g) *appointment of a judicial manager* to a *general insurer*; and

[20] The reference to "an externally administered body corporate" in section 5 of the *Netting Act* will be replaced by a reference to "a Chapter 5 body corporate" on commencement of the relevant part of the *Insolvency Law Reform Act 2016* (Cth).

(h) 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* of the superannuation entity is insolvent, or is likely to become, insolvent.

These proceedings are described in paragraph 1 of Part I.

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 applicable on the occurrence of each of these proceedings.

2.3 Insolvency proceedings applicable to a foreign company

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

(a) proceedings under the *Model Law*;

(b) letter of request;

(c) ancillary liquidation;

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

(e) compromise or arrangement with creditors; and

(f) order recognising foreign liquidation order.

These proceedings are described in paragraph 2 of Part I.

Each of the insolvency proceedings referred to above also 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.

2.4 *Life companies*, *general insurers* and trustees of *superannuation entities*

If the *Australian company* is a *life company* or a *general insurer* it may also become subject to judicial management under the *Life Insurance Act* or the *Insurance Act* (respectively). If the *Australian company* is a trustee of a *superannuation entity*, it may be suspended or removed as trustee of the *superannuation entity* and an acting trustee appointed to take control of the *superannuation entity*. We consider that each of these proceedings falls within the definition of "*external administration*" in the *Netting Act*.[21] 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.

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[21] In the case of a trustee of a *superannuation entity*, the appointment of an acting trustee because the trustee of the *superannuation entity* is, or is likely to become, insolvent, will fall within the definition of "*external administration*". However, 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 1.8 of Part I.

Part D **Close-out netting under the *Master Agreements***

1 Assumptions relevant to questions 1–5

We have been asked to assume the following facts:

(a) Two institutions - each of which is either (i) a corporation, or (ii) a bank or other similar financial institution and one of which is an *Australian company*[22] - enter into a *Master Agreement*. The *Master Agreement* is governed by New York Law or English law. Neither institution has specified that the provisions of Section 10(a) apply to it.

(b) Provisions of the *Master Agreement* that we deem crucial to our opinion have not been altered in any material respect (we have been asked to state, if accurate, that any selections contemplated by Sections 5 and 6 of the *Master Agreement* and made pursuant to a Schedule to the *Master Agreement* or in a Confirmation of a *transaction* would not be considered material alterations).

> **King & Wood Mallesons comment:** It is crucial to our opinion that Sections 6(c) and 6(e) have not been altered. Selections of the type referred to in (b) above do not affect our conclusions.

(c) On the basis of the terms and conditions of the *Master Agreement* and other relevant factors, and acting in a manner consistent with the intentions stated in the *Master Agreement*, the parties over time enter into a number of *transactions* that are intended to be governed by the *Master Agreement*.

(d) Some of the *transactions* provide for an exchange of cash by both parties and others provide for the physical delivery of shares, bonds or commodities in exchange for cash.

(e) After entering into these *transactions* and prior to the maturity thereof, the *Australian company* becomes the subject of *external administration* and, subsequent to the commencement of the *external administration*, either the *Australian company* or an *external administrator* seeks to assume the Confirmations representing profitable *transactions* for the *Australian company* and reject the Confirmations representing unprofitable *transactions* for the *Australian company*.

(f) If the *Master Agreement* is a *1992 ISDA Master Agreement*, that the parties have amended it so that they have adopted the approach of Full Two Way Payments for all Events of Default (called the Second Method in the *1992 ISDA Master Agreement*) as well as Termination Events. Therefore, the enforceability of Limited Two Way Payments (called the First Method in the *1992 ISDA Master Agreement*) should not be analysed. It should be noted that under the *2002 ISDA Master Agreement*, First Method was eliminated, leaving only the Second Method in the *2002 ISDA Master Agreement* (although it is not referred to as such).

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[22] This opinion is given in respect of entities which are within the definition of *Australian company* contained in Part L of this opinion. In summary these are companies which are registered as a company under the *Corporations Act* or a company which does not have its centre of main interests in Australia for the purposes of the *Model Law*. This includes all *Australian banks*. Also, most life companies, trustees of superannuation entities, trustees of unit trusts (including managed investment schemes), building societies, credit unions and other Australian business entities likely to be trading in derivatives are companies registered as a company under the *Corporations Act*. However, this needs to be confirmed in each case. An *Australian company* does not include the Crown and statutory corporations organised under Australia law. Please refer to our qualifications set out in Part K.

2 Questions 1 and 2

2.1 Questions

(a) Assuming the parties have not selected Automatic Early Termination upon certain insolvency events to apply to the *insolvent party*, are the provisions of the *Master Agreements* permitting the *solvent party* to terminate all the *transactions* upon the *external administration* of the *insolvent party* enforceable under *Australian law*?

(b) Assuming the parties have selected Automatic Early Termination upon certain insolvency events to apply to the *insolvent party*, are the provisions of the *Master Agreements* automatically terminating all the *transactions* upon the *external administration* of the *insolvent party* enforceable under *Australian law*?

2.2 Summary

We propose to deal with Questions 1 and 2 together because they are both concerned with the fundamental issue of whether *transactions* can be terminated following *external administration*. The difference between Questions 1 and 2 is the means by which they are terminated (ie automatically or by the Non-defaulting Party).

Our conclusion is that *transactions* can be terminated either automatically or by the *solvent party* following *external administration*.

2.3 Detailed reasoning

The *Master Agreements* describe a number of Events of Default including failure to pay under a *transaction*, representations or warranties becoming incorrect and an insolvency event occurring.

The termination of *transactions* under a *Master Agreement* following an Event of Default will be enforceable following the *external administration* of the *insolvent party*, subject to any specified stay provision that applies to the *Master Agreement*, as considered in detail in paragraph 2.6 of Part B and Part J. This right to terminate is expressly permitted under section 14(2)(c) of the *Netting Act*.

The provision for Automatic Early Termination is equally enforceable, subject to the application of the specified stay provisions, but unnecessary. We consider it is preferable not to provide for Automatic Early Termination because non-automatic early termination gives greater control to the *solvent party* to ensure that its actual profit or loss on close-out is reflected in the amount payable under the *Master Agreement*.

In **summary** therefore we have concluded that the termination of the *transactions* under a *Master Agreement* would be enforceable on the *external administration* of the *insolvent party* whether the termination occurs automatically or by the *solvent party*.

3 Question 3

3.1 Question

Are the provisions of the *Master Agreements* providing for the netting of termination values in determining a single lump-sum termination amount upon the *external administration* of an *insolvent party* enforceable under the *Australian law*?

3.2 Summary

Yes, subject to the application of the "specified stay provisions".

Our detailed reasoning is set out in paragraphs 3.3 – 3.7 below.

3.3 Calculating amounts payable on close-out

The *Master Agreements* provide that if a *transaction* is terminated, a "Market Value" or "Loss" for the terminated *transaction* must be calculated.

Under the *1992 ISDA Master Agreement* if "Market Quotation" is chosen in the Schedule to be applicable, this amount represents the cost or profit to the *solvent party* to enter into another *transaction* that would have the effect of preserving the economic equivalent of the future payment obligations under the original *transaction* had termination not occurred. It is calculated as an average of offers made by other institutions involved in the market for *transactions* of the type terminated.

The *1992 ISDA Master Agreement* also provides an alternative method of calculating profit or loss which can be selected in the Schedule and which applies if market quotations cannot be obtained. The amount equals the profit or loss of the *solvent party* arising or incurred as a result of termination, as determined by the *solvent party* in good faith.[23]

The calculation of termination values under the *1992 ISDA Master Agreement* in respect of the terminated *transactions* under the *1992 ISDA Master Agreement* following an Event of Default will be enforceable following the *external administration* of an *insolvent party*,[24] subject to the application of the "specified stay provisions."[25] This calculation of termination values is expressly permitted under section 14(2)(c) of the *Netting Act.* The *1998 Explanatory Memorandum* states that the *Netting Act* will not apply to contracts where the mechanism for the calculation of the termination value does "not reflect any attempt to calculate the true termination value of the obligation under consideration." We consider that the *1992 ISDA Master Agreement* does reflect an attempt to calculate the true termination value of the *transactions*.

Of critical importance in the *2002 ISDA Master Agreement* is the definition of Close-out Amount. In broad terms, the Close-out Amount is the amount of losses (or gains) of the party determining the Close-out Amount that are or would be realised under then prevailing circumstances in replacing the economic equivalent of the material terms of the terminated *transactions* that would, but for termination, have been required after that date and the option rights of the parties in respect of the terminated *transactions*. Responsibility for calculating the Close-out Amount rests with the Determining Party, who is required to act in good faith and use "commercially reasonable procedures" in order to produce a "commercially reasonable result." In addition, the Determining Party may consider "quotations (either firm or indicative) for replacement *transactions*" supplied by one or more

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[23] There may be minor discrepancies between the two methods because a "mark-to-market" valuation is not generally calculated by reference to quotes from other institutions. Rather it is calculated by reference to a rate decided on as being the prevailing market rate by the institution doing the calculation. However, the concept is the same. Both methods aim to preserve the economic equivalent of the future payment obligations under the original contract.

[24] We consider that the termination calculation will be enforced where the Loss method is specified provided the method used is a reasonable pre-estimate of loss. This is a matter of fact which will be determined by a court. Therefore parties would need to be careful in making such a calculation.

[25] The "specified stay provisions" do not allow the close-out of *transactions* with an *Australian company* that is an *ADI*, a *life company* or a *general insurer* due to specified events, and are considered in detail in paragraph 2.6 of Part B and in Part J.

third parties or, alternatively, relevant market data supplied by one or more third parties and relevant market data in the relevant market.

The calculation of a Close-out Amount under the *2002 ISDA Master Agreement* in respect of the terminated *transactions* under the *2002 ISDA Master Agreement* following an Event of Default will be enforceable following the *external administration* of an *insolvent party*. This calculation of termination values is expressly permitted under section 14(2)(c) of the *Netting Act*. As noted above, the *1998 Explanatory Memorandum* states that the *Netting Act* will not apply to contracts where the mechanism for the calculation of the termination value does not reflect any attempt to calculate the true termination value. We consider that the *2002 ISDA Master Agreement* does reflect an attempt to calculate the true termination value of the *transactions*.

A decision of the Supreme Court of New South Wales on the meaning of "Market Quotation" under the *1992 ISDA Master Agreement* may mean that the choices made in calculating a replacement value or a Close-out Amount may be subject to challenge in the case of *Master Agreements* governed by *Australian law*.[26] The case involved electricity derivatives entered into in Australia within an electricity market that was known for its illiquidity.

