TMA Turnaround Management Association® Australia

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TURNAROUND MANAGEMENT ASSOCIATION AUSTRALIA (TMA) SUBMISSION TO TREASURY

NATIONAL INNOVATION AND SCIENCE AGENDA – EXCLUSIONS FROM STAY OF ENFORCEMENT OF *IPSO FACTO* CLAUSES

1. INTRODUCTION TO TMA RESPONSE

1.1 Frame of reference

The Turnaround Management Association (**TMA**) welcomes the opportunity to comment on the National Innovation and Science Agenda (**NISA**) exposure drafts of the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (**Regulations**) and the *Exposure Draft – Corporations (Stay on Enforcing Certain Rights) Declaration 2018* (**Declaration**), which support the reforms in the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (Cth) (**the Act**) and its amendments to the *Corporations Act 2001* (Cth) (**Corporations Act**) (collectively, the **Regime**).

1.2 What is the TMA?

The TMA is the Australian chapter of a 9,300 worldwide member association formed in 1988, focusing on corporate renewal and turnaround management.

The TMA's membership includes trading and investment bankers, investment funds, financial advisers, lawyers, accountants, insolvency professionals, company directors and managers with expertise in undertaking structural and organisational turnarounds of reference entities undergoing some form of financial distress.

Our education program recognises professional excellence and provides an objective measure of expertise related to workouts, restructurings and corporate renewal.

1.3 Scope of submissions

In these submissions, the TMA discusses the key changes that can be made to the Regime to make it a more useful turnaround tool. These submissions are split into:

(a) key issues for the restructuring and turnaround community; and

(b) other aspects of the regime that require clarification.

While these submissions extend beyond just the Regulations and Declaration to the Act itself, the TMA considers that in some cases it will be possible to clarify and improve the operation of the Act through amendments to the Regulations and Declaration. Where this is not possible, the TMA strongly encourages amendments to the Act.

The TMA does not raise in these submissions any of the technical issues for financiers going to the effectiveness of their rights and remedies. However, the TMA considers that it is important that the Regime strikes an appropriate balance between creditor protections and debtor rights, and that it would be counter-productive for the Regime to undermine the provision of credit in the Australian market. Accordingly, the TMA urges careful consideration of creditor and creditor group submissions in this regard.

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The TMA's key submissions are:

(a) the Act, Regulations or Declaration should explicitly state that the Regime does not affect the exercise or enforcement of rights following non-performance or non-payment;

(b) the stay order provisions should be carved out from the operation of the grandfathering provisions;

(c) the Act should be amended to introduce trigger events relating to entry into a DOCA and to extend the stay that applies in administration for as long as a DOCA remains on foot following that administration;

(d) the effectiveness of the stay order mechanism may depend in many cases on whether insolvency practitioners are able to obtain stay orders *ex parte* (before the counterparty has a chance to exercise its contractual rights). Alternatively, there may be merit in introducing an immediate and automatic stay apply while the stay order is sought. Further, *companies* should have standing to apply for a stay order *before* entering a specified procedure (for example, under the interim stay order provisions), and the likelihood of the counterparty exercising the right should be removed as a factor relevant to obtaining a stay order;

(e) the scope of the operative stay provisions should be extended to apply to related bodies corporate of companies subject to a specified procedure;

(f) the operative stay provisions should prevent "*exercise or enforcement*" of rights, rather than just "*enforcement*";

(g) a definition of "*financial position*" should be inserted into the Act or by way of Declaration;

(h) greater clarity is needed as to whether cross defaults are subject to the Regime (for example by inserting a definition of financial position that includes cross defaults or explicitly excluding cross defaults in the Declaration);

(i) amending paragraph 5(4)(c) of the Declaration or the related Explanatory Statement to clarify whether the standstill exemption is intended to allow enforcement on any basis following termination of a standstill (including financial covenants and other bases related to the financial position of the company that would otherwise be stayed post-appointment);

(j) the Government will need to reflect, in the case of statutory rights that may conflict with the principle of the stay, as to which statutory provisions should prevail; and

(k) the TMA would welcome any clarification in the Act or explanatory materials as to what non-compliance with the *ipso facto* stay would mean for the company receiving the protection of the stay and the infringing counterparty.

