

EXPLANATORY STATEMENT

Issued by authority of the Minister for Revenue and Financial Services

Corporations Act 2001

Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018

Section 1364 of the *Corporations Act 2001* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Subparagraphs 415D(6)(b)(i), 434J(5)(b)(i) and 451E(5)(b)(i) of the Act provide that regulations can prescribe a right contained in a kind of contract, agreement or arrangement to which subsections 415D(1), 434J(1) and 451E(1) respectively do not apply.

The *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (the Amending Act) inserted provisions into the Act to stay the enforcement of ipso facto clauses against relevant entities (the ipso facto stay). The ipso facto stay applies to clauses (including self-executing clauses) which entitle a party to enforce a right under a contract, agreement or arrangement (collectively, arrangements) on the occurrence of various insolvency-related trigger events regardless of the counterparty's continued performance of its obligations under the contract.

The lack of protection from the operation of ipso facto clauses has been a key criticism of Australia's insolvency regime in general, particularly in the context of the voluntary administration regime contained in Part 5.3A of the Act and compromises and arrangements under Part 5.1 of the Act.

The operation of ipso facto clauses can reduce the scope for a successful restructure, destroy the enterprise value of a business entering formal administration, or prevent the sale of the business as a going concern. These outcomes can also reduce or eliminate returns in subsequent liquidation by disrupting the businesses' contractual arrangements and destroying goodwill, potentially prejudicing other creditors and defeating the purpose of a voluntary administration.

The ability of a business' suppliers, customers or other creditors to terminate a contract solely due to the financial position of the company or the commencement of a formal restructure increases uncertainty for the potential investor and makes the business a less attractive investment opportunity. As a result, the operation of ipso facto clauses may deter such investment, or reduce the price a potential investor is willing to pay for a business.

The reforms made by the Amending Act were one aspect of reforms to Australia's insolvency law and formed part of the National Innovation and Science Agenda. The reforms aim to promote a culture of entrepreneurship and innovation, which will in turn reduce the stigma of failure and help drive business growth, local jobs and global

success. The reforms also promote business recovery and restructuring as a means to drive cultural change.

As a result of the reforms, certain rights that amend or terminate an arrangement will not be enforceable and are stayed where a company enters a scheme of arrangement, appoints a managing controller, or has come under voluntary administration, except in limited circumstances.

The ipso facto stay assists businesses to continue to trade in order to recover from an insolvency event. The stay also promotes the objectives of the current restructuring regime in the Act by assisting viable but financially distressed or insolvent companies to continue to operate while they restructure their business.

The ipso facto stay will only apply to the enforcement of rights in arrangements, contracts and agreements. The stay is not intended to interfere with any statutory rights of contractual parties.

The amendments made by the Amending Act include a provision that allow regulations to prescribe the kinds of arrangements where the rights contained in those arrangements will not be subject to the ipso facto stay. Similarly, a Ministerial declaration may exclude the enforcement of certain rights within an arrangement from the operation of the stay even when the arrangement as a whole is not excluded. This reflects the fact that there are a variety of situations where staying the operation of ipso facto clauses is either unnecessary or undesirable. For example, the ipso facto stay should not apply to certain kinds of arrangements where:

- arrangements are required or contemplated by Australia's laws, or where international obligations would be disturbed;
- markets have evolved to depend on established systems and expectations, and the ipso facto stay would significantly disrupt those markets;
- sophisticated counterparties traditionally negotiate their own arrangements in relation to complex transactions or complex financial products, and the ipso facto stay would undermine those arrangements;
- the ipso facto stay would lead to unintended consequences, or would severely disadvantage some contracting parties;
- parties have already entered into arrangements to attempt to alleviate a business' financial stress, and staying ipso facto clauses would undermine or significantly change the terms of those arrangements; or
- the operation of an ipso facto clause is inherent to the operation of an arrangement, and staying it would lead to a perverse outcome.

The Regulations amend the *Corporations Regulations 2001* and insert new provisions that prescribe the kinds of contracts, agreements or arrangements for the purposes of subparagraphs 415D(6)(b)(i), 434J(5)(b)(i) and 451E(5)(b)(i) of the Act. This will ensure that rights in those kinds of arrangements remain available to the parties to those arrangements should the events in subsections 415D(1), 434J(1) and 451E(1) respectively occur.

Submissions received in a public consultation, which took place during the development of the Amending Act, proposed the kinds of arrangements which should be excluded from the operation of the ipso facto stay. These submissions were taken into account in developing the Regulations.

Further submissions were received in targeted consultations which took place during the development of the Regulations. Exposure drafts of the Regulations, and accompanying explanatory materials, were released for public consultation from 16 April 2018 to 11 May 2018. Submissions received during these consultations were also taken into account in the development of the Regulations.

The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

The Regulations commenced on 1 July 2018.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The Regulations prescribe that the stay on ipso facto clauses will not apply to rights contained in the kinds of arrangements set out in Attachment. This ensures that the parties will remain able to exercise their contractual rights where these are triggered by a relevant insolvency event.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.

Explanation of provisions**Clauses 1, 2, 3 and 4—Machinery provisions**

Clauses 1 to 4 of the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (the Regulations) are machinery provisions setting out:

- the name of the Regulations;
- the day the Regulations commenced;
- the authority for making the Regulations; and
- that the items in the schedule to the Regulations amend or repeal each instrument that is specified in the schedule and have effect according to their terms.

Item 1 of Schedule 1—Prescribed kinds of contracts, agreements or arrangements for the purposes of section 415D of the *Corporations Act 2001*

Item 1 of Schedule 1 inserts regulation 5.1.50 into the *Corporations Regulations 2001* (the Corporations Regulations). Regulation 5.1.50 provides that rights contained in the kinds of contracts, agreements or arrangements referred to in subregulation 5.3A.50(2) are not subject to the stay in section 415D of the *Corporations Act 2001* (the Act).

