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EFET Master Netting Agreement and TBMA Cross-Product Master Agreement
Australian law advice

1 Introduction

1.1 You have asked us to provide our opinion in relation to a number of issues and questions raised by the European Federation of Energy Traders in respect of:

(a) the EFET Master Netting Agreement (Version 1.0/June 2010);

(b) the Cross-Product master agreement (February 2000 version) published by The Bond Market Association;

(c) the EFET/IECA Commodities Schedule to the CPMA (Version 1.0/June 23, 2003); and

(d) the EFET Cross-Product Credit Support Annex to the CPMA (Version 1.0 / June 23, 2003).

1.2 Terms appearing in *italics* have the meaning given to them in the dictionary contained in Schedule 1. Capitalised terms not otherwise defined in this opinion have the meaning assigned to them in the relevant *Agreement*.

1.3 We are qualified to advise on the laws of the *Australian jurisdictions*. This opinion relates only to the laws of the *Australian jurisdictions* and is given on the basis that it will be construed in accordance with the laws of New South Wales. In this opinion, "laws" means the common law, principles of equity and laws constituted or evidenced by documents available to the public generally. We express no opinion about the laws of another jurisdiction or factual matters.

1.4 This opinion is given in respect of parties to the *Agreements* which are *Australian companies,* which would include all banks incorporated in Australia. In certain circumstances this may include parties which are not incorporated, or taken to be incorporated, under the *Corporations Act* such as foreign corporations. However, this opinion does not address a party which is a building society, a credit union, a life insurance company, a health insurance company, a general insurance company or acting as a trustee of a trust. We comment separately on partnerships and statutory corporations in paragraphs 3.8 and 3.9.

1.5 This opinion applies to *individual contracts* which are transactions of a type listed in Schedule 2.

2 Assumptions

We have assumed that:

(a) each party:

(i) is validly incorporated under the laws of its place of incorporation;

(ii) has all requisite capacity and power to execute, deliver and perform its obligations under the *Agreement* and all *master agreements* and *individual contracts* under them; and

(iii) has taken all necessary steps to execute, deliver and perform the *Agreement* and all *master agreements* and *individual contracts* under them;

(b) the *Agreement*, each *master agreement* and each *individual contract*:

(i) has been duly authorised, executed and delivered by each party in accordance with all applicable laws; and

(ii) is legally binding on each party under all applicable laws and will constitute valid and enforceable obligations of all the parties to them under all relevant laws (including the laws of the *Australian jurisdictions* except insofar as they affect those obligations of the party expressly addressed by this opinion);

(c) the *Agreement* constitutes valid, binding and enforceable obligations of each party to it under its governing law, which you have instructed us will not be the law of an *Australian jurisdiction*;

(d) none of the terms of the *Agreement*, each *master agreement* and each *individual contract* under them has been varied, waived or discharged (or that if any terms have been varied, they are minor in nature and do not impact in any way on the operation of the *netting provisions*) and each *master agreement* and each *individual contract* under a *master agreement* has been entered into and implemented in accordance with the *Agreement*;

(e) nothing in connection with a *master agreement*, any transaction governed by a *master agreement* or any agreement or transaction otherwise governed by the *Agreement* affects the conclusions reached in this opinion;

(f) no other document in connection with the *Agreement*, any *master agreement* or any transaction under them contains anything that would affect the conclusions reached in this opinion;

(g) the *Agreement*, each *master agreement* and each *individual contract* under them has been entered into for bona fide commercial reasons and on arms' length terms by each of the parties and is for the corporate benefit of each of them;

(h) at the time the *Agreement,* each *master agreement* and each *individual contract* under them are entered into, and at the time that any Eligible Credit Support is transferred, each party is solvent and there has been no formal commencement of any *insolvency proceedings* in respect of a party;

(i) by entering into the *Agreement* or a *master agreement* or an *individual contract* under them, no party has contravened or will contravene sections of the *Corporations Act* regulating dealings between related parties. These provisions are intended to protect shareholders of public companies against the possibility that the value of their investment would be eroded by a related party arranging for a party to enter into a transaction which gives a benefit to the related party. The expression "related party" is widely defined to include directors, spouses of directors and their relatives. It also includes a parent entity and so called sibling entities where there is a common parent entity. There are exceptions to the general prohibition. Relevantly, these include those cases where shareholders sanction the provision of the benefit. There is also an exception where all the shares in the related party are in substance wholly owned by the public company;

(j) no party is on notice (constructive or otherwise) or aware of circumstances which, if investigated, would put it on notice that anything in, or effected pursuant to, the *Agreement*, each *master agreement* and each *individual contract* under them contravenes, or could result in a contravention of, any obligation of the other party to any third person including any breach of fiduciary duty;

(k) none of the circumstances are present which could affect the availability of the *Netting Act* (these circumstances are described in Schedule 5) or insolvency set-off (see paragraph 3.7(b));

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

(m) each *Agreement, master agreement* and *individual contract* under them form a single agreement between the parties under all laws (other than *Australian law*). We note that:

    (i) § 3 ("Single Agreement") of the *MNA* provides that the *MNA*, all Netted Agreements and all transactions under them "shall together constitute a single, integrated and inseparable agreement between the Parties"; and

(ii) clause 10.6 ("Single Agreement") of the *CPMA* provides that the *CMPA*, each Principal Agreement and each transaction under Principal Agreements "shall together constitute a single agreement between the Parties";

(n) each *master agreement* governed by the *Agreement* provides for the calculation of termination values of *individual contracts* entered into under it;

(o) any proceedings relating to an *Agreement* brought before a court of the *Australian jurisdictions* are proceedings in respect of which the court will assume jurisdiction to hear those proceedings;

(p) no party is acting as trustee of a trust;

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

(r) the governing law of the *Agreement* is a law other than *Australian law*.

3 Insolvency and netting

3.1 Insolvency proceedings under Australian law

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; and

(e) if the *Australian company* is an *authorised deposit taking institution* under the *Banking Act*, statutory management where it is, or is likely to become, insolvent.

Each of these *insolvency proceedings* is described further in Part 1 of Schedule 3.

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

(i) proceedings under the UNCITRAL Model Law;

(ii) letter of request;

(iii) ancillary liquidation;

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

(v) order recognising foreign liquidation order.

Each of these *insolvency proceedings* is described further in Part 2 of Schedule 3.

3.2 **Publicly available information of insolvency events**

It is possible to monitor whether particular insolvency proceedings have been commenced on a *Australian company* by putting in place a 'Company Alert' in respect of the company with *ASIC*. A Company Alert can be set to notify the recipient via a nominated email address if certain forms are lodged with *ASIC* on the evening of the day the relevant form is entered into the *ASIC* database. This includes forms which must be lodged following the appointment of the following persons in respect of a local counterparty:

(a) a liquidator or provisional liquidator;

(b) a scheme manager, which administers compromises or arrangements under Part 5.1 of the *Corporations Act*;

(c) an administrator; or

(d) a receiver and manager.

However, the period within which such forms must be lodged varies depending on the person appointed. Further, *ASIC* does not guarantee the accuracy of the contents of a Company Alert and will not be liable for any loss or damage resulting from its use.

Alternatively, it is possible to search certain individual court registries to determine if any cases initiated include the counterparty as a party. For example, Federal Law Search provides selected information on cases initiated in the Federal Court of Australia.

3.3 **Insolvency and specific individual contracts**

There are no specific insolvency proceedings for physically settled *individual contracts* in relation to *Australian companies* or foreign companies under *Australian law*. Such transactions are dealt with under the applicable *insolvency proceedings* in the same way and subject to the same procedures as cash settled transactions.

3.4 **Enforceability of netting provisions**

This paragraph 3.4 refers to the *Netting Act*. The relevant provisions of the *Netting Act* are summarised in Schedule 5.

In our opinion, the *netting provisions* of each *Agreement* will be enforceable following the *external administration* of a party to the *Agreement* provided that:

(i) neither section 14(3) of the *Netting Act* nor section 14(5) of the *Netting Act* apply. These sections are discussed in paragraph 6 of Schedule 5; and

(ii) in respect of the *CPMA*:

(A) clause 10.6 ("Single Agreement") is included; and

(B) clause 10.8 ("Withholding Final Net Settlement Amount") is not included.

Each of the *insolvency proceedings* falls within the definition of *external administration*.

This is because:

- subject to paragraph (ii) in relation to the *CPMA*, each *Agreement* meets the criteria of a *close-out netting contract* as defined in the *Netting Act*. This conclusion is discussed in paragraph 1 of Schedule 5; and

- in the circumstances referred to above, the *Netting Act* expressly permits the termination of obligations, the calculation of termination values of such terminated obligations and the payment of the net amount of such termination values in accordance with the provisions of a *close-out netting contract*.

3.5 Core provisions

The *netting provisions* and the definitions in the *Agreement* relating to the *netting provisions* should not be amended in order to ensure the effectiveness of close-out netting under an *Agreement*.

3.6 Challenge in external administration

Section 14(2)(g) of the *Netting Act* provides that the termination of obligations, the netting of obligations and any payment made by a party under the *close-out netting contract* to discharge a net obligation are not to be void or voidable in the *external administration* of that party. Further, a note is made in the legislation to the effect that the express recognition given to close-out netting in section 14(2) of the *Netting Act* is to remove the basis for arguing that *close-out netting contract*s are void as contrary to public policy embodied in insolvency law.

3.7 Set-off

The classes of set-off available which are relevant to this opinion are contractual set-off and insolvency set-off.

(a) ***Contractual set-off***

Our opinion in respect of the enforceability of the *netting provisions* would apply despite the inclusion of any contractual set-off provision, provided such provision did not amend the *netting provisions*. We do not comment on the enforceability of any contractual set-off provision against an *Australian company*, but note that such provision would not be enforceable to the extent it were inconsistent with the section 553C of the *Corporations Act* (which is described immediately below).

(b) ***Insolvency set-off***

Section 553C of the *Corporations Act* provides that where there have been mutual credits, mutual debts or other mutual dealings between an insolvent *Australian company* that is being wound up and another party, an account shall be taken of what is due from one to the other in those mutual dealings and those sums shall be set-off against one another.

For set off to apply under the *Corporations Act*, the following requirements must be met:

- (***Mutuality***) Set-off is permitted in respect of debts owing to and from a person acting in the same capacity. Mutuality would not exist if parties entered into contracts in different capacities, for example, where some contracts are entered into by a party in its own right and others are entered into by it as trustee or as agent. Nor will mutuality exist if a party has assigned its rights under a contract to another person or granted security or declared a trust over them. Accordingly, mutuality may not be present when dealing with trustees.