1.4 The TMA supports a stay on *ipso facto* clauses

In principle, the TMA supports a stay on certain *ipso facto* clauses where the exercise of such rights would have a substantial detrimental effect on the ability to achieve a restructuring or going concern sale that otherwise benefits creditors of the company as a whole. However, the extent and operation of a stay on *ipso facto* clauses needs to be carefully evaluated in light of this objective, and must have adequate regard to the position of counterparties and creditors

of the company. The regulation of *ipso facto* clauses is a highly complex area and great care must be undertaken to ensure it operates as intended without adverse consequences. Accordingly, the TMA considers that there are a number of key issues with the Regime that need addressing if the Regime is to operate efficiently and effectively.

The TMA considers that an *ipso facto* stay regime could, in some cases, provide greater bargaining power and optionality to restructuring and turnaround professionals and companies undergoing a restructuring, enabling them to engage in unhindered discussions with stakeholders and give them time to properly consider competing restructuring proposals. This could ultimately lead to better results for distressed companies and their creditors and other stakeholders.

The TMA considers that the stay will bring the most benefit in the context of leases, licences and long-term contracts, with committed terms for supply of goods or services. Counterparties in these scenarios often exercise disproportionate bargaining power to the detriment of the insolvent estate and any turnaround and restructuring measures. Insolvency practitioners and the insolvent estate would benefit greatly from a redistribution of bargaining power in these contexts and from the time and space to negotiate favourable terms in pursuit of turnaround efforts.

We are hopeful that the Regime will meet its stated policy objectives in the Explanatory Statements to the Regulations and Declaration of:

- assisting businesses to continue to trade in order to recover from an insolvency event instead of preventing their successful rehabilitation;

- assisting viable but financially distressed or insolvent companies to continue to operate while they restructure their business;

- encouraging the potential for a successful restructure, increasing the enterprise value of businesses entering formal administration and encouraging the sale of businesses as a going concern; and

- maximising returns in subsequent liquidation by protecting businesses' contractual arrangements and goodwill.

The TMA considers that it is critical to the successful operation of the stay and exceptions that a degree of consistent policy and principle is maintained throughout. Any exceptions to the Regime need to be carefully weighed according to policy considerations.

2. KEY ISSUES FOR THE RESTRUCTURING AND TURNAROUND COMMUNITY

2.1 Does the Regime affect enforcement for non-performance or non-payment?

Neither the Act nor the Regulations or Declaration explicitly exclude enforcement for non-performance or non-payment from the operation of the Act. While the Explanatory Memorandum to the Act explains that counterparties will retain their rights to terminate or amend for "*any other reason, such as a breach involving non-payment or non-performance*", the TMA considers that whether the stay (and each of its limbs) applies to breaches for non-performance or non-payment is critical to ensure there is clarity as to the extent and operation of the Regime and that confirmation of their exclusion, if intended, should be inserted into the Act. The lack of such wording in the Act has led many in the industry to query whether a failure to pay due to general insolvency of the company might be covered by the *ipso facto* stay. Whilst we do not think this is the intention of the legislation, we think it would be advisable to make this clear in the Act.

2.2 **Grandfathering and amendments**

Contracts, agreements or arrangements entered into before 1 July 2018 will be exempt from the operation of the Regime by virtue of section 17 of the Act. Further, the Regulations exclude from the operation of the stay, contracts resulting from a novation, assignment or variation on or after 1 July 2018 of a contract entered prior to that time. The Explanatory Statement to the Regulations indicates that this is because 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 and that the provisions are only intended to apply to *new agreements* entered into on or after 1 July 2018.

The TMA considers that the grandfathering regime will mean that the Regime will in practice take effect in a gradual and uneven manner, and this could lead to substantial unfairness between counterparties in insolvencies, and may also significantly reduce the effectiveness of the Regime for a considerable period of time.

The grandfathering provisions will result in asymmetrical enforcement rights amongst counterparties with respect to the same debtor company, meaning counterparties under pre-1 July 2018 contracts will have rights available to them that counterparties under post-1 July 2018 contracts will not. This could lead to materially different outcomes amongst these stakeholders, as in a formal insolvency counterparties often use the existence of *ipso facto* termination rights as leverage to negotiate payment of indebtedness or other improved terms (which ultimately comes at the expense of the general estate and therefore other creditors).