Item 2 of Schedule 1—Prescribed kinds of contracts, agreements or arrangements for the purposes of section 434J of the Act

Item 2 of Schedule 1 inserts regulation 5.2.50 into the Corporations Regulations. Regulation 5.2.50 provides that rights contained in the kinds of contracts, agreements or arrangements referred to in subregulation 5.3A.50(2) are not subject to the stay in section 434J of the Act.

Item 3 of Schedule 1—Prescribed kinds of contracts, agreements or arrangements for the purposes of section 451E of the Act

Item 3 of Schedule 1 inserts regulation 5.3A.50 into the Corporations Regulations. Subregulation 5.3A.50(1) provides that rights contained in the kinds of contracts, agreements or arrangements referred to in subregulation 5.3A.50(2) are not subject to the stay in section 451E of the Act.

Subregulation 5.3A.50(2) provides a list of the kinds of contracts, agreements or arrangements (collectively, arrangements) under which rights are not subject to the stays in sections 415D, 434J and 451E of the Act.

Arrangements relating to laws, international obligations and public services**Paragraph (a)—agreements within the meaning of the Convention in the *International Interests in Mobile Equipment (Cape Town Convention) Act 2013***

Paragraph (a) prescribes that the operation of the stay on the enforcement of ipso facto clauses (the ipso facto stay) does not apply to agreements within the meaning of the

‘Convention’, as defined in section 3 of the *International Interests in Mobile Equipment (Cape Town Convention) Act 2013* (the CTCA). Convention, in section 3 of the CTCA, means the *Convention on International Interests in Mobile Equipment* done at Cape Town on 16 November 2001, as amended and in force for Australia from time to time (the Cape Town Convention).

The CTCA enacts the Cape Town Convention and associated *Protocol on Matters Specific to Aircraft Equipment* into Australian law.

The Cape Town Convention standardises transactions involving movable property by creating international standards for the registration of contracts of sale, security interests, leases and conditional sales contracts. The *Protocol on Matters Specific to Aircraft Equipment* is a protocol that was signed at the same time as the Cape Town Convention and facilitates the financing of aircraft by providing creditors with an internationally recognised set of rights in the event of a debtor’s default or insolvency, and allowing creditors to register their interests in an international register to guarantee the priority of their claim against other parties.

Agreement is defined in Article 1 of the Cape Town Convention as a security agreement, a title reservation agreement or leasing agreement. It is intended that each of these agreements are captured by the provision and the respective rights contained in those agreements are not affected by the ipso facto stay.

These agreements are prescribed on the basis that the CTCA implements international obligations and any agreements and rights contemplated by those instruments should be preserved from the effect of the ipso facto stay.

While there are already provisions in the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* that seek to guarantee the primacy of the CTCA, the agreements contained in the Cape Town Convention are also prescribed in the Corporations Regulations to provide the greatest possible degree of certainty that they are not captured by the ipso facto stay.

Paragraph (b)—Government licences, permits, or approvals

Paragraph (b) prescribes that the ipso facto stay does not apply to arrangements that are licences, permits or approvals issued by the Commonwealth, a State or a Territory, an authority of the Commonwealth or of a State or a Territory, or a local government (such as a council).

Government licences, permits and approvals can come with certain conditions for their validity. The holder must comply with the conditions of the licence, permit or approval otherwise it may be revoked by the issuing authority.

The conditions that a holder is required to comply with are usually specified in statute, and, as a result, can be considered privileges or statutory rights. As the ipso facto stay does not apply to statutory rights, such conditions would not be captured by the stay.

To the extent that the conditions are contained in an arrangement between the issuing body and the holder of the licence, permit or approval, they are excluded from the ipso facto stay by this provision.

The conditions that accompany a licence, permit or approval are often in place for public safety and the greater good of the community. If those conditions are not satisfied, the issuing body might not consider it appropriate that the holder retain the licence, permit or approval.

The ipso facto stay was not intended to prevent Governments from terminating Government issued licences, permits or approvals on the grounds of a relevant insolvency event, if not entering the insolvency event was a condition.

To provide certainty that Government issued licences, permits or approvals are not subject to the ipso facto stay, they have been excluded under this provision.

Paragraph (c)—arrangements relating to Australia’s national security, border protection or defence capability

Paragraph (c) prescribes that the ipso facto stay does not apply to arrangements relating to Australia’s national security, border protection or defence capability.

The important nature of services relating to national security, border protection and defence capability requires the ability to respond to urgent and unforeseen events such as national and international emergencies, natural disasters, and terrorist and cybersecurity events.

Parties are often contracted to provide goods and services relating to national security, border protection and defence capability such as vehicles, vessels, border protection or defence equipment, related assets or facilities, or vital services that support such things.

It was not intended that the ipso facto stay capture arrangements relating to Australia’s national security, border protection or defence capability and to provide certainty that such arrangements operate without disruption, they have been excluded under this provision.

Paragraphs (d) and (e)—arrangements for the supply of goods or services to a public hospital or public health service, or by or on behalf of a public hospital or public health service

Paragraphs (d) and (e) prescribes that the ipso facto stay does not apply to:

- arrangements for the supply of goods or services to a public hospital or public health service; or
- arrangements for the supply of goods or services by or on behalf of a public hospital or public health service.

Public hospitals and public health services provide vital services to the community. It was not intended that the ipso facto stay interfere with arrangements for the supply of goods or services to, or by or on behalf of, a public hospital or public health service.

The provision intends to capture arrangements for the supply of goods or services such as medical or hospital equipment, fixtures and fittings, infrastructure and

building works, or other vital services for the operation of public hospitals or public health services.

