



THE LAW SOCIETY
OF NEW SOUTH WALES

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11 May 2018

Corporations Policy Unit
Consumer and Corporations Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: Insolvency@TREASURY.GOV.AU

Dear Sir/Madam,

National Innovation and Science Agenda – Exclusions from stay of enforcement of ipso facto clauses

The Law Society of NSW appreciates the opportunity to comment on the Exposure Draft Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018 (“draft Regulations”) and the Exposure Draft Corporations (Stay on Enforcing Certain Rights) Declaration 2018 (“draft Declaration”).

Background

The *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* inserted provisions into the *Corporations Act 2001* (“Act”) to stay the enforcement of ipso facto clauses against relevant entities (“ipso facto stay”). The ipso facto stay promotes the objectives of the current restructuring regime in the Act by assisting viable but financially distressed insolvent companies to continue to operate while they restructure their business.

These “ipso facto” or self-executing clauses entitle a party to enforce a right to terminate or modify the operation of a contract, agreement or arrangement on the occurrence of various insolvency-related trigger events, regardless of the counterparty’s continued performance of its obligations under the contract.

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 a subsequent liquidation by disrupting the business’ contractual arrangements and destroying goodwill, potentially prejudicing other creditors and defeating the purpose of a voluntary administration.

The purpose of the proposed amendments is to ensure that, in prescribed circumstances, certain ipso facto clauses will remain enforceable against a counterparty despite the fact that it is in a formal insolvency and reconstruction process.

The draft Regulations and draft Declaration will amend the *Corporations Regulations 2001* by inserting provisions that prescribe the kinds of rights and contracts, agreements and arrangements entered into after 1 July 2018 that will not be subject to the ipso facto stay. These exceptions are an acknowledgement that there are some situations where staying the operation of ipso facto clauses is either "unnecessary" or "undesirable".

General comments

The Law Society, together with the Law Council of Australia, has previously expressed its support for the insolvency law reforms which form part of the National Innovation and Science Agenda and which aim to drive a cultural shift from penalising and stigmatising failure, to providing a better balance between encouraging entrepreneurship and protecting creditors. In particular, the Law Society has supported amendments to the Act to stay the enforcement of ipso facto clauses against relevant entities.

The Law Society considers that that the categories of exceptions proposed by the government are, subject to our comments below, commercially appropriate and further the policy aims of the law reforms. However, we suggest that the breadth of some of these proposed exceptions may create doubt as to whether the Government will be able to achieve its stated objective of promoting and facilitating the restructuring of distressed businesses in Australia, particularly where the proposed exceptions permit a counterparty to remove or take control of assets from the distressed company, making it more difficult to implement a successful restructure or the sale of the business as a going concern.

Proposed subregulation 5.3A.50(2) provides a list of the kinds of contracts, agreements or arrangements under which rights are not subject to the stay in s 451E of the Act. We comment briefly on a number of paragraphs of that subregulation below.

Specific Exemptions

Government licences and permits – paragraph (b)

Paragraph (b) excludes any contract, agreement or arrangement that is a licence or permit issued by a government authority or body. The purpose of this exclusion, according to the Explanatory Statement, is that the conditions placed on permits and licences are often there for public safety and the greater good of the community and therefore the government authority or body should be allowed to terminate government issued licences or permits on the grounds of a relevant insolvency event. However, the exclusion in this paragraph is framed widely, and not linked to any public interest argument.

If the company concerned is otherwise compliant with the terms of its licence or permit, we query whether the government authority or body should be entitled to revoke it merely because the company has been placed into voluntary administration.

The ipso facto stay was intended to maximise the chances of a successful turnaround by providing, in essence, that ipso facto clauses would be ineffective and if counterparties wanted to terminate a contract they would need to find a more substantive reason. Government bodies should be in no different position. If there is a genuine "risk to public safety" or "greater good of the community" basis for cancelling the licence or permit, then it should be cancelled on that basis – not cancelled just because the company is under administration.

Special purpose vehicles- paragraph (l)

Paragraph (l) prescribes that the ipso facto stay does not apply to contracts, arrangements or agreements to which a special purpose vehicle ("SPV") is a party. The example used in the Explanatory Statement relates to asset securitisation arrangements. The Explanatory Statement further notes:

Arrangements to which an SPV is a party 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.

The proposed exclusion in the draft Regulations is not on its face limited to circumstances involving securitisation arrangements. While an SPV is not defined in the draft Regulations, its meaning is referred to in the Explanatory Statement as "an entity such as a company, trust or partnership which is created to carry out a specific purpose or arrangement". Such an entity is widely used for various commercial purposes outside of securitisation. A general exclusion for arrangements to which an SPV is a party appears to provide considerable scope for structuring transactions to deliberately avoid the stay on ipso facto clauses.

Drafting issues

Cape Town Convention "agreements"- paragraph (a)

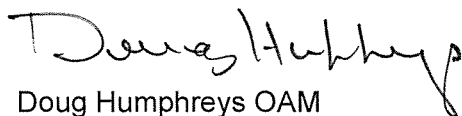
The Law Society does not take issue with a "carve-out" for "agreements" to which the Convention (as defined in paragraph (a)) applies. However, for clarity and the avoidance of any doubt, we suggest that the paragraph should be drafted to state that the carve-out only applies to those agreements "to which the Convention applies", rather than to "an agreement (within the meaning of the Convention...)" as currently drafted.

Arrangements relating to a contract, agreement or arrangement under which the priority of security interests in particular property is changed or can change - paragraph (o)

As currently drafted, it appears that the inclusion of any priority-altering arrangement in a contract will result in the whole contract being exempted from the ipso facto stay. Some only of the supply terms could be amended to include a priority-altering arrangement, resulting in the whole supply agreement being taken outside the scope of the ipso facto protection. This could be addressed by prefacing the clause with the words "Any term of...".

If you have any questions in relation to this submission, please contact Liza Booth, Principal Policy Lawyer, on 02 9926 0202 or liza.booth@lawsociety.com.au.

Yours faithfully,



Doug Humphreys OAM
President