- (***Existence of a claim***) In a liquidation, the date at which claims must exist is the date of commencement of the winding up. If a liability arose after that date, and only by reason of circumstances occurring after that date, it would be disqualified from set off.

  Judicial decisions of Australian courts on the effect of the predecessor to section 553C of the *Corporations Act* have held that the section not only applies to the setting off of actual debts, but also applies to the setting off of contingent debts existing on the date of commencement of the winding up. In the latter case, the contingent debt must mature to an actual debt before the final date on which the liquidator calls for proofs of debt.

- (***Commensurability***) "Commensurability" means that the mutual debts must be capable of being brought together ultimately into a money account, establishing a liability on each side which is pecuniary in nature.

- (***No notice of insolvency***) A party would not be entitled to claim the benefit of the set off provided by section 553C if at the time of giving credit to, or receiving credit from, the *Australian company*, it had notice that the *Australian company* was unable to pay its debts as they fell due.

3.8 Set-off and netting in relation to partnerships

It is difficult to provide a concise answer in respect of the availability of contractual or statutory rights of set-off or close-out netting in the event of the insolvency of a counterparty that is an Australian partnership. This is because the availability of set-off following insolvency and the insolvency proceedings to which an Australian partnership may become subject under *Australian law* may be affected by a number of factors particular to the law of partnerships, the presence or absence of which may vary depending on the circumstances (for example, whether the partnership is, or one or more of the partners are, insolvent).

For this reason, where a party intends to enter into an *Agreement* with an Australian partnership, we consider that it would be prudent to seek advice on the availability of close-out netting and set-off in the particular circumstances of the partnership and the *master agreements* and *individual contracts* contemplated prior to entering into the *Agreement*. It is also usual to include a number of additional provisions in an agreement with a partnership to clarify references to the "parties" and provide appropriate protections.

However, we can confirm that to the extent that the protection of the *Netting Act* is otherwise applicable (see paragraph 3.4) the fact that an Australian party is a partnership does not, of itself, negate that protection.

3.9 Set-off and netting in relation to 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 subject to *external administration* as defined under the *Netting Act*.

However, we note that with respect to statutory corporations, as a matter of principle:

- on insolvency:
  - if a foreign law governs the *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 *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";
  - if a foreign law governs the *Agreement* and the entity is not subject to "external administration" governed by *Australian law*, an *Australian court* should enforce the *Agreement* in accordance with the law of the foreign jurisdiction. The enforceability of a choice of law provision is discussed in paragraph 8.

In respect of a statutory corporation that is registered, or taken to be registered, under the *Corporations Act*, and to the extent that other legislation does not prevail over, or disapply section 553C of the *Corporations Act*, mandatory insolvency set-off, as described in paragraph 3.7, should apply if that statutory corporation is wound up under the *Corporations Act*. We do not comment on the availability of contractual or insolvency set-off to statutory corporations that are not registered, or taken to be registered, under the *Corporations Act*. For this reason, we consider that it would be prudent to seek advice on the availability of set-off against a statutory corporation prior to entering into the *Agreement*.

3.10 **Automatic Termination**

Automatic Termination will be enforceable in circumstances where the *netting provisions* are enforceable, but the application of *Automatic Termination* is not necessary. As a commercial matter, it may be preferable to specify that *Automatic Termination* does not apply because non-automatic termination gives greater control to the terminating party on the timing of the close-out.

3.11 **Single agreement**

In respect of each *Agreement*, it is necessary for the *Agreement*, each *master agreement* and each *individual contract* under them to form a single agreement between the parties in order for the *Agreement*, such *master agreements* and *individual contracts* to constitute a single *close-out netting contract* for the purposes of the *Netting Act*. For this reason, we recommend that clause 10.6 ("Single Agreement") is included in the *CPMA*. Our conclusions with respect to the *CPMA* in paragraph 3.4 are subject to the inclusion of this clause.

Subject to the matters set out in paragraph 3.4, it is possible for the parties to terminate some but not all *master agreements* and/or *individual contracts* in accordance with the *Agreement* without undermining the enforceability of the *netting provisions*. 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.

3.12 **Currency conversion**

For the reasons set out below, the Final Net Settlement Amount may be calculated in a currency other than Australian dollars subject to the terms of the *Agreement*. However, if the Final Net Settlement Amount is payable by an insolvent party, then the amount will need to be proved in Australian dollars.

Section 14(2)(c) of the *Netting Act* provides that the net amount is payable "in accordance with the contract", and 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. 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. These sections are further described in Schedule 5.

Subject to the discretion of an Australian court to award judgments in Australian dollars (in respect of which, please see the qualification in paragraph 11.3(n)(iii)), this would imply that the net amount calculated in a currency other than Australian dollars is also provable in the *external administration* of a party to the *Agreement*. However, such proof would result in significant practical difficulties for a liquidator in ensuring the payment of creditors on a *pari passu* basis.[1] For this reason, we consider that section 554C of the *Corporations Act* is relevant. Section 554C of the *Corporations Act* requires debts to 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.

The rule in section 544C of the *Corporations Act* does not prevent the parties to an *Agreement* from calculating the amount of their liabilities in accordance with the agreement in a currency other than Australian dollars. However, the resulting liability will have to be converted into Australian dollars for the purposes of proof at the rate provided for in section 554C applying on the relevant date.

4 Multibranch parties

4.1 Australian law treatment of multibranch operations

Our conclusions in paragraph 3.4 would not change on the basis that a party was a multibranch party. This is because, under *Australian law*, it is well established that branches are not separate and distinct legal entities, but are branches of a single corporate entity.[2] As a result, provided, in the case of the *CPMA* only that clause 10.6 ("Single Agreement") is included, each *Agreement* will form one contract covering each branch of the *Australian company*. For the purpose of the *Netting Act,* and subject to the matters discussed in paragraph 3.4, each *Agreement* will be a single *close-out netting contract* notwithstanding that obligations terminated under it may have been entered into in various jurisdictions.

4.2 External administration governed by Australian law

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

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

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1 As stated by Lord Hoffman in **Stein v Blake** [1996] 1 AC 234 at 252, 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 being ascertained and his assets simultaneously distributed among his creditors on the bankruptcy date".

2 **Prince v Oriental Bank Corp** (1878) 3 App Cas 325 at 331; Weaver GA and Cragie CR, *The Law Relating to Banker and Customer in Australia*, second edition, The Law Book Company, Sydney, 1990 at 7551. 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.

4.3 Insolvency administration governed by foreign law

If an insolvency administration of an *Australian company's* assets and liabilities in a foreign jurisdiction (for example, the assets and liabilities of a branch in that jurisdiction) were not governed by *Australian law*, 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.

4.4 Foreign multibranch parties

The insolvency proceedings to which a foreign company may become subject under *Australian law* are listed in paragraph 3.1 and described in Part 2 of Schedule 3. Each of these insolvency proceedings falls within the definition of *external administration*. For the reasons set out in paragraph 4.2, where the *external administration* of a party is governed by *Australian law*, an Australian court will apply the *Netting Act* and an external administrator could not segregate transactions entered into with non-netting branches from other transactions under the *Agreement*.

However, it will be a matter for the conflicts of law rules in the other jurisdictions as to whether the laws of the *Australian jurisdictions* are recognised in the other jurisdictions.

5 Collateral

For the purpose of this paragraph 5, we assume that:

(a) the *CSA* will be incorporated in the *MNA*. We note that § 1.2 ("Interpretation") of the *CSA* provides that the *CSA* "supplements, amends, forms part of and is subject to the *MNA*"; and

(b) *Eligible Credit Support* is comprised of Cash and/or Letters of Credit only.

5.2 Letters of Credit

We have been asked to provide certain opinions regarding *Eligible Credit Support* in the form of Letters of Credit. The *CSA* defines a Letter of Credit as:

> "a standby letter of credit, bank guarantee or similar document... issued irrevocably by a leading commercial bank... which obliges the bank to pay the amount guaranteed therein upon first demand of the Transferee".

Australian law would recognise a Letter of Credit issued at the request of the Transferor as a primary obligation of the issuing bank to the Transferee. Accordingly, an obligation of the Transferor to 'transfer' *Eligible Credit Support* in the form of Letters of Credit would be characterised under *Australian law* as an obligation to procure a Letter of Credit in favour of the Transferee. A Letter of Credit does not represent an interest in property of the

Transferor and, accordingly, the paragraphs below consider Cash *Eligible Credit Support* only.

It is worth noting, however, that rights of set-off may be available as between the bank issuing a Letter of Credit and the Transferee which is the beneficiary of such Letter of Credit, although these will arise in limited circumstances.

We do not comment on the terms of any particular Letter of Credit.

5.3 Transfer of Cash Eligible Collateral

Assuming that the conduct of the parties and other surrounding circumstances are not inconsistent with the terms of the *CSA*, we consider that a transfer of *Eligible Credit Support* which is Cash will be construed as an absolute transfer under *Australian law* and will not be characterised as being made by way of security.

The general principles for the characterisation of absolute transfers of property in the *Australian jurisdictions* were recently clarified by the Federal Court of Australia in *Beconwood Securities v Australia and New Zealand Banking Group*.[3] While, in that case, the court considered the terms of a securities lending agreement and not the *CSA*, we consider the principles stated by the court to be instructive in the context of the *CSA*. In referring to the securities lending agreement before it, the court stated:

> "The character of the [agreement] must be determined from its language, particularly of its operative parts. If those provisions are clear, they must be given effect, unless there are provisions which alter that effect.[4]
>
> ...
>
> What this means is that the character of a transaction is to be determined by reference to its legal nature, not to its economic effect.[5]
>
> ...
>
> In light of the foregoing, the argument that the [agreement] can be characterised as a mortgage is simply unsustainable. It breaks down at many points. First of all, by the express terms of the [agreement], unencumbered title in both lent securities and collateral passes on delivery. Secondly, when the transaction comes to an end there is no obligation to hand back in specie the securities initially lent. Nor is there an obligation to return the collateral actually provided. The obligation falling on the Borrower is to deliver the same number and type of securities. The same is true and as regards the collateral. Third, there are the netting and set-off provisions that come into effect on default. This is the means by which the parties mitigate credit risk, converting redelivery obligations into payment obligations. The provisions are particularly important because they confirm that the parties did not intend there to be any equitable property rights retained over lent securities or collateral following

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3 (2008) 246 ALR 361; [2008] FCA 594.
4 (2008) 246 ALR 361 at 370 (paragraph 41).
5 (2008) 246 ALR 361 at 371 (paragraph 42).

their delivery, for if such rights existed, they could not simply be converted by contract to monetary obligations."[6]

We set out the application of those principles in respect of Cash *Eligible Credit Support* under the *CSA*:

(a) first, the terms of the *CSA* state:

§ 7.1 "Each Party agrees that all right, title and interest in and to any *Eligible Credit Support* or Interest Amount which it transfers to the other Party under the terms of this Annex will vest in the Transferee free and clear of any liens, claims, charges or encumbrances or any other interest of the Transferor or of any third person"; and

§ 7.3 "Nothing in this Annex is intended to create or does create in favour of either Party any mortgage, charge, lien, pledge, encumbrance or other security interest in any cash or other property transferred by one Party to the other Party under this Annex";

(b) second, the *CSA* does not prohibit the commingling of Cash *Eligible Credit Support* with other cash of the Transferee; and

(c) third, pursuant to § 9.1 of the *MNA*, Credit Support is applied against the Final Net Settlement Amount following the Early Termination Date.