The provision also intends to capture arrangements for the supply of goods or services provided by or on behalf of a public hospital or public health services, such as patient transport or arrangements for external care of patients.

To ensure the ipso facto stay does not interfere with the supply of such goods or services, such arrangements are excluded from the stay.

Paragraph (f)—arrangements for the supply of essential or critical information technology, or communications technology, products or services, to Government

Paragraph (f) prescribes that the ipso facto stay does not apply to arrangements for the supply of essential or critical information technology, or communications technology, products or services, to Government or to the public on behalf of Government.

Government in this provision includes:

- the Commonwealth, a State, or a Territory;
- an authority of the Commonwealth, a State, or a Territory; or
- a local governing body established by or under a law of a State or a Territory (such as a local council).

The provision also captures the supply of such products or services to the public on behalf of the entities listed above.

Essential or critical information technology, or communications technology, products or services includes items such as radio communications or telecommunications, data storage or hosting, supply and support of Government operating systems, and supply and support of related hardware. It would be a perverse policy outcome for the ipso facto stay to interfere with the provision of products or services that underpin police, fire and rescue, and ambulance information technology and communication services for example.

To ensure the ipso facto stay does not interfere with such arrangements, they have been excluded from the operation of the stay.

Arrangements relating to securities and financial products

Paragraph (g)—arrangements that are derivatives, or are directly connected with derivatives

Paragraph (g) prescribes that arrangements that are derivatives, or directly connected with derivatives, are not subject to the ipso facto stay.

A derivative, for the purposes of this paragraph, is defined in section 761D of the Act and generally means an arrangement where a party agrees to provide consideration to someone in the future, and the amount of consideration to be paid is dependent on the value of something else, such as an asset, rate, index or commodity.

Derivative transactions are generally governed by a master agreement, and can adopt the terms published by the International Swaps and Derivatives Association (the ISDA) master agreement if the parties agree. The ISDA master agreement (as it stands from time to time) may provide for netting, set-off and various standard termination rights, each of which may be triggered by a relevant insolvency event. If such terms vary from the standard terms in the ISDA master agreement, the arrangements are still captured by this provision if they meet the definition of derivative, or are directly connected with derivatives.

The provision acknowledges that derivative transactions can often involve more than just the derivative arrangement itself. Side arrangements that are directly connected with the derivative arrangement can provide for or govern an ancillary set of rights or obligations agreed between the parties. It was not intended that the ipso facto stay capture these arrangements.

The ipso facto stay could undermine the utility of derivative arrangements, including those drawing on the standard terms in the ISDA master agreement, and disturb a large number of subordinate agreements made in reliance on their terms. For this reason any arrangements that are derivatives, or are directly connected with derivatives, will be excluded from the ipso facto stay.

Paragraph (h)—arrangements that are, or are directly connected with, securities financing transactions

Paragraph (h) prescribes that the ipso facto stay does not apply to arrangements that are, or are directly connected with, securities financing transactions (SFT).

SFTs are generally transactions where securities are used to borrow cash or vice versa. In these types of transactions, ownership of securities temporarily change in return for ownership of cash temporarily changing. At the end of an SFT, the changes in ownership revert back to their original position, with a small fee being paid depending on the terms of the transaction. Put simply, SFTs allow investors and firms to use assets they own, such as shares or bonds, to secure funding for their activities.

SFTs include repurchase transactions, which can involve selling a security and agreeing to repurchase it in the future for an additional amount, securities lending, which can involve lending a security for a fee in return for a guarantee in the form of financial instruments or cash given by the borrow, or sell/buy-back transactions.

Such transactions are often entered into between sophisticated parties who are well equipped to engage in those types of transactions. They are prescribed so that the ipso facto stay does not interfere with or undermine those arrangements.

Paragraph (i)—arrangements for the underwriting of an issue or sale of securities, financial products, bonds, promissory notes or syndicated loans

Paragraph (i) prescribes that the ipso facto stay does not apply to arrangements for the underwriting of securities, financial products, bonds, promissory notes or syndicated loans.

Underwriting services are generally provided by financial institutions who accept the financial risk and liability arising out of certain transactions, and guarantee payment to cover damage or financial loss. The provision is intended to capture arrangements between an underwriter and an entity which is issuing or selling securities, financial products, bonds, promissory notes or syndicated loans.

It is common for an agreement to underwrite to be conditional on the entity being solvent at the time at which the underwriting is to take place. The commercial arrangement is not intended to extend as far as binding underwriters to subscribe for the securities of an insolvent issuer.

This provision recognises that the ipso facto stay is not intended to curtail the rights of an underwriter who has promised to subscribe for securities for example, to terminate that arrangement on the occurrence of an insolvency event.

Parliament has previously similarly recognised the importance of rights to termination for insolvency in the context of takeovers or mergers (for example, see paragraph 652C(1)(h) and subsection 652C(2) of the Act).

Paragraph (j)—arrangements for the subscribing, or procuring subscribers, for securities, financial products, bonds, promissory notes or syndicated loans

Paragraph (j) prescribes that the ipso facto stay does not apply to arrangements under which a party is, or may be liable to subscribe for, or to procure subscribers for, securities, financial products, bonds, promissory notes or syndicated loans.

There are many arrangements relating to subscribing for securities, financial products, bonds, promissory notes or syndicated loans that may not be strictly considered to be underwriting agreements for the purposes of paragraph (i). This paragraph excludes those arrangements from the operation of the stay for the same reasons as those at paragraph (i).

Paragraph (k)—arrangements that are, or govern, securities, financial products, bonds, promissory notes, or syndicated loans

Paragraph (k) prescribes that the ipso facto stay does not apply to arrangements that are, or govern, securities, financial products, bonds, promissory notes, or syndicated loans.