Take for example, a company with multiple leases of different property with different landlords where some of those leases were entered before 1 July 2018 and others were entered into (or are amendments of leases entered into) after 1 July 2018. Those landlords with leases not subject to the stay may be able to use the threat of their *ipso facto* termination rights as leverage to extract disproportionate value by negotiation payment of outstanding rent and, should a new lease be entered, improved terms going forward. This would come at the expense of the general estate.

The TMA also considers that the grandfathering provisions as drafted will lead to other anomalous results, including incentivising contracting parties to amend their contracts wherever possible, rather than entering into new ones.

The TMA considers that one solution to the uneven application of the Regime and resulting inequity between the counterparties would be to remove the grandfathering provisions in their entirety. However, the TMA notes that this may be difficult now that market expectations have been set.

Alternatively, the TMA considers that the stay order provisions of the Act (ss 415F, 434L, 451G of the Act) could be carved out from the operation of the grandfathering provisions. The stay order provisions permit certain persons in respect of a company subject to one of the specified procedures to apply to the Court for an order that one or more rights under a contract with the company be enforceable against the company only with the leave of the Court and in accordance with such terms (if any) as the Court imposes. In determining whether to make the order, the Court will likely weigh the interests of the general estate and counterparties against each other. If the stay order provisions were carved out from the operation of the grandfathering provisions, this would allow a company to approach the Court in relation to rights under a pre-1 July 2018 contract and seek orders for their stay on grounds, for example, that the exercise of the right would have a disproportionately negative affect on the general estate, or that the disproportionate bargaining power of the counterparty in relation to other counterparties is unfair and to the detriment of the general estate.

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The TMA considers that this option would be a sensible middle ground to level the playing field between pre- and post-Regime contractual counterparties and allow the *ipso facto* Regime to have some effect in the near future, while not subjecting parties to pre-1 July 2018 contracts to the new Regime where this would be unfair (as determined by the Court).

2.3 Deeds of Company Arrangement

Under the Act, the *ipso facto* stay that applies if a company enters administration continues to apply to the company, if the company immediately enters liquidation following administration, until the company's affairs have been "*fully wound up*". However, there is no corresponding extension of the stay where the company enters into a deed of company arrangement (**DOCA**) as a result of the administration instead of liquidation. The Act therefore as currently drafted creates an unusual situation where a company has the benefit of a stay on the exercise of *ipso facto* rights during its administration, but has no corresponding protection if it then enters into a DOCA. That is, the Regime, as drafted, would allow an *ipso facto* right to be enforced on the basis that a company enters or is subject to a DOCA.

The TMA considers this to be an anomalous result and is likely to be counterproductive in terms of encouraging restructuring. A DOCA is the primary mechanism for implementing a restructure through the administration process. It should be encouraged as the preferred outcome of administration in appropriate cases if restructuring is to be supported.

The TMA strongly recommends that the Act be amended as follows:

- a separate section be inserted into the Act introducing a stay provision in relation to 'entry into or being subject to a DOCA'; and

- extending the operation of the stay that applies in administration for as long as a DOCA remains on foot following that administration.

The TMA considers that failure to do so could significantly undermine the effectiveness of the *ipso facto* regime in practice.

2.4 Stay orders

The TMA considers that the utility of the stay order provisions (ss 415F, 434L, 451G) will be greatly reduced if notice of the court hearing in respect of the stay order is given to the affected parties in the usual way. If so, the TMA is concerned that any affected party would simply exercise their rights before the hearing occurs. Further, it does not appear that there is any power in the Act for the Court to put the parties back to their pre-exercise-of-rights position once this occurs. The TMA notes the ability of parties to seek interim injunctive relief *ex parte* as a matter of court procedure (for example, regulation 25.2 of the *Uniform Civil Procedure Rules 2005* (NSW)) and considers that this issue and right should be referenced in the explanatory materials to the Regime.

In addition, the TMA considers that the stay orders would be more effective if the company could apply for them as a preliminary step before the relevant process commenced. For example, a company could seek a stay order that would apply to administration, before the administration commenced. This would prevent counterparties from terminating once the administrator was appointed, before the administrator could obtain a stay order. While the interim order provisions in the Act (ss 415F(5)-(6), 434L(5)-(6), 451G(5)-(6)) envisage a fast-track stay order process, they do not apply automatically and presumably require notice be given to the affected parties.