The key issue in the case was whether the *1992 Master Agreement* in question required Reference Market-makers in furnishing quotations either:

- to strive to determine or assess the **market value** of a replacement transaction, or
- to provide a figure which they considered to be the amount which, if the dealer were quoting on the Early Termination Date, that dealer would **quote** to be prepared to enter that transaction.

The Supreme Court held that the phrase "that would be paid" appearing in the definition of Market Quotation suggested that the 'market value' interpretation was the most appropriate in this context. The price to be determined was therefore that which "a willing, but not anxious, buyer would pay a willing, but not anxious seller" rather than a price on the side of the bid/offer spread.

In our view, there are strong arguments that the case has been wrongly decided. The decision was to be appealed. However, the parties involved settled the matter prior to the appeal being heard. As a result, there is a risk that the decision could be relied on in the future as support for an interpretation of Market Quotation under the *1992 ISDA Master Agreement* that stresses market value. However, it is important to note that the decision does not mean that participants should interpret *1992 ISDA* Master *Agreements* governed by *Australian law* as requiring uniform quotations at the midpoint of the spread. Obiter dictum in the case suggest that in a different fact scenario (ie where there is a liquid market and where quotes are obtained from dealers as opposed to independent experts) quotes on the side of the spread may be acceptable.

The definition of Market Quotation contained in the *1992 ISDA Master Agreement* has been replaced in the *2002 ISDA Master Agreement* by the definition of Close-out Amount discussed above. In our view, there is a greater risk that an *Australian court* would follow the approach taken by the Supreme Court of New South Wales in relation to a *2002 ISDA Master Agreement* governed by *Australian law* than it would in relation to the *1992 ISDA Master Agreement* governed by *Australian law*. Accordingly, in respect of *2002 ISDA Master Agreements* governed by *Australian law*, we suggest that parties

[26] *Enron Australia Finance Pty Limited (in liquidation) v Integral Energy Australia* [2002] NSWSC 753.

consider inserting the following wording into the definition of Close-out Amount to reduce the risk of the construction adopted in *Enron* being applied:

> "A Close-out Amount is not required to be the market value of the Terminated Transaction or group of Terminated Transactions and the Determining Party is not obliged to use mid-market quotations or mid-market valuations in determining a Close-out Amount." [27]

In **summary** therefore we have concluded that:

- the Market Quotation and Loss concepts in the *1992 ISDA Master Agreement* would be enforceable under *Australian law*; and
- the Close-out Amount concept in the *2002 ISDA Master Agreement* would be enforceable under *Australian law*,

provided the calculation arrived at may be properly characterised as a bona fide and genuine pre-estimate of loss.

3.4 Contractual netting rights

The *Master Agreements* require a process to be followed to determine an overall amount payable by one party to the other following early termination.

First, an amount is calculated equal to, in the case of the *1992 ISDA Master Agreement*, the Settlement Amount or, in the case of the *2002 ISDA Master Agreement*, the **sum** of the Termination Currency Equivalent of the Close-out Amount(s) (whether positive or negative) for each Terminated Transaction (or group of Terminated Transactions). The Settlement Amount (if Market Quotation is applicable) is the sum of the Termination Currency Equivalent of the Market Quotations values of the terminated *transactions* or (if Loss is applicable) the loss (less any profit) of the *solvent party* arising or incurred as a result of termination as determined by the *solvent party* in good faith.

Secondly, other than where Loss is applicable under the *1992 ISDA Master Agreement*, this amount is aggregated with the Termination Currency Equivalent of the Unpaid Amounts. Unpaid Amounts are amounts which became due for payment under a *transaction* before it is terminated, or which would have become due and payable on or prior to such termination date but for the designation of a termination date and remain unpaid as at such termination date (they may also include interest on those amounts). We consider that the calculation of the Termination Currency Equivalent of the Unpaid Amounts would be the calculation of the termination values of the obligations the Unpaid Amounts represent for the purposes of the *Netting Act*.

The aggregation of the Settlement Amount or the Close-out Amount (as applicable) and the Unpaid Amount is the netting of the termination values of obligations that have been terminated. This netting of termination values under the *Master Agreements* in respect of the Settlement Amount or the Close-out Amount (as applicable) and the Unpaid Amounts (as applicable) under the *Master Agreements* following an Event of Default will be enforceable following the *external administration* of the *insolvent*

[27] If parties wish to contractually reduce the risk of the construction adopted in *Enron* being applied to a *1992 ISDA Master Agreement* governed by *Australian law* (despite the strong arguments that the *Enron* decision is incorrect) then wording could be included in a *1992 ISDA Master Agreement* which is of similar effect to this wording.

party. This netting of termination values is expressly permitted under section 14(2)(c) of the *Netting Act.*

3.5 What circumstances could affect the availability of section 14(2) of the *Netting Act*?[28] — Section 14(4) of the *Netting Act*[29]

Under section 14(4), a person may not rely on the application of section 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
- 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.[30]

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*.

3.6 What circumstances could affect the availability of section 14(2) of the *Netting Act*? — Section 14(5) of the *Netting Act*[31]

Section 14(5) of the *Netting Act* provides that section 14(2) of the *Netting Act* does 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

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[28] The unavailability of the *Netting Act* in respect to a *Master Agreement* 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 3.7(c) below).

[29] This would also affect the availability of section 14(1) of the *Netting Act*.

[30] *2016 Explanatory Memorandum*, [1.174].

[31] This would also affect the availability of section 14(1) of the *Netting Act*.

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

(iii) 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*, the *solvent party* 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" 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) the *solvent party* 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.

3.7 What circumstances would not affect the availability of section 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 *Master Agreements* do not prevent netting and termination conducted in accordance with the *Master Agreements*.

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.[32] 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.[33]

(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 *Master Agreements* and would 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*.[34]

(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 separate *close-out netting contracts* 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 *Master Agreements* must be a valid contract. As a result, issues such as the power of trustees to enter into the *Master Agreements* will still be relevant as will other issues such as compliance by directors with their fiduciary duties in entering into *Master Agreements*.

(d) **Any other laws**

Section 14(3) of the *Netting Act* provides that section 14(2) has 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 *Master Agreement*.

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[32] 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, and is considered in more detail in our *Collateral Opinion*. 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.

[33] *2016 Explanatory Memorandum*, [1.124].

[34] 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 "specified provisions" are considered in detail in paragraph 2.5 above, and include sections of the *Banking Act* which provide for the priority depositors with an *Australian bank or other authorised deposit-taking institution* have in respect of the entity's assets in Australia. This means that netting under the *Netting Act* operates ahead of any priority given to depositors under the *Banking Act*. This is explained further in paragraph 2.5 of Part B.

The "specified stay provisions" do not allow the close-out of *transactions* with an *Australian company* that is an *ADI*, a *life company* or a *general insurer* due to specified events, and are considered in detail in paragraphs 2.5 and 2.6 of Part B and Part J.

4 Question 4

4.1 Question

Assuming the parties have entered into either a *1992 ISDA Master Agreement* or a *2002 ISDA Master Agreement*, one of the parties is an *insolvent party* and the parties have selected a Termination Currency other than Australian dollars, will the payment of the net termination amount in that termination currency be provable in the *external administration* of the party without conversion into the local currency?

4.2 Summary

Although the net termination amount may be calculated in a foreign currency, for the reasons set out below, we recommend that the Termination Currency on the *external administration* of the *insolvent party* should be Australian dollars.

4.3 Detailed reasoning

The definition of "close-out netting contract" in section 5 of the *Netting Act* makes specific reference to the fact that the net amount owing may be in a currency other than Australian currency. Section 14(2)(c) provides that the net amount is payable "in accordance with the contract". On this basis the calculation of the termination amount in a currency other than Australian dollars under the *Master Agreements* will be enforceable (subject to the discretion of an *Australian court* to award judgments in Australian dollars in lieu of a foreign currency - see paragraph 5).

In addition, section 14(2)(e) of the *Netting Act* provides that any net obligation owed by a party under the *close-out netting contract* is provable in the *external administration* of the party. Section 14(2)(f) of the *Netting Act* provides that any net obligation owed to a party under *external administration* may be recovered by the *external administrator* for the benefit of the creditors of the party. Subject to the discretion of an *Australian court* to award judgements in Australian dollars, this would imply that the net amount calculated in a currency other than Australian dollars is also provable in the *external administration* of an *insolvent party*. However, such proof would result in significant practical difficulties for a liquidator in ensuring the payment of creditors on a pari passu basis.[35]

For this reason, we consider that if the Termination Currency is not Australian dollars, then section 554C of the *Corporations Act* will be relevant. Section 554C of the *Corporations Act* requires debts to

[35] As stated by Lord Hoffmann in *Stein v Blake* [1996] 1 AC 243, there is a "general principle of bankruptcy law, which governs payment of interest, conversion of foreign currencies etc., that the debts of the bankrupt are treated as having been ascertained and his assets simultaneously distributed among his creditors on the bankruptcy date".

be proved in a liquidation in Australian dollars at the "relevant date" (which is generally the day the winding up order is made but can be earlier) at either an agreed rate or, in the absence of agreement, a rate set out in the section. This means that the resulting net termination amount will have to be converted into Australian dollars for the purposes of proof at the rate provided for in section 554C applying at the "relevant date".

Accordingly, if a party wants to avoid the operation of section 554C (and instead rely on the contractual provisions in the *Master Agreements* for the time and manner of conversion into Australian dollars), it is recommended that the termination currency when the *Australian company* becomes subject to *external administration* should be Australian dollars.

5 Question 5

5.1 Question

Assuming the parties have entered into either a *1992 ISDA Master Agreement* or a *2002 ISDA Master Agreement*, one of the parties is an *insolvent party* and the parties have selected a Termination Currency other than Australian dollars, would an *Australian court* enforce a claim for the net termination amount in the Termination Currency?

5.2 Summary

As a general matter, yes. However, this may not be the case in all circumstances.

5.3 Detailed reasoning

Foreign judgments are enforceable in the *Australian jurisdictions* if registered in accordance with the *Foreign Judgments Act* or *TTPA*, or if recognised at common law.

The *Foreign Judgments Act* permits the enforcement of judgments given by the superior and specified inferior courts in the jurisdictions named in regulations made pursuant to the *Foreign Judgments Act*.[36]

A judgment given by such a foreign court of a named jurisdiction that is:

- enforceable in that jurisdiction; and
- a final and conclusive unsatisfied judgment for an amount of money (excluding amounts in respect of taxes, fines or penalties),

will be enforceable in the Supreme Court of an *Australian jurisdiction* by registration under the *Foreign Judgments Act,* and if denominated in a foreign currency, may be registered and then enforced in that currency. However, a judgment given by a court of New Zealand is only registrable under the *Foreign Judgments Act* if it is given before 11 October 2013.