In our opinion, there is no material risk that any transfer of Cash *Eligible Credit Support* would be re-characterised by Australian courts as being in substance by way of security unless the intention of the parties (evidenced in writing or by conduct) was that such transfers would take effect other than by way of unconditional transfers of title. There is nothing on the face of the *CSA* to indicate that this is the case, so in the absence of any other agreement or conduct to the contrary, transfers of Cash Eligible Credit support under the *CSA* should not be re-characterised in this way.

5.4 Perfection requirements

Under *Australian law*, there are no further actions required to ensure a continuation of title to Cash *Eligible Credit Support* transferred pursuant to the *CSA*.

5.5 Effect of substitution rights

In our opinion, the provisions of § 6 ("Exchange of Eligible Credit Support") of the *CSA* do not change the characterisation of a transfer of Cash *Eligible Credit Support* effected under the *CSA* from that of an absolute transfer. The presence or absence of consent to substitution does not affect our conclusion.

5.6 Effect of insolvency

[6] (2008) 246 ALR 361 at 373 (paragraph 50).

The insolvency of a party to the *CSA* which is an *Australian company* ("**Party A**") would affect the rights of the other party ("**Party B**") to the extent that:

(a) the *netting provisions* are not enforceable. However, please see our discussion in paragraph 3.4;

(b) there is a "claw back" under Australian insolvency law relating to the setting aside and disclaimer of transactions. *Australian law* relevant to claw back is summarised in Schedule 4 and is discussed further in paragraph 5.7.

In addition, in the event that Party A is subject to "administration" (described in Part 1(c) of Schedule 3), an enforcement freeze might inhibit the ability of Party B to take proceedings against Party A to recover any shortfall following closing out and netting in accordance with the *MNA*. This is because, when an administration of an *Australian company* commences, no resolution may be passed or order made for the winding up of the company, no steps may be taken to enforce any security over the company's property, and no other proceedings and no execution or other legal process may be commenced or continued except with the leave of the court or the administrator's consent. However this freeze would not interfere with the ability of Party B to use Cash *Eligible Credit Support* transferred to it absolutely.

5.7 "Suspect periods" under Australian law

Australian insolvency law relating to claw back is summarised in Schedule 4.

In relation to both transfers and substitutions of Cash *Eligible Credit Support*, it is important that a defence to a voidable preference claim can be satisfied at the time of a transfer. In respect of this defence, it is of particular importance to show that the transfer or substitution has been made for valuable consideration.

Although it may be argued that the transfer of Cash *Eligible Credit Support* under the *CSA* is without consideration, we consider sufficient valuable consideration should exist in that the transfer is a payment made in satisfaction of an obligation incurred at the time of entering into the *CSA*. It is then relevant to ensure that consideration is present at the time the party agreed to undertake those obligations, being the time of entry into the *CSA*. This consideration could be present where:

(a) the *CSA* was entered into at the same time as the *MNA* or any *master agreement* or *individual contract* under the *MNA* (meaning that the obligations undertaken under the *CSA* are part of the consideration for entering into such trading relationship); or

(b) either party may be obliged to deliver *Eligible Credit Support* under the *CSA* (meaning that the obligations undertaken by one party were consideration for the obligations undertaken by the other); or

(c) some other consideration is provided.

5.8 Suggested provisions

No revisions to the *CSA* are required as a matter of *Australian law* for the provisions of the *CSA* to be enforceable.

6 Validity of *Agreements*

Subject to the matters discussed in this opinion, the obligations of an *Australian company* to an *Agreement* are enforceable in accordance with their terms. The expression "enforceable" means that the relevant obligations are of a type that the courts in the *Australian jurisdictions* enforce and does not mean that the obligations will necessarily be enforced in all circumstances in accordance with their terms.

7 Confirmation practices

7.1 Formation of a legally binding and enforceable transaction

Generally, no formal act (such as execution in writing, signature, registration or notarization) is required for the formation of a legally binding and enforceable agreement of the type of an *individual contract*. Under *Australian law*, most contracts may be agreed orally or in writing and parties may also incorporate the terms of another document or agreement into a contract by oral reference.

However, it would be prudent for the parties to exchange signed confirmations in respect of *individual contracts*. The reasons for this are twofold:

(a) first, oral agreements can present difficult questions of proof; and

(b) second, sales of electricity and gas may be subject to Sale of Goods legislation in Western Australia,[7] which provides that contracts for the sale of any goods of value A$20 or more are unenforceable by action in the absence of some note or memorandum in writing signed by the party to be charged (or the party's agent), unless the buyer has accepted and received part of the goods or given something in earnest or in part payment for the goods.

7.2 Oral agreements

Subject to paragraph 7.1 and the terms of the relevant *master agreement*, at the time parties orally agree to enter into an *individual contract*, the *individual contract* will be recognised as legal, valid, binding and, subject to its terms (including the terms of the relevant *master agreement* and the *Agreement*), enforceable.

7.3 Failure to object

Subject to the terms of the relevant *master agreement*, the failure by a party to object to any incorrect term of a confirmation will not have the effect of amending the *individual*

[7] *Sale Of Goods Act 1895* (Western Australia).

contract. However, depending on the factual circumstances, certain legal and equitable doctrines such as acquiescence, election and estoppel may limit or affect the ability of a party to enforce its rights in respect of such *individual contract*.

7.4 **Reference to master agreement**

In our view:

(a) § 2.1 ("Designation of Agreements Which May Be Terminated, Closed-Out and Netted") of the *MNA*; and

(b) Part 1.D ("Application of this Agreement") of Division 1 of the *Commodities Schedule* to the *CPMA*,

would be enforceable such that any *individual contract* validly entered into following the date of the *Agreement* would be governed by the relevant *Agreement* irrespective of whether:

(i) the *individual contract* was entered into orally;

(ii) the parties refer to the *individual contract* being an *individual contract* for the purpose of the *Agreement* between them; or

(iii) the parties confirm the *individual contract* in writing, via telex, facsimile, SWIFT, or other means of electronic transmission.

7.5 **Means of evidence**

(a) Telephone recordings

Tape recordings of telephone conversations may be introduced in Australian court proceedings but, consistent with general rules of evidence, would only be admissible if they are relevant. Further, the recordings may not be admissible if it can be shown that they were obtained illegally (eg in breach of legislation) or contrary to public policy.

The law regulating the recording of telephone conversations is set out in the *Telecommunications (Interception and Access) Act 1979* of Australia ("**TI Act**") and certain State and Territory laws.

The TI Act applies to recordings made whilst communications are passing over a telecommunications system within or partly within Australia. Laws in each State and Territory of Australia generally apply to listening devices used where communications have left a telecommunications system. In our experience, most dealing room telephone recording systems are such that the TI Act will apply rather than State or Territory laws.

The primary prohibition in the TI Act is set out in section 7 of the Act, which provides that "[a] person shall not:

- intercept;
- authorise, suffer or permit another person to intercept; or
- do any act or thing that will enable him or her or another person to intercept,

a communication passing over a telecommunications system".

Section 6(1) of the TI Act states that an interception of a communication passing over a telecommunications system "consists of listening to or recording, by any means, such a communication in its passage over that telecommunications system without the knowledge of the person making the communication".

The consequences of breaching the TI Act include substantial criminal penalties, civil actions for damages and the possible inadmissibility in evidence of any recordings.

The TI Act is aimed at preventing interceptions by third parties invading the privacy of a private call. In *R v Evans* (1999) 152 FLR 352, the Supreme Court of Victoria held that recording business calls made by an employee is not an "interception" covered by the TI Act because an employer in such situations is not a third party to the call. Accordingly, in our view the TI Act would not apply in the context of recording the business calls between traders entering into *individual contracts*.

(b) Electronic messages

The *Electronic Transactions Act 1999* of Australia ("**ETA**") (which is mirrored by legislation in the States and Territories) governs electronic transactions and provides for contracts transacted electronically to be as legally enforceable as written contracts. The ETA also allows for other legislation to specify requirements for electronic transactions in order for them to be enforceable. We express no view as to whether the electronic exchange of data would constitute a valid means of entering into a contract. Before a party purports to enter into an *individual contract* electronically, we consider that it would be prudent to seek advice on the law applicable in the particular circumstances.

(c) Witness statements and facsimiles

Witness statements and facsimiles may be introduced in Australian court proceedings but, consistent with general rules of evidence, would only be admissible if they are relevant. Witness statements must comply with formal requirements in order to be admissible as evidence.

8 General validity of choice of law and jurisdiction

A court in the *Australian jurisdictions* would recognise the validity of the choice of law specified in § 12 ("Governing Law") of the *MNA* and Section 6 ("Governing Law and Jurisdiction; Waivers") of the *CPMA* as the governing law of the *Agreement*, provided that:

(a) the choice has been made in good faith;

(b) the choice was not intended to evade the provisions of another legal system with which the *Agreement* has a closer connection;

(c) none of the terms of the *Agreement* nor any provision of the governing law specified in the *Agreement* is contrary to local public policy.

We express no opinion as to whether a court will give effect to a choice of laws to govern an *Agreement* to the extent that the choice of laws applies to non-contractual obligations arising out of, or in connection with, the *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).

A court in the *Australian jurisdictions* would recognise and give effect to the parties' agreement to submit to the jurisdiction of specified courts.

9 *MNA* Arbitration provisions

9.1 Amendments to § 12.4 of the *MNA*

This opinion is subject to the assumption that the Parties to the *MNA* have made the following amendments to § 12.4 where such provisions are specified in the Election Sheet as applying:

(a) the following words are deleted from § 12.4(B):

"*and the Parties hereby expressly waive any right of appeal to any court having jurisdiction on any question of fact or law*";

(b) the following words are inserted in § 12.4(B) after the words "*to recover such damages*":

"*, to the extent permitted by law*";

(c) the following words are deleted from § 12.4(C):

"*ousting the jurisdiction on the ordinary courts*".