If the stay were to apply to these arrangements, it may prevent Australian institutions from enforcing rights based on events of default that are typical and long-accepted in financial markets. This may adversely affect Australian companies seeking to access that capital.

In this provision, securities may include instruments such as debentures, and financial products may include insurance.

Paragraph (l)—arrangements where securities are, or may be, offered under a rights issue

Paragraph (l) prescribes that the ipso facto stay does not apply to arrangements under which securities are, or may be offered, under a rights issue. This paragraph excludes these arrangements for the same reasons as those at paragraph (k).

Paragraph (m)—arrangements for the sale of a business

Paragraph (m) prescribes that the ipso facto stay does not apply to arrangements for the sale of all or part of a business. This paragraph clarifies that a purchase by way of the sale of securities or financial products in the entity being purchased is also captured.

The sale and purchase of a business in financial trouble is often negotiated as an alternative to a formal insolvency process.

The operation of the ipso facto stay on arrangements for the sale of a business in financial trouble can significantly impact the sale price. If the stay was to operate, the sale price would be lower to take into account a purchaser having to complete the purchase of a business that is subject to a formal insolvency process rather than being able to terminate the agreement. This will significantly impact the inflow of capital into a business in financial trouble and make it more difficult to extricate an otherwise performing business from an insolvency or restructuring process.

To ensure the ipso facto stay does not impact on the sale price of businesses, arrangements for the sale of businesses are excluded from the stay.

Paragraph (n)—arrangements for the issue of securities, financial products, bonds, promissory notes or syndicated loans belonging to a pre-1 July 2018 class of fungible instruments

Paragraph (n) prescribes that the ipso facto stay does not apply to certain arrangements related to debt capital market transactions.

It is common in debt capital markets for an issue of tradable notes or bonds (known as ‘notes’) to be made so as to be consolidated with an earlier issue into a single series. All notes in a series are treated, in effect, as being fungible.

Issuance in series, sometimes known as ‘tapping’, can be more convenient to issuers and investors than a new non-fungible series because liquidity in a consolidated series can be higher than liquidity in smaller non-fungible issues. The availability of secondary market trading prices for existing notes also makes ‘tapping’ attractive.

It is critical to fungibility that the rights attaching to all notes in the series are the same. It would be impractical if some rights on some notes were stayed and others not. That would mean the new notes could not be considered fungible, and, in effect, the legislation would preclude tapping. This would disrupt the usual operation of capital markets.

As such, the stay does not apply to a note that is issued after the commencement date of the stay on terms that it is to be consolidated, and form a single class, with earlier issued notes, where the terms are identical in all respects with such notes (except for such details as their respective issue dates, interest commencement dates and issue prices).

Paragraph (o)—margin lending facilities, or arrangements directly connected with margin lending facilities

Paragraph (o) prescribes that the ipso facto stay does not apply to ‘margin lending facilities’, by excluding arrangement which are, or are directly connected with, margin lending facilities.

A margin loan generally lets the borrower borrow money to invest, and uses the borrower’s investments as security for the loan. Margin lending is specifically regulated in the Act.

A ‘margin lending facility’ is, as defined in section 761EA of the Act, a standard margin lending facility, a non-standard margin lending facility or a facility declared to be a margin lending facility. It is intended that this provision captures all of those facilities.

The provision also captures arrangements that are directly connected with margin lending facilities.

The operation of a margin lending contract is time-critical and relies on the operation of ipso facto clauses for its timely operation. The operation of an ipso facto clause is inherent to the operation of such contracts and staying it would lead to a perverse outcome. As such, margin lending facilities are excluded from the operation of the stay.

Paragraph (p)— covered bond arrangements

Paragraph (p) prescribes that the ipso facto stay does not apply to certain covered bond transactions. This includes arrangements that are a covered bond, are for the issue of covered bonds, or are directly connected with a covered bond or the issuing of a covered bond.

‘Covered bonds’ are defined in section 26 of the *Banking Act 1959* as bonds, notes or other debentures issued by an authorised deposit taking institution (ADI) secured by assets owned by a covered bond special purpose vehicle and, from the investor’s perspective, are recoverable from the ADI. In other words, covered bonds are a form of secured funding for financial institutions.

As the bonds are secured against a pool of assets, investors in covered bonds are able to draw on the pool of assets securing the bond if the issuer experiences an insolvency event. Covered bonds are specifically regulated to ensure investors are adequately protected. The operation of the ipso facto stay to these arrangements can undermine their purpose and intended effect. Covered bond arrangements are excluded from the ipso facto stay to provide certainty to investors that they can draw on the pool of

assets securing the covered bonds if the issuer experiences a relevant insolvency event.

Complex arrangements between sophisticated parties

Paragraph (q)—arrangements providing for the management of financial investments

Paragraph (q) prescribes that the ipso facto stay does not apply to arrangements that provide for the management of financial investments.

Financial investment management arrangements are generally arrangements between an investment adviser and an investor, and provide for the management of the investor's assets. These arrangements generally govern the extent to which an adviser can manage assets and make investment decisions, usually in accordance with prescribed investment guidelines. These arrangements might also stipulate associated fees and expenses, custody, reporting, compliance and termination terms.

It is common practice in the asset management industry that investment management arrangements contain clauses which allow termination upon adverse financial situations such as insolvency. Investment management arrangements often involve sophisticated participants and operate in a relatively small market.

To ensure the ipso facto stay does not undermine or interrupt such arrangements, they have been excluded from the operation of the stay.

Paragraphs (r) and (s)—arrangements involving a special purpose vehicle for the provision of securitisation, a public-private partnership or project finance.