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[36] At present, the *Foreign Judgments Act* extends to the superior courts and specified inferior courts of: New Zealand (including specified inferior courts); Province of Alberta, Canada (including specified inferior courts); The Commonwealth of the Bahamas; Province of British Columbia, Canada (including specified inferior courts); British Virgin Islands; Cayman Islands; Commonwealth of Dominica; Falkland Islands; Republic of Fiji; France (French Republic); Federal Republic of Germany; Gibraltar; Grenada; The Hong Kong Special Administrative Region of the People's Republic of China; State of Israel; Italy (Italian Republic); Japan; Republic of Korea; Malawi; Province of Manitoba, Canada (including specified inferior courts); Montserrat; Papua New Guinea; Republic of Poland (including specified inferior courts); St Helena; Federation of St Kitts and Nevis; St Vincent and the Grenadines; Republic of Seychelles; Republic of Singapore; Solomon Islands; Sri Lanka; Switzerland (including specified inferior courts); Taiwan; Tonga; Tuvalu; The United Kingdom (including specified inferior courts); and Western Samoa.

Under the *TTPA*, a judgment of a superior court of New Zealand against an *Australian company* that is given on or after 11 October 2013 and is:

- enforceable in that jurisdiction; and
- for a final and conclusive unsatisfied judgment,[37]

will be enforceable in the Supreme Court of an *Australian jurisdiction* by registration under the *TTPA*, and if denominated in a foreign currency, may be registered and then enforced in that currency.

A foreign judgment that is not able to be registered under either the *Foreign Judgments Act* or the *TTPA* may be enforced in the *Australian jurisdictions* if it is recognised at common law. In these circumstances, it may be necessary to establish that the foreign judgment:

- is enforceable in that jurisdiction; and
- a final and conclusive unsatisfied judgment for a fixed and readily calculable amount of money (excluding amounts in respect of taxes, fines or penalties).

In respect of a judgment recognised at common law, whilst it is now established that an *Australian court* has power to award a judgment in a foreign currency, it is less clear when it will do so and what rate of exchange of the foreign currency into Australian dollars applies.[38]

We express no opinion as to whether:

- a court will give effect to a choice of laws to govern the *Master Agreement* to the extent that the choice of laws applies to non-contractual obligations arising out of, or in connection with, the *Master Agreement* (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
- a foreign judgment in relation to a non-contractual obligation would be enforced in the *Australian jurisdictions*.

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[37] While the *Foreign Judgments Act* largely only applies to monetary judgments, the *TTPA* allows for the registration of both monetary judgments and specific performance judgments.

[38] See the authorities cited in *Who Ya Gonna Call Bark Busters Pty Ltd v Brooke* (2013) 16 DCLR (NSW) 366.

Part E **Close-out netting for Multibranch Parties**

1 Assumptions applicable to questions 6, 7 and 8

We have been asked to assume the same facts as set forth in assumptions (a) to (f) of paragraph 1 of Part D above (as applicable) with the following modifications:

(a) For Questions 6 and 8 set forth in paragraphs 2 and 5 below, we assume that an *Australian bank* has entered into a *Master Agreement* on a multibranch basis pursuant to Section 10(a). The *Australian bank* then has entered into *transactions* under the *Master Agreement* through its head office in Australia and also through one or more branches located in other countries that had been specified in the Schedules to the *Master Agreement*. After entering into these *transactions* and prior to the maturity thereof, the *Australian bank* becomes the subject of *external administration*.

(b) For Questions 7 and 8 set forth in paragraphs 3, 4 and 5 below, we assume that a bank ("*Bank F*") organised and with its headquarters in a country ("*Country H*") other than Australia has entered into a *Master Agreement* on a multibranch basis pursuant to section 10(a). *Bank F* then has entered into *transactions* under the *Master Agreement* through its head office and also through one or more branches located in other countries that had been specified in the Schedules to *Bank F's Master Agreement*, including a branch of *Bank F* located in the *Australian jurisdictions* and therefore subject to *Australian law* (the "*Australian branch*"). After entering into these *transactions* and prior to the maturity thereof, *Bank F* becomes the subject of a voluntary or involuntary proceeding under the insolvency laws of *Country H*.

(c) For Question 8 set forth in paragraph 5 below, we have assumed two scenarios:

Scenario 1: There is an *external administration* in Australia applying to an *Australian bank* which has acted as a multi-branch party booking *transactions* through its home branch and one or more branches located in jurisdictions where close-out netting may not be enforceable ("*non-netting branches*").

Scenario 2: There is an *external administration* in Australia in relation to the *Australian branch* of *Bank F*. *Bank F* has acted as a multi-branch party booking *transactions* through its home office, its *Australian branch* and one or more *non-netting branches*.

2 Question 6

2.1 Question

Would there be any change in the conclusions concerning the enforceability of close-out netting under the *Master Agreements* based upon the fact that the *Australian bank* has entered into *Master Agreements* on a multibranch basis and then conducted business in that fashion prior to its *external administration*?

2.2 Summary

No.

2.3 Detailed reasoning

Under *Australian law*, it is well established that branches are not separate and distinct legal entities, but are branches of a single corporate entity.[39]

As a result, the *Master Agreements* will form one contract covering each of the branches of the *Australian bank*. The *Netting Act* will apply to the *Master Agreements* as a single *close-out netting contract* notwithstanding that the obligations terminated under it were entered into in various jurisdictions.

However, the enforceability of the *Netting Act* outside the *Australian jurisdictions* will be a matter of the local law in those jurisdictions.

3 Question 7(a)

3.1 Question

Would there be a separate proceeding in the *Australian jurisdictions* with respect to the assets and liabilities of the *Australian branch* upon the start of the insolvency proceeding for *Bank F* in *Country H*? Or would the relevant authorities in Australia defer to the proceedings in *Country H* so that the assets and liabilities of the *Australian branch* would be handled as part of the proceeding for *Bank F* in *Country H*? Could local creditors of the *Australian branch* initiate a separate proceeding in Australia even if the relevant authorities in Australia did not do so?

3.2 Summary

The answer to the first two of these questions is - yes, possibly. The answer to the third is - yes, but unlikely to succeed.

Assuming that *Bank F* is an *ADI*, we think the most likely result will be that either:

(a) an *Australian court* would empower the foreign liquidator, under a letter of request mechanism, to exercise the powers available to an Australian liquidator; or

(b) an *Australian court* would make an ancillary liquidation order on the application of the foreign liquidator (this assumes that the *Bank F* is a "registered foreign company" under the *Corporations Act*).[40]

The final result (assuming the pre-condition of the second option is met) will probably depend on the extent and nature of the assets in Australia.

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[39] *Prince v Oriental Bank Corp* (1878) 3 App Cas 325 at 331; G Burton, PM Weaver, AL Tyree and R Sofroniou, *The Law Relating to Banker and Customer in Australia* (Thomson Reuters, 3rd ed, at 3 November 2016) [2.7600]. There are some specific exceptions to this general rule in relation to certain payment instruments and taxation matters, but no exceptions of relevance to the present issue.

[40] We think that an *Australian court* will follow the approach taken by the English courts in an ancillary winding up. This approach has been recently restated in *Re Bank of Credit and Commerce International SA* (No. 10) (1997) 2 WLR 172. Scott V.C. stated that: "the ancillary character of (the local) winding up does not relieve (the local) court of the obligation to apply (local) law, including (local) insolvency law, to the resolution of any issue arising in the winding up which is brought before the court. It may be, of course, that (local) conflicts of law rules will lead to the application of some foreign law principle in order to resolve a particular issue".

3.3 Detailed reasoning

The types of action under *Australian law* that are possible when insolvency proceedings are commenced in the home jurisdiction of a foreign bank having an *Australian branch* are referred to in paragraph 2.3 of Part C.

4 Question 7(b)

4.1 Question

If there would be a separate proceeding in the *Australian jurisdictions* with respect to the assets and liabilities of the *Australian branch*, would the *external administrator* and the *Australian courts*, on the facts above, include *Bank F's* position under *Master Agreements*, in whole or in part, among the assets of the *Australian branch* and, if so, would the *external administrator* and the *Australian courts* recognise the close-out netting provisions of the *Master Agreements* in accordance with their terms? The most significant concern would arise if an *external administrator* or an *Australian court* considering a single *Master Agreement* would require a counterparty of the *Australian branch* of *Bank F* to pay the mark-to-market value of *transactions* entered into with the *Australian branch* to the *external administrator* of the *Australian branch* while at the same time forcing the counterparty to claim in the proceedings in *Country H* for its net value from other *transactions* with *Bank F* under the same *Master Agreement.* In considering this issue, please assume that close-out netting under the relevant *Master Agreement* would be enforced in accordance with its terms in the proceeding for *Bank F* in *Country H*.

4.2 Summary

An *external administrator* appointed under *Australian law* would be bound by the *Netting Act* and, as a result, the close-out provisions of the *Master Agreement* would be applied according to their terms.

4.3 Detailed reasoning

The *Netting Act* requires the netting under the *close-out netting contract* to be conducted in accordance with its terms. As the *external administration* would be governed by *Australian law* (see paragraphs 2.1 and 2.3 of Part C), an *Australian court* will apply the *Netting Act* and an *external administrator* could not segregate those *transactions* entered into with an *Australian branch* from the other *transactions*.

5 Question 8

5.1 Question

Where an *Australian court* has jurisdiction over the assets of an *Australian bank* or an *Australian branch* would that court enforce a multi-branch *Master Agreement* as a single unified agreement in accordance with its terms regardless of the treatment of the *Master Agreement* or *transactions* under it by an insolvency official or court in the jurisdiction of a *non-netting branch*?

5.2 Summary

An *external administrator* appointed under *Australian law* would be bound by the *Netting Act* and, as a result, an *Australian court* would enforce the multi-branch *Master Agreement* so that the close-out provisions of the *Master Agreement* would be applied according to their terms.

5.3 Detailed reasoning

The *Netting Act* requires the netting under the *close-out netting contract* to be conducted in accordance with its terms. Provided the *external administration* is governed by *Australian law,* an *Australian court* will apply the *Netting Act* and an *external administrator* could not segregate those *transactions* entered into with *non-netting branches* from the other *transactions*.