This is because under *Australian law* the ouster of jurisdiction of the Australian courts is contrary to public policy and unenforceable. Australian courts make a distinction between an ouster of jurisdiction of the courts (being contrary to public policy) and an enforceable agreement to submit disputes under a contract to arbitration.[8] In this regard, please also see the qualification to this opinion in paragraph 11.3(j). The words purporting to oust the jurisdiction of the courts are, in any event, unnecessary because where there is a valid agreement to arbitrate, the Australian courts must, upon the application of either party, stay any Australian court proceedings concerning any dispute that falls within the scope of the agreement to arbitrate.

In addition, a wavier of rights available for breach of contract may not be enforceable where those rights are of a public kind and are for the public benefit.[9] Please also see the qualification in paragraph 11.3(x).

9.2 Recognition of arbitration under Australian law

As a matter of *Australian law*, the recognition of an arbitration arising from § 12.4 of the *MNA* between a foreign company and an *Australian company* will be governed by the *International Arbitration Act*. The *International Arbitration Act* gave formal approval for Australia's accession to the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* ("**Convention**").

Section 16 of the *International Arbitration Act* provides that the UNCITRAL Model Law on International Commercial Arbitration ("**Model Law**") has the force of law in Australia. This does not exclude the ability of the parties to apply particular international institutional arbitral rules, such as those of the German Institution of Arbitration or the London Court of International Arbitration, for which the *MNA* provides.

9.3 Intervention by Australian courts

In general, the Australian courts are limited in their ability to intervene in an international arbitration and may only do so on the basis of specific reference in the arbitration agreement or the arbitral rules which are incorporated by reference. The Model Law, for example, provides in article 5 that "in matters governed by this Law, no court shall intervene except where so provided in this Law" and proceeds to set out in subsequent provisions specific circumstances in which judicial intervention is permitted.

In the event that court proceedings are instituted in Australia by either party involving the determination of a matter which falls within the scope of the arbitration agreement and is capable of settlement by arbitration, the court must, on the application of the other party and upon such conditions (if any) as it thinks fit, stay the proceedings (or so much of the proceedings as involves the determination of the matter) and refer the parties to arbitration in respect of that matter unless the agreement is "null and void, inoperative or incapable of being performed".[10]

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8 **Dobbs v National Bank of Australasia Ltd** (1935) 53 CLR 643.

9 **Re Morris** (1943) 43 SR (NSW) 352; **Lieberman v Morris** (1944) 69 CLR 69.

10 Sections 7(2) and 7(5) of the *International Arbitration Act*.

When granting the stay, the court may, for the purpose of preserving the rights of the parties, also make such interim or supplementary orders as it thinks fit in relation to any property that is the subject of the matter to which the stay relates.[11]

The *International Arbitration Act* does not contain any provisions empowering a party to appeal an arbitral award. A party may apply to the Australian courts to set aside an award made in an arbitration seated in Australia, but only on limited grounds. These are:

(a) that there was no valid arbitration agreement;

(b) that a party was not given proper notice of the appointment of the arbitrator or of the proceedings, or was otherwise unable to present his case;

(c) that the award deals with matters that fall outside the scope of the arbitration agreement;

(d) that the composition of the arbitral tribunal was not in accordance with the agreement of the parties;

(e) that the subject matter of the arbitration was not capable of settlement by arbitration under Australian law; or

(f) that the award is in conflict with Australian public policy.

9.4 Recognition of arbitral awards

Section 8 of the *International Arbitration Act* provides that a foreign arbitral award to which the *International Arbitration Act* applies may be enforced in a court of an Australian State or Territory as if the award had been made in that state or territory in accordance with the laws of that State or Territory where:

(a) the award was made in a country (other than Australia) which is party to the Convention; or

(b) the award was made in a country which is not party to the Convention at the time the enforcement of the award is sought but the party seeking such enforcement is, at such time, incorporated or has its principal place of business in Australia or in a country which is party to the Convention.

There are however specific circumstances, set out in section 8(5) of the *International Arbitration Act*, in which the court may refuse to enforce the award at the request of the party against which enforcement is sought. These are namely where:

(i) that party was under some incapacity at the time the arbitration agreement was entered into;

[11] Section 7(3) of the *International Arbitration Act*

(ii) the arbitration agreement is not valid under the law expressed in the agreement to apply, or if so such law is expressed, under the law of the country in which the award was made;

(iii) that party was not given proper notice of the appointment of the arbitrator of the arbitration proceedings, or was unable to present their case;

(iv) the award deals with a matter outside of the scope of the submission to arbitration;

(v) the composition of the arbitral authority, or the arbitration procedure was not in accordance with the agreement of the parties, or if there was no agreement, was not in accordance with the law of the country of the arbitrator; and

(vi) the award is not yet binding, or has been set aside or suspended.

The court also may refuse to enforce the foreign award if the subject matter of the arbitrated dispute is not capable of settlement by arbitration under the law of the Australian state or territory, or to enforce the award would be contrary to public policy.[12]

Finally, as noted above, the award must be an "arbitral award" as defined in the Convention and this does not include certain interlocutory orders.

Where a foreign arbitral award is made and such award is enforceable in Australia pursuant to the *International Arbitration Act*, the time frame for the enforcement of such an award will be similar to that for the enforcement of a domestic award. From our experience, it is unlikely that there would be any inordinate delays in the enforcement of such a foreign arbitral award, although delay could occur if an opponent resisted enforcement vigorously and the responsible judge were to adopt a liberal approach to the application of the *International Arbitration Act*.

10 Other provisions

10.1 Suggested provisions

No revisions to the *Agreement* are required as a matter of *Australian law*.

10.2 Elections

(a) *CPMA Netting provisions*

In relation to the enforceability of *netting provisions*, please see our discussion in paragraph 3.4 with respect to elections under the *CPMA*.

12 Section 8(7) of the *International Arbitration Act*.

(b) *MNA* **Close Out Events**

We recommend that Australian authorised deposit-taking institutions consider *Prudential Standard APS 221 - Large Exposures* with respect to § 3.1(C)(VI) ("Failures to Provide Performance Assurance") of the *MNA*. Given that the requirement to provide Performance Assurance pursuant to § 3.1(C)(VI) is not subject to an objective limitation, there is a risk that the application of this paragraph may result in an unlimited exposure. However, we do not offer any advice as to prudential matters in this opinion.

11 Qualifications

11.1 This opinion is confined to matters of the laws of the *Australian jurisdictions*. The opinions expressed in this opinion are limited to those laws. However, in relation to the laws of the other Australian states and territories, we note that the *Corporations Act* and the *Netting Act* are Acts of the Commonwealth Parliament applying throughout Australia. As our conclusions are based on this legislation, the common law and equity, we are aware of no reason why the conclusions in this opinion would not be applicable in other Australian states.

11.2 Substance versus form

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

11.3 Other qualifications

This opinion is subject to the following further qualifications:

(a) in preparing this opinion, we have reviewed each *Agreement* and the *CSA*. We have not examined any other document;

(b) 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;

(c) where a party is vested with a discretion or may determine a matter, the law of the *Australian jurisdictions* may require that such discretion is exercised or determination is made reasonably. Any provision in the *Agreement*, a *master agreement* and the terms of an *individual contract* providing that any calculation or certification is to be conclusive and binding will not be effective if such calculation or certification is fraudulent, incorrect, unreasonable, arbitrary or shown not to have been given or made in good faith and will not necessarily prevent judicial enquiry into the merits of any claim by any party thereto. A court of the *Australian jurisdictions* may regard any calculation, determination or certification as no more than prima facie evidence of the matter calculated, determined or certified;

(d) the nature and enforcement of obligations may be affected by lapse of time, failure to take action or laws (including, without limitation, laws relating to bankruptcy, insolvency, liquidation, receivership, administration, reorganisation, reconstruction, fraudulent transfer or moratoria), certain equitable remedies and defences generally affecting creditors' rights;

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

(f) the rights of a party to enforce its rights under the *Agreement*, a *master agreement* or an *individual contract* may be limited or affected by:

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

  (ii) conduct of that party which is unlawful including without limitation the failure to hold an Australian financial services licence (as defined in the *Corporations Act*) if required to do so or the failure to comply with obligations in connection with that licence;

  (iii) conduct of that party in relation to the relevant document 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 relevant document;

(g) the expression "enforceable" means that the relevant obligations are of a type that the courts in the *Australian jurisdictions* enforce and does not mean that the obligations will necessarily be enforced in all circumstances in accordance with their terms;

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

(i) an obligation to pay an amount may be unenforceable if the amount is held to constitute a penalty;

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

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

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

(ii) discretions are exercised reasonably; and

(iii) opinions are based on good faith;

(l) the question whether a provision of the *Agreement*, a *master agreement* or an *individual contract* which is invalid or unenforceable may be severed from other provisions is determined at the discretion of a court in the *Australian jurisdictions*;

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

(n) we express no opinion as to:

(i) provisions precluding oral amendments or waivers;

(ii) Australian tax laws (including stamp duty laws);

(iii) whether a judgment for a monetary amount would be given in a currency other than Australian dollars, although recent decisions of English Courts allowing judgments in a foreign currency have been followed in the Courts of New South Wales;

(iv) whether a party in entering into, performing or observing its obligations under the *Agreement*, a *master agreement* or an *individual contract*, is or will be complying with, or is or will be required to do or not to do anything by, the prudential standards, prudential regulations or any directions made by *APRA* or under the *Banking Act*;

(v) the date on which a conversion from foreign currency would be made for the purpose of enforcing a judgment;

(vi) the accuracy, completeness or suitability of any formula set out in the *Agreement*, a *master agreement* or an *individual contract*. 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;

(vii) any provision of the *Agreement*, a *master agreement* or an *individual contract* referring to legal concepts existing under foreign law;

(viii) regulatory requirements specific to any particular party to a *Agreement,* a *master agreement* or an *individual contract*, including, without limitation, any requirement to hold an Australian financial services licence (as defined in the *Corporations Act*);

(ix) the enforceability of a net amount owing by an *Australian company*;

(x) the enforceability of any Letter of Credit;

(xi) matters in connection with the manner of delivery of, or any regulation relating to, physical settlement under any *individual contract*;

(o) we express no opinion in relation to:

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

(ii) any law which has been enacted and has not commenced, or if it has commenced, has not started to apply (including without limitation, the *Personal Property Securities Act 2009* and the *Personal Property Securities (Consequential Amendments) Act 2009* of Australia);