Paragraph (r) prescribes that the ipso facto stay does not apply to arrangements involving a special purpose vehicle (SPV), where those arrangements provide for securitisation or a public-private partnership (PPP).

An SPV is an entity such as a company, trust or partnership with no business record that is created to carry out a specific business purpose or activity. SPVs can play an integral part of asset securitisation, PPP and project finance arrangements.

Securitisation involves pooling various types of financial assets and selling the related cash flows, in one consolidated financial instrument, to third party investors as securities. Contractual debts (such as mortgages, loans and credit cards) are types of financial assets that are often securitised.

A typical securitisation arrangement involving an SPV involves:

- a sponsor pooling together financial assets and selling them to an SPV;
- an SPV purchasing those financial assets and issuing marketable securities to third party investors; and
- service providers who assist and facilitate the transactions.

PPPs are often used by governments to procure large and costly infrastructure projects and related services. While there is not a strict set of criteria that defines a PPP, the principle features include:

- the provision of service-enabling infrastructure that includes private sector skills to deliver a combination of design, construction, financing, maintenance operations and delivery of services;
- risk sharing between the public and private sectors;
- contribution by Government through land, capital works, risk sharing or other supporting mechanisms; and
- payments from Government or users to the private sector on the basis of service delivery.

PPPs often use an SPV to provide a separate entity for the project. An SPV can provide a good vehicle for raising funds, establishing legal relationships, assuring delivery of services and managing risk, all within a single long-term entity. The SPV can be a party to a web of contracts that support and are necessary for project such as sponsors, debt holders, insurance, procurement and construction.

Sophisticated parties are usually parties to an SPV for a securitisation arrangement or a PPP project, and to ensure the ipso facto stay does not interfere with or undermine those arrangements, they have been excluded from the operation of the stay.

Paragraph (s) prescribes that the ipso facto stay does not apply to arrangements involving an SPV where those arrangements provide for project finance.

Project finance arrangements involve financial accommodation that funds a project, such as a loan, being repaid or otherwise discharged primarily from the cash flow of the project when the project starts generating such cash flow. To secure this type of arrangement, the project's assets, rights and interests are held as security for the financial accommodation.

There are a number of advantages of using a project finance arrangement for the completion of a project. Project finance arrangements will often involve an SPV, and, similarly to securitisation and PPP, involve sophisticated parties. The SPV can be party to a web of contracts that support and are necessary for the project such as shareholders, lenders, operators, suppliers, procurement and construction.

These types of arrangements, when they involve an SPV, are typically agreed between sophisticated counterparties who arrange for, and agree on, a bespoke set of rules to apply in the event that a party becomes insolvent. In those instances, it is preferable that the agreed rules, which may provide for the operation of ipso facto clauses, continue to apply, and for that reason such arrangements are excluded from the stay.

Paragraph (t)—arrangements for the keeping in escrow of code or passwords for computer software, or directly associated material

Paragraph (t) prescribes that the ipso facto stay does not apply to certain escrow arrangements such as for the keeping of code or passwords for computer software, or material directly associated with such things.

Code, for the purposes of this provision, includes source code or object code.

This provision intends to capture arrangements such as those which grant a licensee a right to access the source code of software when the licensor experiences a relevant insolvency event.

Where a party obtains a licence to software for example, there is a risk that they will lose access to the source code necessary to continue to operate that software if the licensor fails to maintain it (which may occur as the result of an insolvency event). An escrow arrangement provides for the source code to be deposited with a third party and entitles the licensee to access the source code where the licensor experiences an insolvency event.

These arrangements are prescribed on the basis that it would undermine their purpose if the ipso facto stay were to apply.

Paragraph (u)—arrangements for the commercial charter of a ship

Paragraph (u) prescribes that the ipso facto stay does not apply to arrangements for the commercial charter of a ship, if that ship is not an Australian ship and the purpose of the charter was for an Australian exporter to export goods to another country.

Where an Australian exporter charters a foreign ship, it is common for the governing agreement to contain the right to terminate the agreement on the financial failure of the ship owner. It is beneficial for Australian exporters who charter foreign ships to retain this right to terminate. Additionally, foreign laws often allow termination on similar grounds and not excluding these arrangements from the ipso facto stay has the potential to put Australian exporters at a commercial disadvantage in the international market.

Arrangements relating to debt and the ranking of creditors

Paragraph (v)—arrangements under which the priority of security interests in particular property change

Paragraph (v) prescribes that the ipso facto stay does not apply to arrangements under which the priority of security interests in particular property is changed or can change. These types of arrangements are commonly known as subordination arrangements.

A subordination arrangement is an agreement that establishes one debt as ranking behind another debt in the priority for collecting the repayment debts from a debtor. Priority of debts can become an issue in the context of insolvency.

For example, Shannon and Bruno, both creditors, could enter into an agreement where Shannon agrees to rank her debt behind Bruno's in return for some sort of consideration. If Company Z, the company which owes a debt to both Shannon and Bruno, is wound up, Bruno would rank first in the priority of creditors between Shannon and Bruno. The provision also captures the opposite situation, for example where Shannon and Bruno both agree that Shannon is to rank her debt in front of Bruno's.

It is not the purpose of the ipso facto stay provisions to affect either the statutory waterfall of agreed priorities in insolvency, or any contractual arrangement between a

company's creditors which may change their respective priorities. For this reason it is appropriate to exclude such arrangements from the scope of the stay.

Paragraph (w)—flawed asset arrangements

Paragraph (w) prescribes that the ipso facto stay does not apply to flawed asset arrangements.

A flawed asset is generally understood to be a conditional debt which is not payable until the condition has been met or some event has occurred. For example, an arrangement between a bank and its customer where the customer deposits funds with the bank and those funds are not repayable by the bank until certain events have occurred, such as the repayment of another specified debt, is a flawed asset arrangement.