This is irrespective of the treatment of the *Master Agreement* or *transactions* under it by an insolvency official or court in the jurisdiction of a *non-netting branch*. This is because in the *external administration* proceedings of either an *Australian bank* or an *Australian branch* conducted in the *Australian jurisdictions,* the *Australian court* would be bound to apply *Australian law*.

If an insolvency administration of an *Australian bank's* assets and liabilities in a foreign country (for example, the assets and liabilities of a branch in that foreign country) were not governed by *Australian law* (for example, as a result of insolvency proceedings analogous to those described in paragraphs 2.3 Part C and 2 of Part I being commenced in relation to those assets and liabilities in that foreign country), then the applicability of the *Netting Act* would be determined by the conflict of law rules under the system of law governing that insolvency administration. However, it is arguable that an *Australian court* would not enforce a judgment or order from another jurisdiction which did not give effect to netting as it would be contrary to public policy.

* * * * * * *

Part F **Key differences between the *1992 ISDA Master Agreement* and the *2002 ISDA Master Agreement***

1 Key amendments

We have been asked to consider the following key amendments made in the *2002 ISDA Master Agreement:*

(a) Sections 5 and 6 of the *1992 ISDA Master Agreement* have been amended in several ways. Grace periods in Sections 5(a)(i), 5(a)(v) and 5(a)(vii)(4) have been reduced in length.

(b) Section 5(a)(v) has been amended so that cross-acceleration of a Specified Transaction is not sufficient to trigger an Event of Default; rather, there must be a determination that an acceleration has occurred under the documentation applicable to the relevant Specified Transactions. Thus, "mini close-outs", where fewer than all *transactions* are terminated, are not sufficient in themselves to constitute an Event of Default.

(c) Force Majeure Event has been added as an additional Termination Event in Section 5(b)(ii). While some of the changes to the *1992 ISDA Master Agreement* effected by the inclusion of a Force Majeure Event relate to Sections 5 and 6, none of the changes relate to the focus of this opinion, namely close-out netting in the event of insolvency.

(d) A single measure of damages provision, Close-out Amount, has been added in the *2002 ISDA Master Agreement*, replacing the choice that existed in the *1992 ISDA Master Agreement* between Market Quotation and Loss.

(e) A contractual set-off provision has been added as Section 6(f) of the *2002 ISDA Master Agreement.*

2 Question 9

2.1 Question

Are the conclusions reached in Part D above impacted on by the inclusion of the Force Majeure Event in the *2002 ISDA Master Agreement*?

2.2 Response

We confirm that the conclusions reached in Part D above continue to apply despite the inclusion of a Force Majeure Event. There is nothing under *Australian law* that would prohibit the enforceability of such a Termination Event in the context of the *2002 ISDA Master Agreement*. We do not comment on force majeure and impossibility issues generally under *Australian law*.

3 Question 10

3.1 Question

Are the conclusions reached in Part D above impacted on by the inclusion of the Close-Out Amount in the *2002 ISDA Master Agreement* in lieu of the prior choice between Market Quotation and Loss in the *1992 ISDA Master Agreement*?

3.2 Response

We confirm that the conclusions reached above continue to apply despite the inclusion of the Close-out Amount. Please note our discussion of Close-out Amount in paragraph 3.3 of Part D.

4 Question 11

4.1 Question

Are the conclusions reached in Part D above impacted on by the inclusion of Section 6(f) in the *2002 ISDA Master Agreement*?

4.2 Response

We confirm that the above conclusions apply despite the inclusion of Section 6(f) in the *2002 ISDA Master Agreement*, which is simply a right of set-off that is supplementary to netting and does not impact on the scope of availability of Section 6(e) netting under the *2002 ISDA Master Agreement*. We do not comment on the enforceability of Section 6(f) against an *Australian company*, including on its *external administration*, in this opinion.

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Part G *ISDA* Cross-Agreement Bridges

1 Assumptions

We assume the following facts:

(a) Either the *2001 Bridge* or the *2002 Bridge* is included in the Schedule of a *Master Agreement*.

(b) If the *Master Agreement* is a *2002 ISDA Master Agreement*, each of the *2001 Bridge* and the *2002 Bridge* have been suitably modified for inclusion in the Schedule to the *2002 ISDA Master Agreement*. For example, we note that Section 1(e) of the *2001 Bridge* and Section 1(f) of the *2002 Bridge* contemplate the relevant payment measure being Market Quotation or Loss. Although these terms are used in the *1992 ISDA Master Agreement*, they are not used in the *2002 ISDA Master Agreement*.

(c) The *Master Agreement* to which the *2001 Bridge* or *2002 Bridge* is attached gives rise to a single amount payable which can be included in the Section 6(e) calculation in the *Master Agreement*.

2 Question 12

2.1 Question

Would the inclusion of the *2001 Bridge* in the *Master Agreements* materially affect the conclusions reached in this opinion?

2.2 Response

We confirm that the conclusions in this opinion are unaffected by the inclusion of the *2001 Bridge* in the *Master Agreements*.

The *2001 Bridge* does not expressly state that the obligation to pay a net amount under a bridged agreement is a *transaction* under the *Master Agreement*. For the purposes of the *Netting Act*, it is important that obligations netted under a *close-out netting contract* are also owing under the *close-out netting contract*. Having said that, we consider that the wording contained in Section 1(d)(iii) of the *2001 Bridge* would be sufficient for this purpose.

We note that no specific provision is contained in the *2001 Bridge* to clarify that settlement of the amount owing under a bridged agreement in accordance with the *ISDA* close-out mechanism satisfies the obligation to pay that amount under the bridged agreement itself. However, this is not a matter which this opinion seeks to cover and we make no comment on this. In addition, we make no comment on the validity or enforceability of the *2001 Bridge* under *Australian law.*

3 Question 13

3.1 Question

Would the inclusion of the *2002 Bridge* in the *Master Agreements* materially affect the conclusions reached in this opinion?

3.2 Response

We confirm that the conclusions in this opinion are unaffected by the inclusion of the *2002 Bridge* in the *Master Agreements*.

Our comments in paragraph 2 above apply equally to the *2002 Bridge*, with the exception that the relevant wording is contained in Sections 1(e)(i)(C) and 1(e)(ii)(D) of the *2002 Bridge*. We make no comment on the validity or enforceability of the *2002 Bridge* under *Australian law.*

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Part H *Close-out Amount Protocol* and *June 2014 Amendment* to the *Master Agreement*

1 Question 14 — *Close-out Amount Protocol*

1.1 Question

We have been asked to consider the *Close-out Amount Protocol*. The purpose of the *Close-out Amount Protocol* is to facilitate amendment of existing *1992 ISDA Master Agreements* to replace market Quotation and (subject to the election to preserve Loss provisions) Loss, with Close-out Amount.

1.2 Response

On the assumption that the changes intended by the *Close-out Amount Protocol* are effective as a matter of the governing law of the Covered Master Agreement (as defined in the *Close-out Amount Protocol*), we confirm that the changes made by the *Close-out Amount Protocol* are not material to and do not affect the conclusions reached in Part D of this opinion. This means that the conclusions reached in Part D of this opinion in respect of the calculation of amounts payable on close-out under the *2002 ISDA Master Agreement* will apply to a *1992 ISDA Master Agreement* amended by the *Close-out Amount Protocol*.

2 Question 15 — *June 2014 Amendment* to the *Master Agreement*

2.1 Question

We have been asked to consider the amendments set out in the *June 2014 Amendment*.

2.2 Response

On the assumption that the changes intended by the *June 2014 Amendment* are effective as a matter of the governing law of the Agreement (as defined in the *June 2014 Amendment*), we confirm that the changes made by the *June 2014 Amendment* are not material to and do not affect the conclusions reached in Part D of this opinion.

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Part I **Further information on insolvency proceedings under *Australian law***

With reference to Part C, a more detailed description of the relevant insolvency proceedings follows.

1 *Australian companies*

The insolvency proceedings to which an *Australian company* may become subject under *Australian law* are:[41]

(a) Winding up;

(b) Compromise or arrangement;

(c) Administration;

(d) Appointment of a receiver;

(e) *Appointment of a statutory manager* to an *ADI;*

(f) *Appointment of a judicial manager* to a *life company*;

(g) *Appointment of a judicial manager* to a *general insurer*; and

(h) Appointment of an acting trustee to 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.

Each of these proceedings is considered in turn below.

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 winding up effected by the court (including a winding up in insolvency);
- a voluntary winding up approved by special resolution of an *Australian company's* members; or
- a winding up ordered by the Australian Securities and Investments Commission.

The *Australian company* that is being wound up falls within the definition of an externally administered body corporate in the *Corporations Act* and therefore the definition of *external administration* in the *Netting Act.*

[41] 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*.

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).

The *Australian company* that has entered into a compromise or arrangement with another person the administration of which has not been concluded falls within the definition of an externally administered body corporate in the *Corporations Act* and therefore the definition of *external administration* in the *Netting Act.*

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. Some of the moratoria relevant to creditors (including secured creditors) of an *Australian company* that is subject to administration are considered in paragraph B17 of our *Collateral Opinion*.

The *Australian company* that is under administration or that has executed a deed of company arrangement that has not yet terminated falls within the definition of an externally administered body corporate in the *Corporations Act* and therefore the definition of *external administration* in the *Netting Act.*

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 on behalf of the secured creditor 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.

The *Australian company* in respect of which a receiver, or a receiver and manager, has been appointed (whether or not by a court) and is acting falls within the definition of an externally administered body corporate in the *Corporations Act* and therefore the definition of *external administration* in the *Netting Act.*

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

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

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

(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; or

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

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

(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 financial system stability in Australia; or

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

Such control must continue until:

- the deposit liabilities of the *ADI* in Australia have been repaid (or *APRA* is satisfied that suitable provision has been made for their repayment) and *APRA* considers that it is no longer necessary for the statutory manager to remain in control of the *ADI's* business; or
- *APRA* considers that the *ADI* is insolvent and is unlikely to be returned to solvency within a reasonable time and *APRA* has applied for the *ADI* to be wound up in insolvency under the *Corporations Act*.

The 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 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 statutory manager considers appropriate.

There are restrictions on commencing or continuing court proceedings against the *ADI* while a statutory manager is in control of the *ADI*. 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.

The *appointment of a statutory manager* under the *Banking Act* falls explicitly within the definition of "*external administration*" under the *Netting Act*. However, the impact of a party's ability to close out *transactions* relating to a *Master Agreement* of:

- *the appointment of a statutory manager*; or
- the statutory manager doing an act to facilitate recapitalisation,

is considered in detail in paragraph 2.6 of Part B and Part J.