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

(iv) the implications of any of them;

(p) a party entering into the *Agreement,* a *master agreement* or an *individual contract* 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;

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

(r) a court will not give effect to a currency indemnity, a choice of laws to govern, a submission to the jurisdiction of a court or the provisions of the *Agreement,* a *master agreement* or an *individual contract* if to do so would be contrary to public policy in the *Australian jurisdictions*;

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

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

(u) in order to enforce a foreign judgment in an *Australian jurisdiction*, it may be necessary to establish that the judgment is for a fixed and certain sum of money and is not in the nature of a penalty or revenue debt and, if raised by the judgment debtor, it may be necessary to establish that:

(i) the judgment debtor (or its duly appointed agent) received actual notice of the proceedings in sufficient time to contest the proceedings;

(ii) the judgment was not obtained by fraud or duress or in a manner contrary to natural justice or public policy in the *Australian jurisdiction*; and

(iii) the subject matter of the proceedings giving rise to the judgment was not immovable property situated outside relevant *Australian jurisdiction* (as the case may be);

(v) this opinion does not consider the impact of insolvency laws, other than the insolvency laws of the *Australian jurisdictions*;

(w) where any obligations of any person are to be performed in jurisdictions outside the *Australian jurisdictions*, such obligations may not be enforceable under the laws of the *Australian jurisdictions* to the extent that such performance thereof would be illegal or contrary to public policy under the laws of the *Australian jurisdictions*;

(x) any provision of the *Agreement*, a *master agreement* and/or an *individual contract* which constitutes, or purports to constitute, a restriction on the exercise of any statutory power by any person may be ineffective;

(y) we express no opinion as to the validity or enforceability of an *individual contract* where the record of the terms agreed between the parties contained in the respective confirmations of the parties are not wholly consistent with each other or where a party does not issue a confirmation or its confirmation is inaccurate or incomplete; and

(z) we express no opinion as to any particular *Agreement*, *master agreement* or *individual contract* (including the commercial effect thereof). While every care has been taken in preparing this analysis, we do not accept responsibility for any losses suffered or liabilities incurred arising from use of this analysis in respect of a particular *Agreement*, *master agreement* or *individual contract*.

12 Benefit

This opinion is addressed exclusively to EFET, the members of the EFET Legal Committee and any other entity who has subscribed to EFET for one or more of the country opinions, is for their sole benefit and may not, without our prior written consent, be

(a) relied on by another person;

(b) disclosed, except if required by law or in accordance with an official directive or request (whether or not having the force of law) with which responsible financiers generally comply in carrying on their business; or

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

This opinion is strictly limited to the matters stated in it and does not apply by implication to other matters.

This opinion is given in respect of the laws of the *Australian jurisdictions* which are in force at 9.00am local time on the date of this letter.

Yours faithfully

Mallesons Stephen Jaques

SCHEDULE 1

Dictionary

Agreement means:

(a) the *MNA*; or

(b) the *CPMA*.

ASIC means the Australian Securities and Investment Commission.

Australian company means a company which is:

(a) registered or taken to be registered as a company under the *Corporations Act*; or

(b) otherwise organised under *Australian law* and which may be wound up under Part 5.7 of the *Corporations Act*; or

(c) otherwise capable of being wound up pursuant to and in a manner required by the *Corporations Act*, which would include a foreign company that:

    (i) is registered as a foreign company under Division 2 of Part 5B.2 of the *Corporations Act* (which in general provides that a foreign company must not carry on business in Australia unless it is registered under the Division); or

    (ii) carries on business in Australia.

APRA means the Australian Prudential Regulation Authority.

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

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

Authorised deposit taking institution or *"ADI"* means an authorised deposit-taking institution authorised under section 9(3) of the *Banking Act*.

Automatic Termination means

(a) in relation to the *MNA*, the meaning given in the MNA; and

(b) in relation to the *CPMA*, the procedure set out in Part II.C of the *Commodities Schedule*.

Banking Act means the *Banking Act 1959* of Australia.

Close-out netting contract means a "close-out netting contract" as defined in the *Netting Act* and described in paragraph 1.1 of Schedule 5.

Commodities Schedule means the EFET/IECA Commodities Schedule to the *CPMA* (Version 1.0/June 23, 2003).

Corporations Act means the *Corporations Act 2001* of Australia.

CPMA means the Cross-Product Master Agreement (February 2000 version) published by The Bond Market Association and incorporating the *Commodities Schedule.*

CSA means the EFET Cross-Product Credit Support Annex to the CPMA (Version 1.0 / June 23, 2003).

Eligible Credit Support means "Eligible Credit Support" for the purposes of, and as defined in, the *CSA*.

External administration has the meaning given in the *Netting Act*, which is set out in paragraph 3.2 of Schedule 5.

Individual contracts means transactions under a *master agreement* of a type listed in Schedule 2 settled by way of cash settlement or the physical delivery of shares, bonds or commodities (including emission rights).

Insolvency proceedings means the proceedings described in Schedule 3. Each of the *insolvency proceedings* falls within the definition of *external administration.*

International Arbitration Act means *the International Arbitration Act 1974* of Australia.

Master agreements means:

(a) in relation to the *MNA*, Netted Agreements; and

(b) in relation to the *CPMA*, Principal Agreements.

MNA means the EFET Master Netting Agreement (Version 1.0/June 2010).

Netting Act means the *Payment Systems and Netting Act 1998* of Australia.

Netting provisions is a reference to:

(a) in relation to the *MNA*:

   (i) § 2.3 ("Single Agreement");

   (ii) § 4.3 ("Effect of Initiation of Close-Out");

   (iii) § 7.1 ("Determination of Settlement Amounts");

   (iv) § 8.1 ("Netting-Off"); and

(b) in relation to the *CPMA*:

   (i) clause 10.6 ("Single Agreement");

   (ii) clause 3.1 ("Determination of Settlement Amounts");

   (iii) clause 4.1 ("Set-Off");

   (iv) clause 4.2 ("Discharge of Settlement Amount"); and

   (v) clause 4.4(a) ("Final Net Settlement Amount for Closed-Out Agreements").

SCHEDULE 2

Individual contracts

1. 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.

2. 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 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.

3. 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.

4. 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.

5. 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 cash 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, (or in the case of reference prices not expressed in Ounces, the relevant Units of silver, platinum or palladium).

6. 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).

7. 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).

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

9. 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. The payment calculation is based on the quantity of the commodity and is settled based, among other things, on the difference between the agreed forward price and the prevailing market price at the time of settlement.

10. 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.

11. 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.

12. Contingent Credit Default Swap. A Credit Default Swap Transaction in which the credit protection seller pays an amount determined by reference to the value of a hypothetical swap transaction.

13. 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.

14. 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) or Reference Entities or may be an index transaction consisting of a series of component Credit Default Swaps.

15. 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.

16. 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.

17. 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.

18. 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.

19. 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.

20. 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.

21. 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.

22. 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 of shares of an issuer 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).

23. 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 case of a call) or is less than (in case of a put) a specified strike price.

24. 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) shares of an issuer or a basket of shares of several issuers at a specified strike price. The 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.

25. Equity 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 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.

26. 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 case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in case of a commodity floor).

27. Foreign Exchange Transaction. A 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.

28. 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.

29. 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.

30. 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.

31. 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.

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

33. 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 and national area.

34. 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.

35. 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.

36. 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.

37. 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.

38. 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.

39. 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.

SCHEDULE 3

Insolvency Proceedings in Australia

1 Australian companies incorporated under Australian law

The insolvency proceedings to which an *Australian company* may become subject under *Australian law* are described below.

(a) *Winding up*

An *Australian company* registered or taken to be registered as a company under the *Corporations Act* may become subject to winding up under Parts 5.4, 5.4B and 5.5 of the *Corporations Act*. This may be:

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

(b) *Compromise or arrangement*

An *Australian company* registered or taken to be registered as a company 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 *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).

(c) *Administration*

An *Australian company* registered or taken to be registered as a company under the *Corporations Act* 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 a person who is entitled to enforce a charge over the whole or substantially the whole of the *Australian company's* property if the charge has become and is still enforceable.

During the time from the commencement of the administration to the adoption by the *Australian company* and its creditors of a deed of company arrangement, there are a number of restrictions imposed on the *Australian company* and its creditors. All of the *Australian company's* assets are subject to the administrator's control except for property subject to charges which were already being enforced as at the commencement of the administration. Even then a court may restrict the action of secured creditors if such action may prejudice the administration. By way of exception a person who holds a charge over the whole or substantially the whole of the *Australian company's* property can enforce that charge provided the charge is enforced in relation to all that property within 13 business days from the commencement of the administration.

(d) *Receivership*

A 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 will normally originate from a security interest granted by the *Australian company* to the secured creditor.

(e) *Statutory management under the Banking Act*

(i) **(Statutory manager)** The appointment of a statutory manager to control the affairs of any *Australian company* that is an *authorised deposit taking institution* ("**ADI**") to which the *Banking Act* applies may occur if either that ADI informs *APRA* that it is likely to or *APRA* considers that, in the absence of external support, that ADI may become unable to meet its obligations or suspend payment. In addition, a statutory manager may be appointed to an ADI if *APRA* considers that, in the absence of external support, it is likely that the ADI will be unable to carry on its banking business in Australia consistently with the interests of its depositors and financial stability in Australia.[13]

Such appointment would be made by *APRA* and the statutory manager appointed may be *APRA* itself or some other entity. There is no prescribed period for which a statutory manager may be appointed and the power to terminate the appointment of a statutory manager resides with *APRA*.

The statutory manager may sell or otherwise dispose of the whole or any part of the ADI's business. Directors of an ADI cease to hold office when a statutory manager takes control of the ADI's business and 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.

(ii) **(Relationship between the *Banking Act* and the *Netting Act*)** Prior to the amendments to *the Banking Act* made by the *Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008* of Australia ("*Financial System Legislation Amendment Act*"), section 15C of the *Banking Act* prohibited the appointment of a statutory manager from being a ground for a creditor of any ADI to deny any obligations under a contract with the ADI, accelerate any debt owed by the ADI or close out any transaction relating to a contract with the ADI. The Financial System Legislation Amendment Act replaced section 15C of the *Banking Act* with the following:

13 It is possible for a statutory manager to be appointed to an ADI in circumstances where the ADI is not facing insolvency. This opinion is not concerned with an appointment in such circumstances and the appointment of a statutory manager to an ADI in circumstances where the ADI is not insolvent, or likely to become insolvent, is not an *insolvency proceeding* for the purposes of this opinion and will not fall within the definition of "external administration" for the purposes of the *Netting Act*.