Finally, the TMA is unclear on the reason why the likelihood of exercising the rights needs to be demonstrated to obtain a stay order (see, for example, s 451G(2)(b)). In most cases a company will not know if rights are to be enforced until it happens, especially if there is a stay order regime in place (that is, a counterparty is unlikely to communicate its intention to terminate if it knows a stay order is available – it would just proceed to terminate).

As such, in relation to the stay order provisions, the TMA recommends the following options for consideration:

- reference should be made in the explanatory materials for the ability of parties to seek interim injunctions *ex parte* in the usual way, and that it may be appropriate for insolvency practitioners to proceed in this way in some cases;
- conversely, the Act should provide that a counterparty cannot seek orders to lift the stay "*in the interests of justice*" (pursuant to ss 415E(1)(b), 434K(1), 451F(1)) *ex parte*. Such an order should allow the insolvency practitioner the opportunity to put forward evidence of the impact that excusing the counterparty from performance would have on the turnaround effort;
- the Act could provide for an immediate, automatic, stay to apply for a period of time while a stay order is sought – this would need to take effect at or before the time that the affected parties were notified of the proposed hearing;
- the Act could permit applications for the stay orders by the *company* (as opposed to limited to the scheme administrator (s 415F(c)(iii)), controller (s 434L(2)(c)) or administrator (s 451G(2)(c)) and *before* the company is subject to a specified procedure. This could be achieved be allowing the company to have standing to apply to the Court for an interim order under the interim stay order provisions (ss 415F(5)-(6), 434L(5)-(6), and 451G(5)-(6));
- removal of the 'rights are being exercised, likely to be exercised or there is a threat to exercise them' criterion from requirements to obtain a stay order; and
- as discussed at section 2.2, the stay order provisions could be carved out from the operation of the grandfathering provisions.

2.5 Corporate groups

The *ipso facto* stay only applies to the enforcement of rights for specified reasons against a company subject to one of the specified procedures. The stay does not explicitly restrict the enforcement of rights against another company in the same corporate group, regardless of whether or not that other company is also subject to one of the specified procedures.

For example, Company A is the parent of Company B. If Company A enters a specified procedure, there is nothing explicitly in the Act to prevent a counterparty to a contract with Company B exercising a right of termination, or otherwise enforcing their rights, based on Company A entering a specified procedure. Moreover, if Company A and Company B are both subject to specified procedures, there is nothing explicitly in the Act to prevent a counterparty to a contract with Company A terminating for Company B's entry into a specified procedure, or a counterparty to a contract with Company B terminating for Company A's entry into a specified procedure.

By way of practical example, one of the members of TMA was legal adviser on a matter involving borrowing at a holding company level. The operating companies were subsidiaries of the holding company and held the key contracts. Some of those contracts had termination

rights linked to parent insolvency. The TMA member advised on two alternative restructuring plans. The first, was a consensual restructuring at the holding company level (and this is what eventually took place). The second, was to place the holding company into voluntary administration to carry out a debt for equity swap. However, placing the holding company into administration would have carried contract termination risk in the group. Further, placing all of the remaining group companies would have diminished the value of the group even further and so was not considered viable. In this circumstance, an *ipso facto* stay in respect of rights against the holding company that extended to contractual rights against the subsidiaries (even if they remained outside a formal insolvency or restructuring process) would have led to maximum value preservation and business viability.

The TMA is concerned that failure to extend the stay to group companies could significantly diminish the utility of the Regime and could encourage market participants to build default clauses into their contracts to take advantage of this anomalous outcome. In the view of the TMA, under the current drafting of the Act, the application of the stay to the enforcement of rights for 'reasons that are in substance contrary' to the operative stay provisions would not extend to creating a stay in respect of related companies.

The TMA considers that consideration should be given to extending the operation of the stay provisions to the exercise or enforcement of rights, for example, "*against a body or any of its related bodies corporate*". However, consideration would need to be given as to whether the body and related body corporate would each need to be subject to a specified procedure to take the benefit of this stay. If not, consideration would also need to be given to how this may affect negotiations with third parties who rely on rights against the parent that are triggered by the insolvency of a subsidiary (for example, government entities that rely on parent or cross guarantee rights or parent step-in rights when entering into contracts).