For completeness, we note that if an *ADI* becomes unable to meet its obligations or suspends payment, the assets of the *ADI* in Australia are to be available to meet the *ADI's* liabilities in the order prescribed under the *Banking Act*. However, we consider that this does not override the operation of the *Netting Act* because (as described in paragraph 2.5 of Part B) the *Netting Act* expressly provides that it is to take effect "despite any other law" (including section 13A(3) of the *Banking Act*).

1.6 *Appointment of a judicial manager* in respect of a *life company*

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*.

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*).

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:

- both:
  - the life insurance business of the company has been investigated by *APRA* (essentially, under Division 3 of Part 7 of the *Life Insurance Act*, *APRA* may investigate a company if, amongst other things, the company is, or is likely to become, unable to meet its policy or other liabilities as they become due); and
  - having regard to the results of the investigation by *APRA*, it is in the interests of the owners of policies issued by the *life company* that the order be made;
- that the time needed to complete an investigation by *APRA* would be likely to prejudice the interest of the owners of policies issued by the company, and any of the following apply:
  - the company is, or is likely to become, unable to meet its policy or other liabilities as they become due;
  - the company has failed the solvency standards prescribed by the prudential standards;
  - the company has failed to comply with a direction given by *APRA* under section 230B of the *Life Insurance Act* (this section broadly empowers *APRA* to give a company such written directions as are reasonably necessary to ensure as far as practicable, that the company will be able to meet all policies and other liabilities out of the assets of the statutory fund as they become due); or
  - there are reasonable grounds to believe that the financial position or management of the company may be unsatisfactory.

The judicial management of a *life company* (or part of the business of a *life company*) commences at the time specified in the order as the time at which the judicial management is to commence, 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*.

While a judicial manager is appointed to a *life company* (or part of the business of a *life company*) the management of the *life company* (or the management of the relevant business) vests in the judicial manager appointed by the *Australian court*.

While a *life company* (or part of the business of a *life company*) is under judicial management, a proceeding in a court against the company or in relation to its property cannot be commenced or proceeded with, without the judicial manager's written consent, or with the leave of the court.[42]

The *appointment of a judicial manager* under the *Life Insurance Act* is explicitly within the definition of "*external administration*" under the *Netting Act* where a person, or part of the person's business, comes under judicial management under the *Life Insurance Act.* However, the impact of a party's ability to close out *transactions* relating to a *Master Agreement* of:

- the *appointment of a judicial manager*; or
- the judicial manager doing an act to facilitate recapitalisation,

is considered in detail in paragraph 2.6 of Part B and in Part J.

A judicial manager may recommend and apply to the court for the winding up of the *life company* if, in its opinion, that is most advantageous to the general interest of the policy owners while promoting financial system stability in Australia. The court may then make an order to wind up the *life company* if it is satisfied that this is most advantageous to the general interest of the policy owners. *APRA* also is entitled to apply for an order that a *life company* be wound up if, as a result of an investigation under Division 3 of Part 7 of the *Life Insurance Act*, it is satisfied that it is necessary or proper. The court may then make an order to wind up the *life company* if it is satisfied that it is in the interests of the owners of policies issued by the *life company*.

Section 187 of the *Life Insurance Act* contains specific provisions dealing with the application of assets of a statutory fund in the winding up of the *life company*. However, we consider that this does not override the application of the *Netting Act* because (as described in paragraph 2.5 of Part B) the *Netting Act* expressly provides that it is to take effect "despite any other law" including section 187 of the *Life Insurance Act*.

1.7 *Appointment of a judicial manager* in respect of a *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.

As above, the *appointment of a judicial manager* under the *Insurance Act* is explicitly within the definition of "*external administration*" under the *Netting Act* where a person comes under judicial management under the *Insurance Act.*

However, and as above, the effect of the *appointment of a judicial manager* to a *general insurer* is similar to that outlined above in respect of *appointment of a judicial manager* in respect of a *life company.* Namely:

(a) while a *general insurer* is under judicial management, a proceeding in a court against the *general insurer* or in relation to any of its property cannot be commenced or proceeded with, except with the judicial manager's written consent or leave of the court;[43]

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[42] Although this does not apply to a proceeding in respect of an offence or a contravention of a provision of a law for which a pecuniary penalty (however described) may be imposed.

[43] Although this does not apply to a proceeding in respect of an offence or a contravention of a provision of a law for which a pecuniary penalty (however described) may be imposed.

(b) if the *general insurer* is party to a contract (including a *Master Agreement*):

(i) the *appointment of a judicial manager*; and

(ii) that the judicial manager does an act to facilitate recapitalisation (within its specific powers),

are "specified stay provisions" to which the *Netting Act* protection is subject.[44] The effect of these provisions is considered in detail in paragraph 2.6 of Part B and in Part J).

1.8 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[45] 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 (see paragraph 2.9 of Part B) 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.

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[44] The note in the legislation states that before doing such an act, the judicial manager will usually need to get and consider a report on the fair value of each share or right concerned, and will need to report to the relevant *Australian court* and obtain the court's order for the act.

[45] A self-managed superannuation fund is not a registrable *superannuation entity*.

We think that the appointment of an acting trustee under the *SIS Act* falls within paragraph (c) of 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.[46]

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 2.5 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*.

2 Foreign companies

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

2.1 Insolvency Proceedings under *Model Law*

The *Cross-Border Insolvency Act* gives effect to the *Model Law* on Cross-Border Insolvency of the United Nations Commission on International Trade Law (*Model Law*). The *Model Law* does not apply to *ADIs*, *life companies* or *general insurers*.[47]

Under Article 15 of the *Model Law*, a foreign insolvency official[48] can apply to an *Australian court* for recognition of the "foreign proceeding" in respect of which that foreign insolvency official has been appointed.[49]

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.[50]

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[46] 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.

[47] 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).

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

[49] 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*.

[50] 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.

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.[51] 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".[52] 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*.

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)[53]:

(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[54] of the *Corporations Act*.[55] 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).[56]

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.[57] 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.[58]

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[51] 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.

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

[53] 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*.

[54] 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*.

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

[56] 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 a transaction to which the *Netting Act* applies. 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*).

[57] See Article 21(1) of the *Model Law*.

[58] 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

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.[59]

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

(a) intervene in any proceedings to which the debtor is a party, provided that other requirements under *Australian law* are met;[60]

(b) 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);[61]

(c) initiate certain actions in respect of voidable *transactions* under the *Corporations Act*,[62] 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.[63]

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.

2.2 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[64], 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.[65]

If the letter of request is received from a court of a non-prescribed country, the *Australian court* has discretion whether to assist.[66] However, we believe that, as the purpose of the letter of request

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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*.

59 Article 21 of the *Model Law*.

60 Article 24 of the *Model Law*.

61 Article 12 of the *Model Law*.

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

63 Article 23 of the *Model Law*.

64 "External administration matter" is a term which is defined in the *Corporations Act* and includes winding up and insolvency of a foreign company: section 580 of the *Corporations Act*.

65 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, Malaysia and Jersey.

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

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 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.[67]

2.3 Ancillary liquidation order pursuant to section 601CL(14) of the *Corporations Act*[68]

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");[69]

(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.[70]

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."[71] There is no requirement to pay ordinary local creditors first.[72] 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.[73]

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

68 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*.

69 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.

70 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.

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

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

73 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 *ICLQ* 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

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*.[74]

Moreover, it appears that an *Australian court* might not allow funds to be remitted to a foreign liquidator to the detriment of local creditors.[75]

2.4 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.[76] 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[77] 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*),[78] 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.[79]

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[80]; and

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.

74 *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*).

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

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

77 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*.

78 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*.

79 Section 583 of the *Corporations Act*.

80 *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.

- 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.[81]

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.[82] However, the 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.[83] 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*,[84] 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.[85]

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.[86] 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[87].

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[88].

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

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

82 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 Pty Ltd* (1990) 1 ACSR 743, SC(VIC)).

83 *Re New England Brewery Co Ltd* [1970] QWN 49

84 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*.

85 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.

86 *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

87 *Mercantile Credits Limited v Foster Clark (Australia) Limited* (1964) 112 CLR 169

88 Sections 555 and 583 of the *Corporations Act*.

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.[89]

2.5 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).

2.6 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 five 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.[90]

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 five procedures we have outlined above.

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[89] 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 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.

[90] 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 *ICLQ* 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.

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

1 Stays in *Industry Acts*

In 2016, the *Financial System Legislation Amendment (Resilience and Collateral Protection) Act 2016* (Cth) ("***Collateral Protection Act***") amended a number of stays which may apply to an *Australian company* that is an *ADI, life company* or *general insurer* under the *Industry Acts.*

The amended stays have the effect that the following things do not allow a contract to which a regulated body[91] 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 fact that the relevant regulated body is subject to a direction by *APRA* under the relevant provisions of the *Industry Acts*;[92]

(b) the fact that the relevant regulated body is subject to a recapitalisation direction,[93]

(together, the stays in paragraphs 1(a) and 1(b) are defined in the *Netting Act* as the "direction stay provisions" and are referred to in this memorandum as "**direction stays**"),

(c) the *appointment of a statutory manager* or the *appointment of a judicial manager*;[94]

(d) the fact that a statutory manager or judicial manager of the regulated body does certain acts to facilitate recapitalisation;[95]

(e) the fact that an act is done for the purposes of Division 2 or 3 of Part 4 of the *Business Transfer Act*, or that a certificate of transfer comes into force under Division 3 of Part 4 of the *Business Transfer Act*, in connection with a regulated body,[96]

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

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*

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91 The *Netting Act* defines a "regulated body" to mean, relevantly, (a) a body corporate that is an *ADI* for the purposes of the *Banking Act*; or (b) a *general insurer* within the meaning of the *Insurance Act*; or (c) a body corporate that is registered under section 21 of the *Life Insurance Act*.

92 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.*

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

94 See section 15C(2) of the *Banking Act*, section 62V(2) of the *Insurance Act* and section 165B(2) of the *Life Insurance Act*.

95 See section 14AC(2) of the *Banking Act*, section 62ZB(2) of the *Insurance Act* and section 168C(2) of the *Life Insurance Act*.

96 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.

"despite any other law" (including the specified provisions),[97] 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 party 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 regulated body in accordance with the contract assuming that the exercise of such a right does not involve any of these things. See also paragraph 3.4 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 now 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 contract on the grounds of the direction by *APRA* or the recapitalisation direction. 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* now sets out the circumstances in which non-direction stays may cease.