"(1) This section applies if an ADI is party to a contract, whether the proper law of the contract is Australian law (including the law of a State or Territory) or law of a foreign country (including the law of part of a foreign country).

(2) The fact that an ADI statutory manager is in control of the ADI's business does not allow the contract, or a party to the contract, to do any of the following:

(a) deny any obligations under that contract;

(b) accelerate any debt under that contract;

(c) close out any transaction relating to that contract."[14]

The amendments to section 15C of the *Banking Act* apply to contracts made after the Financial System Legislation Amendment Act commenced on 18 October 2008.[15] We consider that this means that it does not apply to an *Agreement* entered into before this date. Also, we do not consider that section 15C applies where the close-out right is based on some event other than the appointment of a statutory manager (such as a failure to pay) even if a statutory manager has been appointed.

The new section 15C(2) of the *Banking Act* is potentially inconsistent with section 14(2) of the Netting Act to the extent that section 14(2) would permit a party to close-out *individual contracts* under the *Agreement* in accordance with its terms due to the appointment of a statutory manager to an ADI. A general principle of Australian statutory interpretation is that:

"if there is an inconsistency between one statute and a later statue the later statute prevails."[16]

This principle was not of concern in relation to the previous section 15C because it was enacted before the *Netting Act*. However, as the Financial System Legislation Amendment Act was enacted after the *Netting A*ct, there is a risk that the inconsistency between section 14(2) of the *Netting Act* and the section 15C(2) of the *Banking Act* inserted by the Financial System Legislation Amendment Act will result in an implied repeal of section 14(2) of the *Netting Act* to the extent of that inconsistency.[17]

Under *Australian law*, for a court to find that a later statute to operate so as to repeal the terms of an earlier statute:

"[t]he court must...be satisfied that the two enactments are so inconsistent or repugnant that they cannot stand together, before they can from the language of the

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14 Section 18 of Schedule 2 of the Financial System Legislation Amendment Act.

15 Section 19 of Schedule 2 of the Financial System Legislation Amendment Act.

16 **South-Eastern Drainage Board (SA) v Savings Bank of South Australia** (1939) 62 CLR 603.

17 Section 14(4) of the *Netting Act* provides that section 14(2) of that Act has "effect despite any other law". However, in **South-Eastern Drainage Board (SA) v Savings Bank of South Australia**, the High Court of Australia held that similar provisions were not sufficient to protect against implied repeal by later inconsistent legislation. The policy behind these decisions is that one parliament cannot seek to derogate the competency of a later parliament to pass legislation.

later imply the repeal of an express prior enactment, ie, the repeal must, if not express, flow from necessary implication"[18]

For the reasons explained below, in our view, the amendments to section 15C of the Banking Act should not have the effect of impliedly repealing section 14(2) of the Netting Act to the extent of its inconsistency with section 15C of the *Banking Act*. This is because:

(A) first, section 15C(2) should be interpreted as having the same substantive effect as the previous form of section 15C such that the previous section 15C should not be seen as being "re-enacted".

The Explanatory Memorandum, published by the Commonwealth Government when the Bill to enact the Financial System Legislation Amendment Act was introduced to Federal Parliament ("**Explanatory Memorandum**"), acknowledged that the Banking Act already specified in section 15C that the appointment of a statutory manager is not grounds for the counterparty to deny any obligations, accelerate any debt or close out on any transaction under a contract. It noted that section 15C was silent on whether the provision applied to contracts governed by Australian law or the law of a foreign country and that the amendments to section 15C would clarify this.[19] In other words, it seems from this that the purpose of the amendment to section 15C was to introduce the new section 15C(1), not to change the operation of the existing provision.

In addition, section 15AC of the *Acts Interpretation Act 1901* (Commonwealth) states that where an Act has expressed an idea in a particular form of words and a later Act appears to have expressed the same idea in a different form of words for the purpose of using a clearer style, the ideas shall not be taken to be different merely because different forms of words were used. Section 15C(2) of the *Banking Act* (as amended) restates the words of the previous form of section 15C except that whereas the section previously provided that the appointment of a statutory manager "is not a ground" for any other party to deny any obligations, accelerate any debt or close out any transaction, section 15C(2) states that the appointment of a statutory manager "does not allow" a person or the contract to do those things. In addition, the formatting of section 15C(2) and the former section 15C differs. In our view, these formatting and style amendments should not be regarded as substantively amending the effect of section 15C.

If there is no substantive change to the previous section 15C, then the revision of it should not be taken to be new legislation which impliedly repeals any part of the *Netting Act*.

(B) second, it is arguable that there the maxim *generalia specialibus non derogant* applies such that there is not the inconsistency needed to cause any implied repeal of section 14(2) of the *Netting Act*.

[18] **Goodwin v Phillips** (1908) 7 CLR 1 at 10 (Barton J).
[19] Sections 5.22 and 5.23 of the Explanatory Memorandum.

The maxim provides:

> "[w]here there is a general provision which, if applied in its entirety, would neutralise a special provision dealing with the same subject-matter, the special provision must be read as a proviso to the general provision and the general provision, so far as it is inconsistent with the special provision, must be deemed not to apply.[20]

In considering the interaction of section 15C(2) of the *Banking Act* and 14(2) of the *Netting Act*, the maxim may arguably operate on the basis that:

(a) the new section 15C(2) of the *Banking Act* is a broad provision that, amongst other things, provides that the appointment of a statutory manager does not allow a contract, or any other party to the contract, to close out any transaction relating to that contract; and

(b) section 14(2) of the *Netting Act* is a special provision that only operates to protect the enforceability of close-out netting under certain types of contracts.

According to the maxim, section 14(2) of the *Netting Act* would operate as a proviso to section 15C(2) of the *Banking Act*. That is, section 15C(2) would be interpreted as prohibiting close-out netting under any contract to which an ADI is a party following the appointment of a statutory manager to that ADI, other than close-out netting under a *close-out netting contract* that is permitted under the *Netting Act*.[21]

However, the view that section 14(2) of the Netting Act is not impliedly repealed to the extent of its inconsistency with the new section 15C of the Banking Act is not beyond doubt.[22]

2 Foreign companies

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

(a) Under the UNCITRAL Model Law

In July 2008 the *Cross-Border Insolvency Act 2008* of Australia ("**Cross Insolvency Act**") took effect, giving effect to the Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law ("**Model Law**").

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20 **Goodwin v Phillips** (1908) 7 CLR 1 at 14 (O'Connor J).

21 However, it is also arguable that the generalia specialibus non derogant maxim has no application in these circumstances on the basis that both section 14(2) of the *Netting Act* and section 15C(2) of the *Banking Act* are special provisions that deal with particular circumstances, namely, the appointment of a statutory manager and close-out netting.

22 For example, we note that section 5.20 of the Explanatory Memorandum considered the effect of the amendments to section 15C of the *Banking Act*, and in that context expressly referred to the ISDA Master Agreement containing clauses that make the appointment of a statutory manager a defaulting event. This may indicate an intention to prevail over the *Netting Act*.

The Model Law does not apply to *ADIs*[23].

Under Article 15 of the Model Law, a foreign insolvency official[24] can apply to an *Australian court* for recognition of the 'foreign proceeding' in respect of which that foreign insolvency official has been appointed.[25]

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,[26] unless to do so would be 'manifestly contrary' to public policy under *Australian law*.[27] The *Australian court* must decide whether the foreign proceeding should be recognised as the primary (or 'main') or ancillary (or 'non-main') foreign proceeding.[28]

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.[29] A foreign proceeding will be a foreign non-main proceeding if it is taking place in a jurisdiction in which the foreign company has an 'establishment'.[30] 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)[31]:

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

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

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

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23 Article 2 of the Model Law; section 9 of the Cross-Border Insolvency Act and regulation 4 of the Cross-Border Insolvency Regulations 2008.

24 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'.

25 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: Article 2(a) of the Model Law.

26 Article 17(1) of the Model Law.

27 Article 6 of the Model Law.

28 Under Article 19 of the Model Law, 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.

29 Article 17(2)(a) of the Model Law. Under Article 16(3) of 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.

30 Article 17(2)(b) of the Model Law. Under Article 2(f), 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'.

31 Article 29 of 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.

in each case to the same extent as if such a stay or suspension arose under the relevant applicable parts of Chapter 5[32] of the *Corporations Act*.[33] 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 it is applicable)[34].

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.[35] 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*.[36]

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.[37]

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

(a) intervene in any proceedings which the debtor is a party, provided that other requirements under *Australian law* are met;[38]

(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);[39]

(c) initiate certain actions in respect of voidable transactions under the *Corporations Act*, 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.[40]

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

32 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*.

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

34 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 Netting Act prevails over the *Corporations Act*. In any case, the Netting Act is expressed to apply "despite any other law", and the Cross-Border Insolvency Act 2008 is expressed to prevail only over the *Corporations Act* and the *Bankruptcy Act*.

35 See Article 21(1) of the Model Law.

36 Article 29 of the Model Law. This is consistent with the expressed intention of the drafters of the Cross-Border Insolvency Act 2008 that the Model Law is 'in addition to, and not in derogation of, section 601CL of the Corporations Act 2001'. As a result, any relief granted by an Australian court under the Model Law should not adversely affect the ability of a foreign liquidator to obtain an ancillary liquidation order under section 601CL of the *Corporations Act*.

37 Article 21 of the Model Law.

38 Article 24 of the Model Law.

39 Article 12 of the Model Law.

40 Article 23 of the Model Law.

an Australian insolvency official would be in respect of an *Australian company* in the same circumstances.

(b) *Letter of request and cooperation with other courts*

Section 581(3) of the *Corporations Act* provides that, where a letter of request from a court of a country other than Australia, requesting aid in an external administration matter[41], 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.

Section 581(2)(a) of the *Corporations Act* provides in effect that, 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.[42]

Under section 581(2)(b) of the *Corporations Act*, if the letter of request is received from a court of a non-prescribed country, the *Australian court* has discretion whether to assist.[43] However, we believe that, as the purpose of the letter of request provisions is to facilitate co-operation between *Australian courts* and foreign courts in external administration matters, an *Australian court* would require cogent reasons to refuse its assistance.