The term "*related bodies corporate*" would take its meaning from section 50 of the Corporations Act, which includes any holding company, subsidiary or subsidiary of a holding company of a body.

2.6 **Enforcement**

The concept of 'enforcement' of rights generally means by way of legal proceedings, or where a party has security by taking steps to enforce that security. For example, the Corporations Act defines "*enforce*", in relation to a security interest in property of a company under administration, as the exercise of specific rights under that security interest. The Corporations Act also defines "*enforcement process*" in relation to property to mean execution against that property or any other enforcement process in relation to that property that involves a court or sheriff. The Corporations Act does not define enforcement generally.

Enforcement is not understood to extend to the general exercise of rights against counterparties under a contract. Whether the exercise of rights will constitute enforcement will depend on context and will not always be clear. For example, acceleration of a debt may constitute enforcement in some circumstances, but not in others. The TMA considers that the use of the concept of 'enforcement' causes difficulties in respect of the Regime in two ways.

First, the operative stay provisions of the Act provide that "*a right cannot be enforced against a corporation*" for specified reasons in specified circumstances. The TMA considers that it was not intended that the operative stay provisions only stay rights of enforcement, in the strict sense, and that the Regime not apply to the exercise of other rights. The TMA recommends clarifying this by inserting the phrase "*exercised*" into the operative stay provisions as follows, "*a right cannot be exercised or enforced against a corporation for…*" (ss 415D, 434J and 451E).

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Second, sections 9 and 10 of the Act preserve the right under section 441A of the Corporations Act of an all-assets secured creditor to enforce their security during the 13 business day 'decision period' after a debtor company enters administration. The TMA considers that clarification is necessary on whether this means that an all-assets secured creditor will remain stayed from *exercising* other rights, such as rights of acceleration under a facility agreement. The Act or Declaration should make it clear that where a creditor has the right to appoint a receiver over all or substantially all of the assets of the company, they are also entitled to accelerate. Without the right to accelerate, the receiver could collect in assets but may not be able to apply them to pay the secured party's debt until it matures, which seems like an anomalous outcome without any constructive purpose.

2.7 Financial position

During the period of a specified procedure, the operative stay provisions extend to enforcement of a right by reason only of the company's "*financial position*". However, the Act does not define "*financial position*" and the Explanatory Memorandum to the Act provides little guidance other than suggesting it includes insolvency.

The TMA considers that a wide range of factors could be considered to go to the financial position of the company. This can be illustrated by a number of common contractual triggers that can lead to termination or acceleration rights:

(a) factual insolvency (as defined in the Corporations Act – i.e. inability to pay debts as they fall due);

(b) breach of financial covenants that measure various indicators of a company's financial performance;

(c) the occurrence of cross defaults (for example, defaults under other contracts between the company and third parties that may allow the third party to accelerate amounts owing to it) or cross acceleration (where such third parties so actually accelerate such amounts);

(d) the occurrence of material adverse events in respect of a company (the breadth of this concept will vary from contract to contract, but it may include matters relating to the financial position of the company); and

(e) non-payment or other non-performance.

Paragraph 2.3 of the Explanatory Memorandum to the Act states that "*financial position*" is intended to cover the insolvency of the company. Paragraph 2.11 of the Explanatory Memorandum states that the stay is not intended to apply to breaches involving non-performance or non-payment. However, there is significant room for debate with respect to the triggers that fall within these examples (such as those listed at (b), (c) and (d) above). The interpretation of the phrase by the market and the Court will have a significant impact on the operation of the stay as a whole. From the perspective of facilitating comprehensive and successful restructurings, the TMA advocates a broad interpretation of "*financial position*" that covers (b) and (c) above, and (d) to the extent the material adverse event is based on the general financial position of the company. This will ensure that the stay operates to cover the appropriate financial triggers that are used in such circumstances. In relation to (e), the TMA considers that the definition of "financial position" should not extend to, and the Regime should expressly not stay contractual rights triggered by, non-payment or non-performance. The TMA considers that this should be clarified in accordance with our comments at section 2.1.