The *Netting Act* provides that a non-direction stay may cease in accordance with particular provisions in relation to a *close-out netting contract* to which an *ADI, life company* or a *general insurer* 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

  (ii) an obligation of another prescribed kind; and

(b) a non-direction stay applies to a trigger event[98] that happens in relation to the contract.

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[97] 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.

[98] 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*.

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[99] or foreign exchange contract[100] or is of another prescribed kind;[101]

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*.[102]

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*.[103]

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

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

[101] In this regard, the *Collateral Protection Regulation* 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.

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

[103] 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.

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.

Obligation of another prescribed kind

An obligation of a party to a *close-out netting contract* to which an *ADI*, a *life company* or a *general insurer* 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 created under a reciprocal purchase agreement (otherwise known as a repurchase agreement), a sell-buyback arrangement or a securities loan arrangement.[104]

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* will make such a declaration if *APRA* is satisfied that *APRA* 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:

A for the non-direction stay related to compulsory transfers of business under the *Business Transfer Act* — just after the certificate of transfer comes into force (if a certificate comes into force) or at the time declared by *APRA* (which may be made if, relevantly, *APRA* is satisfied that it will not issue a certificate of transfer under the *Business Transfer Act*); and

B for the other non-direction stays (ie those related to statutory management, judicial management and recapitalisation activities) — 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.

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[104] 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 securities loan arrangement is excluded from the definition of "eligible obligation". However, see our *Collateral Opinion* in respect of enforcement of security.

Relevantly for this opinion, such a declaration may be made in respect of:

- an *ADI*, *life company* or *general insurer*; or
- if, under the *Business Transfer Act*, a certificate of transfer will come into force for:
  - a total transfer, the receiving body (as defined in the *Business Transfer Act*); or
  - a partial transfer, either or both of the transferring body (as defined in the *Business Transfer Act*) or receiving body.

APRA may only make the declaration if:

(a) *APRA* is satisfied that certain solvency- and licensing- related matters (considered below) will be satisfied in relation to the party in respect of which the declaration will be made:
  - if a certificate of transfer will come into force under the *Business Transfer Act*, just after that coming into force; or
  - in all other cases, at the time the declaration will be made;

(b) the party in respect of which the declaration will be made 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.[105]

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:

- if a certificate of transfer for a total transfer will come into force under the *Business Transfer Act*, all *close-out netting contracts* to which the receiving body (within the meaning of the *Business Transfer Act*) will become a party and all securities given over financial property, in respect of obligations under those *close-out netting contracts*;
- if a certificate of transfer for a partial transfer will come into force under the *Business Transfer Act*, either or both of the following:
  - all *close-out netting contracts* to which the transferring body is a party, and all securities given over financial property in respect of obligations under those contracts;
  - all *close-out netting contracts* to which the receiving body will become a party, and all securities given over financial property in respect of obligations under those contracts; or
- in all other cases, all *close-out netting contracts* to which the regulated body is a party and all securities given over financial property, in respect of obligations under those *close-out netting contracts*.

[105] 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.

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

- that the party 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 the party under those contracts as and when they become due and payable;
- that the party is solvent (within the meaning of the *Corporations Act*);
- that the party has each material authorisation (however described) necessary for its regulated business;[106] and
- either:
  - the party'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
  - arrangements are in place to ensure that the party performs all its obligations under *close-out netting contracts* to which it is a party and securities given over financial property in respect of obligations of the party 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 party 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.[107]

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."[108]

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.

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[106] 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" of a regulated body is defined in section 5 of the *Netting Act* to mean:

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

[107] 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".

[108] *2016 Explanatory Memorandum*, [1.236].

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.

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***);

(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:

(a) 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

(b) 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.[109]

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 *ADI*, *life company* or *general insurer* fails to make a payment or perform an obligation.[110] The *2016 Explanatory Memorandum* states that:

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

[110] *2016 Explanatory Memorandum*, [1.209].

> "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."[111]

3.5 Protection from certain things being void or voidable

The *Netting Act* also provides that none of the following things done by an *ADI*, *life company* or *general insurer* which is a party to a *close-out netting contract*, while it is under statutory or judicial management[112] 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 of anything mentioned in paragraphs (a) to (c) under a *close-out netting contract* mentioned in paragraph (d).[113]

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:

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

(b) either of the following is satisfied:

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

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[111] *2016 Explanatory Memorandum*, [1.202] (footnote omitted).

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

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

(ii) the other person neither provided valuable consideration under, nor changed their position in reliance on, the transaction.[114]

The definition of "voidable" has been expanded in the *Netting Act*. Accordingly, 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*.

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

Part K **Assumptions and qualifications**

1 Assumptions

Apart from other assumptions set out in various parts of this analysis, the conclusions set out in this analysis are based on the assumptions that:

(a) the *transactions* the subject of the *Master Agreement* are not void under gaming and betting legislation and are not in the nature of insurance;[115]

(b) none of the circumstances are present which could affect the availability of the protections under the *Netting Act* (these circumstances are described in paragraphs 3.5 to 3.6 of Part D;

(c) each *Master Agreement* and the Confirmation for each *transaction* is completed and executed, so as to render each *Master Agreement* and Confirmation valid and in all respects enforceable in accordance with its terms under its governing law; and

(d) given the governing law of the *Master Agreement* is not *Australian law*, the rights and obligations of the parties to the *Master Agreement* would be determined on the basis of the plain meaning of the text of the *Master Agreement*.

2 Limited to the laws of the *Australian jurisdictions*

In this opinion, King & Wood Mallesons advises on the laws of the *Australian jurisdictions*. The opinions expressed in this analysis are limited to those laws. However, both the *Corporations Act* and the *Netting Act* are Commonwealth Acts applicable to all the states and territories of Australia. As our conclusions are based on this legislation we are aware of no reason why the conclusions in this opinion would not be applicable in the other Australian States.

3 Qualifications

You have advised us that you wish to have the enforceability of close-out netting under the *Master Agreements* substantiated for purposes pertaining to bank regulation, in particular capital adequacy rules, and for risk management purposes. This memorandum may be relied upon only for such purposes, and in order to facilitate such purposes, we agree to it being made available to the appropriate bank regulatory authorities administering capital adequacy rules.

This memorandum is given for the sole benefit of *ISDA* and its members and may not be relied upon by any other person unless we otherwise specifically agree with that person in writing.

3.1 General qualifications

Following are a number of general qualifications to this analysis:

(a) The rights of a counterparty to enforce a *Master Agreement* may be limited or affected by:

(i) breaches by that party of its obligations under the *Master Agreement*, or misrepresentations made by it in, or in connection with, the *Master Agreement*; or

[115] Financial products (including derivatives) are now protected from the operation of gaming and betting legislation in the *Australian jurisdictions* under section 1101I of the *Corporations Act*.

(ii) conduct of that party in relation to the *Master Agreement* 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 *Master Agreement* 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 *Master Agreement*.

(b) 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.

(c) A party entering into a *Master Agreement* 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.

(d) The availability of certain equitable remedies (including, without limitation, injunction and specific performance) is at the discretion of a court in the *Australian jurisdictions*.

(e) A provision in a *Master Agreement* 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.

(f) The question whether a provision of a *Master Agreement* or a *transaction* which is invalid or unenforceable may be severed from other provisions is determined at the discretion of a court in the *Australian jurisdictions*.

(g) An indemnity for legal costs may be unenforceable.

(h) Section 9(b) of the *Master Agreements* which states that amendments and waivers must be in writing to be effective may not preclude oral amendments or waivers.

(i) Court proceedings may be stayed if the subject of the proceedings is concurrently before a court.

(j) A court will not give effect to a choice of laws to govern a *Master Agreement* or a submission to the jurisdiction of certain courts if to do so would be contrary to public policy in the *Australian jurisdictions*. However, we consider it is very unlikely that a court would reach such a conclusion in relation to English or New York law.

(k) A document may not be admissible in court proceedings unless applicable stamp duty has been paid.

(l) No view is expressed as to 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.

(m) No view is expressed as to the accuracy, completeness or suitability of any formula set out in any *Master Agreement*. 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.

(n) 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), certain equitable remedies or defences generally affecting creditors' rights.

(o) The term "enforceable" as used in this opinion means that the obligations assumed are of a type which courts of the *Australian jurisdictions* enforce. It does not mean that these obligations will necessarily be enforced in the circumstances or in accordance with their terms in that 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.

(p) 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.

(q) The *Charter of the United Nations (Dealing with Assets) Regulations 2008* (Cth) and other 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 United Nations sanctions or associated with terrorism. As at the date of this opinion, no such approvals are required in respect of payments or *transactions* between Australia and the United Kingdom or the United States of America.[116]

(r) As a matter of law of the *Australian jurisdictions*, claims may become barred under the Limitation Acts.

(s) No view is expressed as to any of the following:

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

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

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

(v) the implications of any of them.

3.2 This opinion does not cover statutory corporations

Statutes which establish such statutory corporations usually do not provide for the statutory corporation to be wound up, and as such it is not possible to opine that such entities will definitely be

[116] The countries, individuals and entities that require approval change from time to time. These listings are maintained by the Australian Department of Foreign Affairs and Trade at the following two websites respectively:
(a) http://www.dfat.gov.au/icat/UNSC_financial_sanctions.html; and
(b) http://www.rba.gov.au/MarketOperations/International/FinancialSanctionsCashReporting/sanctions.html.

subject to "*external administration*" as defined under the *Netting Act*. However, we note that with respect to such entities:

- **prior to insolvency**, where ***Australian law*** governs the *Master Agreement* and the contract is entered into in circumstances that are within Commonwealth constitutional reach (see paragraphs 2.8 and 2.9 of Part B - a *Master Agreement* entered into by such an entity with a foreign corporation would be a contract entered into within "Commonwealth constitutional reach"), section 14(1) of the *Netting Act* should apply to validate the close-out netting provisions;
- **on insolvency**, where a **foreign law** governs the *Master Agreement* and the entity is subject to "*external administration*" governed by *Australian law*, section 14(2) of the *Netting Act* should apply to validate the close-out netting provisions. The definition of "*external administration*" under the *Netting Act* includes a winding up under the *Corporations Act* and someone taking "control of the person's property for the benefit of the person's creditors because the person is, or is likely to become, insolvent";
- **on insolvency**, where a **foreign law** governs the *Master Agreement* and the entity is not subject to "*external administration*" governed by *Australian law*, an *Australian court* would enforce the *Master Agreement* in accordance with the law of the foreign jurisdiction provided it was not contrary to public policy in the *Australian jurisdictions*;
- **on insolvency**, where ***Australian law*** governs the *Master Agreement* and the entity is not subject to "*external administration*" governed by *Australian law*, section 14(1) of the *Netting Act* should still apply to validate the close-out netting provisions provided the contract is entered into in circumstances that are within Commonwealth constitutional reach (see paragraphs 2.8 and 2.9 of Part B).