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

Both sections 581(2)(a) and 581(2)(b) are (to varying degrees) inconsistent with Article 25 of the Model Law, which requires the appropriate *Australian courts* to cooperate to the maximum extent 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.[44]

(c) *Ancillary liquidation order pursuant to section 601CL(14) of the Corporations Act*[45]

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:

(i) the foreign company must be registered under Division 2 of Part 5B.2 of the *Corporations Act* (which makes it a "registered foreign company");[46] and

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

42 Section 581(2)(a) *Corporations Act*. Prescribed countries are those countries which are prescribed by Regulation 5.6.74 of the Corporations Regulations and include Canada, Singapore, Switzerland, the United Kingdom and the United States of America.

43 Section 581(2)(b) *Corporations Act*.

44 Section 22(1)(a) Cross-Border Insolvency Act.

45 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*.

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

(iii) the foreign liquidator must have been appointed in, and not merely recognised by, the foreign company's home jurisdiction.[47]

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."[48] There is no requirement to pay ordinary local creditors first.[49] 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.[50]

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*.[51]

Moreover, it appears that an Australian court might not allow funds to be remitted to a foreign liquidator to the detriment of local creditors.[52]

(d) Winding up under Part 5.7[53]

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.[54] 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 (foreign or domestic)[55] creditor or foreign liquidator.

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46 Section 601CD of the *Corporations Act* provides 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.

47 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.

48 Section 601CL(15).

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

50 Although this point is not without doubt. See for example Grace, AD "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 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.

51 **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 s.556 of the Corporations Act).

52 **Re Standard Insurance Co. Limited; Re Northland Services Pty Limited** (1978) 18 Aust LR 684.

53 The Cross-Border Insolvency Act specifies that the Model Law prevails to the extent that it is inconsistent with Part 5.7 of the *Corporations Act.*

54 Section 582(3); section 9, definition "Part 5.7 body", *Corporations Act.*

55 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.*

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

(i) the foreign company is not able to pay its debts,[56] has been dissolved, 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 (inability to pay debts may be established with the assistance of certain statutory presumptions in section 585); or

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

(iii) *ASIC* 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.[57]

In addition to the statutory grounds listed at 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[58]; and
- there is a reasonable possibility that a benefit will result from the winding up. A benefit may, for example, accrue if there are local assets[59].

Under section 582(3) of the *Corporations Act*, 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.[60] 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[61]. 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,[62] then a winding up under Part 5.7

56 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.

57 Section 583 of the *Corporations Act*.

58 **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.

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

60 Section 582(3). 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).

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

62 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.

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.[63]

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.[64] 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.[65]

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.[66]

In our opinion, if foreign liquidation proceedings have been commenced in the foreign company's home jurisdiction, as a matter of practice it is unlikely that a liquidator would be appointed under Part 5.7. That is because a successful Part 5.7 application in those circumstances would result in competing insolvencies of the same foreign company where more appropriate statutory arrangements exist specifically to deal with those circumstances (namely, the letter of request and ancillary liquidation procedures). However, the Model Law does provide guidance to *Australian courts* that addresses concurrent foreign and Australian insolvency proceedings in circumstances where the foreign proceeding is subject to an application for recognition or has been recognised under *Australian law*.[67]

(e) *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 four kinds of action referred to above.

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63 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.

64 **Re English, Scottish and Australian Chartered Bank** [1893] 3 Ch 386; **Re Suidair International Airways Limited** [1951] 1 Ch 165; **Re Standard Insurance Co. Limited** [1958] Qd R 118.

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

66 Sections 555 and 583 of the *Corporations Act*; Article 13(2) of the Model Law.

67 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.

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[68].

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 four procedures we have outlined above.

68 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, **Primary Producers Bank of Australia v Hughes** (1931) 32 SR (NSW) 14; **Sack v Lord Aldenham** (1911) 7 Tas LR 84 but this proposition is not without criticism. (See for example the commentary in Grace, AD "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.

SCHEDULE 4

Setting aside and disclaimer of transactions

Setting aside transactions

The provisions of the *Corporations Act* which permit transactions entered into by an *Australian company* to be set aside in its winding up or administration are the provisions relating to:

(a) voidable transactions; and

(b) transactions made after the commencement of the winding up or administration of the company.

1 Voidable transactions

Under sections 588FE and 588FF of the *Corporations Act*, certain transactions (referred to as voidable transactions) may, by order of the court, be set aside or modified on application of a liquidator of an Australian company. The transactions must have been entered into, or an act must have been done for the purpose of giving effect to it, within certain time periods before the "relation-back day"[69] which are set out in the table below.

Type	**Suspect period**
Insolvent transaction	6 months
Insolvent transaction which is an uncommercial transaction	2 years
Insolvent transaction which is a related party transaction	4 years
Insolvent transaction for the purpose of defeating, delaying or interfering with creditor's rights on a winding-up	10 years
Unfair loan	whenever made
Unreasonable director-related transaction	4 years

The definition of "transaction" in section 9 of the *Corporations Act* is very wide and includes transfers of property, making payments, incurring obligations and granting releases. Section 588FE also extends to acts done for the purpose of giving effect to a transaction.

Voidable transactions consist of insolvent transactions, unfair loans and unreasonable director related transactions. These are described below.

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69 The relation back day is the earlier of the date on which the winding up taken to have commenced and the date on which the winding-up application is filed (section 9 of the *Corporations Act*). A winding up is taken to commence on either:
(a) the earlier of the day a court makes a winding up order or an effective resolution is passed for a winding-up; or
(b) on the day the administration begins (under the terms of the administrator's appointment) if, when the winding up order is made, the Australian company is (i) under administration; or (ii) subject to an unterminated deed of company arrangement (section 513A of the *Corporations Act*).

2 Insolvent transactions

Under section 588FC of the *Corporations Act*, a transaction will be an "insolvent transaction" if it is an unfair preference given by an Australian company or an uncommercial transaction of an Australian company where at the time of entering into the transaction the company is insolvent or where the company becomes insolvent because of matters including entering into the transaction.

Unfair preferences

Under section 588FA of the *Corporations Act*, a transaction is an "unfair preference" if it is a transaction to which an Australian company and a creditor are parties and which results in the creditor receiving a larger number of cents in the dollar in respect of an unsecured debt than it would have received in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in the winding up of the company. It is not necessary for the debtor company to desire that the creditor receive a preference in order for the transaction to be voidable under section 588FE. One example of an unfair preference is security being granted to an unsecured creditor just prior to the company's insolvency.

Special rules apply to transactions which are an integral part of a continuing business relationship, such as a running account. Transactions in the course of that relationship are only regarded as an unfair preference if, taken as a whole, they constitute an unfair preference. Only the amount (if any) by which the debit balance is reduced during the suspect period, or during any part of that period, is recoverable. The liquidator can choose any date during the suspect period. Thus the date of peak indebtedness can be chosen and the amount claimed can be the amount by which the debit balance was reduced between the chosen date and the date of the relation-back day.

Uncommercial transactions

Under section 588FB of the *Corporations Act*, a transaction is an "uncommercial transaction" of an Australian company if it may be expected that a reasonable person in the circumstances of the company would not have entered into the transaction having regard to the benefit for the company, the detriment to the company in entering the transaction, the respective benefits to other parties to the transaction of entering into it and other relevant matters.

Essentially, the provision is concerned to prevent transactions which involve clear inequality of exchange (for example, the company receives insufficient consideration for its property). Section 588FB contains no specifications as to what is commercial and uncommercial. Rather, it focuses on issues of value and whether a party has received a bargain of such magnitude that it cannot be explained by normal or ordinary commercial practice.

Exceptions to voidability

Under section 588FG(2) of the *Corporations Act*, a court cannot make an order in respect of an unfair performance or an uncommercial transaction which materially prejudices a right or interest of a person if it is proved that:

(a) the person became a party to the transaction in good faith. Good faith would be absent if there were fraud or if there subsisted an intention on the part of the person to obtain an advantage vis a vis the other creditors of the company. 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; and

(b) at the time when the person became a party to the transaction:

(i) the person had no reasonable grounds for suspecting that the company was insolvent (in the sense that its counterparty was unable to pay all its debts as and when they become due and payable) at that time or would become insolvent because of matters including entering into the transaction or a person doing an act or making an omission for the purpose of giving effect to the transaction; and

(ii) a reasonable person in his/her circumstances would have no grounds for so suspecting; and

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 the person an actual apprehension or fear that the company was unable to pay its debts when they became due and payable. The notion also embodies a mistrust of the company's ability to pay its debts as they become due, and an appreciation of the advantage which the person's acceptance of the payment would have as between the person and other creditors of the company; and

(c) the person provided valuable consideration under the transaction or changed his/her 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.

3 Unfair loans

Under section 588FD of the *Corporations Act,* a loan to an *Australian company* is unfair if, and only if:

(a) the interest on the loan was extortionate when the loan was made, or has since become extortionate because of a variation; or

(b) the charges in relation to the loan were extortionate when the loan was made, or have since become extortionate because of the variation,

even if the interest is, or the charges are, no longer extortionate.

4 Unreasonable director-related transactions

Under section 588FDA of the *Corporations Act*, a payment made by an *Australian company*, conveyance, transfer or other disposition of property of an *Australian company*, issue of securities by an *Australian company* or incurrence of an obligation (including a contingent obligation) to make such a payment, disposition or issue and is an unreasonable director related transaction of the company if:

(a) the payment, disposition or issue is, or is to be made to a director of the company, close associate of a director of the company or a person on behalf of, or for the benefit of, either of such persons; and

(b) it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction having regard to:

(i) the benefits to the company of entering into the transaction; and

(ii) the detriment to the company of entering into the transaction; and

(iii) the respective benefits to other parties to the transaction of entering into it; and

(iv) any other relevant matter.

5 Transactions made after winding up or administration commences

Section 468 of the *Corporations Act* renders void any disposition of property of an Australian company effected after the commencement of its winding up by an Australian court (see footnote 1 above). Section 468 does not apply to exempt dispositions, which include dispositions by a liquidator, an administrator or a payment on or prior to the date of the winding up order by an Australian bank in good faith and in the ordinary course of banking business.

Section 437D of the *Corporations Act* renders void a transaction or a dealing purported to be entered into by an Australian company under administration unless entered into, or consented to, by the administrator or entered into under an order of a court.

6 Voluntary conveyances to defraud creditors

We also note that section 37A of the *Conveyancing Act 1919* (NSW) provides that an alienation of property made with intent to defraud creditors is voidable by any person prejudiced by the alienation.[70] The section does not apply to any interest in property alienated to a purchaser in good faith not having, at the time of the alienation, notice of the intent to defraud creditors.