However, the TMA considers that regardless of the breadth of the scope of "*financial position*" intended, it will be to the benefit of the market as a whole to introduce certainty into the Act. Therefore, the TMA recommends the introduction of a definition for "*financial position*" into the Act.

2.8 Cross defaults

Cross default and cross acceleration clauses allow enforcement by a financier under an agreement with a debtor based on the debtor's event of default, or another financier's acceleration, under a different agreement. The TMA considers that it is unclear whether the exercise of rights based on the occurrence of a cross default will be stayed by the Regime and that, if not subject to the stay, this could lead to inequity between counterparties and anomalous outcomes. In certain circumstances, reliance on a cross default by a counterparty may also infringe the Act's anti-avoidance provisions.

For example, the exception with respect to derivatives leaves open the possibility of a situation where by reason of a company entering into administration the lenders of a facility which incorporated hedging requirements are stayed from exercising or enforcing rights under a facility agreement. However, hedged counterparties would not be restricted from enforcing by virtue of the proposed exclusion set out in draft regulation 5.3A.50(c) of the Regulations. Should the hedged counterparties choose to enforce, lenders would normally be able to rely on a cross-default clause in their financial document to accelerate the facility or enforce their security. It is unclear whether this is intended.

The TMA considers therefore that greater clarity is needed as to whether cross defaults are subject to the Regime. This could be achieved, for example, by expanding the definition of "*financial position*" to clarify whether cross defaults are included (as recommended at section 2.7) or clearly excluding cross defaults from the operation of the stay as a type of right under the Declaration.

2.9 Standstill and forbearance arrangements

Paragraph 5(4)(c) of the Declaration excludes "*a termination right under a standstill or forbearance arrangement*" from the operation of the *ipso facto* stay. Standstill or forbearance arrangements are defined by the Declaration and a statutory note accompanying paragraph 5(4)(c) provides that the paragraph "*applies whether or not the standstill or forbearance arrangement suspends, preserves or modifies the right under the other contract, agreement or arrangement to which it applies*".

The wording of the Declaration therefore suggests that the standstill itself should be terminable notwithstanding the stay. However, whether the counterparty is able to then exercise rights in respect of the underlying agreement (which has been subject to the standstill) will depend upon whether the exercise of those rights in the underlying agreement is subject to the stay. If the basis for exercising those rights was due to the financial position of the company, rather than specific non-payment or non-performance of a contractual obligation, then the stay may still apply to the underlying agreement.

However, the Explanatory Statement to the Declaration states, in relation to paragraph 5(4)(c), that:

> *The ipso facto stay is only intended to operate to provide breathing space in formal insolvency when the insolvent party is continuing to meet their contractual obligations. In cases where a forbearance agreement is in place, the insolvent company has already failed to perform its obligations and it would be a perverse outcome to prevent*

a financier from enforcing rights they would earlier have been able to enforce merely because the company has entered formal insolvency.

It is not entirely clear what is meant by this passage from the Explanatory Statement. On one reading the passage suggests that the standstill exemption is intended to be quite broad and to allow enforcement on any basis following termination of a standstill (including the financial position of the company and other bases that would otherwise be stayed post-appointment). If this is intended, the TMA does not believe the language in paragraph 5(4)(c) achieves this result and recommends clarification in the Declaration itself.

Alternatively however, the Explanatory Statement may simply be suggesting that the counterparty would be entitled to enforce for non-performance of a substantive 'contractual obligation' if the standstill terminated (rather than on the basis of the financial position of the company). If this is the case, then the Explanatory Statement should be amended to make it clear that a forbearance agreement may be in place simply due to the financial performance of the company and that the stay would apply to an exercise of rights on that basis, notwithstanding the termination of the forbearance agreement.

2.10 Stay does not apply to statutory and equitable rights

The *ipso facto* stay only applies to contractual rights. It does not apply to rights that arise under statute or equity. That is, equitable and statutory rights can still be utilised as leverage by contractual counterparties in the insolvency process. In some circumstances this could diminish the efficacy of the stay.