3.3 This opinion does not cover a company which does not have its centre of main interests in Australia

If a company is not an *ADI*, a *life company* or a *general insurer* and its centre of main interests is not in Australia, laws including the law of the jurisdiction in which the foreign company has the centre of its main interests may be relevant.

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Part L **Dictionary**

In this opinion, the following terms have the following meaning. Capitalised terms have the meaning given to them in the relevant *Master Agreement*.

1987 ISDA Master Agreement either the 1987 ISDA Interest Rate Swap Agreement or the 1987 ISDA Interest Rate and Currency Exchange Agreement in the form published by *ISDA*.

1992 ISDA Master Agreement means either the Master Agreement (Multicurrency – Cross Border) or the Local Currency – Single Jurisdiction Master Agreement in the form published by *ISDA* with no amendments having being made to Sections 6(c) and 6(e).

1998 Explanatory Memorandum means the explanatory memorandum published by the Commonwealth Government when the Bill to enact the *Netting Act* was introduced in Federal Parliament.

2001 Bridge means the 2001 *ISDA* Cross-Agreement Bridge.

2002 Bridge means the 2002 *ISDA* Energy Agreement Bridge.

2002 ISDA Master Agreement means the 2002 ISDA Master Agreement (Multicurrency – Cross Border) with no amendments having been made to Sections 6(c) and 6(e).

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*).

Amendment means the *June 2014 Amendment* to the *Master Agreement* in relation to Section 2(a)(iii) published by *ISDA* on 19 June 2014.

appointment of a judicial manager means the vesting of the management of a *life company* or a *general insurer*, or part of the business of a *life company,* in a judicial manager under the *Life Insurance Act* (for *life companies*) or the *Insurance Act* (for *general insurers*), as the context requires.

appointment of a statutory manager means the taking control of an *ADI*'s business by a statutory manager under the *Banking Act*.

APRA means the Australian Prudential Regulation Authority.

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

Australian branch has the meaning given to it in paragraph 1(b) of Part E.

Australian company means a company which is registered as a company under the *Corporations Act*. The term *Australian company* includes all *Australian banks*, *life companies*, building societies, credit unions, superannuation trustees and trustees of unit trusts (including managed investment schemes)

which are registered as a company under the *Corporations Act*.[117] The term *Australian company* is 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. However, see paragraph 2 of Part K as to the applicability to other jurisdictions within Australia.

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

Bank F has the meaning given to it in paragraph 1(b) of Part E.

close-out netting contract has the meaning given to it in the *Netting Act* (as described in paragraph 2 of Part B).

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

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

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

Close-out Amount Protocol means the "Close-out Amount Protocol" published by *ISDA* on 27 February 2009.

Collateral Opinion means our opinion in respect of the validity and enforceability under *Australian law* of collateral arrangements under the *ISDA* credit support documents addressed to *ISDA* and dated on or around the date of this opinion.

Collateral Protection Regulation means the *Financial System Legislation Amendment (Resilience and Collateral Protection) Regulation 2016* (Cth).

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

Country H has the meaning given to it in paragraph 1(b) of Part E.

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

Enron means *Enron Australia Finance Pty Limited (in liquidation) v Integral Energy Australia* [2002] NSWSC 753.

external administration has the meaning given in paragraph 2.1 of Part C of this opinion.

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*.

Foreign Judgments Act means the *Foreign Judgments Act 1991* (Cth).

[117] Under *Australian law*, superannuation funds, managed investment schemes and other 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).

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 *Master Agreement* which has become subject to *external administration*.

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

ISDA means the International Swaps and Derivatives Association, Inc.

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

June 2014 Amendment means the Annexes to the 'June 2014 Amendment' to the *Master Agreement* in relation to Section 2(a)(iii) published by *ISDA* on 19 June 2014.

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

Master Agreement means the *1992 ISDA Master Agreement* or the *2002 ISDA Master Agreement* or both, as the context requires.

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

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

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

non-netting branch has the meaning given to it in paragraph 1(c) of Part E.

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

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*.

solvent party means the solvent counterparty to an *insolvent party* under a *Master Agreement*.

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

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*).

transactions means those transactions described in Appendix A.

TTPA means the *Trans-Tasman Proceedings Act 2010* (Cth).

* * * * * * *

Yours faithfully

APPENDIX A
AUGUST 2015

CERTAIN TRANSACTIONS UNDER

THE ISDA MASTER AGREEMENTS

Basis Swap. A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

Bond Forward. A transaction in which one party agrees to pay an agreed price for a specified amount of a bond of an issuer or a basket of bonds of several issuers at a future date and the other party agrees to pay a price for the same amount of the same bond to be set on a specified date in the future. The payment calculation is based on the amount of the bond and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Bond Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

Bullion Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of Bullion in exchange for the strike price or may be cash settled based on the difference between the market price of Bullion on the exercise date and the strike price.

Bullion Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the COMEX Division of the New York Mercantile Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

Bullion Trade. A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a “spot” or two-day basis or on a specified future date. A Bullion Trade may be settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price.

For purposes of Bullion Trades, Bullion Options and Bullion Swaps, “Bullion” means gold, silver, platinum or palladium and “Ounce” means, in the case of gold, a fine troy ounce, and in the case of silver, platinum and palladium, a troy ounce (or in the case of reference prices not expressed in Ounces, the relevant Units of gold, silver, platinum or palladium).

Buy/Sell-Back Transaction. A transaction in which one party purchases a security (in consideration for a cash payment) and agrees to sell back that security (or in some cases an equivalent security) to the other party (in consideration for the original cash payment plus a premium).

Cap Transaction. A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap).

Collar Transaction. A collar is a combination of a cap and a floor where one party is the floating rate, floating index or floating commodity price payer on the cap and the other party is the floating rate, floating index or floating commodity price payer on the floor.

Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price, and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. A Commodity Forward may be settled by the physical delivery of the commodity in exchange for the specified price or may be cash settled based on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index based on the price of one or more commodities.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g., West Texas Intermediate Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

Contingent Credit Default Swap. A Credit Default Swap Transaction under which the calculation amounts applicable to one or both parties may vary over time by reference to the mark-to-market value of a hypothetical swap transaction.

Credit Default Swap Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to enter into a Credit Default Swap.

Credit Default Swap. A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a “Reference Obligation”) issued,

guaranteed or otherwise entered into by a third party (the “Reference Entity”) upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. A Credit Default Swap may also be physically settled by payment of a specified fixed amount by one party against delivery of specified obligations (“Deliverable Obligations”) by the other party. A Credit Default Swap may also refer to a “basket” (typically ten or less) or a “portfolio” (eleven or more) of Reference Entities or may be an index transaction consisting of a series of component Credit Default Swaps.

Credit Derivative Transaction on Asset-Backed Securities. A Credit Default Swap for which the Reference Obligation is a cash or synthetic asset-backed security. Such a transaction may, but need not necessarily, include “pay as you go” settlements, meaning that the credit protection seller makes payments relating to interest shortfalls, principal shortfalls and write-downs arising on the Reference Obligation and the credit protection buyer makes additional fixed payments of reimbursements of such shortfalls or write-downs.

Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument.

Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and or final exchanges of amounts corresponding to the notional amounts.

Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

Currency Swap. A transaction in which one party pays fixed periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

Economic Statistic Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency by reference to interest rates or other factors and the other party pays or may pay an amount or periodic amounts of a currency based on a specified rate or index pertaining to statistical data on economic conditions, which may include economic growth, retail sales, inflation, consumer prices, consumer sentiment, unemployment and housing.

Emissions Allowance Transaction. A transaction in which one party agrees to buy from or sell to the other party a specified quantity of emissions allowances or reductions at a specified price for settlement either on a "spot" basis or on a specified future date. An Emissions Allowance Transaction may also constitute a swap of emissions allowances or reductions or an option whereby one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which the specified quantity of emissions allowances or reductions exceeds or is less than a specified strike. An Emissions Allowance Transaction may be physically settled by delivery of emissions allowances or reductions in exchange for a specified price, differing vintage years or differing emissions products or may be cash settled based on the difference between the market price of emissions allowances or reductions on the settlement date and the specified price.

Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity and shares to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

Equity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of shares of an issuer or a basket of shares of several issuers at a specified strike price. The share option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

Equity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed or floating rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor's 500 Index.

Floor Transaction. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor).

Foreign Exchange Transaction. A deliverable or non-deliverable transaction providing for the purchase of one currency with another currency providing for settlement either on a "spot" or two-day basis or a specified future date.

Forward Rate Transaction. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

Freight Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency based on a fixed price and the other party pays an amount or periodic amounts of the same currency based on the price of chartering a ship to transport wet or dry freight from one port to another; all calculations are based either on a notional quantity of freight or, in the case of time charter transactions, on a notional number of days.

Fund Option Transaction: A transaction in which one party grants to the other party (for an agreed payment or other consideration) the right, but not the obligation, to receive a payment based on the redemption value of a specified amount of an interest issued to or held by an investor in a fund, pooled investment vehicle or any other interest identified as such in the relevant Confirmation (a "Fund Interest"), whether i) a single class

of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests in relation to a specified strike price. The Fund Option Transactions will generally be cash settled (where settlement occurs based on the excess of such redemption value over such specified strike price (in the case of a call) or the excess of such specified strike price over such redemption value (in the case of a put) as measured on the valuation date or dates relating to the exercise date).

Fund Forward Transaction: A transaction in which one party agrees to pay an agreed price for the redemption value of a specified amount of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests at a future date and the other party agrees to pay a price for the redemption value of the same amount of the same Fund Interests to be set on a specified date in the future. The payment calculation is based on the amount of the redemption value relating to such Fund Interest and generally cash-settled (where settlement occurs based on the difference between the agreed forward price and the redemption value measured as of the applicable valuation date or dates).

Fund Swap Transaction: A transaction a transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency based on the redemption value of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests.

Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

Interest Rate Swap. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

Longevity/Mortality Transaction. (a) A transaction employing a derivative instrument, such as a forward, a swap or an option, that is valued according to expected variation in a reference index of observed demographic trends, as exhibited by a specified population, relating to aging, morbidity, and mortality/longevity, or (b) A transaction that references the payment profile underlying a specific portfolio of longevity- or mortality- contingent obligations, e.g. a pool of pension liabilities or life insurance policies (either the actual claims payments or a synthetic basket referencing the profile of claims payments).

Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a commodity, such as oil including oil products, coal, electricity or gas, at a fixed or floating price for actual delivery on one or more dates.

Property Index Derivative Transaction. A transaction, often structured in the form of a forward, option or total return swap, between two parties in which the underlying value of the transaction is based on a rate or index based on residential or commercial property prices for a specified local, regional or national area.

Repurchase Transaction. A transaction in which one party agrees to sell securities to the other party and such party has the right to repurchase those securities (or in some cases equivalent securities) from such other party at a future date.

Securities Lending Transaction. A transaction in which one party transfers securities to a party acting as the borrower in exchange for a payment or a series of payments from the borrower and the borrower's obligation to replace the securities at a defined date with identical securities.

Swap Deliverable Contingent Credit Default Swap. A Contingent Credit Default Swap under which one of the Deliverable Obligations is a claim against the Reference Entity under an ISDA Master Agreement with respect to which an Early Termination Date (as defined therein) has occurred.

Swap Option. A transaction in which one party grants to the other party the right (in consideration for a premium payment), but not the obligation, to enter into a swap with certain specified terms. In some cases the swap option may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity"), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation.

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.

CERTAIN COUNTERPARTY TYPES

Description	Covered by opinion	Legal form(s)
Bank/Credit Institution. A legal entity, which may be organized as a corporation, partnership or in some other form, that conducts commercial banking activities, that is, whose core business typically involves (a) taking deposits from private individuals and/or corporate entities and (b) making loans to private individual and/or corporate borrowers. This type of entity is sometimes referred to as a "commercial bank" or, if its business also includes investment banking and trading activities, a "universal bank". (If the entity only conducts investment banking and trading activities, then it falls within the "Investment Firm/Broker Dealer" category below.) This type of entity is referred to as a "credit institution" in European Community (**EC**) legislation. This category may include specialised types of bank, such as a mortgage savings bank (provided that the relevant entity accepts deposits and makes loans), or such an entity may be considered in the local jurisdiction to constitute a separate category of legal entity (as in the case of a building society in the United Kingdom (**UK**)).	Yes, covered by our Netting Opinion if it is an *Australian company*. Partnerships are not covered by our Netting Opinion.	*Australian company* includes all Australian companies and corporations which have been or are taken (by the *Corporations Act*) to have been registered as a company under the *Corporations Act* and companies which may be wound up under the *Corporations Act*. This includes all *Australian banks* and also, Australian branches of foreign-incorporated banks to the extent expressly set out in our *Netting Opinion*. The easiest method of obtaining a degree of certainty as to whether an Australian entity is an *Australian company* is to conduct a search of the company and business name register maintained by the Australian Securities and Investments Commission (which is accessible for free at ASIC's website: www.asic.gov.au).
Central Bank. A legal entity that performs the function of a central bank for a Sovereign or for an area of monetary union (as in the case of the European Central Bank in respect of the euro zone).	No, not covered by our Netting Opinion.[118]	
Corporation. A legal entity that is organized as a corporation or company rather than a partnership, is engaged in industrial and/or commercial activities and does not fall within one of the other categories in this Appendix B.	Yes, covered by our Netting Opinion provided it is an *Australian company*.	*Australian company* includes all Australian companies and corporations which have been or are taken (by the *Corporations Act*) to have been registered as a company under the *Corporations Act* and companies which may be wound up under the *Corporations Act*. However, to be certain as to whether such an entity is an *Australian*

[118] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

Description	Covered by opinion	Legal form(s)
		company, a company search would need to be conducted as described under "Bank/Credit Institution" above.
Hedge Fund/Proprietary Trader. A legal entity, which may be organized as a corporation, partnership or in some other legal form, the principal business of which is to deal in and/or manage securities and/or other financial instruments and/or otherwise to carry on an investment business predominantly or exclusively as principal for its own account.	Yes, covered by our Netting Opinion provided it is an *Australian company*. Partnerships and individuals are not covered by our Netting Opinion.	*Australian company* includes all Australian companies and corporations which have been or are taken (by the *Corporations Act*) to have been registered as a company under the *Corporations Act* and companies which may be wound up under the *Corporations Act*. However to be certain as to whether such an entity is an *Australian company*, a company search would need to be conducted as described under "Bank/Credit Institution" above.
Insurance Company. A legal entity, which may be organised as a corporation, partnership or in some other legal form (for example, a friendly society or industrial & provident society in the UK), that is licensed to carry on insurance business, and is typically subject to a special regulatory regime and a special insolvency regime in order to protect the interests of policyholders.	Yes, covered by our Netting Opinion provided it is an *Australian company*. Partnerships and individuals are not covered by our Netting Opinion.	*Australian company* includes all Australian companies and corporations which have been or are taken (by the *Corporations Act*) to have been registered as a company under the *Corporations Act* and companies which may be wound up under the *Corporations Act*. This includes most life insurance companies but to be certain as to whether such an entity is an *Australian company*, a company search would need to be conducted as described under "Bank/Credit Institution" above.
International Organization. An organization of Sovereigns established by treaty entered into between the Sovereigns, including the International Bank for Reconstruction and Development (the World Bank), regional development banks and similar organizations established by treaty.	No, not covered by our Netting Opinion.[119]	

[119] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

Description	Covered by opinion	Legal form(s)
Investment Firm/Broker Dealer. A legal entity, which may be organized as a corporation, partnership or in some other form, that does not conduct commercial banking activities but deals in and/or manages securities and/or other financial instruments as an agent for third parties. It may also conduct such activities as principal (but if it does so exclusively as principal, then it most likely falls within the "Hedge Fund/Proprietary Trader" category above.) Its business normally includes holding securities and/or other financial instruments for third parties and operating related cash accounts. This type of entity is referred to as a "broker-dealer" in US legislation and as an "investment firm" in EC legislation.	Yes, covered by our Netting Opinion provided it is an *Australian company*. Partnerships and individuals are not covered by our Netting Opinion.	*Australian company* includes all Australian companies and corporations which have been or are taken (by the *Corporations Act*) to have been registered as a company under the *Corporations Act* and companies which may be wound up under the *Corporations Act*. This includes all *Australian banks*. However to be certain as to whether such an entity is an *Australian company*, a company search would need to be conducted as described under "Bank/Credit Institution" above.
Investment Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide investors with a share in profits or income arising from property acquired, held, managed or disposed of by the manager(s) of the legal entity or arrangement or a right to payment determined by reference to such profits or income. This type of entity or arrangement is referred to as a "collective investment scheme" in EC legislation. It may be regulated or unregulated. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by general law and/or, typically in the case of regulated Investment Funds, financial services legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Investment Fund (for example, a trustee of a unit trust) contract on behalf of the Investment Fund, are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	Yes, covered by our Netting Opinion to the extent that the relevant entity is a legal entity which is an *Australian company*.	Under *Australian law*, managed investment funds are not legal entities. The relevant legal entity is the trustee acting in its capacity as trustee of unit trusts (including managed investment schemes). As per the statement at the commencement of our Netting Opinion, most trustees of Australian unit trusts (including managed investment schemes) have been or are taken (by the *Corporations Act*) to have been registered as a company under the *Corporations Act*. However to be certain as to whether such a trustee is an *Australian company*, a company search would need to be conducted as described under "Bank/Credit Institution" above.
Local Authority. A legal entity established to administer the functions of local government in a particular region within a Sovereign or State of a	No, not covered by our Netting Opinion.[120]	

[120] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

Description	Covered by opinion	Legal form(s)
Federal Sovereign, for example, a city, county, borough or similar area.		
Partnership. A legal entity or form of arrangement without legal personality that is (a) organised as a general, limited or some other form of partnership and (b) does not fall within one of the other categories in this Appendix B. If it does not have legal personality, it may nonetheless be treated as though it were a legal person for certain purposes (for example, for insolvency purposes) and not for other purposes (for example, tax or personal liability).	No, not covered by our Netting Opinion.[121]	
Pension Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide pension benefits to a specific class of beneficiaries, normally sponsored by an employer or group of employers. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by pensions legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Pension Fund (for example, a trustee of a pension scheme in the form of a common law trust) contract on behalf of the Pension Fund and are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	Yes, covered by our Netting Opinion to the extent that the relevant entity is a legal entity which is an *Australian company*.	Under *Australian law*, superannuation funds are not legal entities. The relevant legal entity is the superannuation trustee acting in its capacity as trustee of the superannuation fund. As per the statement at the commencement of our *Netting Opinion*, most superannuation trustees have been or are taken (by the *Corporations Act*) to have been registered as a company under the *Corporations Act*. However, to be certain as to whether such a superannuation trustee is an *Australian company*, a company search would need to be conducted as described under "Bank/Credit Institution" above.
Sovereign. A sovereign nation state recognized internationally as such, typically acting through a direct agency or instrumentality of the central government without separate legal personality, for example, the ministry of finance, treasury or national debt office. This category does not include a State of a Federal Sovereign or other political sub-division of a sovereign nation state if the sub-division has separate legal personality (for example, a Local Authority) and it does not include any legal entity owned by a sovereign nation state (see "Sovereign-owned Entity").	No, not covered by our Netting Opinion.[122]	

[121] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

[122] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

Description	Covered by opinion	Legal form(s)
Sovereign Wealth Fund. A legal entity, often created by a special statute and normally wholly owned by a Sovereign, established to manage assets of or on behalf of the Sovereign, which may or may not hold those assets in its own name. Such an entity is often referred to as an "investment authority". For certain Sovereigns, this function is performed by the Central Bank, however for purposes of this Appendix B the term "Sovereign Wealth Fund" excludes a Central Bank.	No, not covered by our Netting Opinion.[123]	
Sovereign-Owned Entity. A legal entity wholly or majority-owned by a Sovereign, other than a Central Bank, or by a State of a Federal Sovereign, which may or may not benefit from any immunity enjoyed by the Sovereign or State of a Federal Sovereign from legal proceedings or execution against its assets. This category may include entities active entirely in the private sector without any specific public duties or public sector mission as well as statutory bodies with public duties (for example, a statutory body charged with regulatory responsibility over a sector of the domestic economy). This category does not include local governmental authorities (see "Local Authority").	No, not covered by our Netting Opinion.[124]	
State of a Federal Sovereign. The principal political sub-division of a federal Sovereign, such as Australia (for example, Queensland), Canada (for example, Ontario), Germany (for example, Nordrhein-Westfalen) or the United States of America (for example, Pennsylvania). This category does not include a Local Authority.	No, not covered by our Netting Opinion.[125]	

[123] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

[124] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

[125] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.