For the purposes of the operation of the stay on ipso facto clauses, flawed asset arrangements may be treated in much the same way as a right of set-off, close-out netting arrangements or arrangements that change the priority of creditors and so it is appropriate to exclude them from the operation of the stay for the same reason.

Paragraph (x)—factoring arrangements, or arrangements directly connected with factoring arrangements

Paragraph (x) prescribes that the ipso facto stay does not apply to debt factoring arrangements, and extends to arrangements which are directly connected with a factoring arrangement.

Debt factoring occurs when an entity sells debts that are owed to it (such as accounts receivables or invoices for goods/services where amounts are owing to the entity) to a third party. The debts are usually sold at a discount. The entity receives a monetary payment from the third party in exchange for transferring the debt. The debt then becomes payable to the third party. Businesses may enter into debt factoring arrangements to improve their cash flow.

Where parties have already entered into arrangements to attempt to alleviate a business' financial stress, such as factoring arrangements, staying ipso facto clauses would undermine or significantly change the terms of those arrangements and so these arrangements are excluded.

The provision also captures arrangements which are directly connected with a factoring arrangement, recognising that many common commercial factoring arrangements can involve multiple arrangements for the transactions.

Arrangements relating to financial markets, and clearing and settlement facilities

Paragraph (y)—the operating rules (other than the listing rules) of a financial market

Paragraph (y) prescribes that the operating rules (other than the listing rules) of any financial market licensed under Part 7.2 of the Act are not to be subject to the stay.

Part 7.2 of the Act governs the licensing of financial markets. Licensed markets must be run in accordance with the market's operating rules, which take effect as a contract under seal between licensees and participants in accordance with section 793B of the Act. The operating rules may provide for the suspension or expulsion of participants when they experience a relevant insolvency event. The operating rules are important to the operation of licensed financial markets in the manner contemplated by the Act, and therefore are appropriate to exclude from the ipso facto stay.

Paragraph (z)—the operating rules of a clearing and settlement facility

Paragraph (z) prescribes that the operating rules of a clearing and settlement facility licensed under Part 7.3 of the Act are not subject to the ipso facto stay. A clearing and settlement facility provides a mechanism for parties to financial product transactions to meet certain obligations to each other.

Part 7.3 of the Act governs the licensing of clearing and settlement facilities. Licensed facilities must be run in accordance with their operating rules, which take effect as a contract under seal between licensees and participants in accordance with section 822B of the Act. These operating rules may provide for the suspension or expulsion of participants when they experience a relevant insolvency event, and must provide for how defaults are to be managed. The operating rules are important to the operation of these facilities in the manner contemplated by the Act and therefore are appropriate to exclude from the operation of the ipso facto stay.

Paragraph (z) also extends the exclusion from the operation of the ipso facto stay to securities settlement facilities which are exempt from the licensing requirement (but would otherwise be required to be licensed under Part 7.3 of the Act).

Paragraph (za)—arrangements that confer rights on the operator of a financial market or clearing and settlement facility in relation to the operation of the market or facility

Paragraph (za) prescribes that any arrangement that confers rights on the operator of a financial market or a clearing and settlement facility in relation to the operation of the market or facility are not subject to the ipso facto stay. It follows that parties to those arrangements will be able to enforce the rights in those arrangements in the event of any insolvency events.

This exclusion is intended to capture contracts other than the operating rules (which are excluded under paragraph (z)) that are necessary to operate the market or facility. This would protect the clearing and settlement facilities' rights under contracts to supply services that are essential to the operation of the market or facility. Such rights are important for the stable operation of the relevant markets and facilities and have been excluded from the stay.

Paragraph (zb)—arrangements of which the parties include the Reserve Bank of Australia and the operator of a clearing and settlement facility

Paragraph (zb) prescribes that any arrangement of which the parties include the Reserve Bank of Australia and the operator of a clearing and settlement facility, is not subject to the ipso facto stay.

Paragraph (zc)—arrangements under which participants in a clearing and settlement facility settle obligations on behalf of other participants in the facility

Paragraph (zc) prescribes that any arrangement under which participants in the clearing and settlement facility settle obligations on behalf of other participants in those systems is not subject to the ipso facto stay.

‘Participant’, for the purposes of this paragraph, is defined in section 761A of the Act and means, in relation to a clearing and settlement facility, a person who is allowed to directly participate in the facility under the facility’s operating rules. ‘Participant’ in this context also includes a recognised affiliate when used within the provisions outlined in paragraph (a) of the definition of ‘participant’ in section 761A of the Act.

This exclusion is intended to capture indirect arrangements for participating in clearing and settlement facilities which may not fall within the various contractual arrangements that the clearing and settlement facility is a party to. To preserve the stability and manage the risks of the relevant facility, it is important for the stability of the clearing and settlement facility that a direct participant remains able to enforce rights when they receive notice that an indirect participant has experienced an insolvency event.

RTGS systems and netting arrangements within the operation of the *Payment Systems and Netting Act 1998*

Paragraph (zd)—legally enforceable arrangements that support an approved Real Time Gross Settlement (RTGS) system

Paragraph (zd) prescribes that RTGS systems (including associated operating rules) approved under section 9 of the *Payment Systems and Netting Act 1998* (PSN Act) are not subject to the ipso facto stay.

RTGS systems allow participants to settle their gross financial obligations with finality in real time. An RTGS system can be approved by the Reserve Bank of Australia under section 9 of the PSN Act if, among other things, the system is supported by a legally enforceable arrangement between the participants in the system and the rules that govern the system empower the system administrator to suspend participants when they enter external administration.