Take for example rights of stoppage of goods in transit. Section 46 of the *Sale of Goods Act 1923* (NSW):

> *Subject to the provisions of this Act, when the buyer of goods becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transitu, that is to say, the seller may resume possession of the goods as long as they are in course of transit, and may retain them until payment or tender of the price.*

There are similar statutory provisions in other Australian states. In effect, this would allow sellers of goods to hold goods in transit as leverage in the insolvency process to, for example, demand payment, renegotiation of favourable terms or termination. The Government should consider whether such statutory rights conflict with the principle of the stay, and if so which statutory provisions should apply.

2.11 Outcome of non-compliance with the *ipso facto* regime

Neither the Act nor the Explanatory Statement specifically addresses the effect of a counterparty purporting to exercise rights in breach of the *ipso facto* stay.

Presumably, if a party purports to exercise a right under a contract where that right is in fact stayed by virtue of the *ipso facto* stay, then the purported exercise of the right will have no effect. For example, if a counterparty purported to exercise a right of termination when that right was in fact subject to the stay and ceased performing the contract, then the purported termination would presumably be of no legal effect. It may also be that in some cases such purported termination may amount to a breach or repudiation of the contract under general principles of contract law which could give the company a right to contractual damages.

Given the significant impact this could have on counterparties, the TMA would welcome any clarification in the Act or explanatory materials as to what non-compliance with the *ipso facto*

stay would mean for the company receiving the protection of the stay and the infringing counterparty.

3. OTHER ASPECTS OF THE REGIME THAT REQUIRE CLARIFICATION

3.1 Loan acceleration

Paragraph 5(4)(g) of the Declaration provides that rights to accelerate are only excluded from the operation of the stay for the purposes of set-off, combination and netting. The Regulations and the Declarations do not provide a general exception for acceleration. The TMA queries, and recommends greater clarity be provided on how the general stay of acceleration rights will operate, including in the contexts of:

- enforcement under section 441A of the Corporations Act by an all-assets secured upon entry of a debtor company into administration where lenders are unable to first accelerate their debt;
- under paragraph 6(4) of the Declaration, enforcement of a right (for example, appointment of a receiver) by a person who has a security interest in property where a receiver has already been appointed or a right to appoint a receiver has been enforced;
- enforcement of guarantees and indemnities where the underlying debt cannot be accelerated; and
- set-off, combination and netting, whether debts can be accelerated in whole or must be accelerated to the value required to set-off, combine or net – and how a concept of 'partial acceleration' would work.

3.2 Meaning of SPV

Draft regulation 5.3A.50(l) excludes any contract, agreement or arrangement of which, "*a special purpose vehicle is a party*". Neither the Act nor the Regulations provide a definition of "*special purpose vehicle*". The TMA considers that this exclusion may lead to anomalous outcomes.

The TMA can see merit in the policy justification for an exclusion targeting securitisations, project finance, public-private partnership (**PPP**) and certain other types of specialised financing structures entered into by sophisticated parties who have effectively agreed upon their own 'rule book' for how insolvency of the SPV will be addressed. However, the TMA considers the current exception is too vague and broad – it could potentially be exploited by parties to bring any transaction within the scope of the exclusion simply by ensuring that an SPV company is party to the contract (in some capacity). The TMA prefers that a general exception be inserted into the Regulations or Declaration to exclude securitisations, project finance and PPP contracts from the operation of the stay. Alternatively, the TMA considers that greater clarity could be introduced around what a special purpose vehicle is, for example by the introduction of a definition into the Regulations, and that the exclusion could be included in the Declaration in respect of enforcement of rights against an SPV counterparty, rather than excluding the contract as a whole under the Regulations.

3.3 Meaning of security and whether bonds and notes are intended to be generally excluded from the ipso facto stay

Draft regulations 5.3A.50(d)-(i) exclude certain contracts involving securities. Draft regulation 5.3A.50(d), for example, excludes contracts under which a party is or may be liable to "*subscribe for, or to procure subscribers for, securities or financial products*". The TMA

considers that this would pick up the Corporations Act definition of "securities", which includes certain types of debentures and bonds.

The TMA considers greater clarity is required as to the definition of "security" and as to whether the Regulations are intended to generally exclude bonds and notes from the operation of the stay. If bonds and notes are generally intended to be excluded, the TMA queries the policy justification for excluding bonds and notes but not loan agreements. This would appear to give preferential treatment to a particular type of financing instrument. Ultimately the TMA expects this would simply encourage financiers to structure loan agreements by way of note subscription agreements.