Law Council
OF AUSTRALIA

Business Law Section

21 May 2018

Mr Jake Sullivan
The Treasury
Langton Crescent
PARKES ACT 2600

By email: Insolvency@treasury.gov.au

Dear Mr Sullivan

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

The Business Law Section of the Law Council of Australia (**BLS**) welcomes the opportunity to provide this submission to Treasury on the *National Innovation and Science Agenda – Exclusions from stay of enforcement of ipso facto clauses* **(Clauses).**

1. Introduction and overview

1.1 As you may be aware**,** the Law Council of Australia is the peak national representative body of the Australian legal profession. The BLS deals with all business law matters. It provides a forum through which lawyers and others interested in the laws affecting business can discuss current issues and contribute to the process of law reform in Australia. The BLS operates through committees comprised of leading private practice, government and academic lawyers that have focuses relevant to this consultation, in particular the Insolvency and Restructuring Committee **(IRC**), and also the Corporations Committee (**CC**).

1.2 The consultation deals directly with important issues for the restructuring and insolvency field. Accordingly, this submission has been prepared by the IRC of the BLS, with input from the CC.

1.3 In summary, the BLS:

(a) supports the overall policy bases for the proposed exclusions from stay of enforcement of ipso facto clauses, as communicated in the draft explanatory statements published by The Treasury in this consultation; and

(b) proposes some discrete modifications to those proposed exceptions, in order to have the exceptions both better reflect those policy bases and also reflect market practice in the Australian business community.

1.4 These submissions are set out in short detail below. If we can assist by providing greater detail or information, please do not hesitate to contact us.

2. Policy bases for the proposed exceptions

2.1 For convenience, and to shorten this submission, we do not repeat the policy bases for the proposed exceptions, which are set out in the draft explanatory statements published by The Treasury in connection with this consultation.

2.2 Broadly, the IRC supports the policy bases explained by Treasury in the draft explanatory statements. Of central importance is a balancing of (a) the valuable public policy being pursued by the implementation of the "ipso facto" moratorium, with (b) the importance of the freedom of contract enjoyed by participants in Australian commerce (recognising that the moratorium is a brake on that freedom of contract). Obviously, providing for exceptions to the moratorium, in certain circumstances, serves continuing freedom of contract, particularly in situations where, as identified in the draft explanatory statements, well established practices amongst sophisticated parties would be disturbed by a curb on that freedom through imposition of the moratorium.

2.3 Some aspects of the proposed exceptions, however, do, in the view of the IRC, merit review by Treasury, in order to best pursue (and balance) those policy objectives.

3. Special Purpose Vehicle exception

3.1 In order to be consistent with the draft explanatory statement, we recommend that the proposed exception for situations involving "special purpose vehicles" be narrowed, to only apply to agreements/arrangements that are directly involved in securitisation structures. Concern to protect securitisation structures (an important source of wholesale finance in Australia, that effectively requires use of special purpose vehicle finance entities) is rightly identified in the draft explanatory statement as an important policy objective.

3.2 The current draft exception, however, goes much wider than securitisation structures. As drafted, the exception could apply to any situation (whether for financing or otherwise) that involves a special purpose vehicle. Such vehicles are regularly used across a very wide range of commercial transactions in Australia; for instance, in transactions across real estate development, property leasing, mining, infrastructure, intellectual property ownership and licensing, and simple joint venture transactions.

3.3 It does not appear to be intended that the proposed exception apply to such a wide-ranging group of transactions and commercial structures. We consider that such a wide application would, if adopted, pose a real risk of largely undermining the moratorium (in that a very large range of transactions would be excluded from that moratorium), where there is no clear policy basis for doing so.

3.4 Further, and importantly, the current draft exception also tends to encourage avoidance behaviour, through the unnecessary and artificial insertion of special purpose vehicles in all manner of transactions and corporate structures for no other purpose than avoidance of the moratorium. Such behaviour should obviously not be encouraged and would indeed be inconsistent with the objectives of the moratorium (which includes robust anti-avoidance measures).

4. Government licenses

4.1 Appreciating that there may be difficulty in having Commonwealth legislation purport to deal with government licenses issued by the States, we propose that consideration be given to not excepting all government licenses from the moratorium.

4.2 Acknowledging what is said in the draft explanatory statement, government licenses are often critical to business turnaround. Excluding those licenses from the moratorium tends to place the government licensor in a position to "hold up" a restructure or destroy a company as a going concern.