The PSN Act provides various protections to transactions carried out through approved RTGS systems. In particular, such transactions are irrevocable and cannot be ‘clawed back’ merely because a participant enters insolvency. Therefore it is vital for the stability of these systems that the administrator remains able to exercise certain rights when a participant experiences an insolvency event.

The Act and PSN Act each provide that the PSN Act is to prevail over the stay to the extent of any inconsistency. However, in order to provide the highest possible level of certainty to participants, these systems are also prescribed in the Corporations Regulations.

Paragraph (ze)—approved netting arrangements

Paragraph (ze) prescribes that netting arrangements approved under section 12 of the PSN Act are not to be subject to the stay. Broadly speaking, netting arrangements allow the participants to set off their gross financial obligations with each other to reach a net position and settle their payments accordingly. In order for a netting arrangement to be approved, the PSN Act requires the rules governing the arrangement to provide that, if a party to the arrangement goes into external administration, the coordinator may exclude the party from the arrangement. As such, termination may be triggered by one of the parties experiencing an insolvency event.

The Act and PSN Act each provide that the PSN Act is to prevail over the stay to the extent of any inconsistency. However, in order to provide the highest possible level of certainty to participants, these systems are also prescribed in the Corporations Regulations.

These arrangements are captured in order to preserve the intended operation of the arrangements. This will provide certainty to parties that rights contained in these arrangements are not subject to the ipso facto stay.

Paragraph (zf)—arrangements that confer rights on the operator of an approved RTGS system or the coordinator of an approved netting arrangement

Paragraph (zf) prescribes that any arrangement that confers rights on the operator of an approved RTGS system or the coordinator of an approved netting arrangement in relation to the operation of that system or netting arrangement is not subject to the ipso facto stay.

The exclusion is also intended to capture the entire terms and operating rules of an approved RTGS system or approved netting arrangement (that is, not just the rules relevant to netting), and any other contracts that are necessary to operate the system or arrangement. This ensures the operator and coordinator respectively can mitigate against the effect of the insolvency of a participant, and protect the security, reliability and integrity of the system or arrangement.

Paragraph (zg)—arrangements under which parties to an approved RTGS or netting arrangement settle obligations on behalf of other parties to the arrangement

Paragraph (zg) prescribes that any arrangement under which parties to an approved netting arrangement may settle obligations on behalf of other parties to that approved netting arrangement is not subject to the ipso facto stay.

‘Parties’, for the purposes of this paragraph, is defined in section 5 of the PSN Act and means a person who is a party to the approved netting arrangement in accordance with the rules governing the arrangement.

This exclusion is intended to capture arrangements which may not fall within the various legislative schemes governing approved netting arrangements.

Paragraph (zh)—close-out netting contracts

Close-out netting contracts are contracts within the meaning of Part 4 of the PSN Act, including a contract for a security interest or other right with respect to property given by a person to secure the performance of their obligations under the contract.

The parties to a close-out netting contract may terminate their obligations and settle them based on a net position. The termination and subsequent netting may be triggered by an insolvency event. These rights are exempt from the stay, as are the parties' rights to enforce any associated security.

However, subsections 14(4) to (6) of the PSN Act limits a party's rights and obligations under a close-out netting contract in some circumstances (for example, when a person enters the contract with the knowledge that the other party was insolvent). It is not anticipated that the Regulations will alter the ordinary and usual operation of subsections 14(4) to (6) of the PSN Act.

Paragraph (zi)—arrangements where security is given over financial property in respect of eligible obligations of a party to a close-out netting contract

The arrangements that are prescribed under paragraph (zi) are arrangements that preserve the intended operation of the arrangements prescribed under paragraph (zh), and are, for that reason, excluded from the operation of the stay.

Paragraph (zj) and (zk)—netting markets and market netting contracts

A 'netting market' is defined in section 5 of the PSN Act and includes a market licensed under Part 7.2 of the Act, a clearing and settlement facility licensed under Part 7.3, and other markets approved by the Minister or declared in the Regulations. The ipso facto stay may undermine the operation of these markets by preventing parties from exercising netting rights arising upon relevant insolvency events, and disturb the operation of the associated market rules in unintended ways.

Part 5 of the PSN Act governs market netting contracts entered into in connection with approved netting markets. The parties to a market netting contract may be entitled to terminate their obligations and settle them based on a net position. This may, among other things, be triggered by an insolvency event. Market netting contracts have been excluded from the ipso facto stay to ensure these rights and rights for parties to enforce any associated security remain undisturbed.

Paragraph (zl)—arrangements where security is given in accordance with a market netting contract, in respect of obligations of a party to the contract

The arrangements that are prescribed under paragraph (zl) are arrangements that preserve the intended operation of the arrangements prescribed under paragraph (zk) and are for that reason excluded from the operation of the stay.

Paragraph (zm)—outsourcing arrangements for the purposes of *Prudential Standard CPS 231* (CPS 231) *Outsourcing* or *Prudential Standard SPS 231* (SPS 231) *Outsourcing*

Paragraph (zn) prescribes that the ipso facto stay does not apply to outsourcing arrangements for the purposes of CPS 231 *Outsourcing* or SPS 231 *Outsourcing*.

In 2018, CPS 231 was set out in the *Banking, Insurance and Life Insurance (prudential standard) determination No. 6 of 2016*, and SPS 231 was set out in the *Superannuation (prudential standard) determination No. 3 of 2012*. CPS 231 applies to all ‘Australian Prudential Regulation Authority (APRA)-regulated institutions’, as defined in paragraph 2 of CPS 231, while SPS 231 applies to all registerable superannuation entity (RSE) licensees under the *Superannuation Industry (Supervision) Act 1993*.

CPS 231 and SPS 231 both set out the prudential requirements for all outsourcing arrangements involving material business activities entered into by APRA-regulated institutions and RSE licensees respectively. These are arrangements for the outsourcing of certain activities undertaken by both APRA-regulated institutions and RSE licensees.