Disclaimer of transactions

Section 568 of the *Corporations Act* provides that a liquidator of a company may disclaim property of the company at any time, including any contract entered into by the company.[71] If the liquidator considers that the contract is unprofitable, they may disclaim it without leave of the court; otherwise leave of the court is required.[72]

Where leave is required, the court may grant leave subject to conditions and orders the court considers just and equitable.[73] In deciding whether to give leave the court will consider the prejudice various classes of creditors would be likely to suffer in the event of disclaimer and in the event of leave being refused.[74]

A contract will be considered unprofitable for the purposes of section 568 *only* "if it imposes on the [insolvent] company continuing financial obligations which may be regarded as detrimental to the creditors".[75] Before a contract will be unprofitable it must also give rise to prospective liabilities.[76] The fact that the company could have made a better bargain is not a reason for characterising a

70 There are equivalent provisions in the Property Law Act 1958 (Vic) s 172; Property Law Act 1974 (Qld) s 228; Law of Property Act 1936 (SA) s 86; Conveyancing and Law of Property Act 1884 (Tas) s 40; Property Law Act 1969 (WA) s 89.

71 Section 568(1)(f) of the *Corporations Act.*

72 Section 568(1A) of the *Corporations Act.*

73 Section 568(1B) of the *Corporations Act.*

74 **Re Tulloch Ltd (in liq)** [1978] 3 ACLR 808.

75 **Re Real Investments Pty Ltd (in liq)** [2000] 2 QdR 555 per Chesterman J.

76 **Re Real Investments Pty Ltd (in liq)** [2000] 2 QdR 555.

contract as unprofitable.[77] Nor will a court characterise an agreement as an "unprofitable contract" merely because it is financially disadvantageous to the company.

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*.

77 **Dekala Pty Ltd (in liq) v Perth Land & Leisure Ltd** (1987) 17 NSWLR 664 at 667.

SCHEDULE 5

Australia's Netting Act

The *Netting Act* was enacted to remove certain legal doubts as to the efficacy of netting operations under the law of the *Australian jurisdictions*. In addition to close-out netting, the *Netting Act* validates certain market netting contracts, approved real time gross settlement payment systems and the existing 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*".

1 What is a "*close-out netting contract*"?

1.1 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."

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

1.3 We consider that the *MNA* is a *close-out netting contract* for the purposes of the *Netting Act*.[78] This is because under the *MNA*:

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[78] We consider that this conclusion is supported by the decision of the Federal Court of Australia in **Lindholm, re Opes Prime Stockbroking Limited (Administrators appointed) (Receivers and Managers appointed)** [2008] FCA 1425 at paragraph 41 (Finklestein J).

(a) pursuant to § 2.3, the *MNA*, all Netted Agreements and all transactions under the Netted Agreements, are expressed to form a single agreement between the parties;

(b) if a Close-Out Event has occurred and is continuing:

(i) pursuant to § 4.3 ("Effect of Initiation Close-Out"), with effect from the Early Termination Date, all further payment and performance obligations in respect of all transactions under such Netted Agreements are released (and not merely suspended) and existing duties and obligations of the parties are replaced by the obligation of one Party to pay the other a Settlement Amount in respect of each Closed-Out Agreement;

(ii) pursuant to § 7.1 ("Determination of Settlement Amounts"), the Settlement Amount under each Closed-Out Agreement must be determined; and

(iii) pursuant to § 8.1 ("Netting-Off"), Settlement Amounts owed by both Parties are aggregated and netted-off and only the difference is owed by the Party with the larger aggregate obligation.

1.4 We consider that the *CPMA* is a *close-out netting contract* for the purposes of the *Netting Act* if, and only if, clause 10.6 is included in the *CPMA* and clause 10.8 is not included in the *CPMA*.[79] This is because under the *CPMA*:

(a) pursuant to clause 10.6, all Principal Agreements and all transactions entered into under the Principal Agreement are expressed to form a single agreement between the parties; and

(b) if a 'Section 2 Notice' has been given:

(i) pursuant to clause 3.1 ("Determination of Settlement Amounts"), the Settlement Amount for each Principal Agreement and each transaction under a Principal Agreement must be determined; and

(ii) pursuant to clause 4.1 ("Set-Off"), the Settlement Amounts owing by each party are aggregated and set-off against the Settlement Amounts owing by the other party; and

(iii) pursuant to clause 4.2 ("Discharge of Settlement Amount"), each party's obligation to pay a Settlement Amount under a Principal Agreement and each transaction under a Principal Agreement is discharged to the extent of the set-off under clause 4.1; and

(iv) pursuant to clause 4.4(a) ("Final Net Settlement Amount for Closed-Out Agreements"), a net amount becomes payable by one party to the other.

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

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

- is governed by *Australian law*; and

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79 We consider that this conclusion is supported by the decision of the Federal Court of Australia in **Lindholm, re Opes Prime Stockbroking Limited (Administrators appointed) (Receivers and Managers appointed)** [2008] FCA 1425 at paragraph 41 (Finklestein J).

- is entered into in circumstances that are within "Commonwealth constitutional reach";

then:

- obligations under a *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*.

Section 14(1) only applies in circumstances where the *close-out netting contract* is governed by *Australian law*. As instructed, we have assumed that the relevant agreements are not governed by *Australian law* and have therefore not considered section 14(1) of the *Netting Act* further in this opinion.

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

3.1 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" where:

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

then:

- obligations under a *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*.

3.2 Section 5 of the *Netting Act* provides that "a person goes into external administration if:

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

(b) they become an individual who is an insolvent under administration within the meaning of the *Corporations Act*; or

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

3.3 In addition, sections 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; and

- 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.

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

4 Relationship with other law

4.1 Section 14(4) of the *Netting Act* provides that section 14(2) has "effect despite any other law". In addition, specific reference is also made to the fact that section 14(2) overrides any Australian legislation which provides for:

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

- the priority of a bank's debts to the Reserve Bank of Australia over the other debts owed by the bank (other than those owed to depositors).

4.2 Specific reference is made to the insolvency provisions of the *Corporations Act* and certain provisions of the *Bankruptcy Act 1966* of Australia. A note is made in the legislation to the effect that the express recognition given to close-out netting in section 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. Please see Schedule 3 which considers the extent to which recent amendments to the *Banking Act* may prevail over the *Netting Act*.

5 Constitutional reach of the *Netting Act*

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

5.3 Constitutional scope of section 14(2)

As noted above, section 14(2), which deals with the operation of close-out netting on the "external administration" of a party, applies only if:

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

- *Australian law* governs the external administration.

6 Circumstances affecting the availability of section 14(2) of the *Netting Act*

6.1 Section 14(3)

Under section 14(3) of the *Netting Act*, netting under section 14(2) of the *Netting Act* will not be available to a party (the "**Solvent Party**") if, at the time of "acquiring" the right or obligation under the *Agreement*, it has notice of the fact that the other party was not able to pay its debts as and when they became due and payable (the "**Insolvent Party**").

We consider that the expression "acquiring" in the context of an *individual contract* means an acquisition by the Solvent Party of that *individual contract* from an original counterparty of the Insolvent Party and does not include entry into new *individual contract*s by the Solvent Party with the Insolvent Party under the *Agreement* (please see 6.2 below in relation to entry into new *individual contract*s with notice of insolvency).

Accordingly, any profit or loss arising in respect of an *individual contract* acquired by the Solvent Party at a time when that party had notice of the insolvency of the Insolvent Party will not be permitted to be netted under the *Agreement* against profits and losses under other *individual contract*s.

6.2 Section 14(5)

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 another person where the party has become subject to *external administration*, the obligation has been terminated and either:

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

(b) when the transaction that created the terminated obligation 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:

   (i) entering into the transaction; or

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

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

It follows that it is important for a counterparty seeking to rely on the *netting provisions* of the *Agreement* that it:

(a) enters into the *Agreement*, each *master agreement* and each *individual contract* under them in good faith. Good faith would be absent if there were fraud or if there subsisted an intention on the part of the counterparty to obtain an advantage vis a vis the other creditors of the *Australian company*. An *Agreement*, *master agreement* or *individual contract* 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;

(b) at the time when it became a party to an *individual contract* or received *Eligible Credit Support* (in the case of the *CSA*), the counterparty had no reasonable grounds for suspecting that the *Australian company* was insolvent (in the sense that the *Australian company* was unable to pay all its debts as and when they become due and payable) or would become insolvent if it entered into the *individual contract* or received *Eligible Credit Support* transferred to it (in the case of the *CSA*). 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 the counterparty (as payee) an actual apprehension or fear that the *Australian company* was unable to pay its debts when they became due and payable. The notion also embodies a mistrust of the *Australian company*'s ability to pay its debts as they become due, and an appreciation of the advantage which the counterparty's acceptance of the payment would have as between the counterparty and other creditors of the *Australian company*. To avoid this occurring, the counterparty might wish to consider putting in place systems to ensure that it is notified of any insolvency of the *Australian company*; and

(c) the counterparty provided valuable consideration under the *individual contract* or changed its position in reliance on the *individual contract*. 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 an *individual contract* to make payments or deliveries would constitute valuable consideration for these purposes.

8 Circumstances not affecting the availability of section 14(2) of the *Netting Act*

8.1 Assignments and other interests

As discussed in paragraph 3, 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 person other than the *Australian company* and the counterparty in a *master agreement* and each *individual contract* under a *master agreement* terminated and netted under the *Agreement* does not prevent netting and termination conducted in accordance with the *Agreement*.

8.2 Liquidator's right to disclaim unprofitable contracts

Section 568(1) of the *Corporations Act* allows a liquidator to disclaim unprofitable contracts, as described further in Schedule 4.

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 the *Australian company* would not be entitled to disclaim any particular *master agreement* or *individual contract*s under a *master agreement* under the *Agreement* and would only be entitled to disclaim any net amount payable by the counterparty following the operation of the termination and netting in accordance with the *Netting Act*.

8.3 Mutuality

The *Netting Act* requires only the presence of a *close-out netting contract* between the parties and does not require that the obligors under 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 is 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 *individual contract*s entered into between them can be netted even where some *individual contract*s 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), we believe that it may be appropriate that "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 *Agreement* must be a valid contract. As a result, issues such as the power of trustees to enter into the *Agreement* will still be relevant, as will other issues such as compliance by directors with their fiduciary duties in entering into the *Agreement*.

8.4 Any other laws

Section 14(4) of the *Netting Act* provides that section 14(2) takes effect "despite any other law (including the specified provisions)". As discussed in Part 4 of this Schedule the "specified provisions" include sections of the *Banking Act* which provide for the priority depositors with a bank have in respect of the bank's assets in Australia. This means that, subject to our comments in Schedule 3, the netting pursuant to the *Netting Act* operates ahead of any priority given to depositors under the *Banking Act*.