4.3 It is right, as Treasury has done, to have real concern to avoid instances of companies continuing to hold a license in circumstances where, conscious particularly of public safety, they are perhaps financially unfit to do so. That said, consistent with the over-arching policy of the moratorium, the simple fact of entry into voluntary administration, a scheme of arrangement or receivership, does not necessarily mean that a company in financial difficulty is unfit. Indeed, very often the primary purpose of a well-planned voluntary administration scheme of arrangement or receivership is to ensure that the company is relieved of its financial difficulty, such that it can continue to be fit to conduct its business (including operation under relevant government licenses).

4.4 In our view, government licensors, like other contract counterparties affected by the moratorium, may properly protect their interests by looking to other rights to cancel licenses held by companies in financial distress (or who are in external administration) aside from "ipso facto" rights. This approach would mean that:

(a) a company in distress (which would benefit from restructuring) whose business is dependent on government licenses would not be dis-incentivised from undertaking a beneficial restructuring, for fear of losing those licenses (and thus losing its ability to function as a going concern) simply as a result of the fact of entering into a restructuring procedure; but also

(b) were a government licensor to be unsatisfied that the company, once in external administration, was not (despite the effort to restructure as a going concern) fit to continue to hold the relevant license (for example, because of mismanagement), the licenses could still be terminated (or temporarily suspended).

4.5 In our view, this balancing of the interests of the distressed company, as a going concern, with the interests of government licensors, should be considered by Treasury.

5. Investment Management Agreements

5.1 The Australian asset management industry has a well-developed precedent investment management agreement, used for both superannuation and non-superannuation related mandates in that industry. Standard template documents are maintained by the Financial Services Council in Australia, the peak industry body.

5.2 Those industry-standard documents contain termination rights upon adverse financial situations, including insolvency, and often including administration, receivership and schemes of arrangement, for both parties to the agreement (i.e. the investment manager and the client/asset owner). These arrangements are common practice in this market worldwide, and not only in Australia.

5.3 Negotiations on these agreements are almost always between sophisticated participants in this market, for instance, institutional wealth holders (such as superannuation funds, sovereign wealth funds and the like) and institutional wealth managers (fund managers, investment banks and the like). Those parties are obviously experienced and well advised in entering into arrangements of this kind.

5.4 It is also noteworthy that, in addition to the market practice and sophistication involved, the market in Australia for these kinds of agreements is relatively small. It may be assumed quite safely that excepting these agreements from the moratorium would not tend to materially or substantially lessen the wider application of the moratorium.

5.5 Taking those matters into account and noting the policy objectives driving the proposed exceptions more generally, we recommend that Treasury consider excluding (in the draft regulations) investment management agreements from the moratorium.

6. Purposes of agreement/arrangement

6.1 Finally, we propose that drafting be included that makes clear how the exceptions (in the exposure draft regulations) are intended to apply where an agreement/arrangement has multiple purposes, including one that is an excepted purpose.

6.2 In our view, the only realistic option is to exclude any agreement/arrangement that includes provisions with an excepted purpose; the other option, of taking a "dominant purpose" approach, would, we expect, lead to uncertainty and disputes as to the "dominant purpose". Obviously, in the relatively fast-moving field of formal insolvency, there is little time for dealing with such disputes, and uncertainty should be avoided wherever possible.

6.3 For completeness, we do not think that a "sole purpose" approach in this instance would be feasible. That approach would largely undermine the policy objective of allowing highly sophisticated parties to maintain some freedom of contract, noting that agreements and arrangements in fields such as equity capital markets, finance or mergers and acquisitions, typically struck between sophisticated and well-advised parties, often serve multiple purposes.

6.4 Our recommended approach would, in our view, be balanced by the anti-avoidance provisions of the moratorium itself, which will serve to mitigate the potential of abuse.

7. Drafting of Cape Town Convention exception

7.1 Finally, the drafting of the exception (in the proposed regulations) for "an agreement (within the meaning of the Convention defined in section 3 of the *International Interests in Mobile Equipment (Cape Town Convention) Act 2013*)" ought to be clarified. As presently drafted, there is a risk of that exception being construed in a fashion that is too broad and that takes the exception beyond its intended reach.

7.2 In that regard, we propose that the exception be amended so that it applies to an:

> *"agreement to which the Convention defined in section 3 of the International Interests in Mobile Equipment (Cape Town Convention) Act 2013 has application."*

7.3 This will ensure that there is no confusion, for readers of the proposed regulation, as to the "agreements" intended to be within this exception.

Thank you for the opportunity to provide this short submission and for considering the above proposals.

Please contact Peter Leech, Chair of the Restructuring and Insolvency practice of Cowell Clarke, on 08 8228 1111, or David Walter of Baker McKenzie on 02 8922 5294 in the first instance, if you require further information or clarification.

Yours sincerely,

Rebecca Maslen-Stannage
Chair, Business Law Section