Both CPS 231 and SPS 231 define a ‘material business activity’ in paragraph 14 in CPS 231 and paragraph 9 in SPS 231 as one that has the potential to, if disrupted, have a significant impact on, having regard to certain factors:

- the APRA-regulated institution’s or group’s business operations, or its ability to manage risk effectively;
- an RSE licensee’s business operations, or its ability to manage risk effectively;
or
- in the case of RSE licensees only—the interests or reasonable expectations of beneficiaries, or the financial position of the RSE licensee, any of its RSEs or its connected entities.

Excluding such outsourcing arrangements involving material business activities will ensure that APRA-regulated institutions and RSE licensees subject to these standards are able to exercise rights (including termination rights) in those arrangements in the event of a counterparty insolvency, and that the ipso facto stay does not interfere with promoting sound practices regarding the governance and risk management.

Arrangements prescribed for a certain period of time

Paragraph (zn)—novating and assigning rights from pre-1 July 2018 arrangements and varying pre-1 July 2018 arrangements

Paragraph (zn) prescribes that the ipso facto stay does not apply to arrangements entered into on or after 1 July 2018, but before 1 July 2023, where those arrangements are a novation or an assignment of rights under an arrangement entered into before 1 July 2018.

Novation and assignment are both acts that can involve replacing a party to an arrangement with a new party. Novation can only occur with the consent of all parties to the original arrangement while assignment is generally valid if the other party to the arrangement has been given notice.

If an arrangement contains the ability for a party to novate or assign rights in the arrangement, the novation or assignment often creates a new arrangement between all continuing parties. The new arrangement, if entered into on or after 1 July 2018, would be captured by the operation of the ipso facto stay.

It was not intended for the ipso facto stay to capture arrangements entered into as a result of rights exercised in arrangements on foot prior to the commencement of the stay provisions. On that basis, new arrangements entered into on or after 1 July 2018 as a result of exercising novation or assignment rights in arrangements entered into before 1 July 2018, will not be captured by the ipso facto stay.

On the same basis, where contracts entered into before 1 July 2018 are varied by subsequent arrangements entered into on or after 1 July 2018, the subsequent arrangements will also not be captured by the stay. For example, variations to statements of work that have been signed under a contract on foot before 1 July 2018, and incorporate the same terms and conditions, are intended to be captured by this provision.

This provision will only apply to new arrangements entered into on or after 1 July 2018 as a result of arrangements entered into before 1 July 2018.

The provision only applies to renewals or novations entered into on or after 1 July 2018, but before 1 July 2023. This five year period for the operation of the provision will allow parties to consider how to structure their affairs in the future.

Paragraphs (zo) and (zp)—certain construction contracts entered into on or after 1 July 2018, but before 1 July 2023

Paragraphs (zo) and (zp) prescribe that the ipso facto stay does not apply to construction contracts worth over \$1 billion for a period of five years from the commencement of the stay provisions.

Due to the complex nature of large scale construction projects, the arrangements for or that support the completion of the project have been excluded for a period of five years. This transitional period recognises the nature of such projects, and provides certainty and stability about the operation of the ipso facto stay to these construction projects, while allowing parties time to consider how to structure affected arrangements in the future.

Paragraph (zo) captures arrangements for certain work, goods or services for a particular project.

A construction project might take place at more than one site. This is particularly the case for a development of a residential suburb, or infrastructure projects such as railways or roads. This provision intends to capture the work done on, or goods or services provided to, multiple work sites which, collectively, would form part of the particular project.

The provision draws on the meaning of ‘building work’ in section 6 of the *Building and Construction Industry (Improving Productivity) Act 2016* (the BCI Act), and certain items of work within the meaning of ‘construction work’ in section 5 of the

Building and Construction Industry Security of Payment Act 1997 (NSW) (the NSW Security of Payment Act).

The definition of ‘building work’ in the BCI Act, and ‘construction work’ in the NSW Security of Payment Act, contain almost similar meanings. However, missing from the meaning of ‘building work’ in the BCI Act is the meaning of ‘construction work’ in paragraphs 5(1)(d) and (f) in the NSW Security of Payment Act. Paragraph 5(1)(d) of the NSW Security of Payment Act defines ‘construction work’ to mean “the external or internal cleaning of buildings, structures and works, so far as it is carried out in the course of their construction, alternation, repair, restoration, maintenance or extension”. Paragraph 5(1)(f) defines ‘construction work’ to mean “the painting or decorating of the internal or external surfaces of any building, structure or works”. This extension recognises additional construction work items that are intended to be captured by this provision but have not been provided for in the definition of ‘building work’.

In respect of goods or services, the provision captures the meaning of ‘related goods and services’ in section 6 of the NSW Security of Payment Act.

While the provision draws on definitions in an Act enacted by the state of New South Wales, it is intended that those definitions apply within the jurisdiction of the Act for the purposes of this provision. In other words, other States and Territories are not intended to be disadvantaged by the use of the definitions in the NSW Security of Payment Act.

The threshold of \$1 billion is intended to be tested against the value of all payments made under all arrangements for the project for work, goods or services of those kinds in subparagraphs (zo)(i) to (iii). This could require the head contractor or procurer to work out the value of the payments to be made under all contracts and subcontracts for the particular project, and determining whether they come to at least \$1 billion.

For the purposes of this provision, it intended that the threshold of \$1 billion be tested against the reasonable and expected market value of the work, goods or services to be provided under all contracts and subcontracts.

Paragraph (zp) intends to capture all subcontracts that have been entered into to enable the satisfactory completion of the primary project, and that also provide work, goods or services, so that these arrangements are excluded from the operation of the ipso facto stay.